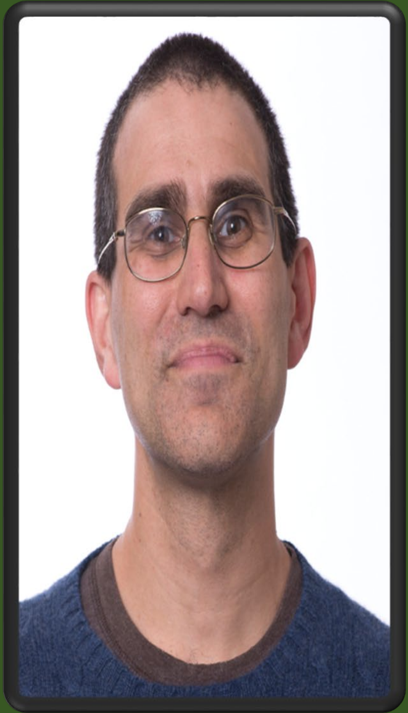
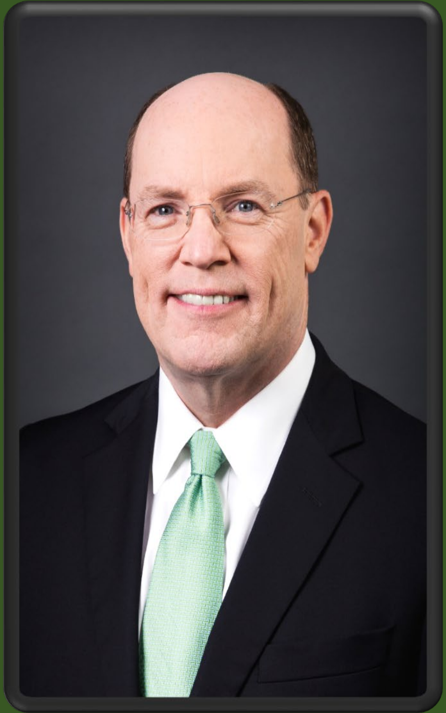
Stress Tests as a Policy Tool

Michael Gibson

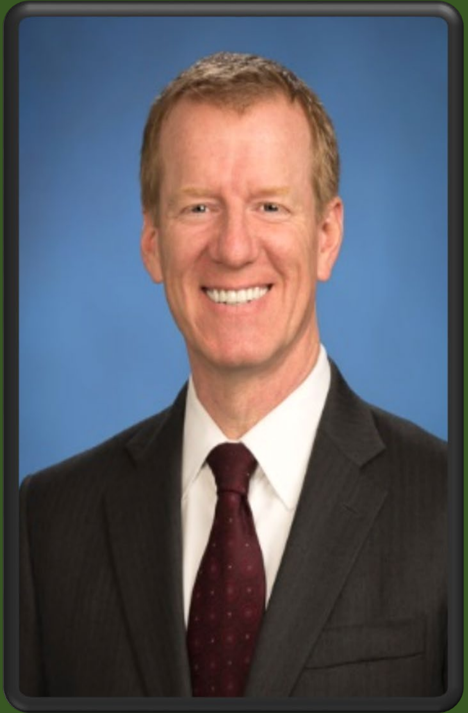


Andrew Metrick

Charlotte Gerken



Dennis Kelleher



Brian Lee

Stress Tests and Policy

Greg Feldberg and Andrew Metrick
Yale School of Management
Yale Program on Financial Stability
Presentation at Federal Reserve Stress-Testing Conference
July 9, 2019

OUTLINE

- Introduction
- Observations
- Implications

INTRODUCTION

The stress test in the United States was a “wartime” innovation.

We now have almost a decade of “peacetime” stress tests.

How are we doing?

Are there any principles we can use to guide the evolution of stress tests going forward?

OBSERVATIONS

1) INDIVIDUAL BANKS KNOW MORE THAN SUPERVISORS DO ABOUT THEIR BANKS' IDIOSYNCRATIC RISKS; BUT SUPERVISORS KNOW MORE THAN BANKS DO ABOUT SYSTEMWIDE RISKS.
2) IN BANK SUPERVISION, TRANSPARENCY IS A DOUBLE-EDGED SWORD.
3) EVEN WITH PERFECT MODELS ACCEPTED BY EVERYONE, BANKS AND THEIR REGULATORS WILL RATIONALLY DISAGREE ON THE OPTIMAL SPEED OF ADJUSTMENT AFTER A STRESS TEST.
4) IN PEACETIME, REGULAR STRESS TESTING IS CRITICAL TO KEEP RISK MANAGERS' AND SUPERVISORS' EYES ON THE BALL.
5) MIGRATION OF FINANCIAL ACTIVITY AWAY FROM BANKS, WITHOUT APPROPRIATE OVERSIGHT OF THE NONBANK FINANCIAL SECTOR, WILL WEAKEN FINANCIAL STABILITY.

IMPLICATIONS

- Macroprudential vs. Microprudential
- Speed of Adjustment
- Transparency: Inputs and Outputs
- Peacetime and Wartime