Scenario Design Choices

Andreas Lehnert
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Key Design Issues in Scenarios

1. Severity
2. Tuning to unique business model and risks
3. Incorporating bad events
4. Addressing orthogonal risks
The Fed Scenario

• Can be thought of: A financial panic followed by a severe U.S. recession

• Fairly generic—targets essentially undiversifiable asset price and credit risk
  – Stress time-varying salient risks (e.g. leveraged loans, emerging markets)
  – Global trading shock—financial panic—applied to firms with large trading books

• Adverse (“middle”) scenario is qualitatively different—in 2014 a yield curve steepening
BHC Scenarios

• Should reflect firms’ unique vulnerabilities
  – Creatively tailor scenarios
  – Capture features missed by the Fed scenario

• Severity of outcome—higher losses under BHC scenario than under Fed scenario

• Broad scenario tuned to primary weakness in business model
  – Steep vs. flat yield curve, low vs. high oil prices etc.

• Bank is in a position of weakness—e.g. rogue trader, IT breakdown, ratings downgrade, etc.
Comparing Severity and Outcomes

• Compare severity of BHC scenario to net income

• Some important caveats
  – Peak unemployment rate not a perfect measure of severity
  – No requirement that peak unemployment rate in the BHC scenario exceed that in the Fed scenario
  – Net income affected by additional non-macro features such as the global market shock and counterparty default assumptions
From selected BHCs' capital plans, peak U.S. unemployment rate under BHC scenario, rounded to nearest 0.25 percent

Supervisory severely adverse (SSA) scenario
From selected BHCs' capital plans, net income under BHC scenario less net income under the SSA scenario (rounded to nearest 0.1 basis point)
More net income in BHC scenario relative to SSA scenario

More stressful BHC scenario

Difference in Net Income: BHC less SSA

BHC Scenario Peak Unemployment Rate

(Rounded to near 0.1 bp)

BHC Scenario Peak Unemployment Rate

(Rounded to near 0.25 percent)