**Financial Advisory Roundtable (FAR)**
June 8, 2012

**Next Steps in the Design and Implementation of Supervisory Stress Testing**

1. Using stress tests for macroprudential objectives versus microprudential objectives of safety and soundness of individual financial institutions
    a. What macroprudential goals can be achieved using stress tests as a tool?
        i. Sustain lending capacity of the system?
        ii. Ensure sufficient capital at firms so that "strong" can acquire "weak"?
        iii. Pre-emptive countercyclical capital requirements (e.g., by varying the severity of the macroeconomic scenario).
    b. Are there situations where macroprudential and microprudential objectives can conflict? What are these situations?
        i. For example, a macroprudential objective might be to encourage lending sufficient to support economic growth while from a microprudential perspective, it might be acceptable for lending to fall if this strengthens banks' balance sheets.
    c. In such cases, which set of objectives should prevail?

2. How can supervisory stress tests be structured to assess both capital and liquidity?
    a. What constitutes a liquidity stress?
        i. Should the same scenario apply to both capital and liquidity stress?
        ii. How should lender of last resort be thought of in a system-wide liquidity stress event?
    b. What specific approaches should be used to integrate capital and liquidity stress testing?
        i. Alter the capital target across firms to reflect differences in liquidity positions?
        ii. BHC-specific funding costs, reflecting each firm's capital position over the stress test horizon?
        iii. Balance sheet changes, reflecting the economic conditions assumed in the scenario and/or the condition of each BHC?
        iv. Explicit assumptions on funding runs and on precautionary holdings of assets by banks?

3. Should supervisory scenarios be responsive to market developments?
    a. Are there useful aggregate indicators that signal the buildup of systemic risk?
        i. Exposure of institutions to stress scenarios and to market risk
        ii. Asset valuations
        iii. Structural measures of maturity mismatch and interconnectedness
        iv. Macro financial linkages such as the credit to GDP ratio
    b. Should stress scenarios depend only on macroeconomic variables, or also financial market indicators?
    c. How strongly should the scenarios react to such indicators?
    d. To what extent should particular current market or economic risks be built into the scenario versus using general recession scenarios?

4. How should supervisory stress tests for non-traditional BHCs and non-bank financial institutions be structured?
    a. What features of the stress tests should be altered or adjusted to capture the risks facing these firms?
    b. How should the scenario be defined? Should it differ from the scenario used for more traditional bank holding companies?

5. Should supervisory stress tests be designed individually for all firms to capture their unique risks? What is the tradeoff between developing a cross-firm perspective (common approach applied to many firms) and tailoring the tests to the unique characteristics of groups of firms?
    a. Standardized models for losses and revenue versus firm-specific models?
    b. Firm-specific versus industry-average ("top down") loss and revenue rates?
    c. Firm-specific adjustments to modeled results?

6. What supervisory stress test results should be disclosed to the public?
    a. What is an appropriate objective for disclosure of supervisory stress test results?
        i. Information about the performance of firms under stress?
        ii. Information about supervisory decisions based on stress test results?
        iii. Information about individual firms versus information about the banking or financial system?
    b. What kind of information best addresses these objectives?
    c. How much detail is useful?
        i. "Line item" detail (granular information about losses by category, revenue and expense by source)?
        ii. "Time series" detail (quarter-by-quarter or year-by-year results, versus cumulative over the period)?
        iii. Results under both stress and baseline scenarios?
            1. Are baseline scenario results tantamount to earnings projections?