Grant Thornton

Unintended consequences and stress tests

Transcript

00:00:07:09 - 00:00:14:13

DIANE SWONK:

What are you trying to game out with our clients that could be other areas that there might, unintended consequences the law of unintended consequences?

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GRAHAM TASMAN:

Right. Right. And you know, obviously banks are very conservative by nature. So their view of just sort of a here and now and some of the discontinuity in a very unsettled state makes it hard for them to sort of plan anything effective. Would they like to rely on is sort of the long-term horizon. And so the proxies that we see are like stress testing right from coming back to the financial crisis and trying to develop really hardened scenarios around that.

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GRAHAM TASMAN:

In fact, the Fed just last month came out with their new CCAR guidance and their hypothetical stress test for '22 was much more severe because we had just lived through a pandemic, right.

00:00:50:12 - 00:00:51:05

DIANE SWONK:

Right.

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GRAHAM TASMAN:

Their test case had, for example, the U.S. unemployment rate going up to like five and a half percent, peaking over two 10% in a couple of years, and with a 40% decline in commercial real estate prices, just really high experiences.

00:01:09:00 - 00:01:10:00

DIANE SWONK:

Yeah.

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GRAHAM TASMAN:

And so the whole idea is to make sure that the sort of the balance sheet could hold up under that strain. And so that's, that's for this year. But again, that's a longer-term view. It's really hard to predict in kind of the immediate acute scenarios that are happening what those impacts are. But I do think they take that longer view.

00:01:26:12 - 00:01:48:03

GRAHAM TASMAN:

And I think, you know, on a global basis, those stress tests as well do look at banks that are operating with large trading operations globally. When they have tests against market shock, right. So they have to verify that, you know, they can, they can withstand that. And so I think the frameworks and mechanisms are there to deal with it.

00:01:48:09 - 00:02:19:13

GRAHAM TASMAN:

But it's hard to advise a bank on, you know, what do you do tomorrow based on something that might be a hotspot in a certain part of the world. It's just really hard to predict that, that way. And I think the fact that they're looking at broader, more stringent stress testing is good. And that also kind of plays into the, to the allowance for loan loss on the CECL front, where you know banks are having to check their models and look at sort of the assumptions and what's going into them and do more validation and make sure that the loss projections are as accurate as they can be.

00:02:21:05 - 00:02:50:08

DIANE SWONK:

I mean one of the things that I heard a major central banker former central banker say, you know, that they were pretty sure about that we really had gone pretty far with these stress tests that, that had helped us to make a more resilient financial system. What we hadn't tested is the living wills. And you know, the too big to fail. And we hope that from these kinds of scenarios that we don't get to test those, but we certainly hope that they hold up.