

## Macro-Prudential Stress Testing

**Recommendation:** The Financial Services and Risk Management (FS&RM) Subcommittee of the Financial Research Advisory Committee (FRAC) recommends that the Office of Financial Research (OFR) play a lead role in applying stress testing for macro-prudential analysis. Specifically, the FS&RM Subcommittee advocates:

- (1) The OFR should spearhead the use of supervisory stress testing to assess systemic risks at an aggregate or macro-prudential level.
- (2) In support of this role, it is essential that the OFR be given access to the stress testing dataset compiled by the Federal Reserve through the Comprehensive Capital Analysis and Review (CCAR) process. The FRAC previously recommended that the OFR secure access to the CCAR data to fulfill its mandate under Dodd-Frank to evaluate and report on stress testing. We want to expand the rationale for the prior recommendation to reinforce the importance of CCAR data for macro-prudential analysis. While we recognize legitimate concerns over the confidentiality of firms' stress testing submissions, we urge the Federal Reserve and the OFR to find ways to share the CCAR dataset that protect confidential firm data from disclosure.

### **Background:**

Supervisory stress testing is arguably one of the most powerful policy tools to emerge from the financial crisis. While to date supervisory stress testing, particularly the Federal Reserve's CCAR process, has focused on assessing the resilience of systemically-important financial institutions (SIFIs) at the individual firm level, the FS&RM Subcommittee recommends that the OFR spearhead the use of supervisory stress testing to assess systemic risks at an aggregate level. Our recommendation distinguishes between the use of stress testing for *micro-prudential* supervision – which addresses the safety and soundness of individual firms, and is the responsibility of other Federal agencies – and *macro-prudential* analysis, which is concerned with systemic risk and is core to the OFR's mission.

Dodd-Frank recognizes the importance of stress testing by requiring that all SIFIs in the U.S. – not just banks – be subject to semi-annual stress tests. Appropriately, responsibility for the design and implementation of supervisory stress tests sits with the Federal Reserve, which is the lead consolidated supervisor of U.S. SIFIs. While the Federal Reserve has put tremendous effort into administering stress testing and using CCAR to conduct assessments of the resilience and capital adequacy of individual firms under adverse scenarios, it is our observation that the Federal Reserve has not prioritized leveraging CCAR for systemic risk analysis. We think this gap can and should be filled by the OFR.

In particular, the dataset that is collected by the Fed through the CCAR process is a rich source of information on exposures within the banking system – and, as CCAR is extended to other

non-bank SIFIs, the dataset will be expanded to other parts of the financial network. Without being prescriptive, we think there is a wide range of important macro-prudential questions that can be framed by CCAR analysis and addressed by CCAR data. As examples, the CCAR dataset can be used at the macro-prudential level to:

- Help populate the funding map (developed as a proof of concept by FS&RM) to develop balance sheets for major classes of participants under baseline and stressed conditions
- Identify the build-up of systemic risk in asset classes and/or sectors
- Highlight system-wide vulnerabilities and pressure points in response to prescribed market shocks
- Assess the distribution of losses and capital impairment under different economic scenarios
- Monitor the flow of funding and availability of credit under both baseline and stress conditions

Failure to exploit the CCAR data set for macro-prudential purposes is a lost opportunity.

We recognize that there are legitimate concerns with the Federal Reserve sharing confidential and proprietary firm-level data from CCAR with the OFR. If the OFR is going to play a meaningful role in macro-level stress analysis, however, there is no alternative other than for the OFR to gain access to the Federal Reserve's CCAR dataset. Given the effort and expense (both within firms and the regulatory community) of reporting and synthesizing stress data, it would be highly inefficient for the OFR to attempt to collect similar data on its own. Moreover, under Dodd-Frank, the OFR is directed to rely, to the extent possible, on data collected from other Federal agencies rather than duplicating the collection burden.<sup>1</sup> We think there ought to be ways that firm-level data can be shared with the OFR without violating confidentiality restrictions. We urge the OFR and the Federal Reserve to explore ways to share the CCAR information for macro-prudential purposes that protects the confidentiality of individual firm disclosures.

Once the data issues have been resolved, we encourage the OFR to launch a dedicated effort to:

- Identify the set of systemic risk questions that are informed by macro-prudential stress testing and that can be addressed through use of CCAR data
- Initiate either internally, through OFR staff, or in conjunction with academic or industry research collaborators, a research program aimed at macro-prudential stress testing
- Publish findings on system-wide vulnerabilities and resiliency stemming from the macro prudential stress testing
- Build a link between the CCAR data set and the OFR funding map, particularly at the sector level
- Develop recommendations for enriching the Federal Reserve's CCAR analysis for macro-prudential purposes

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<sup>1</sup> See Dodd-Frank Act, Section 22(3)(B) MITIGATION OF REPORT BURDEN.—Before requiring the submission of reports from any nonbank financial company or bank holding company that is regulated by a member agency or any primary financial regulatory agency, the Council, acting through the Office of Financial Research, shall coordinate with such agencies and shall, whenever possible, rely on information available from the Office of Financial Research or such agencies.