

(STRESS) TESTING FOR RESILIENCE

EUI Webinar: Assessing the preliminary impact of COVID-19 on the EU banking sector

Til Schuermann
July 2nd, 2020

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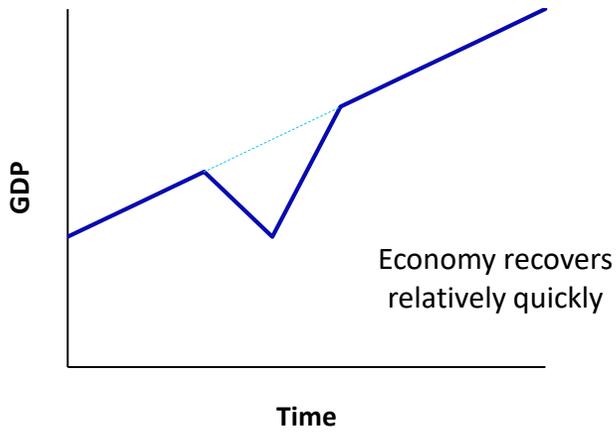
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WITH SO MUCH BAD NEWS, AND SO MUCH UNCERTAINTY, SHOULD WE WORRY ABOUT THE BANKS?

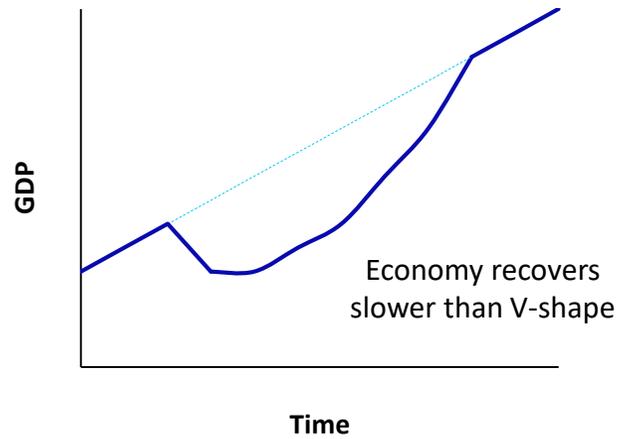
- It is hard to design and implement policy – public health or bank stability – with poor information
- Public health: test, test, test
- Bank health: (stress) test
- Banks entered this crisis much better capitalized than the last one
 - But: do they have enough?
 - How do we know?
- Stress tests have become the tool of choice for assessing bank resilience to shocks
 - Which shocks should we try?
 - Pandemic with massive and wide-spread economic fallout was not in the scenario library
- Uncertainty is very high – which makes risk management very very difficult
 - Need to try a range of scenarios
 - Sensitivity testing
- Both EU and US regimes have conducted sensitivity analysis on their banks – but based on different approaches

THERE ARE SEVERAL POTENTIAL PATTERNS FOR ECONOMIC RECOVERY

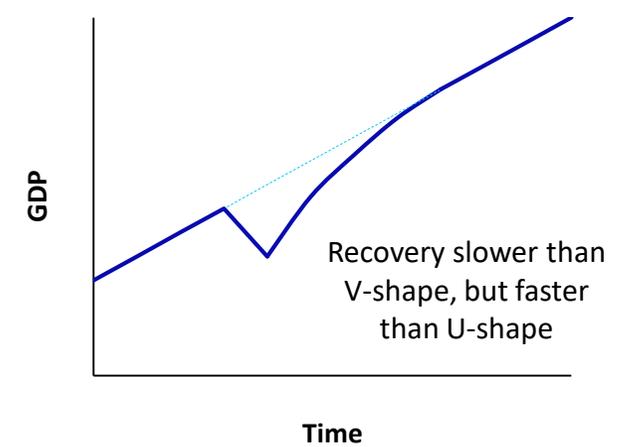
V-shaped recovery



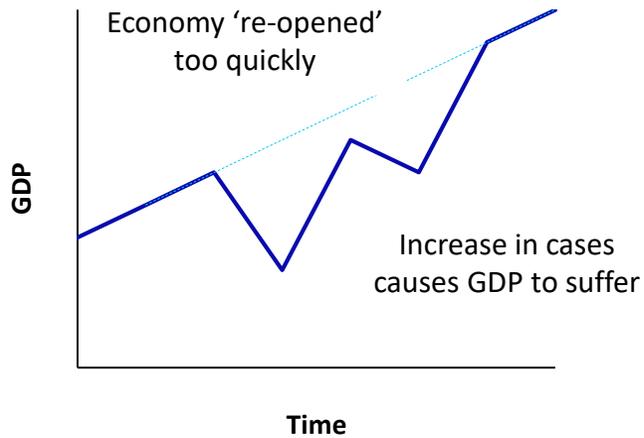
U-shaped recovery



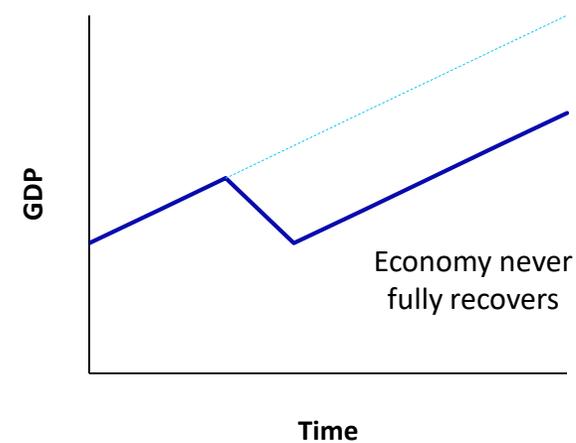
Swoosh-shaped recovery



W-shaped recovery

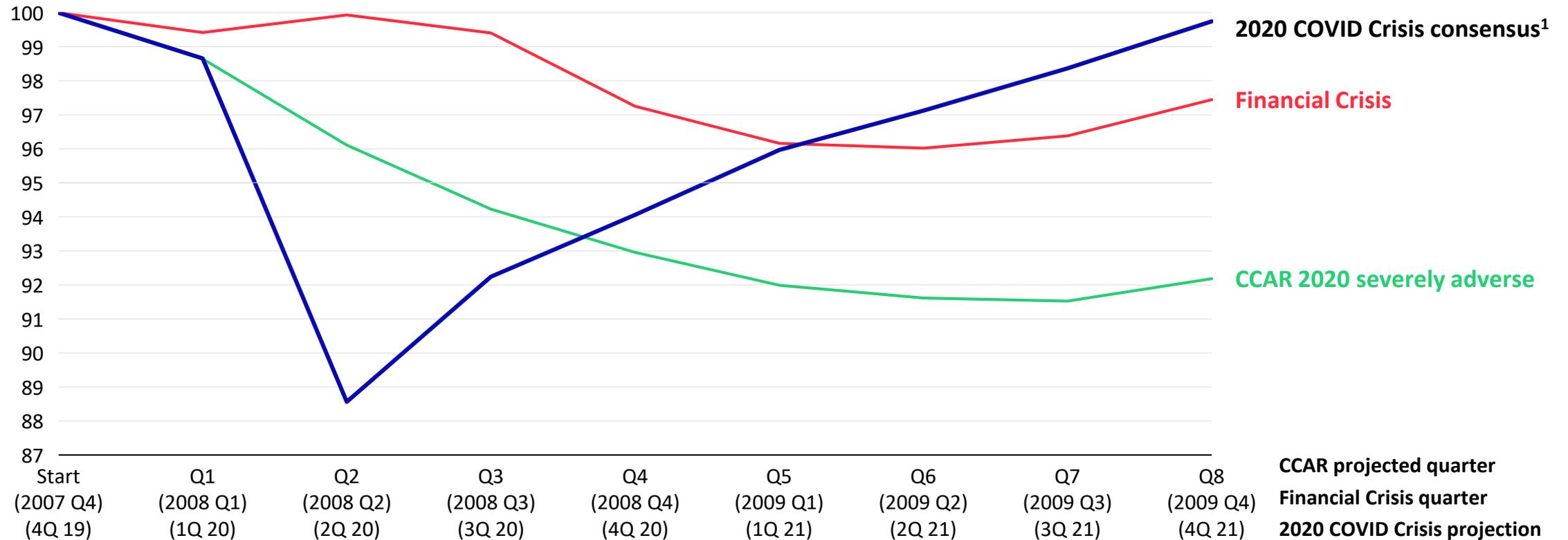


L-shaped recovery



U.S. GDP PROJECTIONS ARE WORSE THAN FINANCIAL CRISIS EXPERIENCE AND DIFFERENT THAN 2020 BANK STRESS SCENARIO

U.S. Real GDP relative to Q4 2019 (100) and compared to CCAR and Financial crisis
 Estimates as of May-20¹ US GDP Indexed to P0 (CCAR 2020)² and 4Q07 (Financial Crisis)³



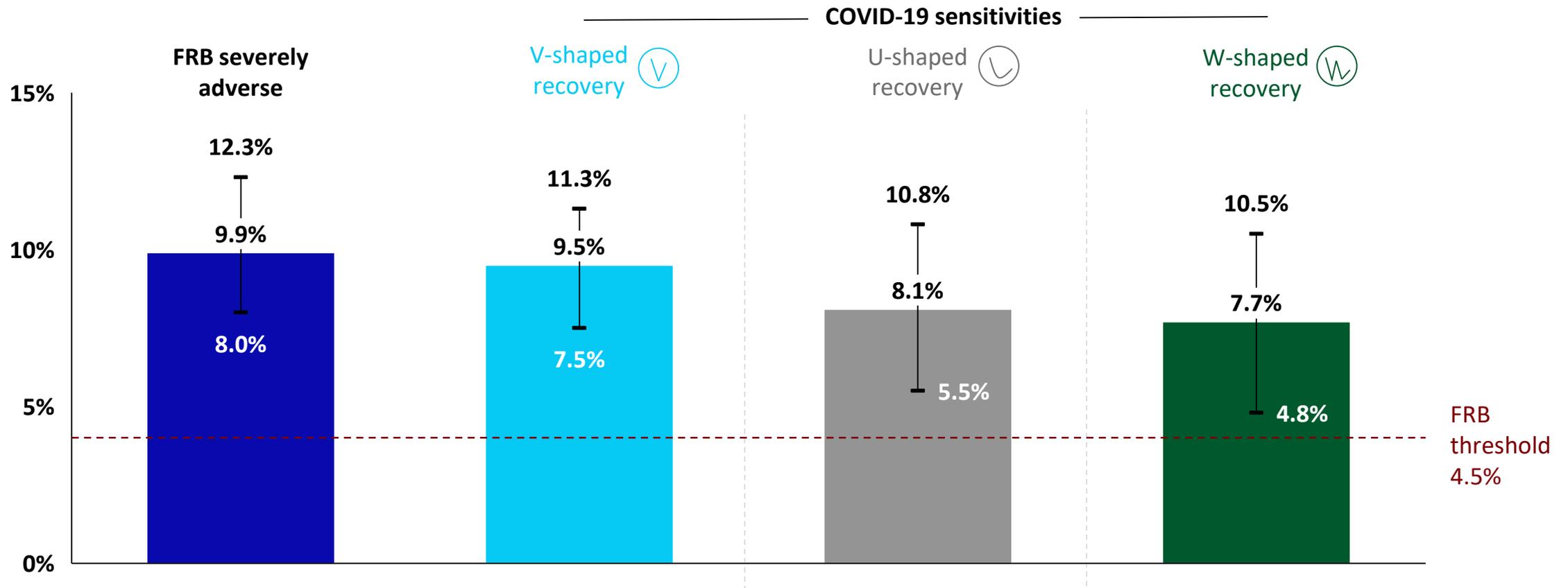
1. Consensus as the average of Bank of America (June 5), Morgan Stanley (June 15), CBO (May 19), UBS (June 10), Goldman Sachs (June 18), JP Morgan (June 12), Deutsche Bank (June 9), Q1 estimates based on latest forecast before release of Q1 GDP Actual
 2. Source: "CCAR 2020 data release", "CCAR 2019 data release" - Federal Reserve
 3. Source: Federal Reserve Economic Data

2020 STRESS TEST RESULTS, INCLUDING SENSITIVITY ANALYSIS BASED ON COVID-19

Sensitivity analyses demonstrate that the impacts of COVID-19 vary significantly by the path of recovery, but are worse than the Severely Adverse scenario - bottom-quartile firms approach the regulatory minimum in the W-shaped scenario

Minimum CET1 ratios by scenario

Industry weighted average and interquartile range



Note: Fed estimates do not assume CECL allowances; however, banks reporting on a CECL basis must forecast CECL allowances in their own capital planning, which could result in higher capital depletion

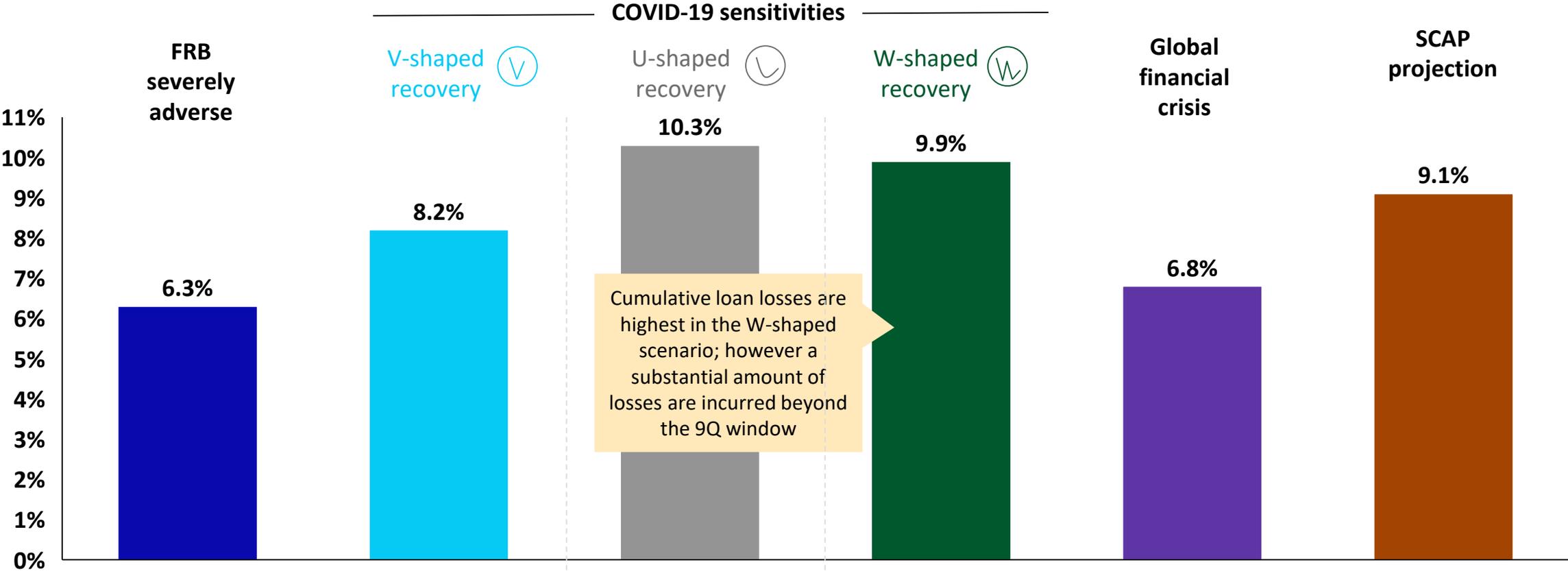
Source: FRB "Assessment of Bank Capital during the Recent Coronavirus Event", June 2020

LOAN LOSS SENSITIVITIES

Loan losses drive the biggest divergence in losses between scenarios – loss rates across each of these scenarios exceed the losses experienced in the GFC and some exceed those projected for SCAP participants in 2009

Cumulative loan losses rates (as percent of portfolios)

Industry weighted average



Source: FRB "Assessment of Bank Capital during the Recent Coronavirus Event", June 2020

TEST THE POPULATION, STRESS TEST THE BANKS

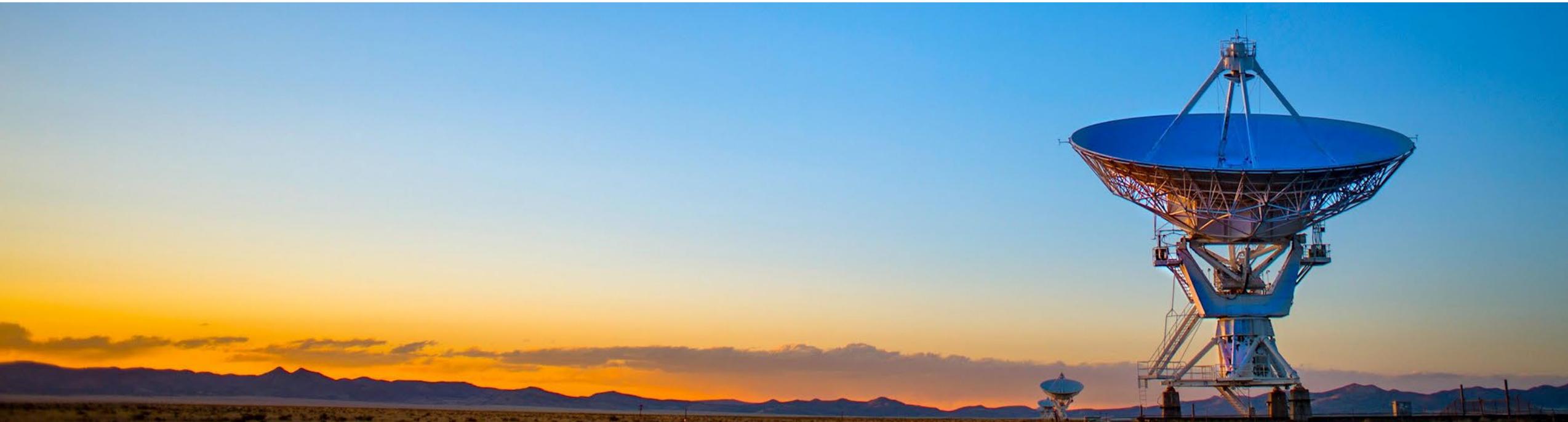
- People can develop antibodies that, hopefully, last – to remain resilient
- Banks can stock up financial capital and develop human capital (e.g. risk management expertise) – to remain resilient

READ OUR LATEST INSIGHTS ABOUT COVID-19 AND ITS GLOBAL IMPACT ONLINE

Oliver Wyman and our parent company Marsh & McLennan (MMC) have been monitoring the latest events and are putting forth our perspectives to support our clients and the industries they serve around the world. Our dedicated COVID-19 digital destination will be updated daily as the situation evolves



Visit our dedicated COVID-19 website:
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