

Issues in the Communication of Stress Test Results



CENTRAL BANK OF
TRINIDAD & TOBAGO

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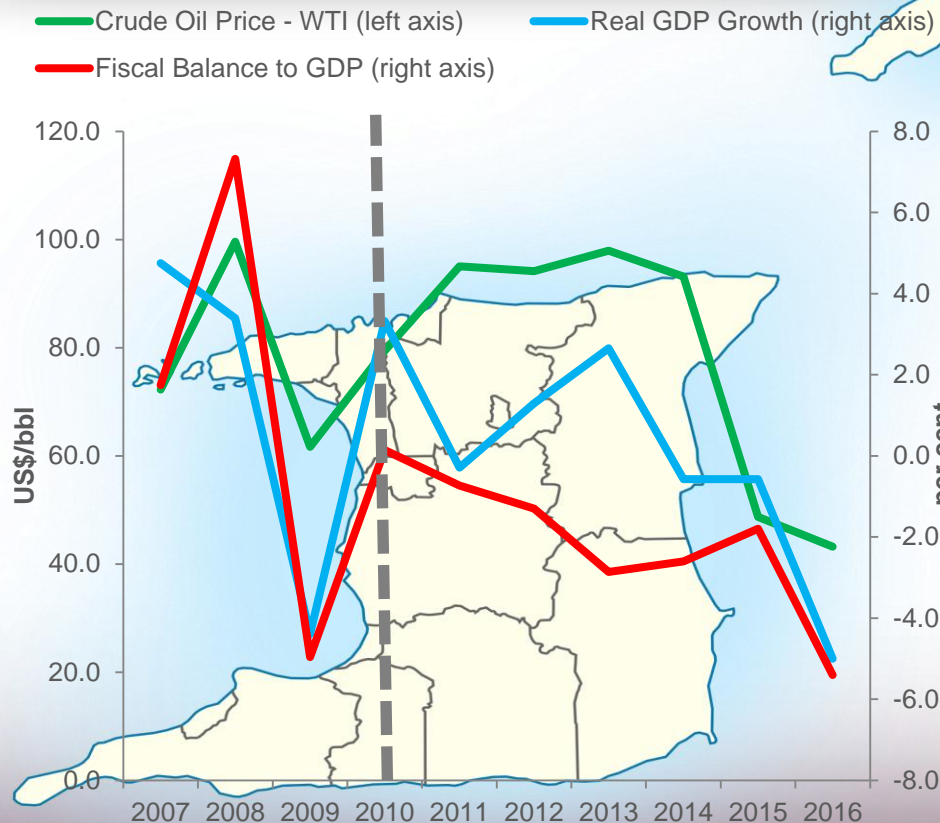
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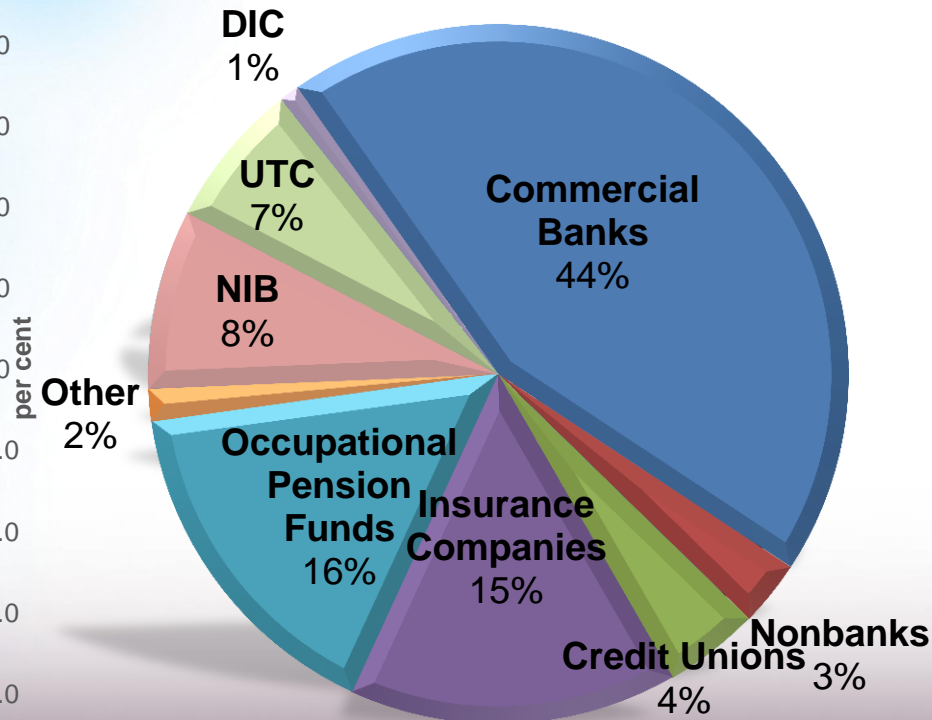
Outline



1. Context and background to the bank stress tests
2. Setup and basic results
3. Issues in communication of findings:
 - i. What audiences are we trying to reach?
 - ii. How can we reach these audiences most effectively?
 - iii. How do we communicate major variations among financial institutions?
 - iv. How can we be candid without precipitating problems?
 - v. How do we keep the messages alive and relevant?
 - vi. How do we measure effectiveness in communication?
4. Comparison with other jurisdictions and the way forward



Share of Assets in 2016



2(i)

Setup and basic results



Liquidity Risk

30-day deposit run



Interest Rate Risk

700bps↑
100bp↓



Exchange Rate Risk

40% depreciation of exchange rate



Credit Risk

30% decline in asset quality (including property) ; specific large exposure



Energy Price Scenario

50% decline in energy prices



Local & Regional Natural Disaster Scenarios

Declines in revenues, exports, GDP, regional asset values

CBTT
2010-
2016

FSAP 2010

Deposit run and withdrawal of other liabilities over 30 days

200bps ↑

40% depreciation

Decline via GDP

No test

No test

FSAP 2005

No test

500bps↑
300bps↓

10-50% depreciation

Decline via GDP

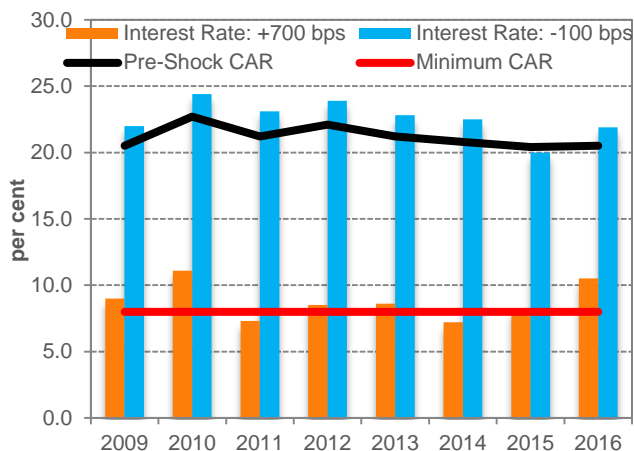
50% decline in energy prices

Regional disaster



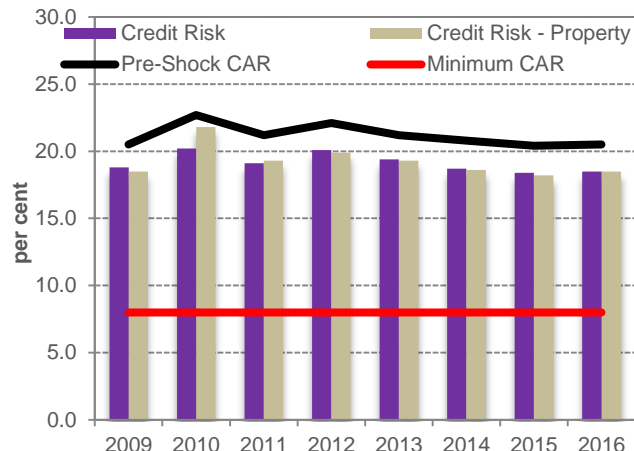
2009-2016 Commercial Bank System-Wide Stress Testing Results

Interest Rate



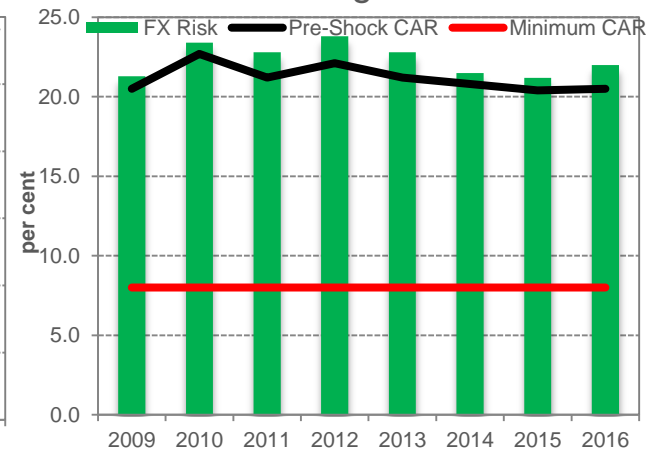
Interest Rate Risk... *“commercial banks manage their interest rate risks adequately.”*

Credit



Credit Risk... *“banks need to maintain strict vigilance with respect to credit risk.”*

Exchange Rate

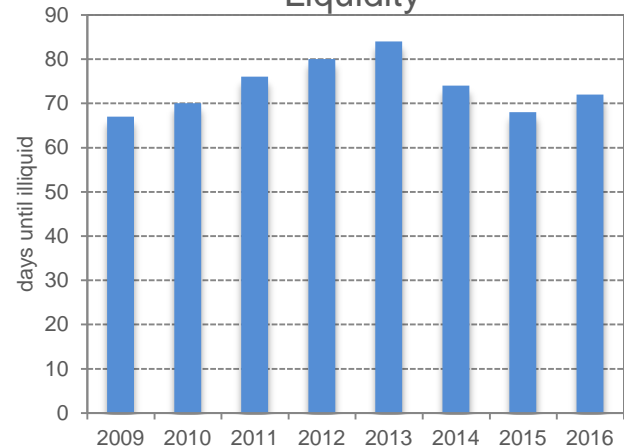


Exchange Rate Risk... *“banks in Trinidad and Tobago were well hedged against large exchange rate variations.”*



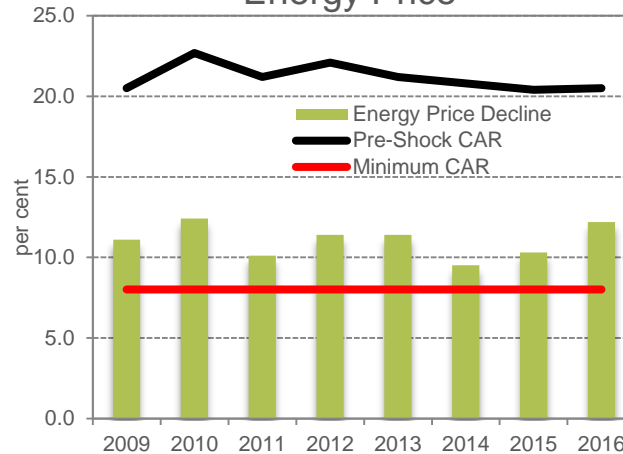
2009-2016 Commercial Bank System-Wide Stress Testing Results

Liquidity



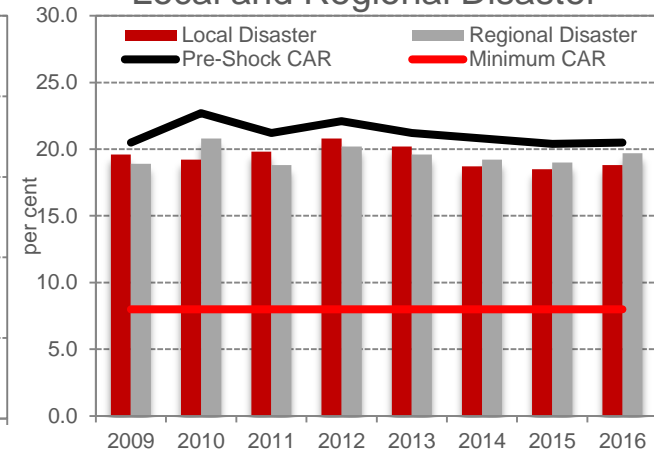
Liquidity Risk...“almost 50% of bank investments were readily marketable and hence accessible in case of unexpected withdrawals...”

Energy Price



Energy Price...“a sudden and significant drop in energy prices could...have a large impact on the banking system.”

Local and Regional Disaster



Local and Regional Disaster...“Interestingly, there was very little impact on the domestic banking system as a whole...”



3(i)

What audiences are we trying to reach?



1. Buy-in from Central Bank supervisory staff.
How to integrate concretely into the supervisory toolkit.
2. The Boards and management of commercial banks.
Utilizing the results to shore up internal governance and attention to risk.
3. Other financial institutions not covered by the stress tests.
Translating the stress testing approach to their specific circumstances.
4. Domestic and international investors.
Appreciating the meaning of the results for country risk and the individual institutions.
5. The man in the street.
Getting a simple, clear understanding of whether or not to be worried.

3(ii)

How can we reach these audiences most effectively?

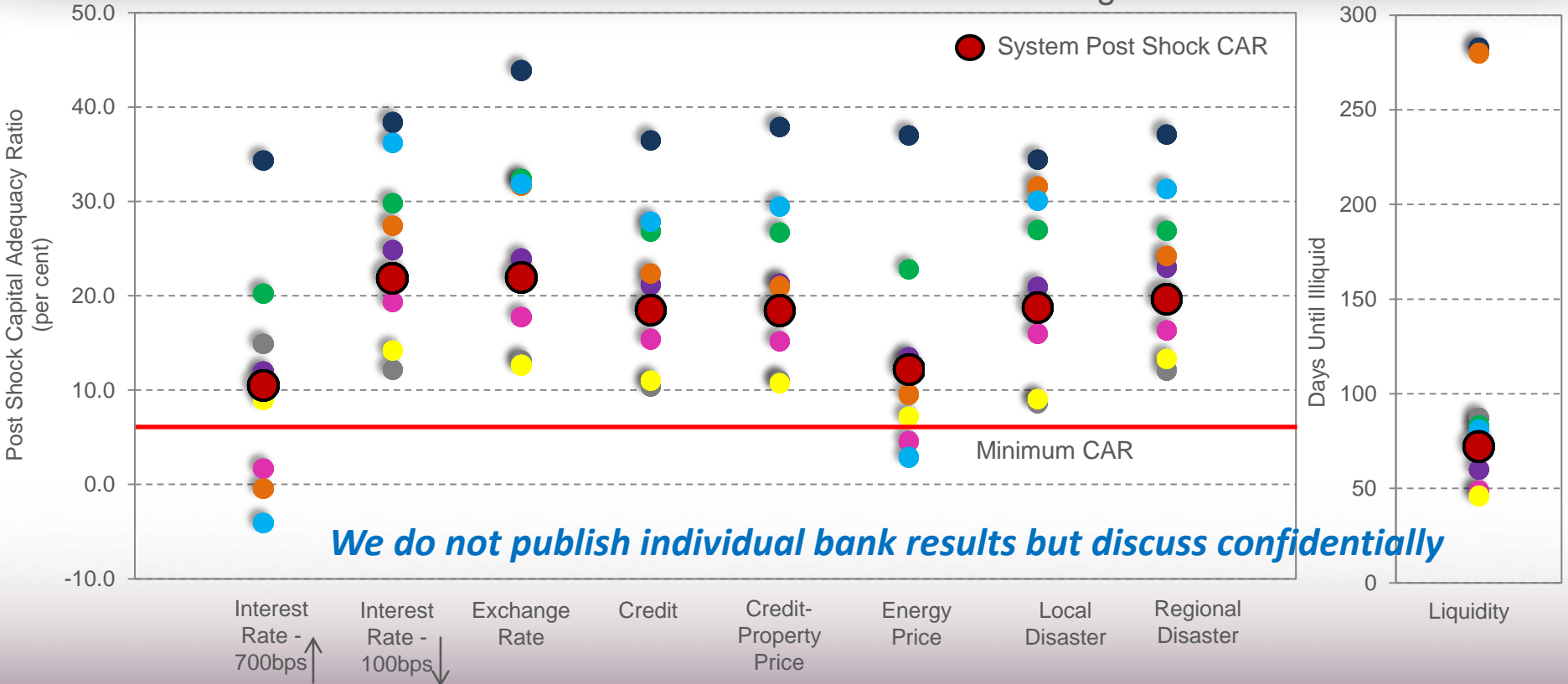


- The Central Bank has used 3 vehicles for public communication on the stress tests:
a. Financial Stability Reports; b. Research Papers; c. Press conferences at FSR launches.
- Efforts have been made to simplify the messages for the layman.
- Internally, there is an ongoing process to fully integrate the stress tests into supervisory work via more consistent communication between the Research and Supervision Departments.
- Each commercial bank receives the results of its own stress tests along with the system-wide results. The Central Bank discusses the implications with each institution.

3(iii) How do we communicate major variations among financial institutions



December 2016 Individual Bank Stress Testing Results



3(iv)

How can we be candid without precipitating problems?



- In a small economy with relatively few commercial banks, it is a constant juggling act.
- The Central Bank needs to be candid to maintain its credibility.
- Reports on the stress tests tend to be nuanced, as readers may easily interpret factual Central Bank statements as policy positions or laden with messages.
- So far, the system-wide results have been good, but individual banks may be more exposed to certain stresses.
- The Bank is very direct with individual institutions' senior managers but work needs to be done to assure commercial bank Boards are more well informed.

3(v) How do we keep the messages alive and relevant?



- When the stress tests results were initially published in 2011, there was much interest among financial institutions and the wider public.
- Skepticism has occasionally been voiced about whether the tests are strong enough and their predictive power e.g. *Would stress tests have helped to forestall the collapse of a major financial conglomerate in 2009 that required a huge government bailout?*
- Over time, there is a concern in the Central Bank that the tests have become routine and possibly mechanical exercises, dampening their effectiveness.
- The economic situation has changed since 2010, with Trinidad & Tobago now adjusting to a major terms of trade shock, so the test parameters need to be updated to take into account new potential economy-wide threats and bank-specific vulnerabilities.

3(vi) How do we measure effectiveness in communication?



- Feedback on the stress tests results from the banks is generally quite strong.
- The Central Bank has moved to quarterly stress tests; this helps to keep close track of developments but leaves little time for deep reflection on results and implications.
- There is evidence that banks are progressively integrating stress testing into their operations; the Central Bank’s “top down” stress tests may have helped.
- Investors and financial analysts appear to have understood the stress test results in the context of the general messages of the Central Bank related to financial stability.
- Journalists and the man in the street relate to the tests if relevant to current circumstances— *one renowned local journalist recently enquired whether the tests simulated a major depreciation and what were the results?*



2016 Stress Test Reports

| Country | Financial Institutions | What was communicated | How was it communicated |
|---------------------|--|-----------------------|--|
| Trinidad and Tobago | Commercial banks | System wide results | Integrated in Financial Stability Report |
| Barbados | Commercial banks and deposit-taking Institutions | System wide results | Integrated in Financial Stability Report |
| Jamaica | Banks and building societies | System wide results | Integrated in Financial Stability Report |
| US | Bank holding companies | Individual results | Detailed stand alone reports |
| UK | Banks and building societies | Individual results | Detailed stand alone reports |
| Ireland | Deposit banks | Individual results | Detailed stand alone reports |
| EU | Banking sector | Individual results | Detailed stand alone reports |

- Trinidad and Tobago is closer to other Caribbean countries in terms of communication of test results.
- Larger and more complex financial systems are capable of disseminating detailed reports with individual company information without provoking difficulties.
- It is likely that in other parts of the world size and sophistication of the financial sector would influence the communication on stress test results.



- Communication, credibility and confidence remain the stock in trade of financial regulators.
- In Trinidad and Tobago stress tests have helped in the understanding of bank vulnerabilities, communicating such vulnerabilities to a wide audience and influencing banks' behavior.
- Areas for further development in technique and communication include:
 - Updating test parameters to cater for a wider range of threats
 - Simplifying and disseminating more information on methodology and results
 - Advancing communication with commercial bank Boards
 - Extending the tests to other financial institutions
 - Complementing the “top-down” approach with more “bottom-up” tests by banks themselves.



Thank You