Testing Financial Sector Resilience

In recent history, there have been a number of country-specific, regional and global banking and financial sector crises. Each such crisis has been unique in terms of precipitating events, severity, duration and resolution. Cases-in-point include the U.S. Savings and Loan Crisis (late 1980's), the Asian Financial Crisis (late 1990's) and the Global Financial Crisis (late 2000's).

In 2020, the COVID-19 pandemic has unquestionably had a devastating human toll. The pandemic has also significantly impacted the global economy. From emerging to developed economies, there is a keen focus on financial sector stability. Given the vital role of a nation's banking sector, its resilience is critical to overall financial sector stability.

As with every crisis, there are lessons to learn and apply. For example, in the aftermath of the Global Financial Crisis, new regulations were passed in the United States designed to a) stress test the survivability of financial institutions and b) enhance the resolvability of institutions in the event of failure. Other countries implemented similar post-crisis reforms.

> **Resilient:** adjective
> *Capable of withstanding shock without permanent deformation or rupture*

We are watching financial sector resilience being tested in real time. In 2020, the U.S. economy fell into recession, real GDP declined 31.4% (Q2 2020) and the unemployment rate spiked to 14.7% (April 2020). Subsequently, real GDP increased 33.1% (Q3 2020) and unemployment fell to 6.9% (October 2020).

On June 25, 2020, the U.S. Federal Reserve released the results of its 2020 stress tests performed on the largest U.S. financial institutions. The stress tests covered a range of economic scenarios including a sensitivity analysis to account for COVID-19 and the potential timing and shape of economic recovery. In summarizing the results, Fed Vice Chair Randall K. Quarles stated, in part, *"...the results of our sensitivity analyses show that our banks can remain strong in the face of even the harshest shocks."*

According to the Federal Deposit Insurance Corporation, four U.S. banks failed year-to-date through October 2020. Total assets across these banks were approximately $458 million, or 0.002%, of the roughly $21.2 trillion in total assets of all U.S. commercial banks. As of September 30, 2020, sector-wide asset quality remained in check with noncurrent loans (90+ days past due or in nonaccrual status) comprising approximately 1.17% of total commercial bank loans.

In its November 2020 Financial Stability Report, the U.S. Federal Reserve stated that *"Banks absorbed large losses related to the pandemic but remained well capitalized throughout; moreover, capital ratios have since generally recovered to pre-pandemic levels."*

The ultimate impact of the COVID-19 pandemic on financial sector stability will be determined, in large part, by a) controlling the pandemic through an effective public health response and b) mitigating negative economic impact through fiscal intervention and monetary policy. Highlighted below are the key elements of a mitigation framework.

Key take-aways:

To date, the U.S. banking sector appears to have remained resilient to the COVID-19 shock. Lessons learned and regulatory changes implemented following the Global Financial Crisis appear to be working. However, the U.S. economy and financial sector are by no means clear of the risk of further deterioration in the current cycle. Certain elements of U.S. fiscal policy, stimulus, and consumer and business protections are scheduled to roll off at the end of 2020. It remains critically important to focus on an effective public health response, monitor economic impact and be swift and nimble in fiscal, monetary and regulatory response.

Contributing Editor

ROBERT YOUNG

Robert Young is the Managing Principal of Financial Point Advisors, LLC. He leverages over 30 years of global commercial banking, investment banking and financial advisory experience to provide a range of strategy, risk and transaction advice to corporate and financial sector clients. Robert has operated in a range of industry and advisory capacities across multiple financial sector crises in the U.S., Asia, Europe and globally. Being at the coalface through such crises and the follow-on restructuring and reform enables Robert to deliver deep insights and sharpened perspectives. Prior to Financial Point Advisors, Robert spent 17 years with Deloitte member firms globally where he established and managed client service offerings in Asia, Europe and the Americas.