



Impact of Banking Stress Assessments on Risks and Returns

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DESCRIPTION

Effects of the announcement and disclosure of the clarification, methodology, and outcome of the United States banking stress tests on bank equity prices, credit risk, systematic risk, and systemic risk. Show evidence that stress tests influenced stock and credit markets after the findings were disclosed. In addition, nearly all years following the publication of stress test results, banks' systematic risk, as measured by betas, decreased. Our findings suggest that stress tests influence systemic risk.

Stress testing has evolved into an important tool for bank regulators. The implications for individual banks' financial positions under various macroeconomic scenarios are examined in stress tests, taking the banks' exposures and business models into account. Bank behaviour may be influenced by stress tests. Stress tests result in banks with lower capital and risk-weighted asset ratios. However, there is no evidence that stress-tested banks significantly change the composition of their loan portfolios in response to stress-testing results, nor that they reduce their interbank borrowing and lending. Differences between banks in the United States that participate in stress tests and those that do not participate in stress tests. They discover that stressed banks reduce dividends significantly more than non-stressed banks. Finally, banks participating in stress tests spend significantly more money on lobbying. They conclude that stress tests have helped to counteract the procyclicality of bank capital and that stress tests have improved risk management and capital planning at the institutions that have undergone them. Furthermore, when compared to non-tested banks, tested banks increased loan spreads and reduced loan availability, particularly for riskier loans.

There are several characteristics of stress tests. First and foremost, they are forward-thinking. Second, they generally place a high value on highly adverse scenarios, providing supervisors with information about potential risks. Third, common scenarios are applied to banks to ensure that supervisory standards are applied consistently across banks. Finally, unlike traditional supervisory examinations, the results of bank stress tests are frequently made public in order to restore confidence

and reduce market uncertainty. The market is widely believed to have benefited from stress tests conducted in the United States. In response to post-crisis stress tests. Even when there is no crisis, disclosing stress test results and assessments provides valuable information to market participants and the general public, improves transparency, and promotes market discipline.

Stress tests, on the other hand, reveal unique information to outsiders, and there are potential endogenous costs associated with such disclosure. For example, disclosure could disrupt the operation of the interbank market and the risk sharing provided by this market. It may also induce suboptimal behavior by banks, who will have an incentive to pass the tests rather than take prudent risks. Other potential negative effects of disclosure on market operations include panic among bank creditors and other bank counterparties, as well as a reduction in market information aggregation and processing. This implies that no optimal disclosure strategy exists. The impact of banking stress tests in the United States on bank stock prices, CDS spreads, systematic risk, and "systemic risk" from 2009 to 2015. Consider the effects of disclosing stress test results, but also the financial market impact of disclosing other information about stress tests, such as their announcement and the stress test methodology. The Supervisory Capital Assessment Program (SCAP) of the 19 largest bank holding companies is the first test considered (BHCs). On May 7, 2009, the outcomes of the test were made public. The Federal Reserve has since implemented two supervisory programmes.

The first programme, the Comprehensive Capital Analysis and Review (CCAR), has been conducted annually since 2011 and evaluates banks' capital planning processes and capital adequacy. The CCAR combines quantitative stress test results with qualitative evaluations of banks' capital planning processes. The second programme is mandated by the Dodd-Frank Act and entails determining how bank capital levels would fare in stressful scenarios. On March 7, 2013, the first Dodd-Frank Act Stress Test (DFAST) results were made public. Distinguishes analytically between the DFAST and CCAR exercises because the underlying assumptions between the tests differ and, as a result, market participants' weighting of their results may differ.

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CCAR, for example, incorporated the capital plans proposed by the banks and thus may have better reflected banks' creditworthiness,

whereas DFAST was conditional on no change in banks' capital distributions.