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Yale Program on Financial Stability
Lessons Learned

Kevin Stiroh

By Mercedes Cardona

Kevin Stiroh was head of the Financial Sector Analysis Supervision Group at the Federal Reserve Bank of New York (FRBNY) during the Global Financial Crisis of 2007–2009 (GFC). At the FRBNY, Stiroh was a leader in the design of the "stress test" for the banking system, the Supervisory Capital Assessment Program (SCAP). In the aftermath of the GFC, members of the FRBNY, including Stiroh, drafted a report on systemic risk and bank supervision, laying out lessons learned from the crisis and their recommendations. In February 2021, Stiroh transitioned from the FRBNY to a leadership position with the Federal Reserve Board where he leads the system's supervisory work related to the financial risks of climate change and chairs the Supervision Climate Committee, a newly formed Federal Reserve System–wide group that will build the system's capacity regarding the potential impacts of climate on financial institutions, infrastructure and markets. This Lessons Learned is based on an interview with Stiroh conducted in December 2020; the full transcript can be accessed here.

Absorb the lessons from prior crises to enhance monitoring systems and future crisis response.

Stiroh noted that, since the GFC, the Fed Board of Governors has modified its approach to financial stability assessment and analysis. It now considers how firms interact with each other and with markets regarding certain financial assets, looking to assess how the cumulative systemic effects of these interactions might differ from what is observed for any individual firm.

According to Stiroh, the response to the 2020 COVID-19 pandemic and resulting recession also demonstrated that policymakers have absorbed other lessons from the GFC, specifically in the way they structure and execute programs to provide liquidity and support for the economy. He points out,

> Focusing on some of the steps that the central bank took, I think there were clear lessons that were learned from the financial crisis in 2008 and 2009 about the way to structure and roll out, communicate and execute the different programs to provide credit and liquidity support for the economy. There was also recognition that this shock was different in the sense that it didn't emanate from a financial system that had a deep weakness due to the assets that it held and the credit that it was exposed to. Credit goes to those folks who worked on the facilities during the COVID period to know to learn the lessons from the earlier crisis, not just to try to do exactly the same thing, because it was a different crisis. I think when we look back, history will say that the intervention from the Fed, those who worked on the facilities, had a meaningful, positive impact.

Resources are better spent developing possible interventions for a variety of outcomes instead of debating the odds that any one scenario would occur.

The GFC, and more recently the pandemic, were catastrophic events that required a proportional response. To prepare for another such upheaval, decisionmakers need to put less emphasis on debates about the probability of another crisis and instead think through the possible steps to take if it does happen, said Stiroh.

> We spent a lot of time prior to the financial crisis talking about housing prices, and whether there was a bubble, or whether housing prices nationwide could fall a dramatic amount. You could have that debate at length, and we did. One lesson would be to not necessarily try to come to the definitive answer to a question like that, but ask yourself what would be the impact if your assumption is right, and if your assumption is wrong, and try to find steps to take that would be robust across a range of possible outcomes.

Operationalizing this thinking requires having a diversity of viewpoints and opinions available and channeling them into exercises, analytics, and other tools. He says,

> I don't think there would be any single silver bullet, but you can do a number of things to try to build your capacity. That would include tabletop exercises, different analytical tools that you can use to challenge yourself, whether it's different cognitive diversity exercises—pre-mortem exercises is one that we've used, where you imagine a bad outcome and ask yourself: Now, what are the assumptions? What are the actions? What are the steps that might have led to that bad outcome? And what can we do about it now to prevent it?

When designing crisis interventions, having a multitude of perspectives will deliver better results.

It is helpful to have a range of views, perspectives, and experiences when studying policy alternatives, said Stiroh, especially when considering problems that are complex and uncertain, which is most of the problems that will be encountered in a crisis. "It really does help to have people who think about problems in different ways working together," said Stiroh. A diversity of perspectives helps the group "think through intended and unintended consequences and come up with better, more robust policy advice" for policymakers, he explained. And that particularly for complex problems, when there's uncertainty, it makes solutions to those problems more robust than they would be in isolation.

This approach also fueled the development of the stress test for banks. Just bringing together the skillsets of different groups was "enormously valuable" to the response during the GFC, said Stiroh.

> Thinking just about the stress-testing work that we developed primarily through 2008 and the first half of 2009—we would have bank examiners, financial analysts, economists, accountants, lawyers, and communications people all working together to think through these really complex problems. And for me, that was one of the big lessons—that you need that kind of multiple diverse perspective to really be able to address complex problems.

He recalled that during the GFC, several financial agencies also collaborated on thinking through how to address problems in the banking system:

> I remember working very closely with colleagues at the Treasury, at the FDIC, at the OCC, at the Fed jointly, thinking about, what are the potential range of adverse outcomes for the banking system and how might policy respond to them? There were a number of meetings in Washington with colleagues from all the different agencies, thinking of ideas, brainstorming, developing pros and cons for policymakers to evaluate.

Having other professionals with complementary experiences pushes people out of their comfort zone, said Stiroh, who added he's heartened to see that this development has been incorporated into the infrastructure of how the Federal Reserve does supervision, both for financial stability purposes and for microprudential purposes.

Having a flexible, versatile staff that is willing and able to work under pressure and go beyond their ordinary duties is invaluable in crisis fighting.

The Fed staff went far above and beyond the call of duty during the GFC, said Stiroh. The commitment of the staff across the system was remarkable, Stiroh noted.

> There were people who were asked to do things they were never trained to do. They were asked to work nights and weekends under enormous pressure, both a time pressure, but also the pressure of knowing about the importance and the consequence of what individuals were working on. Never once did I see somebody complain or be unwilling to do what was asked. I'm sure we didn't get everything right, but the amount of effort and commitment to trying to achieve the public good was absolutely remarkable, and I think that's what I'll remember most about that period.

Teamwork is also important, said Stiroh. As the crisis wore on, the staff had to pivot often into new areas, such as the launch of the bank stress tests. He continued,

> People were told to report to duty on this team, or for that project, or to work on this topic, and in some cases you had the background and the experience, and in other cases you learn from your colleagues. You ask questions. You supported one another, and people developed what was needed to answer the question of the day

Much of the credit goes to the teamwork and dedication of the Fed staff, Stiroh observed.

Dated: December 2022

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