



STRESS TESTING

Interagency guidance states that all institutions should plan for ways to meet funding needs under stressed conditions. A stress test is a forward-looking, quantitative evaluation of stress scenarios that could impact an institution's financial condition and capital adequacy. Stress tests are used to evaluate whether existing financial resources, such as capital and liquidity, and operational resources, such as staffing and internal systems, are sufficient to withstand economic downturns or unexpected events. And while stress testing is required for financial institutions with assets of under \$10 billion with a concentration of commercial real estate loans, regulators consider it prudent for all financial institutions.

Stress-test risk assessments are based on assumptions about potential adverse market events. While the financial institution determines the potential events to test, stress testing, like other forward-looking calculations, requires access to comprehensive sets of loan data for analysis. The MST Stress Test accesses the data collected and managed within the Loan Loss Analyzer, applies assumptions to reveal impacts to reserve and subsequently capital. By leveraging the complex quantitative modeling that financial institutions are already using for calculating their ALLL, the MST Stress Test model begins with a supportable baseline, rather than an arbitrarily chosen starting point.

According to Stress Testing Credit Risk at Community Banks (FDIC Supervisory Insights, Summer 2012), "Financial institutions can create a variety of stress tests to evaluate credit portfolio risk and the potential impact on capital. These types of generalized stress tests can be used by community banks to meet supervisory expectations (e.g., expectations contained in the 2006 CRE Guidance) or by institutions seeking to complement and enhance their other risk management activities."

The FDIC list of possible stress test examples includes Transactional Sensitivity Analysis, Stress Portfolio Loss Rates, Scenario Analysis, Loss Migration Analysis and Reverse Stress Testing.

Consequently, the OCC Supervisory Guidance on Community Bank Stress Testing (OCC BULLETIN 2012-33, October 18, 2012) echoes this same basic understanding by mentioning such specific stress test examples as Transaction Stress Testing, Portfolio Stress Testing, Enterprise-Level Stress Testing, and Reverse Stress Testing.

By accessing data managed within the MST Loan Loss Analyzer, MST's Stress Test feature gives users the ability to perform three of the stress test types listed in the above-mentioned regulatory guidance, including:

- Stressed Portfolio Loss Rates
- Loss Migration Analysis
- Reverse Stress Testing

One capability not mentioned in the guidance, but useful to management, involves stressing based on anticipated loan growth for a given portfolio segment.

MST Stress Test:

- Supports analysis based on changes to Probability of Default (PD), Loss Given Default (LGD), historical loss rates, loan migrations, and loan growth
- Allows for assessment at a portfolio and individual portfolio segment level
- Is used to analyze risk in the overall portfolio or portfolio segment for those factors applicable to that assessment
- Applies the calculated impact to the reserve, then to Tier 1 and Tier 2 Capital to evaluate adequacy
- Provides stress-test results documentation