Don't Stress It, Or Maybe You Should

by Steve Brown

A survey done at the end of 2014 found that US employees only use about half of their paid time off. Harris Interactive surveyed some 2,300 workers who receive paid vacation and found that on average they only used about 51% of their eligible time off. What's more, the survey found that 61% worked while on vacation, despite complaints of family members, and 1 in 4 was contacted during their time off, by either co-workers or their bosses. The syndrome of employees who don't take their allotted time off has been called the "work martyr complex." What drives this complex is not surprising; many employees fear a mountain of work upon their return and others believe that no one else can carry out their work. 17% fear that they will lose their job though, and this is hardly a case of martyrdom. In any case, American workers take far less vacation than their international counterparts, and this can only mean that stress abounds in the workplace.

Not all stress is a bad thing though. In fact, some might say bank regulators find it to be a favorite topic as they certainly impose stress upon bankers during exam time. However, in terms of measuring and managing risk, regulators feel that regardless of the size of the financial institution, some sort of stress testing should be adopted.

The OCC set out some best practices in its Bulletin 2012-13 for banks $10B and less in size. The bulletin states that some form of stress testing or sensitivity analysis of loan portfolios on at least an annual basis should be a key part of sound risk management for community banks. Banks should make a reasonable determination of how much impact stress events or factors might have on earnings and capital and should then incorporate this analysis into the bank's overall risk management process and asset/liability strategies. Results should also be considered in the bank's strategic and capital planning processes. Banks with CRE concentrations are expected to use more robust stress testing practices to effectively manage those concentrations and to ensure adequate capital is maintained.

At a minimum, banks should annually stress test their strategic plan using historical loss rate data by asset class (top down approach) for both the bank and for the loan portfolio. The stress test should cover at least 2Ys. These results should be incorporated into the bank's strategic plan, along with adjustments for decreased interest income due to higher non accruals associated with the stressed loans and increased noninterest expense associated with collection activity. Adjusted capital ratios should be calculated to determine if the bank remains well capitalized in various stress scenarios.

Suggested historical loss analysis may include the following scenarios: average loss rates, average loss rates including various confidence intervals, highest annual loss rate by asset class, highest two year loss rate by asset class, and finally the highest three year loss rate by asset class.

If results of the summary stress test show the bank has excessive risk in certain asset classes, more loan level stress testing may be required. Given the likelihood of increasing interest rates, banks with a large quantity of adjustable rate loans should also look at the effect of rising interest rates on DCRs as an indication of borrowers' ability to repay debt in a higher rate environment.

If all this complexity stresses you out, remember that PCBB has an outsourced stress test solution that covers all the above requirements and more. You don't have to toil away at the ant farm all the time and once this task is off your desk, you may even have time to take a vacation. Give us a call if we can help.

BANK NEWS

Opt Out Reminder

Banking regulators remind community banks (not using advanced approaches rules) that they may elect to calculate regulatory capital using the treatment for accumulated other comprehensive income (AOCI) permitted in the FDIC's general regulatory capital rules in effect prior to January 1, 2015. This is a one-time, permanent election to opt out of the requirement to include most components of AOCI in regulatory capital. To opt out you must: 1) add to common equity tier 1 capital any net unrealized losses and subtract any net unrealized gains on available-for-sale debt securities; and 2) include in common equity tier 1 capital any net unrealized losses on available-for-sale equity securities (including mutual funds). The opt-out election must be made on Schedule RC-R of the Call Report for the March 31, 2015 report date.

Regional Banks

FOMC member Tarullo said he would support a higher SIFI threshold above $50B, but that he does not expect any changes to have an easy path through Congress.

Strange

The OCC said it recognizes the importance of the $3.6T municipal securities market, the active role banks play in it and supports prudent investments in the sector. Nothing else was indicated, though, so we cannot tell if they think a bubble is forming, they just want everyone to know they support municipalities or that it is ok for banks to invest in municipals. This seems to come out of the blue, so we will let you know if we hear anything further on the subject.

US Dollar

Weakness overseas and a strong US economy have pushed the dollar to 11Y highs lately. That is a key driver why equity analysts have cut Q1 profit forecasts for larger global companies at the fastest level in 6Ys. Meanwhile, Bloomberg quotes 2 voting FOMC members as saying while the strong dollar is a headwind for growth, they still believe raising rates in Jun, Jul or Sep makes sense.