



No Reason to Stress - Remain Calm

stress testing

A wearable device developed by Arizona-based research firm Brain State Technologies could help improve sleep and thereby lower the risk of developing post-traumatic stress disorder (PTSD), new research suggests. Research has shown that sleep disturbance has many negative consequences, including added stress, weight gain and the potential for violence induced by lack of shut eye. The hope is that by improving sleep, Brain State's headband can help reduce new-onset cases of PTSD and other ancillary issues as well.

Too much stress is never a good thing, which is why bank regulators conduct annual supervisory stress testing of bank holding companies with \$50B or more in assets. Further, Dodd Frank requires banks with assets of \$10B or more to conduct their own stress tests at least annually. Finally, existing regulations require all banks with high levels of commercial real estate exposures to capital to do stress testing.

There is a lot of stress in banking so it makes sense regulators would want to test this now and again to see how things are going overall. As such, performing a macro assessment regularly can be a good offensive move for community banks (particularly those seeing strong loan growth or with outsized exposures to regulations or peer groups).

While some community banks may be loath to place additional burdens on themselves, it can add value too. The goal of community bank stress testing should be to identify potential exposure from certain events or conditions which could threaten capital adequacy or the ability to meet funding demands. This is supported by a white paper put out by the Conference of State Bank Supervisors (CSBS). In addition to projected credit losses, including investment losses, stress factors should include any related operating and provision expenses, according to the report.

To do stress testing at the community bank level, it is important to know that you don't have to buy a complex model or build expensive internal programs. You just need to recognize that stress testing can add value and do it right with appropriate controls to ensure the data at the end has integrity and adds value to your risk management processes.

Even for banks that are already doing some sort of stress testing, there's room for improvement. According to an online survey that Crowe Horwath LLP recently conducted, 80% of banking officials polled said they currently run stress tests on at least one portfolio or product, but only 37% conduct enterprise-wide stress tests. That means risks may still be lurking around the bank that are not only not seen but also could lead to some damage down the road if not identified and tested.

No matter how often you do stress testing or how you do it, such testing can deliver competitive advantage. Consider research by PwC in fact, that found such testing can enable businesses when used properly, enhance reporting, and boost management and the board's understanding of where risks may exist and which ones could be the most damaging in the future. This can give bankers a deeper view into the organization as you

seek to understand areas that may need additional assistance or levels of "insurance" to adequately protect the organization.

Certainly, while some bankers may not always think about stress testing because it is not formally required by regulators, it is nonetheless a valuable tool in your arsenal as you seek to better understand and categorize risk. At the very least, performing a thorough stress testing analysis periodically could help your bank's management team rest easier at night. Email us if you would like to see a demonstration of what our stress testing analysis and reporting tool can do for your bank.

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