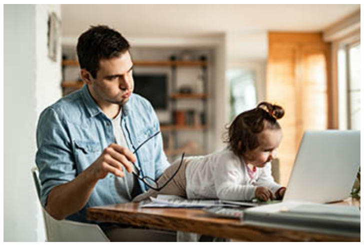

Stress Testing And Liquidity

stress testing liquidity pandemic

Summary: Combining liquidity and credit stress testing provides a more complete picture around your institution's resiliency.

According to a Harvard study, 55% of Americans were more stressed in May than in January. COVID-19 has really stressed us out...even bankers, as they work on their stress testing.

All bankers are busy stress testing their loan portfolios, to find out the potential effects of COVID-19. Getting a quick assessment is invaluable to see how loan losses will affect capital. In addition to loan portfolio stress testing, liquidity stress testing is also imperative. Combining liquidity and credit stress testing provides a more complete picture around your institution's resiliency.

Liquidity depletion. Most bankers have experienced a rise in liquidity given the government stimulus funding, unspent PPP funds, and overall lower consumer spending due to restrictions in the number of open businesses. Yet, this situation is likely to change and these changes should be captured in your liquidity stress test. As you plan your liquidity stress test, you will want to consider secondary liquidity sources, including: how they may be affected by external environmental issues and how your credit stress results may affect primary and secondary liquidity. Finally, don't forget to include different liquidity stress scenarios that show various levels of depletion.

Regulator answers. With the effects of COVID-19, regulators have expressed concerns about liquidity. So you will want to make sure you have thoughtful answers for them. Some of the questions they may be asking:

- Do you understand and forecast your liquidity (short-term and longer term)?
- Have you stressed your liquidity for possible events? (Such as a run on deposits or drawdowns due to COVID, unexpected funding of unfunded commitments, a loss of access to brokered and other types of wholesale deposits and/or a loss of access to secured and unsecured lines.)
- Have you analyzed your available secondary liquidity under stressed environments?
- Have you converted your stress analysis results into an action plan (i.e., a contingency funding plan)?

Take the time. Liquidity stress testing can only be done with your institution's information, so this will take some time. First of all, it may be obvious, but the better your data, the better your results. So make sure that you have confirmed all the credit information, such as PPP loan information and loan modifications, and included current non-accruals, wholesale, uninsured deposit amounts, betas, and decay information for the best overall results.

Right approach. A bottom-up stress testing approach will allow you to capture the details needed for your liquidity testing, which should give you the impact on primary and secondary liquidity including any potential for overlines in future periods. All the assumptions should be tested and run through a cash flow model in order to be adequately prepared.

If you are looking for help with liquidity stress testing, we can assist you. We have a time-tested process that now includes COVID-19 factors to show resiliency. Our team is here for you.

HAVE YOU TESTED YOUR LIQUIDITY TODAY?

After stress testing your loan portfolio, time to test liquidity. We have a solution that allows you to validate your contingency funding plan, so you are ready for your next exam. Learn more about liquidity stress testing today.