Top six stress testing tips during COVID-19

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If you're like most bankers, your last stress test was scenario-based. But what scenario fits best as you try to capture all of the uncertainties created from the pandemic? Where do you start? In order to help you with this, today we will provide you with our six stress testing tips for COVID-19.

1. Sensitivity Testing

COVID-19 is an example of the need to do sensitivity testing as well as scenario testing. For instance, can my portfolio withstand an event that is one, two, or three standard deviations (that the far outer edges of normal might be), regardless of where the pressure comes from? Let's not try to capture all of the causes of stress, but let's look at what happens if you change the distance from normal.

Along with looking to the future, consider sensitivity back-testing to document how specific actions, by your institution and the government, remediated events. There may be actions you've taken during the crisis that were not documented in the heat of the action that need to be captured for future planning, board education, and employee training. We don't know when this pandemic will be over, nor do we expect this will be our last. When we finally get a chance to breathe, this is a great teaching moment for those who are following in our footsteps.

2. NAICS

Conventional stress testing of loan types may be useful, but does it capture the difference between essential and non-essential businesses? You may find it more valuable to test by NAICS (North American Industry Classification System). That is, specifically test hotels, restaurants, bars, gaming, etc. rather than CRE or C&I. In some counties, bars that serve food have been allowed to open, while bars without food service have not. Once segmented, decide what stresses to place on a specific NAICS. Will restaurants offer service at full capacity or only 50%? What other retail establishments are primarily in my lending area? Will they have the cash to meet their obligations? What other industries could be impacted?

3. Supply Chain Relationships

Remember to look at your supply chain relationships, especially in agriculture and C&I. Just-in-time supply chain businesses are hit hard and some continue to struggle, as different parts of the economy move forward. A few weeks ago, there were concerns about oil storage, and more recently, there are concerns about meat processors, which caused losses with producers. As the economy restarts county by county or unfortunately, shuts down due to localized infections, future disruptions in the supply chain are likely to happen.

4. Dig Deeper

After looking at the direct impact from supply chain relationships, dig a little deeper. Are the revenues that support debt service coming from those NAICS businesses that have been deemed non-essential or only eligible for future phased openings? For example, apartment buildings located near non-essential businesses or near a meatpacking plant. Which landlords are dependent on a diversified portfolio of small business owners in non-essential businesses?

5. Loan Structures

Finally, pay attention to loan structures. Balloons that are coming due have a greater chance of becoming a Troubled Debt Restructure (TDR) with charge-offs. What proportion of your portfolio is due to mature within the next 18 months? Will borrowers be able to

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