

Alvarez & Marsal

Financial Industry Regulatory Advisory Services (FIRAS)



LEADERSHIP • PROBLEM SOLVING • VALUE CREATION

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Stress Testing

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Purpose of Stress Testing

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Stress testing is a means to better understand the range of a financial institution's potential risk exposures and their potential impact on;

- Liquidity
- Earnings
- Capital

Per joint Regulatory Issuance Key Components for a stress testing program should include:

- Activities and exercises that are tailored to the banking organization and capture the companies exposures, activities and risks.
- Multiple conceptually sound stress testing activities and approaches.
- Forward-looking and flexible
- Clear, actionable, well supported, and inform decision-making.



Establishing a Stress Testing Program

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Stress Testing Policy and Procedures should be implemented

Stress Testing Program should developed by management and review and approved by the Board or Committee of the Board.

Key individuals or business lines should be involved in the stress testing program

- CEO
- CFO – Finance
- Senior lender commercial – lending
- Head of Retail Lending – lending
- Chief Credit Officer – credit administration
- Chief Risk Officer - risk management



Commercial Stress Testing

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Commercial book should be segmented. For example:

Investment Real Estate

- Office
- Warehouse
- Hotel
- Apartment
- Retail

Once the book has been segmented, then key data elements need to be obtained to assist in the stress testing, For example regarding Office Lending:

- LTV
- DSC
- Current rent role
- Occupancy



Retail Stress Testing

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- Home Equity Loans
- Home Equity Lines of Credit
- **Note: Home Equity loans or lines should be divided by the following:**
 - 1st liens and 2nd liens
 - Geography.
 - FICO Scores
 - Vintage
- Mortgage Lending
- **Note: book should be divided up by geography, FICO scores and vintage.**
- Auto Lending, either direct or indirect
- Consumer loans



Final Steps

Once the book has been segmented and key data elements obtained and tested for data quality, stress test scenarios should be applied.

Scenarios should be done on a best case, most likely and worst case basis.

Key factors that could be included in these 3 scenarios could be;

- Unemployment rate
 - Oil prices
 - Real Estate Market data by segment and geography
 - Historical loss data by loan segment
- Impact to earnings and capital should be estimated and analyzed and recommendations made to address impact.
- Findings should be presented to the Board for review and approval.

Note: Stress Testing impact should be checked against the banks risk appetite to see if current balance sheet positions are in line with the banks risk appetite.





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