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Stress Testing for Community Banks
A Telephone Seminar

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Presented By:

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Operator: Welcome to today's MCBS National Conference Call, Stress Testing for Community Banks, presented by the Office of the Comptroller of the Currency. At this time, it's my pleasure to turn things over to today's OCC moderator, Jennifer Kelly, Senior Deputy Comptroller for Midsize and Community Bank Supervision. And Jennifer, welcome.

Jennifer Kelly: Thank you Tim, and good morning everyone. I want to thank you for participating in today's call. Our presenters today are Grant Wilson, the Director for Commercial Credit Risk, John Brown, the Commercial Credit Lead Expert for the Western District and Darrin Benhart, the Deputy Controller for Credit and Market Risk.

Grant and John are going to spend about 40 minutes going through the slides that we sent out to all of you, and then we will open up the line for questions. To kick things off, we have some introductory comments from the Comptroller of the Currency, Tom Curry.

Tom Curry: Good morning. I'm happy to have the opportunity to take this discussion about community banks' stress testing processes and tools. Why is there such an emphasis on stress testing you may ask? Bankers and regulators have used the term for several years, but until recently, it has been a somewhat ambiguous process, with a limited understanding of what to do, how to do it and how to take actions based on the outcome.

In our view, the purpose and value of asking and analyzing "what if" questions and scenarios that stress testing entails, are to assist management, the board and regulators, to better understand changes in the risk profile of an institution over time. I think those last words, "over time" are often an aspect of stress testing that is overlooked. The real value in stress testing is looking at the trends in outcomes, to understand how risk is changing and then taking action based on that quantified risk.

At the OCC, we are looking at lessons learned from the recent crisis and trying to find ways that we could have better quantified the build-up of risks in the marketplace. For example, we saw in too many cases, concentrations in commercial real estate lead to significant losses and failures of community banks. The vast majority of community bank failures over the past three years involved commercial real estate, and in most of these cases, that exposure was the primary reason for failure.

Construction and development loans were by far the worst performers in the crisis, and concentrations in C&D proved to be a reliable indicator of the likelihood of failure for both national and state community banks. In March of 2007, nearly 2000 of these banks held C&D loans that exceeded their capital. By September of last year, 13% of them had failed. Numbers like that are hard to ignore. So you can understand the increased emphasis on stress testing loan portfolios, as part of bank's approach to risk management.

While stress testing can be a helpful part of a bank's risk management practice, we have heard and understand the concerns from bankers about the lack of clarity in this area. In response, we recently issued guidance tailored to community banks and a stress testing tool, which community banks can use to assess their commercial real estate portfolio, a class of assets which is often the largest for many community banks.

The guidance and this useful tool are all part of the OCC's ongoing commitment to provide technical assistance and practical solutions to the community bank sector of the industry. Stress testing does not have to be overly complicated, nor do banks need to rely on third party vendors to conduct their testing. Our guidance provides ample flexibility for banks to conduct stress testing in a manner that makes sense for them. Thank you for the opportunity to speak with you today, and I hope the remaining part of the call will help you better understand our supervisory expectations for stress testing in your institution.

Jennifer Kelly: Thank you Tom, and now I'll turn things over to Grant Wilson to begin the presentation.

Grant Wilson: Thank you Jennifer for organizing this call, and Comptroller Curry for those opening comments. And we welcome each of you to the conference call and thanks for your participation. Today we will discuss the recently issued community bank stress testing guidance, in an effort to clarify certain parts of the guidance and explain our supervisory expectations for community banks going forward.

We will also discuss supervisory information related to the income producing CRE loan stress testing tool we issued recently, including how our examiners plan to use the tool during supervisory

examination activities. And as Jennifer mentioned, we will have plenty of time for questions at the end of the presentation.

On slide two, we give you some background on the history of our decision to issue this guidance. We go back to May of this year when the Federal Banking Agencies issued a joint statement to clarify that the Dodd-Frank Act stress test requirements, the Federal Reserve Board's capital plan rule and the Interagency Large Bank Stress Testing Guidance do not apply to community banks under $10 billion. It did, however, emphasize that the agencies expect all banks, regardless of size, be able to assess and understand their vulnerability to adverse economic conditions or outcomes.

The statement also re-emphasized that previously issued guidance relating to this type of risk management process continue to apply to all banks. After issuing that statement, the OCC continued to receive questions from community bankers and examiners about supervisory expectations for stress testing. That led us to believe that additional guidance and clarity on the subject was necessary and would be helpful for the industry and our examiners.

So we began work on the guidance. Moving to slide three, you will see that the concept of stress testing as an integral part of sound risk management program is not new to the OCC or the banking industry. In fact, we have been promoting its use as an effective risk management tool since the 1990s. This slide lists current applicable regulatory guidance documents issued over the past 15 to 20 years that are still in effect and address the use of stress testing.

The most recent issuance is OCC Bulletin 2012-16, Guidance for Evaluating Capital Planning. This document describes four components of an effective capital planning program. The first component is having the ability to identify and evaluate all material risks applicable to the institution. The second component is to evaluate the institution's long-term capital needs in relation to the material risks and the institution's strategic direction.

In assessing capital needs, a bank should evaluate, among other things, its exposures to the business cycle and changes in the financial and economic environment. The guidance also states that incorporating the results of stress testing into capital planning is an effective means of quantifying the potential impact of the identified risks. Banks can use a variety of methodologies to translate risk into capital needs. But regardless of methodology chosen, the bank needs to ask the appropriate "what if" questions and incorporate the answers into the institution's risk management process, with an overall goal to quantify loss potential and the impact on earnings and capital adequacy.

Moving to slide four we discuss the stress testing guidance Bulletin 2012-33, which was issued on October 18th 2012. This guidance

applies to national banks and federal savings associations with total assets below $10 billion, which we refer to as community banks. Its primary purpose is to provide clarity on the OCC's supervisory expectations for stress testing. In general, the guidance explains the benefits of incorporating stress testing into an institution's risk management program and provides examples of stress testing methods that are appropriate for community banks to consider.

It also re-emphasizes that other supervisory guidance documents that reference stress testing remain applicable and should be used in conjunction with this guidance, since this document primarily focuses on the loan portfolio and concentrations of credit.

The title of the next slide is, Why Stress Test? This is a simple but a common question we hear. As you are well aware, the recent financial crisis and recession have clearly demonstrated the need for risk management processes that effectively identify, assess and require action on the potential impact of adverse economic events on a financial institution's earnings and capital. The OCC believes that a sound risk management program must be able to provide an understanding of an institution's key vulnerabilities and have a system in place to analyze and report the potential impact of such events. An appropriately designed and implemented stress testing program is a proven, well established process that can help accomplish this.

Stress testing can provide critical information for establishing and monitoring an institution's strategic plans, its risk appetite and tolerance levels and specific line of business strategies and operating plans. And as previously discussed, it is considered to be an important component of a sound capital planning program.

The next slide contains information we have been sharing with banks and examiners in other presentations. Comptroller Curry made reference to one part of the information on this slide during his opening comments related to the percentage of banks with large concentrations of credit in construction loans that failed between March 31st 2007 and September 30th of 2011. In addition to the banks that had significant C&D concentrations referenced by Mr. Curry, there were also 1,300 banks with total CRE concentrations over 300% of their risk based capital and had a 50% CRE loan growth rate the prior three years. Twenty-one percent of those banks ended up failing.

And of the banks meeting all three criteria, the construction, the total CRE and the growth rate, 23% of those banks ended up failing. And interestingly, of the banks that did not meet any of the three criteria, only one half of one percent failed. We show this information to emphasize that significant adverse events do occur and can lead to substantial financial harm to institutions that do not effectively manage concentrations of credit risk.

Moving to slide seven, we discuss several key points included in the guidance. The OCC believes that for any form of stress testing to be effective, it should be performed on at least an annual basis. And as Comptroller Curry stated earlier, the real value in stress testing is looking at the trends and outcomes over time, to understand how risk is changing and provide the institution an early warning mechanism so management can take appropriate action based on those potential adverse outcomes.

The program should fit an institution's unique organizational structure, its business strategy and overall risk profile and be a recurring part of the institution's strategic and capital planning programs. It does not have to be sophisticated nor are institutions required to use outside vendors. These are types of decisions that remain the responsibility of bank management. The guidance explains basic stress testing methods that are appropriate for community banks, and it provides an example of a simple portfolio level stress test framework that a community banks can use as a guide or starting point for designing an appropriate stress testing program. And I'll go over that framework in a few moments.

But first, let's talk about another key concept provided in the guidance, that explains what bank management should do with a stress testing result. The output from any type of stress test method used should be evaluated by bank management and compared to the institution's established risk tolerance thresholds, its business strategies and capital planning documents. If a stress test result reflects a degree of risk that exceeds that institution's established risk tolerance thresholds, such as minimum capital levels, bank management should develop a plan that will appropriately address or mitigate the risk. And the guidance lists specific examples of types of risk mitigating actions that could be considered by management.

Moving to slide nine, I'll now explain the simple portfolio stress test example included in the guidance, as well as provide a real life example using data from a bank that failed in 2010. The stress test example provided in the guidance uses an Excel spreadsheet, call report data, and historical loss rates from three recent financial stress time frames to estimate potential losses and the impact to capital. We do not expect bank management to use this framework exactly as provided. The framework, if used, is exactly that, a starting point. It should be customized to fit an institution's unique loan portfolio composition and risk characteristics, and use management developed scenario inputs.

The example in the guidance uses loss rates from a historical loan loss rate table that provides rates experienced during the last three stressed economic periods, 1990 to 1991, 2001 to 2002 and 2008 to 2010. This table is provided on the OCC's BankNet website for banker use.

Moving to slide ten, we see the first section of the test. The framework has three sections, and I'll cover each section on the next three slides. The first section estimates the potential loan losses over a two-year stress test horizon for the entire loan portfolio. This section includes four components. The first column stratifies the loan portfolio into segments, similar risk characteristics. Management should consider the bank's material risk exposures and co-relations across the entire credit portfolio, with particular emphasis on the bank's key vulnerabilities, such as concentrations of credit risk.

Management may approach this by using its loan information systems or through the call report categories on Schedule RC-C, and that is what is used in this example. If you look at the first column, you'll see the loans are broken down according to the call report schedule RC-C. The second column aggregates the quarter end loan balances by the loan portfolio categories selected above. A bank can run a stress test at any point in time, but management information systems and reporting at community banks are often more robust at quarter end.

The third column applies aggregate loss rates to the loan portfolio segments over the stress time horizon. Typical economic downturns result in credit cycle impacts that evolve over a two-year or longer period. So the analysis should consider at least two years of stress losses. Bankers can use their own loan loss rate data, third-party vendor data, or the OCC provided historical loss rate data as a reference. For purposes of this example, we selected an average loss rate within the ranges provided in the historical stress loan loss table mentioned earlier.

For example, if you look at the construction and development rate, it shows 20%. In the table, the range for construction and development is 5.5 to 14.9%. So we use the 10% median rate, multiplied it times 2 to get the 20%. To select appropriate rates, management would consider the current financial and economic environment, underwriting standards, concentrations of credit and recent trends in collateral values, in addition to other unique bank specific factors.

The fourth column represents the multiplication of the loan balances and the loss rate to arrive at the two-year stress period losses for each of the loan categories in the first column. The next section shown on side 11 uses the sum of these losses.

The second section estimates the potential impact to net income from the stress scenario, two-year period. There are five components in this section. First, estimate all revenue and expenses except loan loss provisions and income taxes over the two-year stress horizon. Management should consider what might happen to revenue and expense levels during the stressed environment. For example, net interest income could be impacted by lower loan volume and higher non-accruals. And expenses would be impacted by increased collection costs. Management should also consider, if applicable,

information from interest rate risk stress tests to assist in estimating the potential decline in net interest income over the two year stress period.

The second component represents the provision expense necessary to replenish the allowance for the stress period loan losses. In this example, projected loan losses are $62 million. The $62 million is input in this cell.

The next component estimates the additional provision necessary to maintain the allowance at an adequate level at the end of the stress period. In stressed environments, the risk in the loan portfolio increases significantly, causing a need for a higher allowance than before the stress period started. Management can use its experience during previous recessionary periods to estimate an appropriate ending allowance. In this framework, the amount entered here will be the difference in the required ending allowance and the allowance balance at the beginning of the stress period.

The fourth component is the estimated income tax expense or benefit at the end of the stress period using the bank's effective tax rate. The fifth component represents the aggregate net income over the two year stress period. The impact to capital is shown in the third section of the test, which is on slide 12.

This section estimates the hypothetical impact on capital in a stress scenario. The framework uses tier one capital and the tier one leverage ratios to help analyze the potential change in capital during the stress timeframe. Banks could use other relevant capital measures. The tier one capital component represents the amount of tier one capital at the beginning of the stress period, in this example $88 million.

The net change in tier one capital applies only to the stress scenario and represents the reduction in capital generated by this stress scenario for the aggregate two year stress period net income calculated in section two, in this example a negative $27 million. The adjusted tier one capital represents the sum of the previous components and is the bank's hypothetical capital at the end of the stress period.

The quarterly average assets component is an estimate of the bank's recent quarterly average assets at the end of the stress period. This example anticipates the bank generates no loan growth during the stress period, and average assets decline in line with reductions in the loan portfolio from stress losses. Management will have to determine the appropriate estimate for this value based on the bank's unique characteristics and market. The numbers in this example are just to illustrate the way the framework works.

The tier one leverage ratio component measures the bank's ratio at the start and the end of the stress scenario. You see at the start of this period the tier one leverage ratio was 11%, and after the stress scenario inputs were put in the ending tier one leverage ratio dropped to 8.2%.

Now the next slide shows the historical loan loss rate table that I've been referring to that we prepared to help banks by giving them some background information on historical loan loss rates in the three scenarios. The details on the construction of the table are described in the notes at the bottom. But in general, the table provides a range of loss rates experienced by FDIC insured banks, national and state banks, in the 75th and 95th percentiles during the three recent US recessions, broken out by specific call report loan categories. And, as previously noted, this table is available on the OCC's BankNet website.

Now let me make a quick note here about the BankNet website, because it will be unavailable beginning at nine pm on December 6th until six am on December 11. That's nine pm on December 6th until six am on December 11.

All right, now let's apply this framework to real bank data. This will help illustrate the type of information that even a simple stress test framework such as this can provide. We'll look at the results on a bank that actually failed in 2010. For this test example, we used the bank's loan portfolio data as of December 31st, 2006. On this date, the bank already had significant concentrations of commercial real estate loans. You don't see it here, but it's over 400% in construction loans, nearly 250% in one to four single family loans, and over 300% in other CRE loans.

Because this date is prior to the most recent recession, we used historical loan loss rates from the 1990/1991 recession in the 95th percentile range because this bank experienced rapid commercial real estate loan growth over the previous three years. Empirical evidence does show that banks with high loan growth rates experience loan losses in the higher end of the ranges. Now remember the rates used in this example are simply doubled to get a two-year loss rate, and we realize loss rates don't actually move like this. But it may be different in real life applications.

Now you can see that the stress results would indicate loan losses of $35 million over the two year period. So we'll move to slide 15 and see the estimated impact on the bank's earnings. During the prior two years, the bank had aggregate pre-provision net income of $13 million dollars. Now to adjust for the impact of the stress period, we simply lowered that value by 5% per year, a total of 10%. This is just a subjective percentage we use for this example. We have no empirical data to support it, and it is not intended to be a prescribed rate we expect you to use in your own program. As previously discussed,

management should determine the appropriate adjustments to projected net income from the adverse conditions.

So we deduct the $35 million provision expense to replenish the two year loan losses, and then apply a $10 million provision to increase the allowance to 3% of adjusted total loans at the end of the stress period. This 3% adjustment is made to compensate for increased risk in loan portfolio due to the stress scenario. Like the 10% net income adjustment, the 3% allowance is simply a subjective number we picked to illustrate the methodology. It may be higher or lower, depending upon management's assessment of the conditions during the adverse economic scenario.

Next we add back the income tax benefit for the operating losses and we arrive at a two year aggregate net income of a negative $20 million. How does this impact capital? Let's go to slide 16, and adjusting starting tier one capital of $35 million by the net income amount from section two, resulting in tier one capital of $15 million at the end of the stress period. The leverage ratio declines to 3.8%, a percentage below the adequately capitalized bank minimum requirement.

At this point in time, management and the board could have seen the significant amount of risk the bank was exposed to from large concentrations of credit in the CRE loans that built up over the past three years, even though in 2006 and into early 2007, the economy, loan performance metrics, and bank earnings were still strong based on historical measures. Over the next year and a half, the bank did inject some capital, but when the recession hit in 2008, the actual loss rates experienced in 2009 and 2010 were even higher than those used in this example.

We also ran this test on the bank's data for 2003, 2004 and 2005. And while we don't include the results of those tests as part of this presentation, the results do show the risk build-up quite clearly over that time frame. And had this information been available, even this simple type of stress test output, perhaps more effective loan strategies and capital plans could have been implemented earlier in the cycle and the ultimate result prevented.

The final slide of this part of the presentation provides some information about what you can expect from OCC examiners going forward. We are encouraging our examiners to discuss stress testing concepts and benefits with their assigned banks through the normal supervisory process. These discussions will initially focus on the steps management has or is taking to address the guidance. Our supervisory objective will be to encourage and work with management to assess each institution's need and help develop and implement a suitable risk management framework that includes some form of periodic stress testing, customized to the institution's unique structure and risk profile.

Bankers can expect to have these discussions with examiners during regularly scheduled reviews of loan portfolios and capital planning processes. There are no plans to set up horizontal targeted exams focused solely on stress testing and community banks.

This concludes my part of the presentation and John Brown will now provide some information about the OCC's income producing CRE loan stress tool. John?

John Brown: Thanks Grant. Starting with slide 18, I want to talk to you about a tool the OCC has made available to help you identify the risk characteristics of an income producing commercial real estate portfolio. The tool is intended just for income producing real estate, which may be a component of a bank's overall stress testing program, as discussed by Grant. Next slide.

The tool is available to all national banks and federal savings associations on BankNet. Use of the tool by bank management is not required, but when significant concentrations of income producing commercial real estate exist, we expect management will be able to analyze the impact of adverse events on their financial condition. And as Grant discussed, incorporate those findings into their strategic and capital planning processes. There are two versions of this tool, a banker version, with no pre-loaded economic data, and an examiner version.

Moving on to the next slide. The tool is flexible and allows for multiple loans to multiple borrowers over numerous geographies. It works by estimating potential reserves by type and geography, on a borrower by borrower basis. During a given economic scenario run, a borrower's ability to service debt is impacted by variables that change with a given economic scenario. The variables that I'm talking about are vacancy rates, rental and lease rates, interest rates and cap rates. All variables are customizeable by loan type and by geography. Individual borrower results are aggregated in a bottom up approach, to extrapolate the total reserves needed for the entire income producing commercial real estate portfolio.

In the banker version, the scenarios are defined by management. In the examiner version, economic assumptions are provided by a third party vendor. Examiners have the additional flexibility of customizing assumptions and can use historical loss data for a particular institution. Let's move now to slide 21.

On a borrower level, the tool aggregates the borrower's cash flows and determines their debt service coverage. Debt service includes net operating income, from the income producing property, and any other cash flows entered by the user, such as guarantor support. The net operating income calculated in the model, is a function of the individual variables discussed on the previous slide. The tool allows

for multiple borrowers, which provides the flexibility needed to meet real world situations. Continuing on the next slide.

Using the debt service coverage estimates, the tool determines if there is a shortfall in debt service coverage and then estimates an appropriate provision expense. The tool aggregates these loan loss provisions for each borrower, under each scenario. Based on the overall concentration allocation of income producing loan types and geographies, the tool extrapolates a total provision expense for the income producing commercial real estate portfolio. And we've provided an example on this slide, looking at the Houston office property sample, totals $10 million, and the total aggregate estimated provision expense for a given scenario, is a $1 million provision, or a 10% reserve rate.

The total portfolio size of this given institution for the Houston office property segment is $100 million. The tool estimates the total portfolio provision expense for this portfolio segment, would be $10 million for this scenario, and it would do that for each geography in each property type. Moving on to slide 23.

The tool treats the estimated provision as an expense on the bank's income statement. Net income is reduced by the estimated provision, and the tool recalculates year to date net income, as well as return on average assets. Capital is reduced by the amount of the provision expense and tier one leverage ratio is recalculated.

Slide 24 is an example of some of the reports the tool generates that examiners and bank management can use to determine the risk characteristics of this particular portfolio of loans. Shown are examples depicting what happens to total classified, debt service coverage, loan to value, earnings and provision expense for a set of assumptions.

Slide 25 is an example of a report showing the granularity available from the tool. This chart clearly depicts where the risk in this particular income producing portfolio resides. And it can be a powerful tool, an information source, regarding an institution's concentration risk profile. In this particular example, the Atlanta apartment and retail, as well as the Dallas hotel segments, are the drivers of risk for this particular scenario run.

On slide 26 I want to cover some of the guidance for examiner use of the tool. When income producing commercial real estate concentrations are large or complex enough to require enhanced risk management, we expect examiners to discuss stress testing of that portfolio with bank management. Examiners will need to understand management's efforts to incorporate our guidance. If management has implemented a program to measure and monitor risks from these concentrations, we will evaluate that program's effectiveness.

We can't stress this following point enough. This tool is just one method by which examiners and bankers can perform stress testing on income producing commercial real estate loans. Other methods, such as the example provided by Grant, may be more appropriate, depending on the bank's size and portfolio complexity. Moving to slide 27.

One of the ways we may use the tool, is to test management's stress testing processes, by comparing results and discussing differences in scenarios and assumptions. Results from running the tool can also be used to provide context for risk management discussions, using real bank data. Finally, when an institution's strategic plan calls for aggressive growth in income producing commercial real estate, the results of the tool can provide valuable information regarding the potential impact on risk profiles, capital planning and necessary risk management enhancements.

We will be very happy to expand on any of these points made today or answer any other questions that you may have regarding these points. Jennifer?

Jennifer Kelly: Okay, thanks a lot John. And Tim, if you want to give people instructions on how they can queue up to ask questions?

Operator: All right, very good. To ask a question by telephone, all you need to do is press star one on the touchtone keypad of your telephone. That's star followed by one. That will place you into our questions queue, and when your turn comes up, I will call on you by the city you're located in. So press star one to ask a questions by telephone, or you can send in that question by email, as several of you have, and that email address to use is Modb@krm.com. Modb@krm.com. So either way, send it by email or press star one to ask your question by telephone. And Jennifer, as folks populate the phone queue, I'll pass it over to you for our first questions.

Jennifer Kelly: Okay, we have a couple of questions queued up here, so I'll ask our presenters these questions. First of all, the guidance speaks to community banks setting risk tolerances. Are there any other documents that bankers can use to help with setting risk tolerances?

Grant Wilson: This is Grant Wilson. Absolutely, we have some guidance out there that can help banks, assisting them with how to establish risk tolerances and their risk thresholds. Last December we issued a revised Concentration of Credit Handbook, and in that handbook it talks about setting limits and thresholds for concentrations of credit risk that would be appropriate and very relevant to the stress testing guidance. And also we issued a capital planning bulletin this summer that has some very good information about responsibilities for implementing an effective capital planning program, including ways that management and the board can establish—or should establish, their risk appetite as it relates to different aspects of the banking

organization and how to push those into setting thresholds that can be measured and managed over time.

And as I mentioned earlier in the presentation, it talks about how stress testing can be used as an effective means of managing risk within this type of framework.

Jennifer Kelly: Grant, someone was trying to locate the historical loss table that you referenced on BankNet, and they weren't able to find it. Can you—

Grant Wilson: Well, I think it's—if you're on the main screen of BankNet, it should be under the banking tools tab. I know that the stress test tool itself is there, and the—I'm looking at it here. It should be under the banking tool and listed down toward the middle of that section. It's on there. We will try to find exactly—confirm exactly where it is and send that back out.

Jennifer Kelly: But I think after this call, just since we are featuring it today, we'll bring it back up so that it's right there when you log on and you can see it easily.

Grant Wilson: Yeah, we'll put it on the front page to make it easier to find.

Jennifer Kelly: Okay, we've got some callers in the queue. So I'll hand it back to Tim to open up their lines.

Operator: All right Jennifer, and we have several calls, from Florida, plus Georgia and Indiana. Let's start first in Tampa Florida, Lynelle's location. And go ahead with your question.

Tampa: Hi, I just wanted to ask if the stress test really is focused only on commercial real estate loans or other areas of concentration that fall under the guidance or other identifying categories that the banks [indiscernible] about concentrations.

Darrin Benhart: Thank you. This is Darrin Benhart. I'll take a shot at that initially. The intent is to have a holistic framework to look at your entire balance sheet. That's what our guidance document is really about. So we would want you to look at all the loans in your loan portfolio, paying particular attention to any concentrations that you do have. We provided the commercial real estate tool specifically because that is an area that community banks, many, tend to have a concentration in. So that's a way to dig a little deeper, rather than staying at the very high level example that we provided in the guidance.

So the tool itself is just one component of an overall stress testing that you would do on your entire loan portfolio.

Jennifer Kelly: Okay, next question.

Operator: Thank you for the question. We have a couple of calls from Miami. Let's go first to Miami, Florida and Nicholas' site, and your line is open. Go ahead please.

Miami: Hi. I had a question in regards to the actual, on a per loan basis. If a loan can withstand a 20% decline in rent or a 10% increase in vacancy, or it can't, regardless, at what—is there a set point where [they test] the action taken? Or is that something that is also to be defined on—per bank? Or how does that work?

Darrin Benhart: John, why don't you go ahead and take an initial shot at that one?

John Brown: Well, as far as the tool itself, when we're looking at that portion of it, all of those are aggregated and then you would make an overall strategic decision or a capital decision based on the overall risk profile of an institution. When bank management is looking at individual loans, of course, they're going to have to make specific decisions regarding the administration of a particular loan, given its particular risk characteristics.

And that's really why we discuss building in appropriate loan covenants and financial monitoring for those individual relationships, so those actions can be taken in a timely manner.

Darrin Benhart: So—and maybe I'll just add, from a classification standpoint, we wouldn't anticipate that this hypothetical stress test would have any implications. Clearly we're just going to look at, as you do now in risk rating your loan portfolio or your specific loans, the condition of the borrower at this time. The stress test is really just to identify hypothetically what kind of risk might be out there on a downturn on any given loan and then aggregate that up as John indicated.

Operator: And let's take that other call from Miami, and you can go ahead with your question. Go ahead Miami, Florida, Alicio's [ph] location.

Miami: Sales location, got it. Can you speak a little bit about using—about the bank using its own loss rates in the exercise? If a bank has very, very low loss rates, how does that play into the analysis and obviously the view that the examiners could take?

Grant Wilson: This is Grant. Well, I think that it could be very appropriate for a bank to use its own historical loss rate history, through different recessionary periods or other instances where we've had financial stress. What were your loss rates during that timeframe? Now I think you'd have to keep in mind today, on the loans on your portfolio, are they underwritten the same way as the portfolio was when you had those rates in the prior periods? If there's very little change in the portfolio and very similar risk characteristics there, then I guess it might be reasonable to assume in the next recession or next adverse downturn, you might experience similar loss rates that you experienced in the past. But that's a decision you'd have to determine

by looking at your current portfolio to see how similar it was to the portfolios in prior periods.

Jennifer Kelly: Okay, I think that's it, Tim.

Operator: And we have three other callers in the queue. Why don't we take one more. We'll go to Lawrenceville, Georgia for our next question, and you can go ahead.

Lawrenceville: In your discussion of the stress testing for income producing real estate, you're suggesting a pretty significant loss rate. Is that something you want us to somehow include in our FASB-5 or 114 calculations? What is the implication of—if we look at our loan portfolio compared to three of the worst times, going back empirically, is that going to tie us—are you going to start making us tie that back into our loan loss allowance calculation?

Darrin Benhart: This is Darrin. No. The stress testing and the hypotheticals that you would generate to try to identify what level of risk you may have in the future, wouldn't have any implications for your FAS-5 or your FAS-114 or your allowance methodology really at all, because that is a hypothetical and you would want to look at, as they term it, the inherent loss today in your portfolio. So no, you wouldn't use the stress testing results in your allowance methodology. Although you might start with, obviously you have historical loan loss tracking, and you might start with that data, to inform what might be loss rates you might use in the stress testing methodology. The results of the stress test don't come back into the allowance methodology.

Lawrenceville: Okay, and if I could follow up, it would seem to me that if we look at any portfolio compared to three of the worst downturns in recent times, it's going to show that our capital is significantly exposed to deterioration.

John Brown: Let me, I guess, discuss your point about the three worse scenarios. Actually, the 2001 was really a very mild recession, and loss rates during that timeframe were not that adverse compared to the recent one, which was pretty severe and kind of a unique event, perhaps. The 1990, '91 recession was driven largely by commercial real estate and it was a pretty healthy recession. But I don't think that one necessarily stood out tremendously from other recessions we've had.

We're just providing this as a reference source. You're not required to use it. It's just there for your information and your use if you wanted to use it. And there's a range of rates. We start with the 75th and go all the way to the 95th percentile, so it gives you a range and options of rates that you might consider in this kind of framework.

Darrin Benhart: And this is Darrin. Again, this is really about communicating with your examiners and communicating amongst, within the bank and with your board, about what assumptions you use. Because we have

shown and we have experienced these as plausible, actual loss rates that banks experienced throughout the various recessions.

So you know, no one or no region is necessarily totally immune from this. That's why I think you really need to think about where in those ranges you might want to select. As we are just coming out of the recession, asset values and commercial real estate especially, are relatively depressed. Underwriting over the last few years has been relatively conservative.

So you might be selecting things toward the lower part of the range as opposed to when we were in 2006 and 2007, when over the last three years, there'd been significant growth, significant loosening in underwriting, there'd been significant asset appreciation, lending itself to risk. That's when, you know, those situations, you probably have to select rates toward the higher side of those scenarios because of the market that you're operating in. In order to compete, you have to be in the game also, so you're going to be exposing yourself to those higher risks. So again, that's the types of things that you'll talk with your board and your examiners about and have a discussion about what risk you have to your institution.

John Brown: This is John. Let's also revisit the comments by Comptroller Curry in regards to looking at what happens to a portfolio over time and how that informs what is happening to the direction of risk and to the overall risk profile, and that is in and of itself sometimes more informative than the absolute level of risk that's been depicted, although that's not immaterial.

Operator: And Jennifer, we have a couple more callers in the queue. Do you want to continue on with phone calls or take an email question?

Jennifer Kelly: Yes, why don't we take a couple more callers and then I've got quite a few email questions here as well.

Operator: Very good. And if you do have a question, press star one on your touchtone telephone, or send by email, Modb@krm.com. We'll go next to Munster, Indiana. And you can go ahead with your question.

Munster: We're just curious if the examiner version of the model or at least the third party vendor provided data is going to be made available to the industry as a frame of comparison in [indiscernible] use this tool as an independent check of management stress testing, if industry will know what the examiners are looking at in the vendor provided third party data.

John Brown: The third party data that we're using the examiner version is proprietary data, so we can't make that available. We can, however, discuss with individual bank management what the assumptions we're currently using in that run are, to inform those conversations so that

we can really talk about differences. Again, we're not saying that ours will result in a better answer. What we're suggesting is that the differences that may show up might inform an examiner where conversations with bank management would be most appropriate.

Operator: Let's take another call. We'll stay in Indiana. This time, New Albany, Indiana, and your line is open. Go ahead, please. Albany, Indiana, Sylvia's location.

New Albany: When you run the scenarios, does the model save each scenario? Do you have to save it off as a separate model each time you run it?

John Brown: The model saves a collection of three different scenarios when you're doing your scenario run. The data that you've entered into is always there, so you can go through and do multiple runs and multiple tests and multiple sensitivity analysis on the same data. So yes, it does save it. You can save it as a model run with the particular name so that you can identify it later for other comparisons to potentially different scenario runs.

New Albany: Okay. And then our second question is, during our last exam, our examiners asked us to expand our use of SIC codes in our system, so now we're using the standard industrial codes. But we—before, we think ours was better. Ours was more defined down into your chart on 25, we had retail, office, medical buildings. So for this purpose, don't you almost have to group it down into five our six groups? You can't use SIC codes because they're all over the place.

John Brown: Well, I'm not going to get into the specifics around SIC codes because I tend to agree with you. But the model is flexible enough to go to whatever level of granularity is necessary to get the most information out of the scenario run.

Darrin Benhart: But maybe I'll jump in. Oh, I'm sorry. Go ahead.

New Albany: Well, so maybe it's a question for our local examiner, just to say we've come up with our own groupings rather than use the SIC codes because they're just a wide range of things.

Darrin Benhart: Yeah, and this is Darrin, and maybe I'll just jump in, because we got a similar question about using NAICS codes also, even on the broader, across the entire loan portfolio. You know, we gave call report breakouts in the broader, very simplistic stress test, but you know, you should feel free to, if you have more detailed or in depth information, to go ahead and use that information based on your MIS in the stress test. Oftentimes, the more segmentation you can do, more slicing you can do, the better.

You know, we use SIC and NAICS codes to do analysis also. Oftentimes, we find that if you get it to the individual SIC or NAICS

code, the information can get somewhat meaningless because you just don't have enough loans in that specific item. So you know, we often, even ourselves, roll these up into specific industry groups or some type of grouping to make the analysis more meaningful. But again, you're absolutely right. I think you're the best of judge of how to look at your information and should talk with your local examiners about what might work best.

Jennifer Kelly: This is Jennifer. Perhaps what the examiners were getting at is just they were recommending more segmentation in the analysis, so again, it needs to be a dialog back and forth and we would refer you back to your examiners, and the examiners always have the lead experts such as John, who's the lead expert in the Western District, that are available to them as resources if there needs to be more conversation.

We had a question come in. Do you have worksheets available to use that we can use, or do we need to write our own? I think this is relating to the simple stress test.

Grant Wilson: Well, at this time we haven't decided to send out the framework. As I mentioned earlier, we developed it using an Excel spreadsheet. That's how we've used it here. And we did not make that framework available to the BankNet side or even to our examiners yet. It's really just given to you to help you set up and give you a starting point and a guide to set up something that's at a minimum a simple tool that you can use that might work for some small, non-complex community banks.

So it's just an Excel spreadsheet and it's very easy to construct. It doesn't take 15, 20 minutes to build it. And you can make it as complex as you want. You can start at the basic framework that we give you, or you could build it out and make it very complex. I mean, it's just an Excel spreadsheet. But no, we haven't. We didn't want to send that out so that that's what everyone automatically uses, right. We really didn't want this to be the framework that most banks accept and take and use. We want you to develop your own framework and customize it to fit your bank. So we didn't want to give you a template that was going to be used by everyone like that.

Jennifer Kelly: Okay, here's a higher level question. Who in the bank is typically responsible for stress testing? The Chief Risk Officer, the CFO, or loan credit administration?

Darrin Benhart: I think that's a relatively easy answer. Yes! Honestly, it should be an aggregation of all of those folks there because they all have something to bring to the table, relative to what might be the best way to look at the stress test. Your loan review folks are in there looking at the individual files on a regular basis. Clearly, your Chief Risk Officer ought to have a feel of what the risks are across the institution. You

know, some banks even have the Chief Financial Officer who has input into other various financial information such as the earnings side of the equation, would be involved also. So you know, it really does need to be kind of an effort across the institution.

Jennifer Kelly: I think we've got one more caller in the queue right now?

Operator: Yes, we do. And for that, let's go to Dalton, Georgia. And you can go ahead with your question.

Dalton: Yes. Are you able to hear me?

Jennifer Kelly: Yes.

Dalton: Great. My question is twofold. First, my question has to do with historic loss ratios. If, before the recession, you made lots of widget loans, during the recession, all of your losses came from widget loans, and you've made the policy determination in your bank that you're not making any future widget loans, and you have no widget loans on your books, would the historic—would that not dramatically affect what you might use as a historic loss ratio?

And my second question is, in looking at concentration levels for CRE, commercial real estate, I'm a little confused in that I'm not sure if that includes or does not include owner-occupied commercial real estate. Thank you.

Darrin Benhart: So I'll start with the second one. It does not include owner-occupied. When we reference the commercial real estate concentrations, we are talking about the 2006 guidance and the definition that was in there that does exclude owner-occupied. What we saw through the last recession was that owner-occupied commercial real estate, while it clearly is different than your standard commercial real estate, if the underlying commercial business gets in trouble, you have a commercial real estate loan, to some extent, that you have to foreclose on. So the performance really was in between, from a loss rate standpoint, in between commercial loans and your traditional income-producing commercial real estate.

But for stress testing purposes, obviously if you have a significant concentration in owner-occupied, you would want to look at what the implications for that are. I don't know, Grant, do you want to kind of touch the first part of his question about not making the same widget?

Grant Wilson: Well, I think that the impact comes from the reduction in volumes. I mean, loss rates are what they are. I mean, you have historical loss rates in your widget portfolio that you experienced during the most recent adverse economic event, but if you stop making widget loans and your volume goes down to zero, then in a stress test like this, there would be no impact, right? Even if the loss rate was 50%, if you

have zero widget loans, there's no impact in this form of stress testing framework. So as you reduce your portfolio of widgets, I think you would still use a realistic loss rate because those loans would still be subject to what adverse loss rates from a historic standpoint. But as your volumes go down, the impact—the capital would go down as well.

Darrin Benhart: Right, and that's why we tried to—we would have loved to give more specific loss rate information as a reference, but we can only go to the segmentation of the call report because that's all the level of detail that we have. You know, oftentimes when you stop making widgets, the 'widget 2' becomes the new in thing and the new product that everybody starts marking, and you don't have a lot of historical information. And so that's where you might need to reference some outside information for kind of an idea of what loss rates can do, hopefully at a high level, at least if our loss rate data gives you a starting point.

Jennifer Kelly: Tim, do you have any other callers in the queue?

Operator: We do have one more call, so why don't we take that? We'll go to Louise's site in Winter Park, Florida. And go ahead, please.

Winter Park: Yeah, just a question about correlations. Do you have any practical suggestion as to how a community bank should address correlations? I mean, is everything assumed to be perfectly positive? Is it done by the way you group the loans into the subgroups? Just some practical guidance, please.

John Brown: This is John. I'm seeing quite a few recent analyses, and it really is based on overall statistical breakdown of the behavior of your portfolio. So for many community banks, the analysis is difficult because there isn't a large enough sample available in order to determine real correlation coefficients between loan types. But if you do have the data, you really can establish what those individual portfolios may have, contributing risk factors, and whether or not there is some negative correlation and some offset between those.

But that being said, again, it requires some fairly large digging. It's very dependent on the overall types of loans that are being underwritten, the underwritings themselves, the geography and the overall economic conditions that are impacting those, because those correlations that are negative in one economic scenario can turn positive at another. So you can see the analysis can get quite complicated.

Jennifer Kelly: Thanks, John. Anybody else in the queue, Tim?

Operator: Nobody in the queue right now, Jennifer.

Jennifer Kelly: Well, I've got plenty of questions here. The comptroller started with warnings about ADC loans. The tool relates to income-producing loans. If we're so concerned about ADC loans, why are we then talking about an income-producing CRE stress test?

Grant Wilson: Well, the reason we built the CRE income-producing stress testing tool, because a lot of community banks and midsize banks still have concentrations of credit in that line of business. And so it was in kind of a first effort to come up with some kind of tool that can help our banks in this area. We are starting—we do have something in progress to develop a construction—acquisition, development, construction tool that we're working on, and we hope to have that out sometime in the first quarter of next year. So you know, we are trying to get a tool in that area as well.

Darrin Benhart: And this is Darrin. Again, all these tools, including the more robust income-producing tool, are based on the individual loan tools that some of you may be familiar with that we currently have out on BankNet. So we do have a number of basic Excel-based individual loan stress test tools that you can use out there currently. And as Grant indicated, we're kind of—it's not an easy nut to crack to think about AD and C and construction lending broadly because it covers such a broad spectrum.

Grant Wilson: It's a different animal.

Darrin Benhart: It is a little bit more difficult. But we are trying to help you out in that area, also.

Jennifer Kelly: Okay. Here's a very specific question. Do you consider one to four family retail income properties as CRE for this test? Income-producing [indiscernible].

Darrin Benhart: Yeah. We just actually put some guidance out in this area, and where we indicated oftentimes, especially where you have a portfolio or an individual borrower who has multiple properties of a significant size, these oftentimes begin to look much more like commercial real estate loans than owner-occupied residential, and they probably behave different. We're challenged again because we only have call report information and it isn't specifically broken out. These get lumped in with the residential from a loss rate standpoint. But generally, the risk would be higher for these types of loans.

Grant Wilson: And even right now, our guidance on that particular product line doesn't change how those are reported in the call report, so they're still, like Darrin said, in the one to four, owner-occupied, they're still grouped in there, and so when you're calculating your CRE guidance concentrations, they wouldn't be caught. As we had defined it today, they would not be caught in those threshold criteria. But we do feel like banks need to pull those out and look at those as a separate kind

of portfolio and apply more commercial real estate oriented policies and procedures around them.

Jennifer Kelly: Again, we put that guidance out to help people understand our expectations.

Grant Wilson: Yes. It talks more about underwriting and credit administration and portfolio management of those types of loans. It didn't really change the call report or capital allocations against this.

Jennifer Kelly: It's really risk management— as opposed to reporting.

Jennifer Kelly: Another question. What is the CRE concentration level which you look at to require a stress test?

Darrin Benhart: As we indicate in our guidance, we think stress testing is just a sound risk management process that every institution, even at a very basic level like we lay out, can do and then can really help them as they look at it over time. I agree that for many institutions, especially in today's time period, as we've just gone through a significant recession, probably aren't going to show significant stresses to their portfolio. But what we saw, especially as we've looked back on a number of institutions over the 2003 to 2006 time period, we think this tool, even this very basic tool, could have really helped some institutions better anticipate and be more proactive in their risk management, to avoid some real issues that many institutions had.

Grant Wilson: We have another question here. It says could you elaborate on the loss rates as discussed in the example. E.G. 20% were C and D loans, regarding where the probability of default has been taken into account. For example, using $100 million exposure in C and D loans and 20% loss rate, leading to $20 million in expected losses, are you not assuming that 100% of these would fail at least 20% of the balance at default?

Well, in this very simple framework that we have built, we've just tried to use pure historical loss rates and apply those to portfolio balances over the two-year stress time period. The probably of default system isn't really part of what we've built here, but you certainly can incorporate that into a more complex stress test if that's the direction you want to go. But for purposes of this guidance and what we're trying to accomplish with just a simple tool, it wasn't part of the equation in this system.

Darrin Benhart: Yes, we've just given you expected loss at the end of the day.

Jennifer Kelly: Tim, you have anybody in the queue?

Operator: Yes. We do have one caller in the queue, and for that, let's go to Flushing, New York. And go ahead with your question. Your line is now open.

Flushing: Yes. We just want to ask about why the OCC did not take into account the LTV ratios in these risk factors?

Darrin Benhart: Sure, that was just like the answer that we just gave. Actually, if you have PD and LGD information, you know, clearly, you can use that to help you and you can use that in a stress test. What we did again, since this was for community banks, we just went with the simple expected loss or the loss rate that you had. So LTV, if you had a probability of default loss, given a default model, LTV would impact the loss given default that you would anticipate that you would have in that scenario.

And clearly, you can take that into consideration when, for example, you're selecting a loss rate that we provide in the table, you should consider your underwriting criteria. And one of those considerations probably would be your kind of going in loan to value. But as we saw through the last crisis, because asset values had appreciated so significantly, LTV clearly didn't totally protect many institutions from significant losses when asset values depreciated very quickly.

Operator: All right. And we do have another caller, so why don't we take that, Jennifer, as we go to Hammond, Indiana. And you can go ahead.

Hammond: Okay, I'm just trying to make sure I understand in terms of, for non-complex, smaller institutions, it seems like that there is different levels of testing you can do. The one example that you gave that you said you could just build your own spreadsheet, okay, would be one form of stress testing that could take place. Okay, then you have, like on the BankNet site, you have the portfolio template. So that would be then a secondary source. And then you can also then take it down to the loan by loan basis. Is that correct?

Darrin Benhart: Yeah, you're right. The commercial real estate tool could be used as one component of the broader, kind of basic Excel spreadsheet overall portfolio view. So you know, the commercial real estate tool is really—you build that at the bottom. What we'd called a bottoms up, borrower by borrower you would put in. You could put in a certain percentage of your portfolio and then it will extrapolate that to your entire commercial real estate portfolio. You could use the output of that because it's going to be more granular and more detailed as one component of kind of the overall, as you look at your overall loan portfolio, what the stress tests might be.

Hammond: But if you don't have a large portfolio of commercial real estate, then that probably wouldn't be as appropriate as either doing the portfolio commercial real estate stress test or if you truly don't have much in

the way of commercial real estate loans, then perhaps just the generic spreadsheet that you presented in the PDF?

Darrin Benhart: Yeah. Yeah, the generic spreadsheet will work for a majority of institutions. Again, the use of the more detailed loan-level tool is not required at all. It's just another tool. If you do have a concentration there and you feel like you want to understand it a little better, institutions that have used it have found that it did give them some value in looking at where their risk was in their commercial real estate portfolio. But clearly, if you don't have a concentration there or don't feel you need that, the generic tool will probably be just fine.

Hammond: Okay. And I see you can import, then, the interagency file into that portfolio analysis.

Darrin Benhart: I think John can talk to that.

John Brown: Yeah, you can, and it brings in borrower data specific to name, address, location, that types of things, which makes the data entry that much easier. The problem that we have with the interagency file is we still have to touch each one of those because it doesn't have the variables captured that you're going to need in the model itself, for example LPV, debt service coverage ratio, net operating income, those types of things.

Hammond: Okay. And final question because I'm missing it on the BankNet site, but where you have the loss ratios for the stress period for the 75th to 95th, where exactly do you find that at?

Grant Wilson: Okay, I'm glad you asked that question. We have found where the data is on the BankNet site. If you go to the BankNet home page, and you look on the left, there's a tab that says National Bank and Thrift Statistics. If you click on that, it'll take you down to where it again says National Bank and Thrift Statistics, and under there, there's four or five tabs, pieces of information. One of those is the loan loss stress rate table that we've been referring to.

Hammond: Okay. No, I see it.

Grant Wilson: Got it? All right, great.

Hammond: I appreciate it. Thank you.

Jennifer Kelly: I just want to thank the caller from Hammond for asking all those question because again, that is the point we're trying to get across in our guidance and we're trying to get across in this call, is that this is not one size fits all. It's doing what makes sense for your institution and the tool that we've talked about is something that we developed. Actually, it was started by an examiner who came up with this

concept, and we worked on, refined it further and now are making it available to the industry.

But it's intended to be a tool, and if it's helpful to you to use it, that's great, but it's not by any means a requirement. But we want to be upfront about the fact that our examiners do have this tool and they will be using it and they may show you the results of that tool and so you'll understand what it is we're talking about. So I thank you for asking that question and giving us a chance to clarify that further.

Tim, do you have anybody else in the queue?

Operator: Well, we do have a couple of callers. So why don't we take one. It looks like their last name is Steele [ph], and you can go ahead with your question.

Mr. Steele: Yeah, thank you. If I go back to the handout material, on page 10, when you have the stress testing method example there, that second column over—actually, I guess it's the third column over—where you taking that two year stress period loss rate. And it sounded like the presenter was talking about taking the actual information off the BankNet website, averaging it, multiplying it by two, and that's how you get to this information that's in the column here. Is that the accepted and expected methodology that the OCC would want us to do? Or do we use some other method, or can we just actually take maybe the 95th percentile loss rate and plug that in? What's the direction that you want to see us go there?

Grant Wilson: Well, I tried to explain just how we did it for this example, and I hope that I can emphasize that this is just an example. And we had to make a determination of how to put this in the template. So just for simplicity's sake, for example on the construction and development line on slide 10 where the 20% rate. Well, what I did, I went to that table, and for construction and development, the range of rates were 5.5 to 14.9%. So just for this example and this example only, I took 10% which is kind of the median rate between those ranges, and I multiplied it by 2 to get the 20%.

Now, that may not be what you want to do in real life. You know, you have to probably put more analysis into it and look at your portfolio and your underwriting standards and your history of loss rates, and compare it to what happened to other banks in the past and come up with a number that's realistic and supportable in the type of stress environment that you would be projecting as part of your program. So that's the way this is built.

Now, you don't have to do it this way. If you have a way that fits your bank more appropriately, then by all means, use a different method. So we're just providing this to give you a starting point and a place

where you can at least know the regulators have given you something that's a starting point and puts you in the right direction for this.

Darrin Benhart: And I think what you're going to find is we realize this is kind of an evolutionary process. You know, we really want to see you just get started and try this and work with some of this a little bit, and have some discussions with your board and have discussions with your examiners.

So I think you're going to find our examiners are going to have a lot of flexibility, especially initially, around how you go about doing this. Because we had a call specifically with our examiners, a national call, a week ago, to talk through this, and we encouraged—you know, everybody is new to this, but it is a very important process that we think is part of sound risk management that, you know, let's get this started and then we can evolve it and worry about the details and the specifics and tying every last number out. But right now, it's about getting a good start and seeing where it might lead and where you might need to do a little bit more work.

Operator: And one more caller in the queue, so for that, we'll go to Mark in Missouri.

Missouri: Yes, I was calling just to kind of reconfirm the information that you had about the historical loss. I'm out here searching, and about the only thing I can see is the OCC Community and Midsize Bank Loss Rates, and that's by bank rate, risk ratings or the CAMEL ratings, versus by year. Is that what we need to look at?

Grant Wilson: Are you on the BankNet site right now?

Missouri: Yes.

Grant Wilson: And did you click on the National Bank and Thrift Statistics?

Missouri: Yes.

Grant Wilson: If you go—the last item there says Stress Period Loss Rates Table.

Missouri: Yes, sir.

Grant Wilson: That's the table.

Missouri: Okay. And then—

Grant Wilson: That's exactly what is in the presentation. It's just a copy of it, so.

Missouri: Okay. So that's just a culmination of the years of those stress years? Or is that just last year?

Grant Wilson: It takes all three years. For example, in the 75th percentile, if you just look at mortgage residential, one to four family, that 0.95, that's probably the low rate at the 75th percentile. And the 3.4 is the high rate in the 95th percentile. So that's the low to the high, based on the banks that are in those percentiles.

Darrin Benhart: And I think maybe to your point, different recession periods had different, higher loss rates for different products. So for example, the 2000 scenario, clearly there was a lot of technology. It was more of a C&I issue, so some of the higher loss rates came from that time period. As Grant mentioned, of course, the early '90s and the most recent one were more dominated by higher losses in commercial real estate. So it is an aggregation of all the recessionary periods that we did see.

Grant Wilson: Yeah, you can't tell what period those rates come from, actually. You can't. It's just the high and the low within those three periods for that product line.

Missouri: So that's not really the average of those loss ratios? It's just a culmination of the high and low for all three economic [problems]?

Darrin Benhart: Yeah. If, what our economics folks did was, they did a distribution of the losses across those time periods and they picked the 75th to 95th percentile loss ranges for those specific products across those three recessionary periods.

Missouri: Okay.

Darrin Benhart: So again, you know, clearly you're going to want to pick, depending on what's happening in your area, maybe C&I is the new hot product. I know a lot of banks are looking to grow their C&I portfolios, and in order to do that, oftentimes you have to liberalize underwriting standards somewhat.

So again, maybe in the C&I, as you're looking at, you've tightened up on commercial real estate, you wouldn't necessarily pick the highest in commercial real estate. Maybe you shade toward, you know, where is the competition at? Where is the aggressive growth? Where's—thus risk is layering in. Maybe you pick that, you reference that one a little bit higher from your loss rates.

Missouri: Well, as an example, I'm looking at the [economy] what it is today and interest rates being as low as they historically have been. Typically in the past, we've done a 200 basis points shock for stressing the interest rate. Is that still appropriate going forward?

Darrin Benhart: Now you're getting into the interest rate risk stress testing guidance that we have. And again, I'll probably defer to our resident examiners on the interest rate risk. But again, in the guidance that we have in

that area as far as looking at interest rate risk shock, I don't know that I'm probably the best one to talk about that. But again, that's just another part of kind of how you go about looking at the stresses that you might be in. Clearly, from a credit standpoint, we're somewhat concerned with the level of interest rates and the repayment ability if interest rates would rise without a corresponding improvement in the economy, I'm sure a lot of commercial real estate borrowers may have trouble servicing their debt.

John Brown: What this caller and what the last caller are highlighting is something that I want to make sure we make very clear, and that's the documentation around the assumptions that are being used in the modeling. That's really what informs a conversation around model results, is what kind of assumptions are you using, why did you pick them, and why are they appropriate for your institution? That goes a long way with an examiner who's evaluating the effectiveness of the program in providing them with keys to management's overall understanding of the risk profile.

Operator: And with that, we do have one more call, and we'll take quick call from Miami, Florida, Marshall's location. And your line is now open.

Miami: Yes. Does the OCC put forth any sort of statistical information in regards to uniform bank performance reports that could aggregate by asset size and concentrations and that sort of thing, that would give us some sort of perspective on what kind of loss experience during those three downturns you talked about, banks could correlate to use for the statistical sampling?

John Brown: One of the challenges that we have in regards to this area, are that we're dealing with call report data, aggregating up with just the level of detail that's in that information. What we don't have in that, and what makes comparisons difficult, especially in a modeling scenario, is we don't know the underwriting standards. We don't know the LTV on those loans. We don't know the debt service coverage ratio. We don't know the NOI of the property. We don't know the cap rates that are being used to derive any of these things.

So in drawing those types of comparisons, it really takes a human hand to try to—that has intimate knowledge of other institutions of similar type in order to provide those. So unfortunately, no, we don't have that.

Darrin Benhart: Yeah, and the information that you do see in the loss rate information is just for institutions less than $10 billion. So we did provide that level of segmentation, but we haven't gone to any further stratification.

Operator: And we have just a couple of minutes left, so let me pass the microphone over to Jennifer Kelly. Jennifer?

Jennifer Kelly: Well, we haven't gotten through all of our questions, but there are a couple of high level questions that I wanted to touch on. And if you had a specific question that we didn't get to, I would encourage you to follow up with your local examiner.

And the first question was, will there be a tutorial program for the stress test tool? There is a user guide that's available on BankNet, and we've seen that there are quite a few people downloading that. So I would encourage you to pull that user guide down if you haven't already taken a look at it.

Hopefully, that will give you all the information you need to successfully use the tool, but also as Darrin mentioned, we did have a call with our examiners last week. We've done some local training as well. Our credit lead experts are very familiar with the tool. So if you are trying to use the tool and the user guide isn't giving you as much guidance as you need, feel free to call on your local examiner. They should be able to give you the assistance and help you understand how to use it.

And then someone else asked if we were going to send the seminar out to our participants because they got called away during part of the presentation. Once we get the final recording back, we will be posting that. So that'll be available for anybody who wants to go back and listen to any part of this.

So with that, I would like to thank all of you for participating, and thank our presenters for doing a great job on the presentation and fielding the questions. I hope you all have found the information beneficial, and that you will be interested in joining future webinars. There will be an online evaluation form and I would encourage you to let us know if there's anything we can do to improve the quality of our programs. And if you have any suggestions for future topics for this format, we'd be very interested in hearing about that as well. Thank you very much for participating, and goodbye.

Operator: And thank you, Jennifer. That concludes today's MCBS National Conference Call, presented by the Office of the Comptroller of the Currency. And as Jennifer mentioned, there is an online evaluation form for today's program. Instructions are on the final page of your handout materials, and we very much appreciate your comments and suggestions. Thank you to all of our speakers today. Special thanks to Jennifer Kelly as being our facilitator for today's event. And we thank you for joining us today. Enjoy the rest of your day. You may hang up now.

[End of Recording]