



4 Ways to Mitigate Risk in Banking

Some tips banks can use to improve their stress testing, credit analysis and other risk-related processes.

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Bankers in today's environment face a number of challenges, including deciphering and complying with ongoing regulatory changes, developing and conducting adequate stress testing methods (<http://www.sageworks.com/blog/post/2013/04/16/4-Methods-of-stress-testing.aspx>), and justifying or defending changes in their allowance reserves.

But bankers can do many things to mitigate risk in those areas, according to several industry experts participating in the 2nd Annual Sageworks Risk Management (<http://web.sageworks.com/risk-management-summit/>) Summit next month. Here are four pieces of advice:

1. Document the rationale for loan upgrades. Linda Keith CPA (<http://www.lindakeithcpa.com/>), whose firm trains business lenders in credit analysis, says bankers should be careful to document the thinking behind their judgment that a loan should be upgraded for purposes of the allowance for loan and lease losses (ALLL). "It's important to eliminate regulator guesswork," she says. It's also important, she says, for financial institutions to verify that guidelines for analyzing a potential upgrade are "clear, clearly communicated to, and consistently followed." Keith will help lead a presentation on deciding and defending upgraded loans for the ALLL at the Dec. 5-6 summit.

2. Don't be afraid to uncover vulnerabilities. RMPI Consulting (<http://www.rmpiconsulting.com/>) partner Jay Gallo, who will discuss "Integrating Risk Appetite, Stress Testing and Capital Planning," says stress testing is positive in that it enables financial institutions to gauge their potential vulnerability to exceptional but plausible adverse events. "Stress testing should assess and quantify your institution's vulnerabilities under multiple unfavorable scenarios," he says. "Once the potential downside is understood, you can take steps to reduce or mitigate those risks, or you can ensure you have sufficient capital to manage those risks."

[For More On Stress Testing, Check Out: How Legacy Systems and Lack of Data Undermine Stress Tests (http://www.banktech.com/regulation-compliance/antiquated-systems-and-lack-of-data-unde/240160215?cid=nl_bt_daily&elq=bd03bb19056f4155a8c98c6d0845a0db#comment-1013637856?itc=edit_in_body_cross)]

3. Develop a successful stress testing framework with three "knows." Jack Gregory and Dave Keever, senior stress testing and credit experts for Crowe Horwath (<http://www.crowehorwath.com/>), say financial institutions looking to prepare and manage stress test forecasts need to know three key things: • The institution's portfolio.

- The scenarios and their impact on the bank's capital and liquidity.
- The forecasts including what they show and why.

Gregory and Keever's presentation will also outline three lines of defense all institutions need for stress-test production. **4. Set deadlines.** "To make the year-end ALLL as efficient as possible, it is best to get as much work done as possible prior to year end," says Mike Lubansky, director of consulting services at **Sageworks** (<http://www.zerohedge.com/news/skynet-wars-how-nasdaq-algo-destroyed-bats>). To do that, financial institutions should set hard deadlines for:

- Risk-rating changes.
- Charge-offs.
- Updating the core system to reflect the risk-rating changes.
- Determining the loans that need to be reviewed for impairment (FAS 114/ ASC 310).
- Updating the data on the impairment analyses (appraisal values and selling costs, or cash flows).

Industry experts will participate in a panel discussion on year-end ALLL calculations at the summit.

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