

# **Texas Department of Banking**

## **Press Release**

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### **Texas Department of Banking Announces Loan Stress Testing Process**

Date: October 29, 1999

Experiences from the 1980's in Texas banking indicate that a bank's long-term viability is greatly dependent upon how well risk management systems identify and address credit risk. In December 1998, the Texas Banking Department initiated an examination process to enhance the risk assessment of loan portfolios during the examination process. Its primary focus is to identify those institutions that could be more susceptible to deterioration during economic downturns.

Examination procedures are geared toward evaluating credit risk under current economic conditions. "Stress testing a sample of loans by modifying factors such as interest rates, collateral valuations, sales volumes, profit margins, and foreign market influence, gives both the institution and the regulators insight into those areas of economic risk to which the bank may be most vulnerable," states Deputy Commissioner Randall S. James. Sampled loans are assigned one of three risk categories. These results are then tabulated, analyzed, and discussed with bank management and the Board.

Initial results of this examination process indicate that loan portfolios generally appear to be satisfactorily positioned to withstand moderate shifts in economic factors affecting collateral values and repayment streams. "Due to our limited experience with the program and the number of banks included in this initial review, however, we are not prepared to draw any far-reaching conclusions regarding the state-banking system in Texas as a whole," James stated.

"This examination process is designed to encourage bankers to perform similar reviews to identify loans or groups of loans that are more susceptible to negative economic changes. By identifying these changes, management can be better prepared to respond to changing conditions and minimize the impact to the bank's financial condition." Deputy Commissioner James also stated "as the program moves forward and the number of banks included in the sample increases, we anticipate that the information collected will provide insight and assist in achieving supervision objectives and resource management decisions."

The related Commissioner Policy Memorandum #1016 can be found on the Department's website [www.banking.state.tx.us](http://www.banking.state.tx.us) under "What's New!"