

Breakout 3:
**Managing Credit
Risk in Uncertain
Economic Times**

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Managing Credit Risk in Uncertain Economic Times

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Welcome



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Don't Be Scared, Be Prepared

When the unknowns can be scarier than the knowns, it's best to be prepared. This goes beyond simply providing tables and charts, but really understanding credit risk management from a holistic view.



Managing Credit Risk in Uncertain Economic Times

Managing your credit risk doesn't have to be cumbersome or complex. Sometimes it's just a matter of stepping back and going back to basics.



Agenda



01 STRATEGIC PLANNING

02 STAFFING RESOURCES

**03 LOAN PORTFOLIO
MANAGEMENT**

05 RISK REPORTING

**06 RISK ASSESSMENT
PROGRAMS**

**07 COMMITTEE AND BOARD
GOVERNANCE**



Strategic Planning

FORWARD LOOKING

You can't predict the future, but you can be better prepared. Strategic planning should be more than just focusing on growth; it should take into consideration risk management programs that would allow the organization to grow strategically while having adequate controls and mitigating factors in place.



Strategic Planning (Cont.)

THE CORES OF A SUCCESSFUL STRATEGIC PLAN

- Identify and share core values
- Create a mission and purpose statement
- Identify who your competitors and what differentiates your organization from them
- Analyze peer and market data and identify where your strengths and weaknesses are



Strategic Planning (Cont.)

DEVELOPING AND IMPLEMENTING GOALS

- Short- and long-term goals
- How realistic are they; are they too aggressive?
- Who, what, when, and how are they measurable?
- Review historical and current performance and trends
- Does it align with the bank's risk appetite?
- Analyze peer and market data to mitigate potential risks



Strategic Planning (Cont.)

RISK MANAGEMENT

Non-financial Risk Management

- Human, including succession planning
- Compliance
- Reputation



Strategic Planning (Cont.)

RISK MANAGEMENT

Financial Risk Management

- Capital planning
- Balance sheet
- Liquidity
- Interest risk
- Market risk



Strategic Planning (Cont.)

FRAMEWORK

- Who is involved and frequency of meetings
- Frequency and materiality of deviations from approved strategic plan
- Establish key performance indicators (KPIs) and risk tolerance
- Are there triggers in place prior to the KPIs being breached?
- Documented procedures for breaching KPIs



Staffing Resources

STAFFING IS A DELICATE BALANCING ACT

You can't necessarily cut corners, and you also can't necessarily assume "build it and they will come."

STAFFING CHALLENGES

- Retaining talent
- Talent pool is shrinking
- Increasing cost of salaries and wages



Staffing Dos and Don'ts

DO'S

- Re-allocate resources
- Re-distribute and/or repurpose roles
- Evaluate current processes and services/products
- Automation
- Stretch assignments
- Outsource work
- Consider customer impact and regulatory impact

DON'TS

- Don't just hire the cheapest
- Don't solely cut expenses through staff reduction
- Don't cut corners
- Don't overload your staff
- Create undue risks/lack of mitigation or controls
- Outsource work



Staffing Resources (Cont.)

ORGANIZATION STRUCTURE

- Matching talent and experience to position
- Not all organizations require the same number of staffing levels or positions
- Streamline processes and policies, resulting in consistency of oversight
- Evaluate business lines, product lines, services, etc. that are loss leaders; ensure it doesn't have a CRA or reputation risk impact



Loan Portfolio Management

NOT ALL LOANS ARE CREATED EQUAL

- The required level of managing your loan portfolio should match to the risk profile.
- Not all loans from origination to ongoing management requires the same level scrutiny.
- Portfolio management takes some creativity while balancing the risk and reward.



Loan Portfolio Management (Cont.)

LOAN FILE REVIEWS (INTERNAL AND EXTERNAL)

- Sampling methodologies using a risk-based approach
 - Full loan review versus targeted scope
 - Portfolio coverage and sample size
 - Select loans with multiple risk attributes
- Streamlined approach
- Automation of small dollar loans



Loan Portfolio Management (Cont.)

Portfolio management goes beyond loan file reviews. Frequent monitoring (formal and informal) and discussions with key credit personnel helps justify your sampling methodologies and promotes proactiveness

- Run and review reports; focus on key areas and trends
 - Reports are helpful, but they don't always tell you the full story nor does it provide non-financial impacts



Loan Portfolio Management (Cont.)

Frequent discussions with management, key personnel, and other areas

- Key personnel may include business line management, approvers, relationship managers, and sales and risk staff
- Discuss staffing changes, new areas of concerns, new product line, and material policy or procedure changes
- Status updates on material credits that are adversely risk rated, as well as projections



Loan Portfolio Management (Cont.)

Validate areas of concerns as an interim process

- Conduct your own internal validation
 - Select a small loan sample and focus on key areas
 - Expand scope and sample size if needed or hire an independent contractor to complete the review
 - Better to have someone else identify potential issues than the regulators
 - Allows time for your organization to fix the issue



Loan Portfolio Management (Cont.)

STRESS TESTING

- Bankwide, industry, business line, loan product
- Interest rate, cash flow, vacancies, market conditions, current state of the economy
 - Reverse stress testing, meaning how much does interest rate need to drop in order to break even versus interest rate stress testing by 200 to 300 bps



Risk Reporting

GOING BEYOND CHARTS AND TABLES

When reporting your enterprise risk, get behind the numbers, provide credible challenge, conduct your own research

REPORTS SHOULD PROVIDE THE FOLLOWING:

- Track KPIs and results
- Provides context behind the numbers
- Target key audience



Risk Reporting (Cont.)

CONTENT OF REPORTS

- Track KPIs, results, and context behind the numbers
- Develop a heat map; this helps monitor increasing trends prior to a breach
 - Is there an escalation process in place
- Provides trend analysis
- Data integrity



Risk Assessment Programs

NO LONGER A 'NICE TO HAVE', BUT A MUST

Evaluating your risk assessment programs is essential and assists in identifying potential issues and establishes a baseline for areas of improvements and best practices.



Risk Assessment Programs (Cont.)

Has there been any independent validation of the risk programs

- Is it conducted by an external or internal party?
- Material issues identified?
 - Has it been resolved and is the follow-up practices in place?
 - Periodically assess policies and procedures to ensure they continue to align with regulatory requirements



Committees and Board Governance

EFFECTIVE COMMITTEE AND MEMBERS

An effective committee and members are essential in building a strong foundation to your organization.

- Rotate your board and committee members
 - Establish term lengths, including positions
 - Set age limitations
 - Replace or add members when appropriate



Committees and Board Governance (Cont.)

EVALUATE YOUR COMMITTEES AND MEMBERS

- How frequently do the individual members show up to meetings?
- Do the members provide credible challenge and add value?
- Are your members diverse and complement each other?
- Do the members' experience match to the committees they serve?
- Is there independence between the members and bank management



Committees and Board Governance (Cont.)

ADEQUACY AND EFFECTIVENESS OF MEETINGS

- Is there formal governance training?
- Frequency of meetings
- Composition of committees and board
 - Independence
 - Adequate number of members
 - Conflict of interest



Committees and Board Governance (Cont.)

ADEQUACY AND EFFECTIVENESS OF MEETINGS

- Contents of meetings
 - Material issues identified by regulatory agencies and audits—updates should include remediation plans and progress
 - Historical trends and material changes should have context behind the numbers



Committees and Board Governance (Cont.)

ADEQUACY AND EFFECTIVENESS OF MEETINGS

- Informal and formal continuing education
 - Members should self educate themselves through reading periodicals
 - Provide credible challenge and, if it doesn't make sense, hire an independent contractor to validate or educate
 - Meet with regulators to discuss hot buttons, outstanding issues, results of recently completed reviews, etc.
- Periodic updates from different areas of the bank



Conclusion

FOOD FOR THOUGHT

- Does your strategic plans take into consideration historical and current economic trends and events and does it include plans to mitigate potential risks?
- Have you recently assessed your staffing levels? Are they in the right position for their area of expertise?



Conclusion(Cont.)

- Are there processes that can be streamlined or automated to manage portfolio more effectively?
- Are your reports robust enough and does it tell the story behind the numbers?
- Have you had an independent risk assessment completed?
- How strong and diverse is your board and committees?



➤ Q&A

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