

BankDirector

Breakout 3:
**The Board's Role in
Overseeing Credit
Quality in More
Stressful Times**

David Ruffin

*IntelliCredit, A Division of
QwickRate*

#BBTF23

BankDirector.

Bank Board Training Forum

The Board's Role in Overseeing Credit in More Stressful Times

September 12, 2023



David Ruffin,
Principal, IntelliCredit



Today's Presenter



David Ruffin

- Principal, IntelliCredit™
- 49 Years in Banking
- 16 years as Chief Credit Officer / Commercial Lender
- 3,000+ Loan Reviews
- ~350 Capital Raise or M&A Due Diligences
- Former Co-Founder of Credit Risk Management
- Prolific author and speaker on credit risk topics

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Affordable Fintech Solutions for Real Bank Problems.



QwickRate®

- Non-brokered Funding and Investing
- DTC CDs, Other Fixed Income Investments (*QwickBonds*)



IntelliCredit™

- Loan Review Services (*by our experts*)
- Loan Review Tool (*for your internal team*)
- Annual Review Tool
- Portfolio Analytics and more



QwickAnalytics®

- CECL Solver Compliance Tool
- Credit Stress Test
- Bank Research, Performance Metrics and Analysis

Loan Review and Credit Intelligence Solution

IntelliCredit Solution



Annual Review (for use by your team)

Move to an automated process that makes annual reviews easy, organized and repeatable – with everything right at your fingertips



Smart Loan Review™ (for use by your team)

Revolutionary online solution that expedites your entire loan review process, making it simple, retrievable online – and fast



Portfolio Analyzer (for use by your team)

Delivers insightful analysis of your portfolio and loan data so you can detect risk earlier – no need to build reports, create spreadsheets or hire consultants

Loan Review



Smart Loan Review™ (performed by our experts)

Benefit from a smarter loan review service that uniquely combines deep credit expertise and an online, real-time portal – so you see progress and results as they happen

Online. No installation. No software integration. SOC2 compliant.



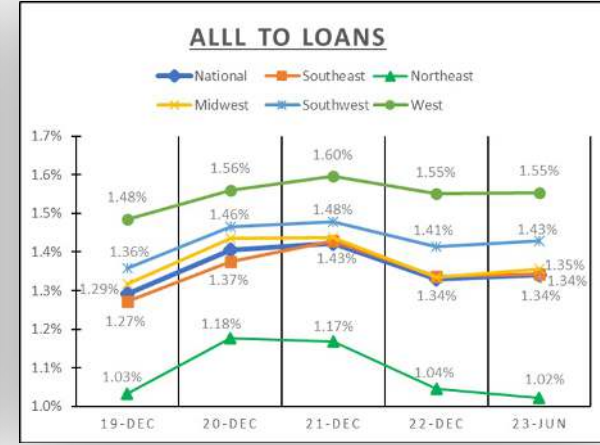
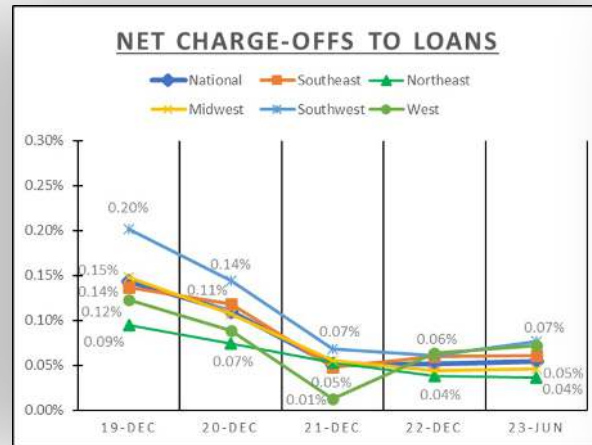
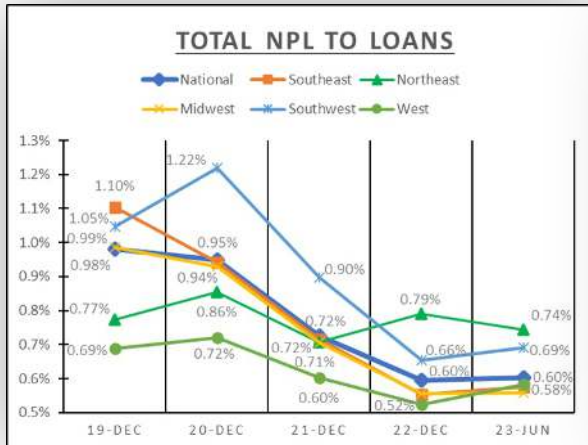
Credit quality *published* metrics are at generationally high levels . . . so let's take a look.

Trifecta of Loan Quality: Banks <\$10B

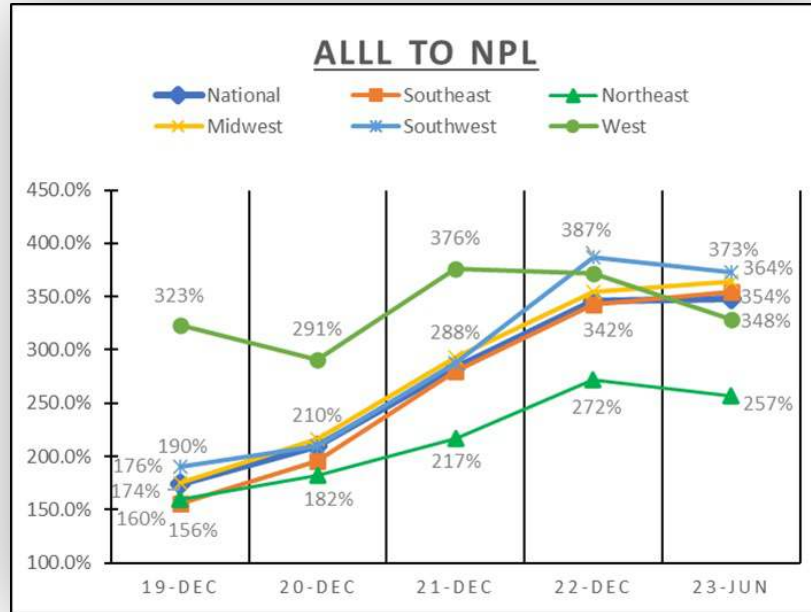


Q2 '23 Call Report Data QwickAnalytics®

National / Southeast / Northeast / Midwest / Southwest / West



Trifecta of Loan Quality: Banks <\$10B



QwickAnalytics®

Q2 '23 Call Report Data

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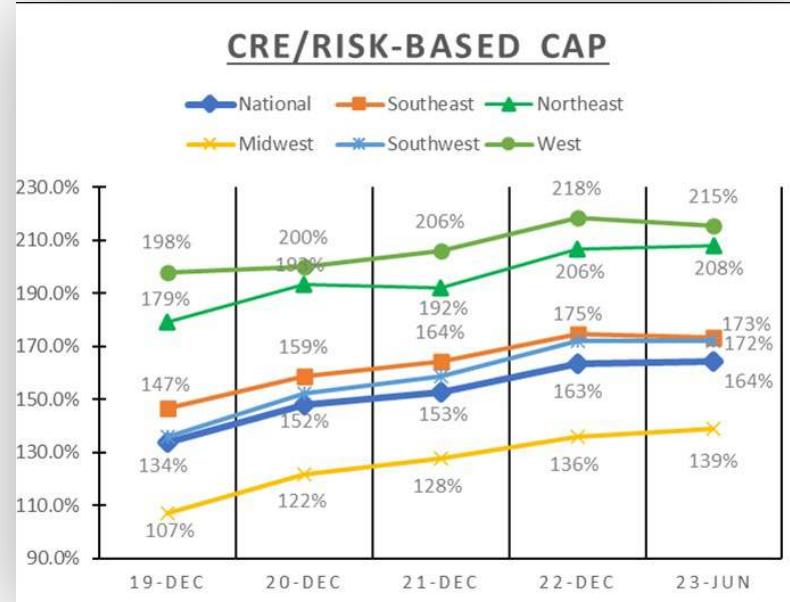
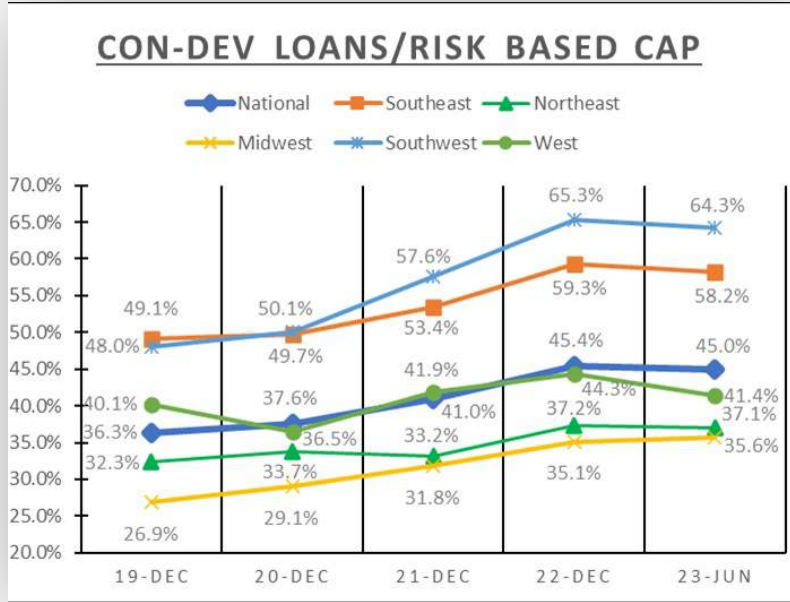
Regional CRE Concentrations: Banks <\$10B



Regulatory Guidance:
≤ 100% RBC

Q2 '23 Call Report Data

Regulatory Guidance:
≤ 300% RBC



272 National / 86 Southeast / 15 Northeast / 77 Midwest / 82 Southwest / 14 West

↑ 100%:

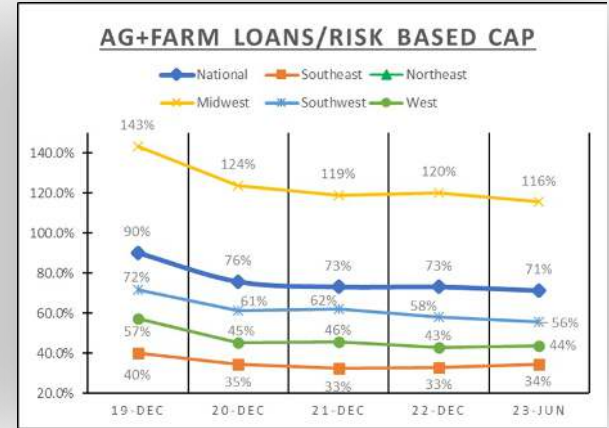
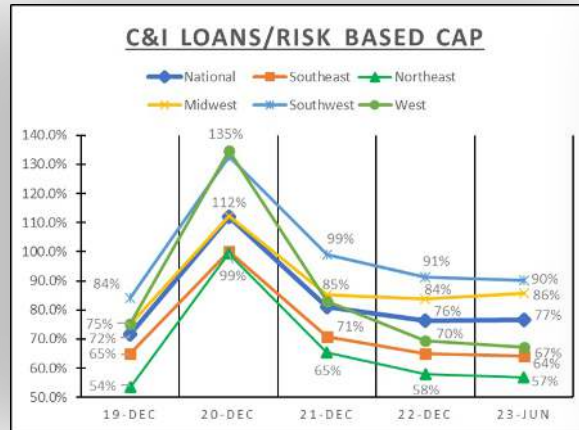
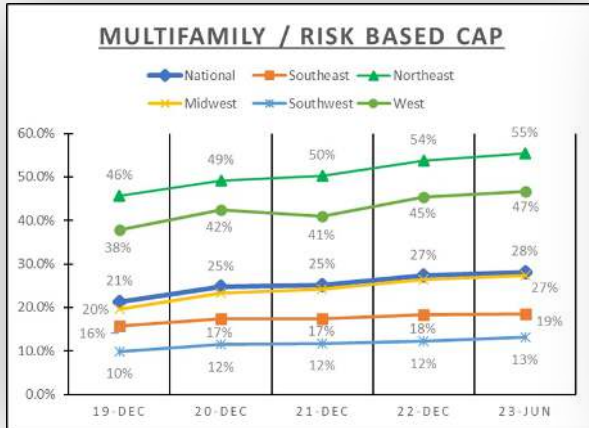
328 National / 56 Southeast / 69 Northeast / 116 Midwest / 50 Southwest / 42 West

↑ 300%:

Regional Other Concentrations: Banks \leq \$10B



National / Southeast / Northeast / Midwest / Southwest / West

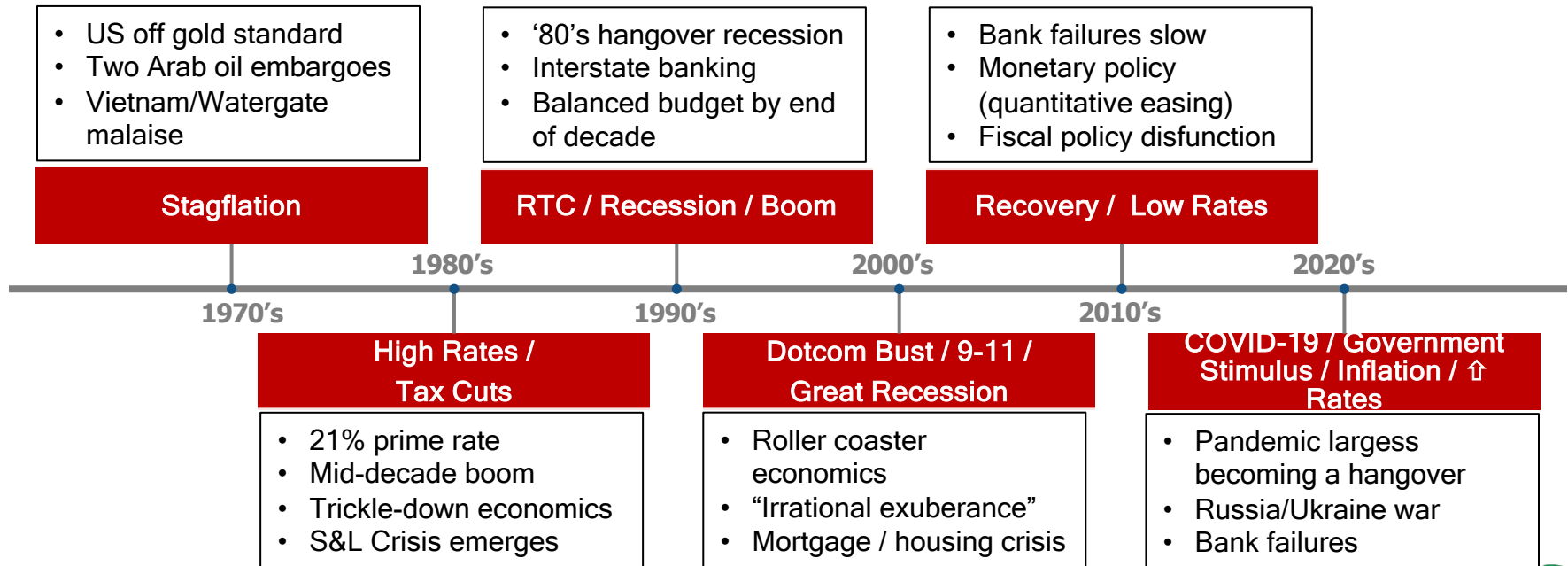




However, there are increasing industry-wide concerns over the direction of credit quality...

Credit cycles over the last 50 years hold a pattern:

► **Credit stress always preceded by economic/political/financial turmoil!**



Current Credit Concerns (General)



Credit *performance* metrics still good, but future clouded by several factors.

Reserves beginning to level out.

Loan demand moderating; will there be a “credit crunch”?

Credit servicing continues to struggle.

The vintages of recent loan growth require monitoring.

Rising consumer debt and delinquencies are now real.

Be prepared for overreaction (investor & regulatory) over first signs of stress.

But, for commercial bankers, most concern should be about CRE loans!

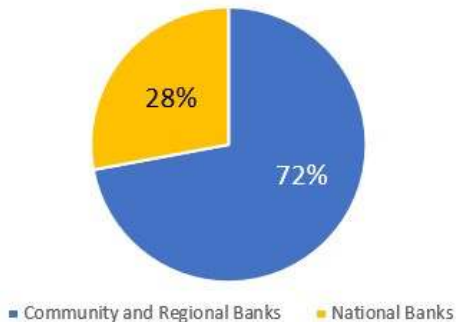
Community & Regional Banks:

CRE Has Exploded in Exposure *Just Since the Pandemic!*



Commercial Banking Exposure

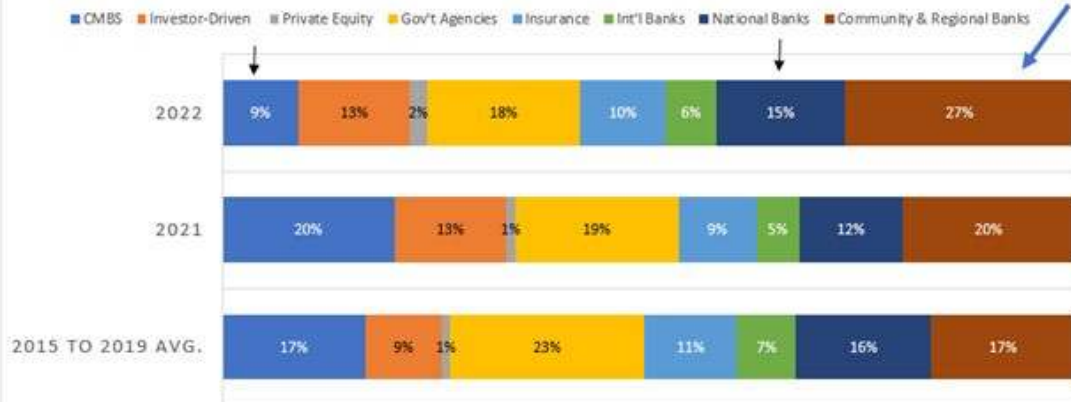
CRE Holdings (Excluding Multifamily)



Source: Federal Reserve H.8 Data - April 2023

All CRE Exposure

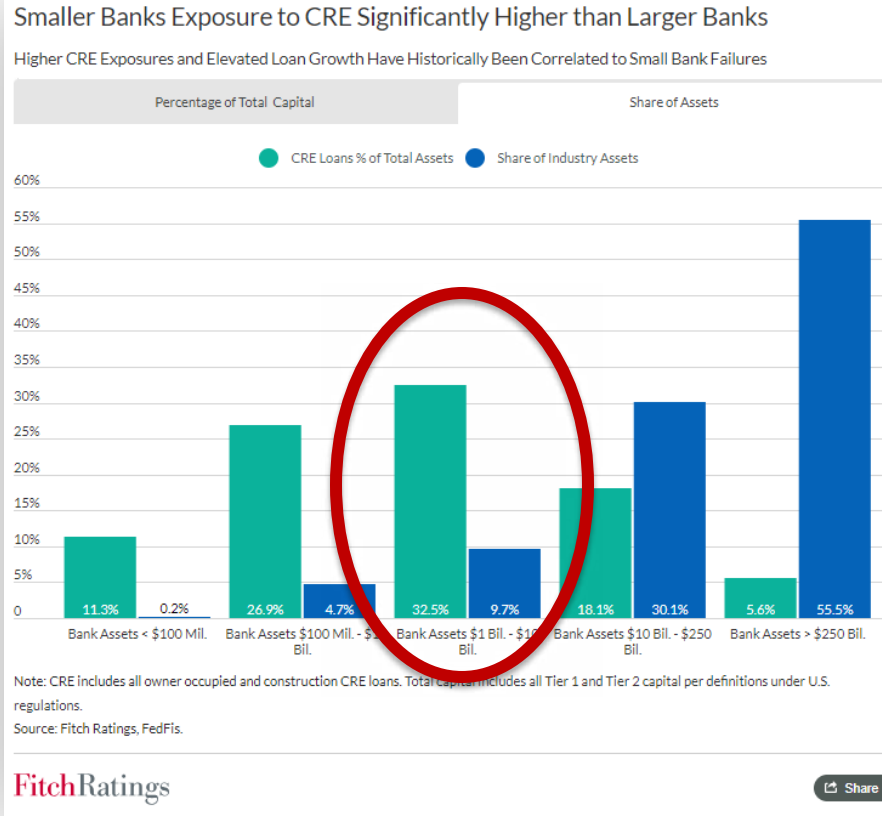
SHARE OF CRE MARKET



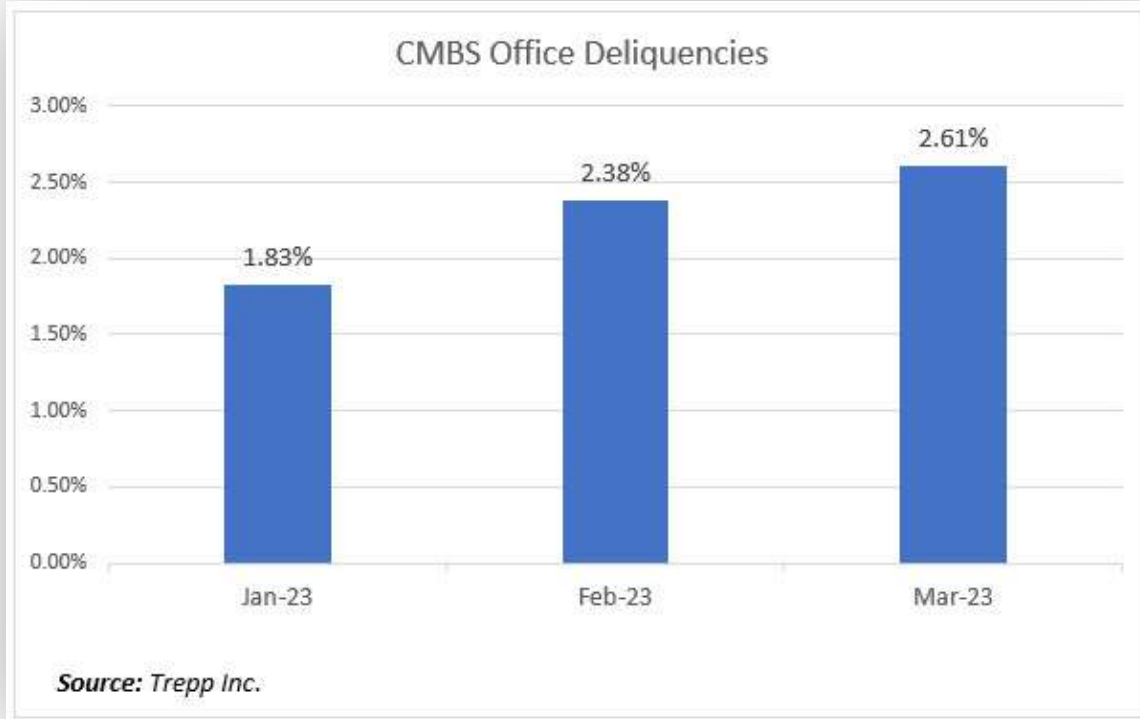
Source: MSCI Real Capital Analytics

CRE Lending (% of Assets):

Smaller Banks' CRE Exposure Dwarfs Larger Banks



Delinquencies – Especially Office Space – Rising!



- June CMBS delinquencies **↑20 bps / ↑16%** in last six months
- Morgan Stanley estimates **\$1.4T** in office space lending will be up for rate adjustments in next 24 months

All Four National Regulators Send **Red Flag** On CRE



PRESS RELEASE / June 29,
2023

Inter-Agency Guidance Policy Statement on Commercial Real Estate Loan Accommodations and Workouts

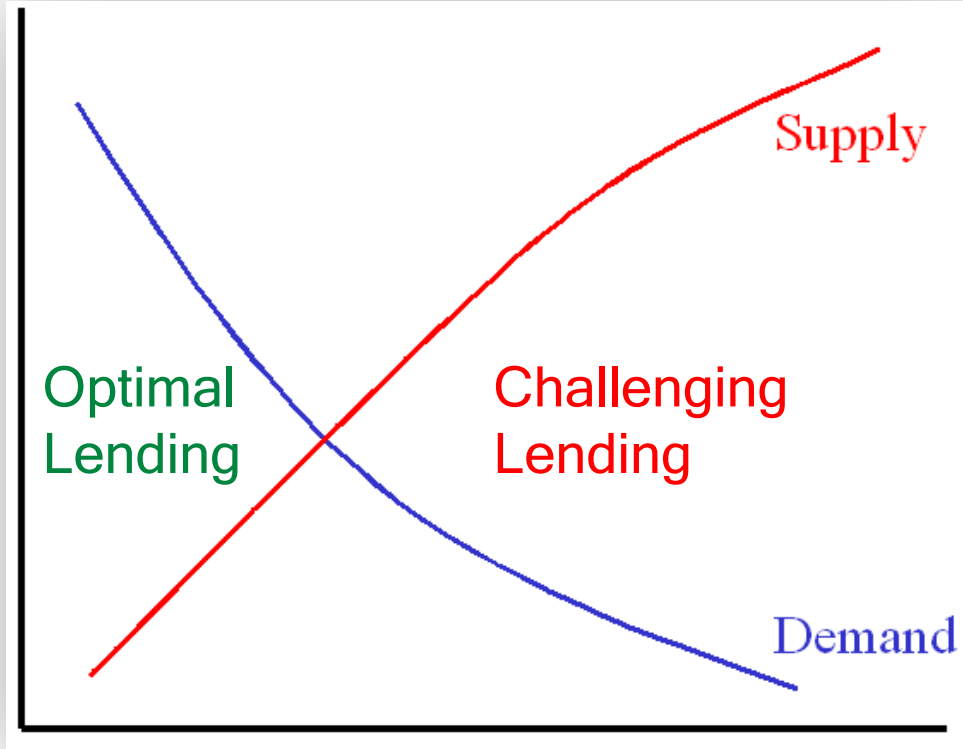
IF within basic safety & soundness protocols, examiners will not:

- criticize financial institutions adopting CRE workout plans and short-term accommodations; and
- Automatically downgrade loans to “substandard or worse” solely due to declining RE values, and borrower objectively is not deemed to be beyond ultimate repayment capacity.
- BUT, must be tied and documented to your policies and procedures!

The Most Fundamental Metric In CRE – *Whatever The Type*



\$ Value

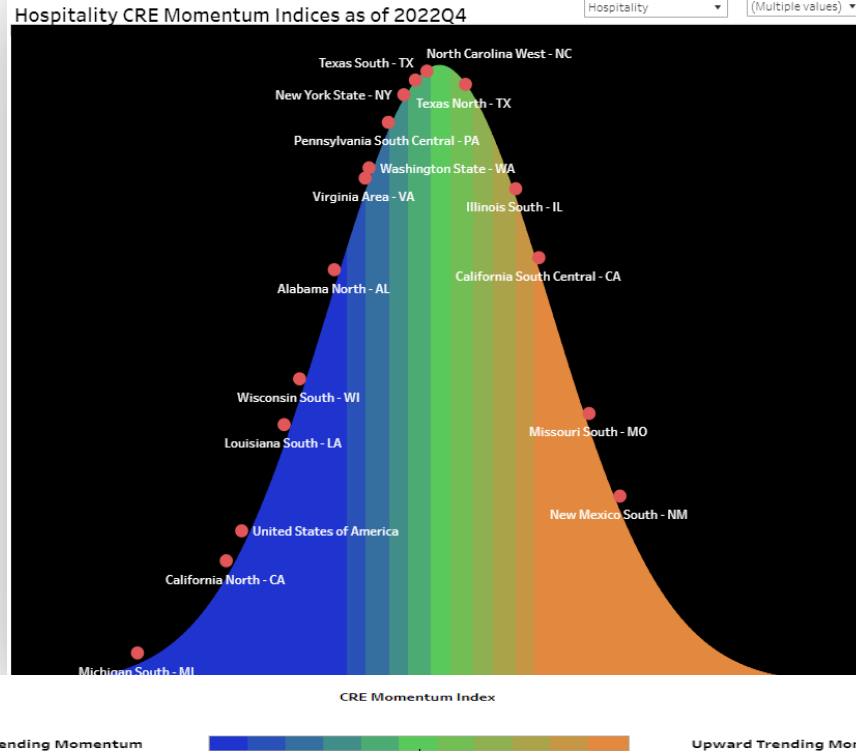


Units Available

CRE Locations And Loan Types Aren't The Same



Hospitality



Source: ATL FED
CRE Momentum Index

Current Credit* Concerns (By Industry)



Highest Risk: CRE Office & Retail / Consumer* / Small Business

Moderate Risk: CRE Hospitality / Specialty Lending / Manufacturing

Lowest Risk: Agriculture (Most)

*Based on recent regulatory commentary / our DD & LR findings

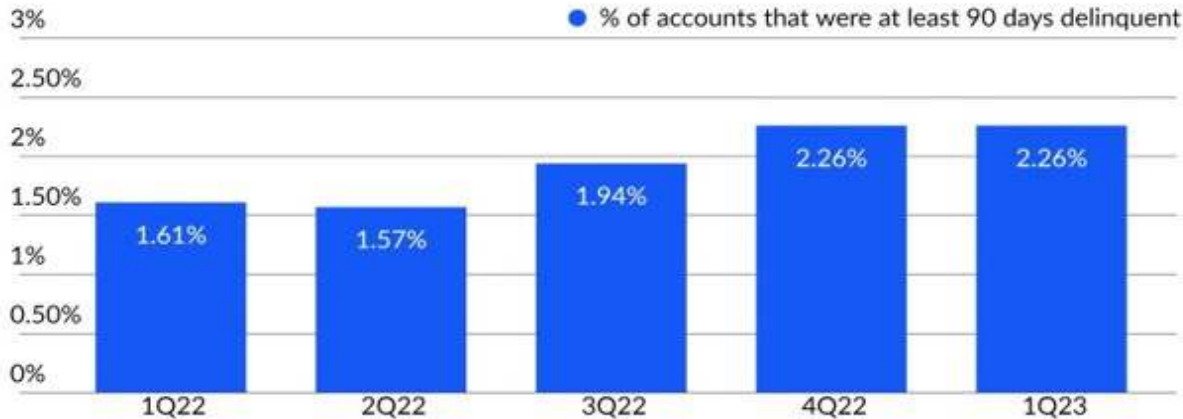
**Susceptible Consumer*

Early Signs of Stress . . . Mainly Consumer



Cardholders falling behind

Late-payment rates on credit cards remained unusually low in the first half of last year, but they have since climbed back to more normal levels



Source: TransUnion

- The increase was driven by subprime borrowers, who have been more vulnerable to inflation and interest rate hikes than borrowers with higher credit scores.
- U.S. credit card balances: \$917B in the Q1 '24 from \$769B in Q1 '23.
- Mortgage repayment performances remain strong.
- Truly a tale of two consumer segments!

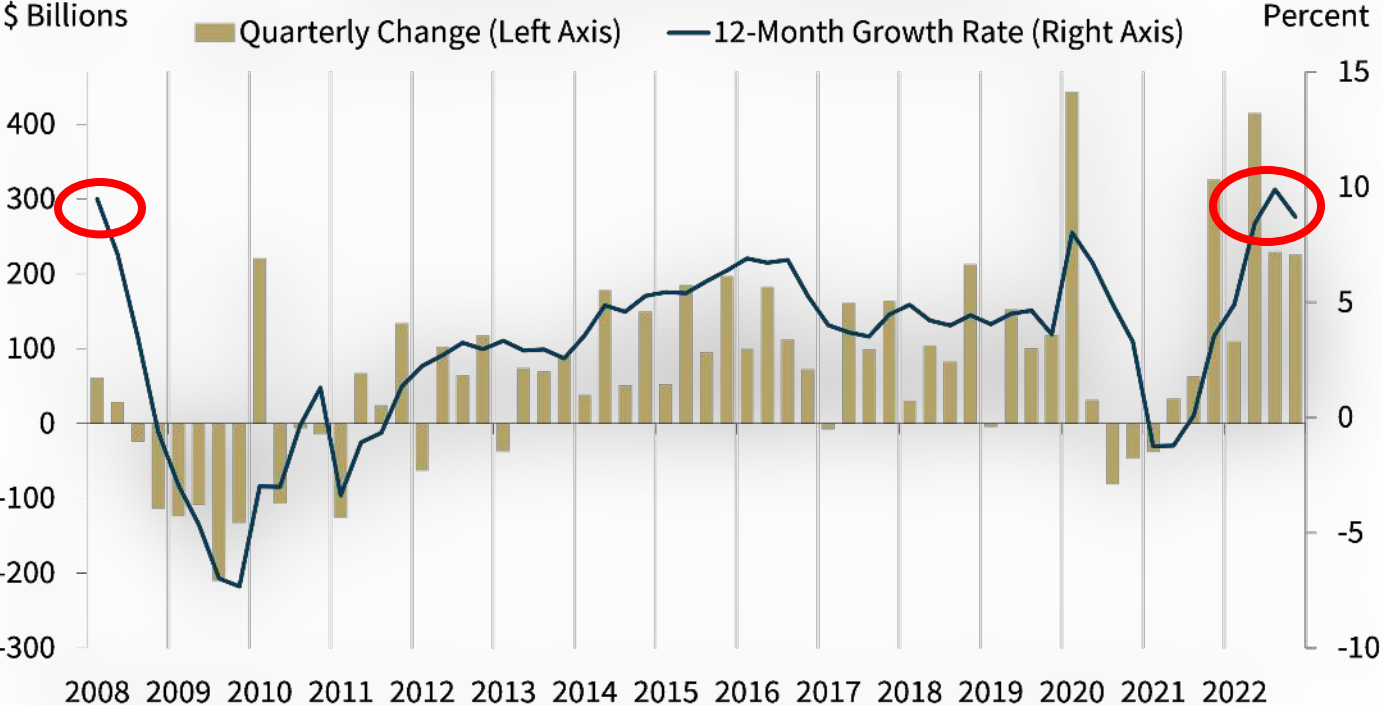
--American Banker May, '23

Consumer debt passes \$17 trillion for the first time despite slide in mortgage demand

--CNBC May, '23

National Loan Growth Trends: All Banks

Quarterly Change in Loan Balances



Source: FDIC.

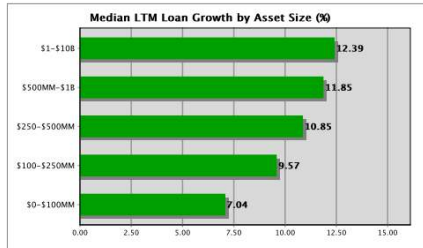
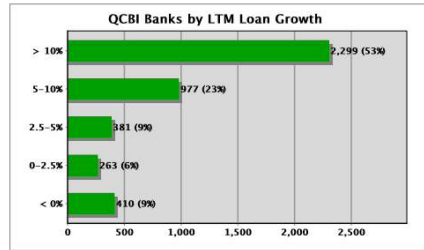
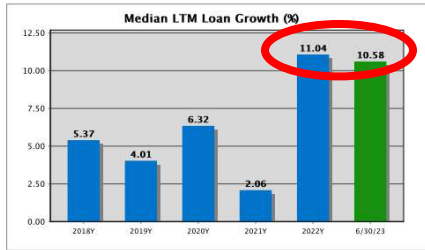
National Loan Growth Trends: Banks <\$10B



Q2 '23 Call Report Data

QwickAnalytics National Performance Trends Loan Growth Trends

U.S.
Banks
June 30, 2023



* LTM = Last 12-months (or "trailing" 12-months)

QwickAnalytics™

Vintages matter: A weakened economy will disproportionately penalize credit quality from the most recent bursts of growth!

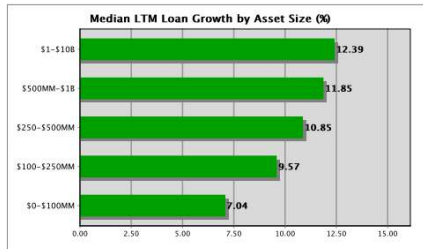
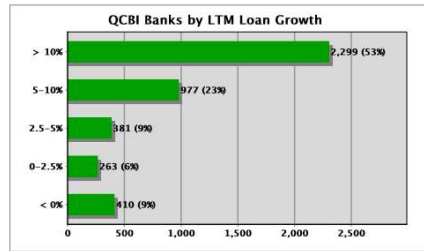
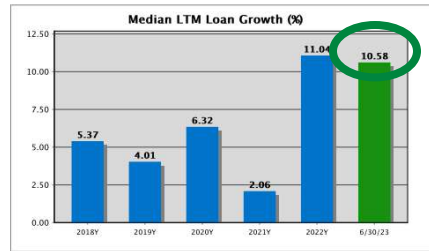
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Q2 '23 Call Report Data

QuickAnalytics National Performance Trends Loan Growth Trends

U.S.
Banks
June 30, 2023



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QuickAnalytics™

Banks losing ground to nonbanks

--American Banker article 10-4-2021

Neck and neck

While corporate bonds continue to account for the majority of commercial debt, nonbanks have almost caught up with banks in market share.



~57% of CRE/C&I now funded by non-banks—
Piper Sandler AQB Conference 1/31/2023

Fed Funds Rate (Last 10 years / Last 50 years)



👉 Last 10 Years

Last 50 Years 👉





Moving from *Typical* to Optimal
Credit Risk Management
(from the Board's Oversight Perspective)

Typical, Non-synced, Credit Management Input

Bank Management



Optimal, Coordinated, Credit Management Input

Bank Management

Informed, Educated Decision Making

Shared methodologies
and corporate values

Of optimal value

Prescriptive of risk appetite



Ongoing and interactive

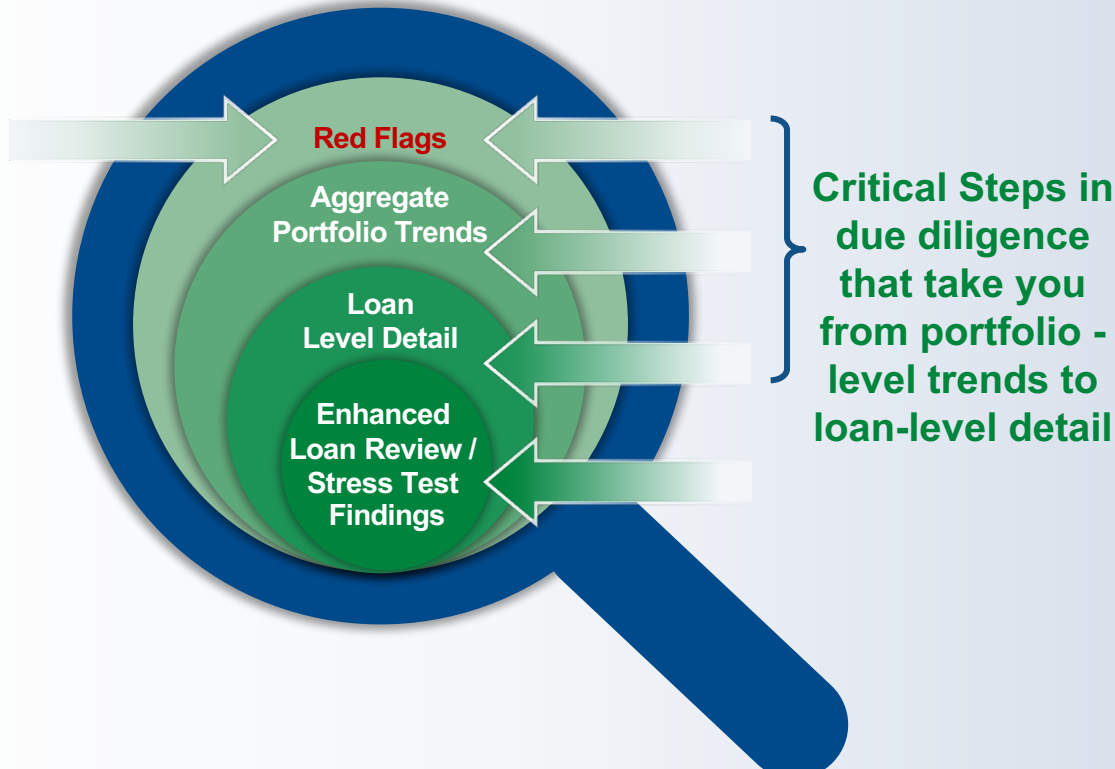
Complementary and
coordinated

Let's Start With A Critically Informing Concept . . .



Public Data

Non-Public Data



Remember:

- The external stakeholders see a target through the lens of public (call report) data.
- Only with non-public, idiosyncratic loan data can you discern the whole story.



Credit Analysis / Decisioning / Review Pyramid

- Utilize reviewers that have *been there / done that*
- The power of *persuasion / collaboration*
- Companion with quality documentation review
- Require bios during RFP process
- Recognize loan review is a key first line of defense—*an asset, not an adversary?*

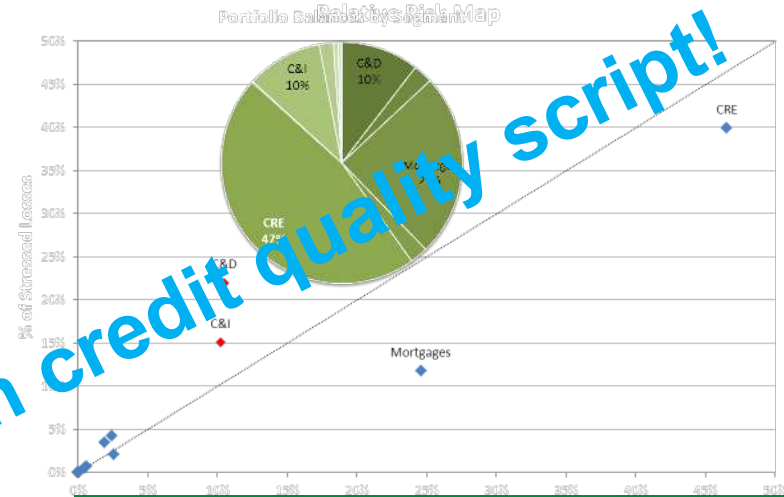


Portfolio Analytics: *Data mine Your Portfolio DNA* (*Business Intelligence*)



- We're different from the Great Recession where only one industry (1-4 family housing) was the focus
- Data mine all aspects of the broader portfolio, loan review findings, and annual reviews
- Ferreting out hotspots will be the name of the game for perhaps years to come
- Early detection: reduced losses

Goal: write your own credit quality script!

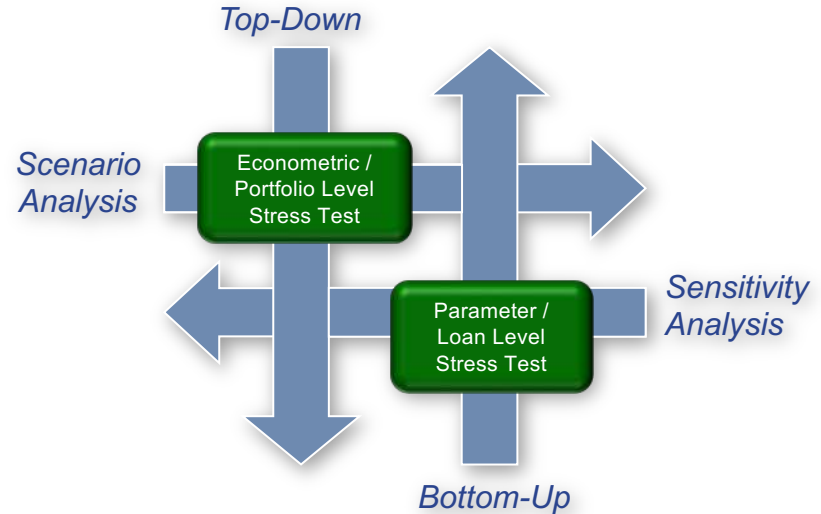


While balances and risk are correlated – they are not one in the same.

Stress Test: Companion With Loan Review



- Loan review arguably has the most “real-time” perspective of a borrower’s current circumstance, off-setting risks of relying on potentially out-of-date initial credit underwriting data
- A sensitivity stress test on a subset portfolio, concurrent with the broader loan review, is a good faith attempt at a loan level approach on a significant concentration



Pre-Stress		CRE Loan-To-Value			
Debt-Service Coverage	60-69%	70-79%	80-89%	90+%	
>1.75x	5.0%	45.5%	38.0%	7.5%	
1.51x to 1.75x	19.0%	74.0%	53.0%	15.0%	
1.26x to 1.50x	22.5%	58.0%	60.0%	12.5%	
1.16x to 1.25x	7.5%	35.0%	17.5%	0.0%	
1.01x to 1.15x	0.0%	5.0%	25.0%	0.0%	
<=1.0x	0.0%	0.0%	0.0%	0.0%	

Note: Cell data represent the volume of loans, as a percentage of total risk-based capital, that meet the LTV and DSC criteria for that cell.

Post-Stress		CRE Loan-To-Value			
Debt-Service Coverage	60-69%	70-79%	80-89%	90+%	
>1.75x	0.0%	5.0%	15.0%	7.5%	
1.51x to 1.75x	0.0%	7.5%	45.0%	12.5%	
1.26x to 1.50x	5.0%	12.5%	20.0%	25.0%	
1.16x to 1.25x	0.0%	20.0%	17.5%	12.5%	
1.01x to 1.15x	0.0%	50.0%	125.0%	70.0%	
<=1.0x	0.0%	10.0%	35.0%	5.0%	

Note: Cell data represent the volume of loans, as a percentage of total risk-based capital, that meet the LTV and DSC criteria for that cell.

In Summary *(Jointly for Bank Management & Boards)*



The current uncertain credit environment requires:

- Accepting the axiom: *early detection of credit weaknesses correlates to reduced loan losses*
- Enhancing your loan review, diagnostic credit tools, and practical stress testing
- Writing your own credit risk narrative—*before a regulator does it for you*; and
- At all cost, avoiding the most toxic dynamic: *too many credit surprises!*





Q & A



Please Reach Out on any Credit Portfolio Review Needs. Also, Deeply Experienced in M&A / Re-Caps.

Real-time combo:
Loan Review / Portfolio Analytics



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