BankDirector®

Breakout IV:
So A Recession is Coming... What Can We Do To Prepare for It?

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Session Presenters

Erica is a former FDIC examiner and banker who is a principal and national leader for CLA’s (CliftonLarsonAllen LLP) Credit Risk Services. With over 20 years of experience, Erica utilizes her experience as former regulator, bank risk director, and commercial lender to lead the credit risk team and work with financial services companies across the country to assess overall loan portfolio quality, evaluate credit risk identification procedures, and assess the overall effectiveness of credit administration practices.

Susan is a CPA with 25 years of combined experience in public accounting and the financial services industry, including experience with Fortune 500 financial services companies. Susan serves as the managing principal of CLA’s (CliftonLarsonAllen LLP) financial services practice. Her responsibilities include providing engagement oversight in the areas of assurance and internal audit. In addition, Susan provides board advisory and management consulting services in the areas of strategic planning and mergers & acquisitions. Susan has been involved in multiple mergers & acquisitions of sizes ranging from $150 million to $500 billion with engagement at all stages of the process.

Today’s Objectives

2023 Economic Outlook

2023 Lending Credit Risk Outlook

Actions You Can Take

2023 Economic Outlook

2023 Outlook – Executive Summary

Half Full

Economy: Robust consumer spending to continue.

Industry: Strong business profitability trends forecasted while the use of data insights and outsourcing should increase given labor shortages.

Financial markets: Attractive valuations in both equity, fixed income and alternative markets.

Policy: Congress and the Biden administration will work together on bipartisan and “must pass” legislation.

Portfolios: Well-constructed portfolios can participate in market upside while mitigating volatility to help achieve your goals.

Half Empty

Economy: Slowing GDP growth expected in 2023.

Industry: Tight labor markets and rising cost of capital may challenge unprepared business owners.

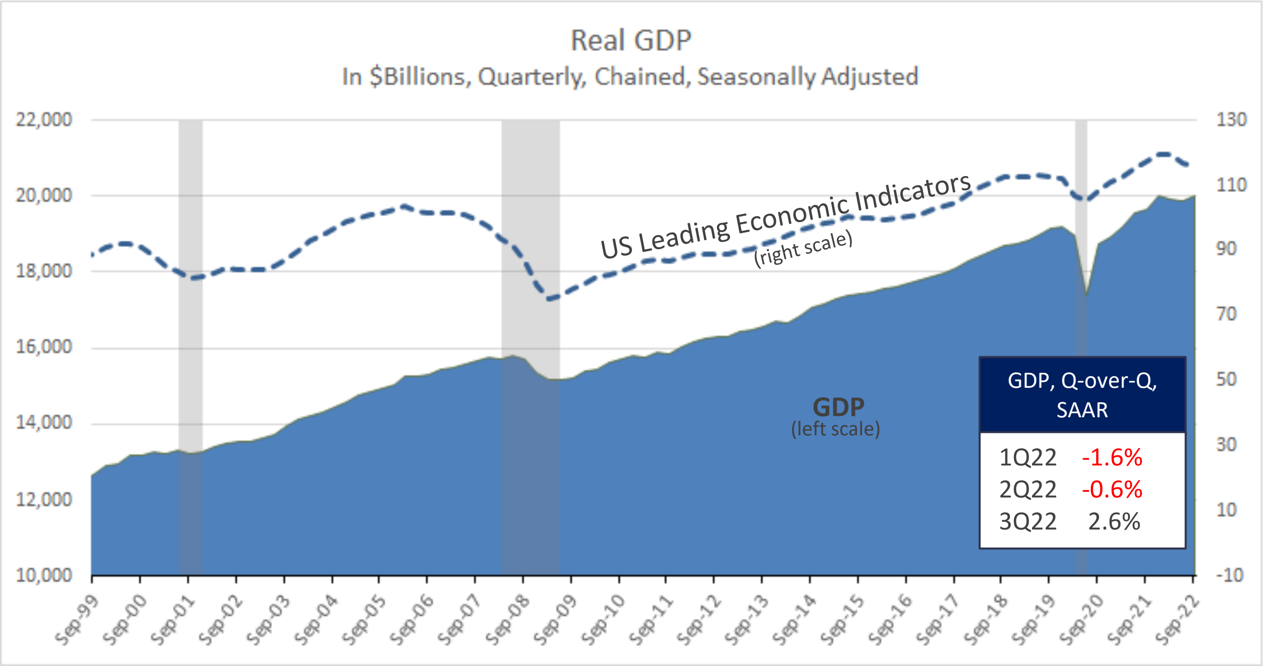
Financial markets: Expect more restrictive credit conditions as the Federal Reserve continues to withdraw liquidity in a bid to fight inflation.

Policy: A divided government may result in gridlock.

Portfolios: Recoveries take time and reward patient long-term investors rather than market-timers.

Macroeconomy: GDP

GDP growth is slowing — but still resilient

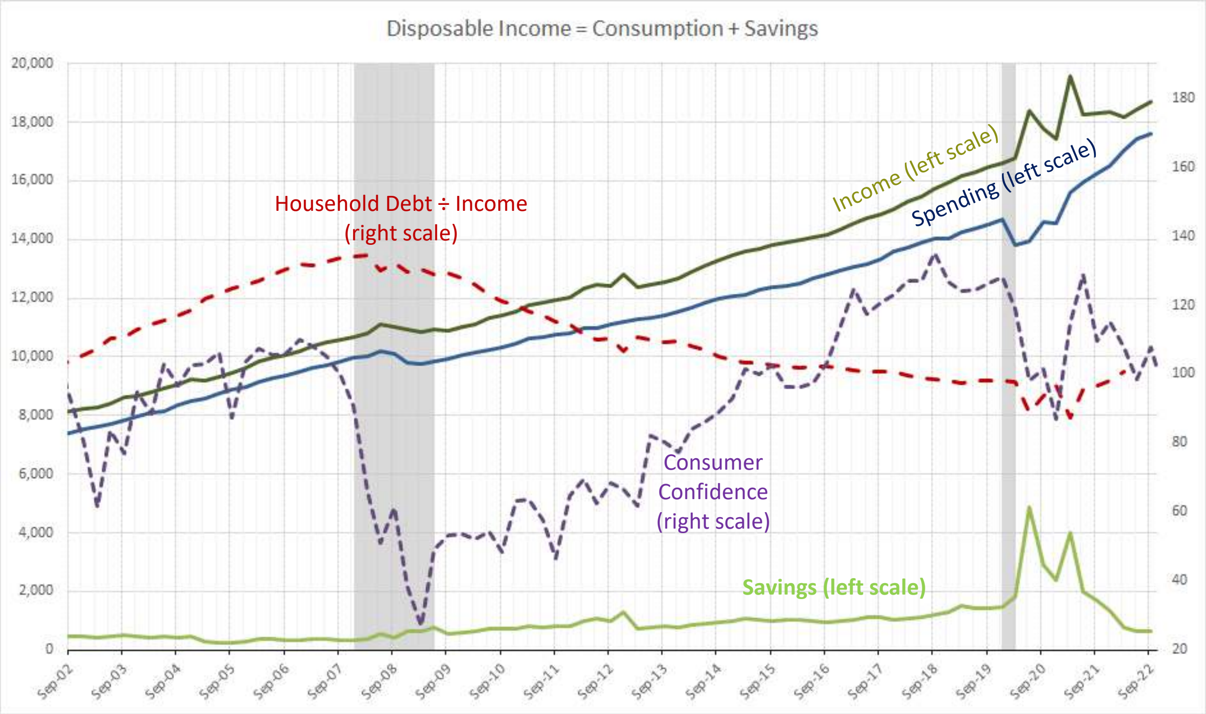


Grey areas denote recessions.

Source: US Bureau of Economic Analysis, Conference Board, National Bureau of Economic Research, Bloomberg, CLA Wealth Advisors

Macroeconomy: Consumer

Healthy consumer spending and income levels despite lower savings



Source: US Bureau of Economic Analysis, Federal Reserve, Conference Board, Bloomberg , CLA Wealth Advisors

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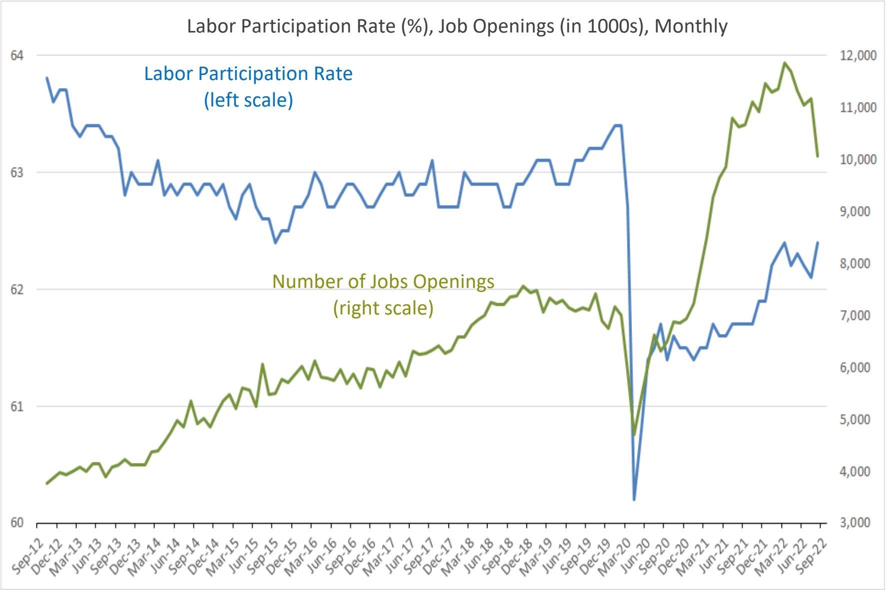
Macroeconomy

Low unemployment remains, making it tough to find labor



Source: U.S. Department of Labor, Atlanta Federal Reserve, Bloomberg , CLA Wealth Advisors

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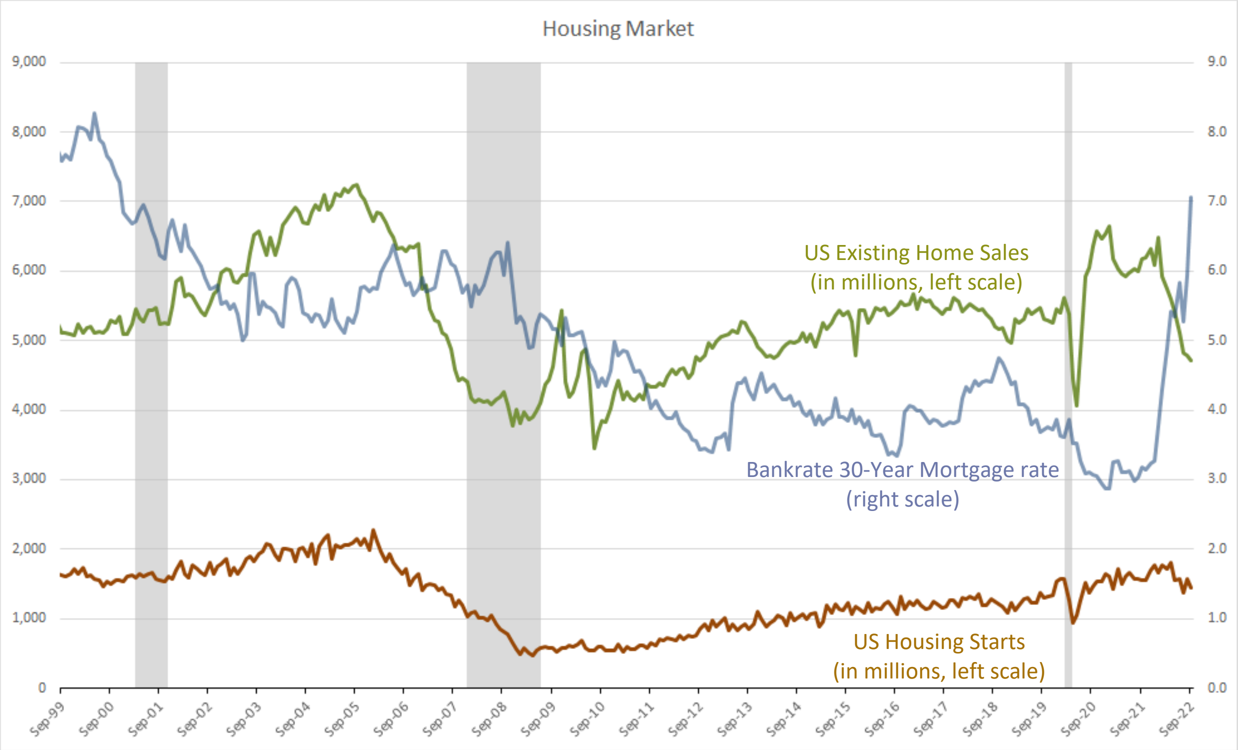
Macroeconomy: Housing

Home sales are starting to fall due to higher mortgage rates

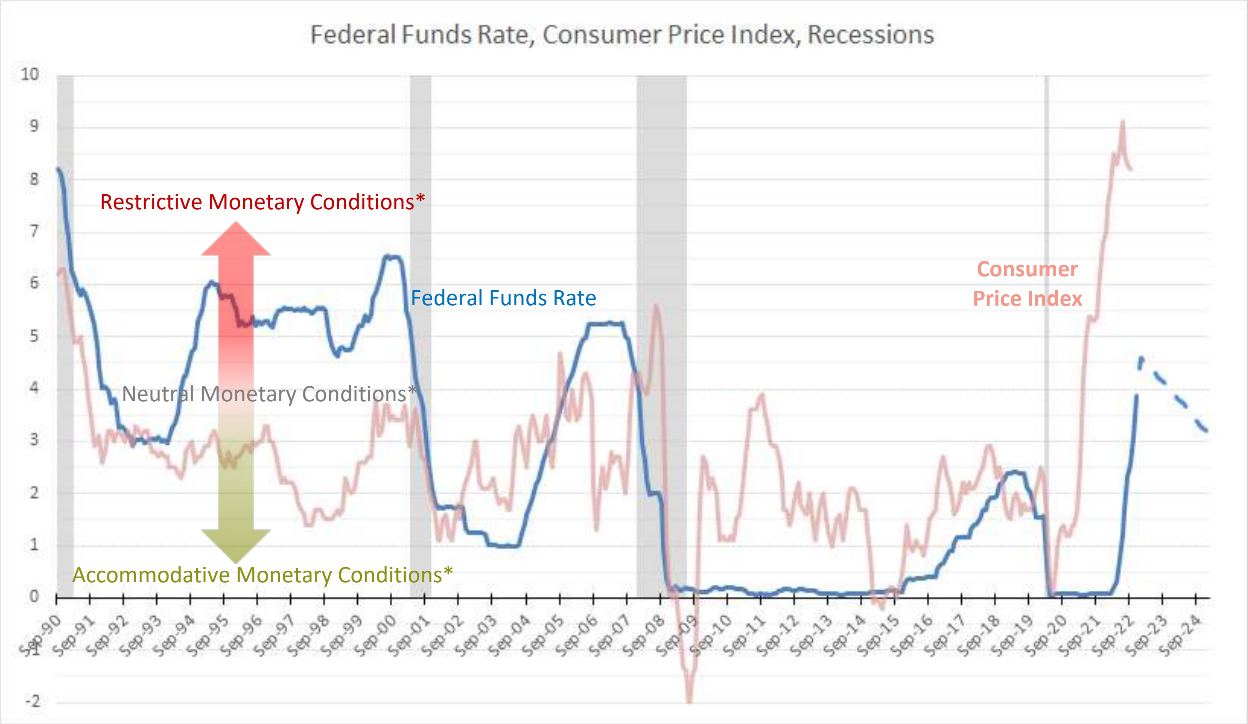


Source: Bankrate.com, National Assoc. of Realtors, U.S. Census Bureau, Bloomberg, CLA Wealth Advisors

Grey areas denote recessions.

Federal Reserve Policy

The Fed may raise rates from 0% in 2022 to ~ 5% in 2023

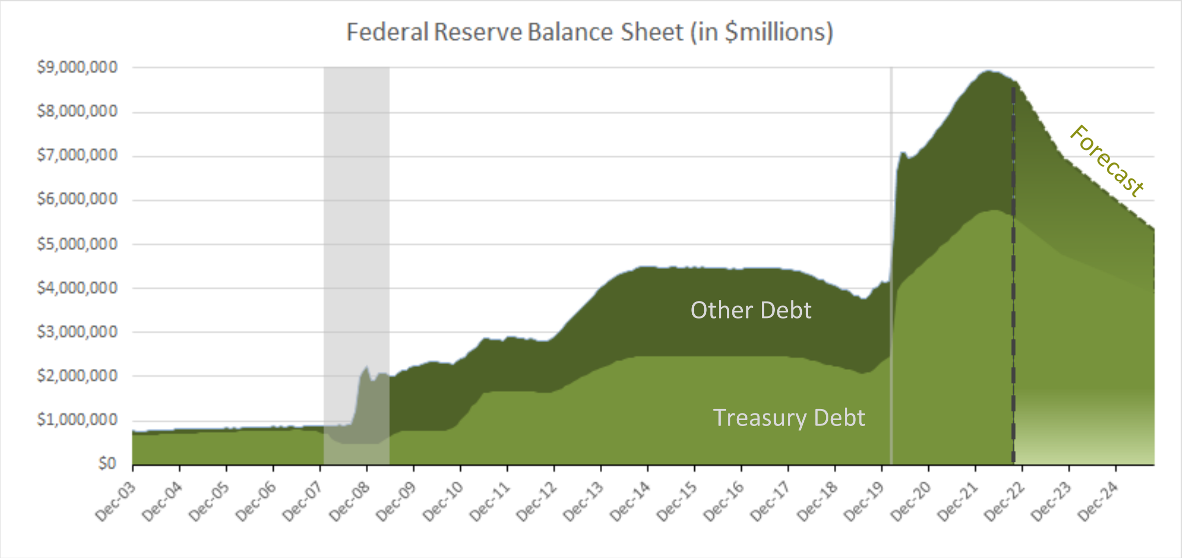


Source: Federal Reserve Board, Bloomberg, NBER, CLA Wealth Advisors

Grey areas denote recessions.

Federal Reserve Policy

Further tightening seen with $95bln / month of balance sheet runoff

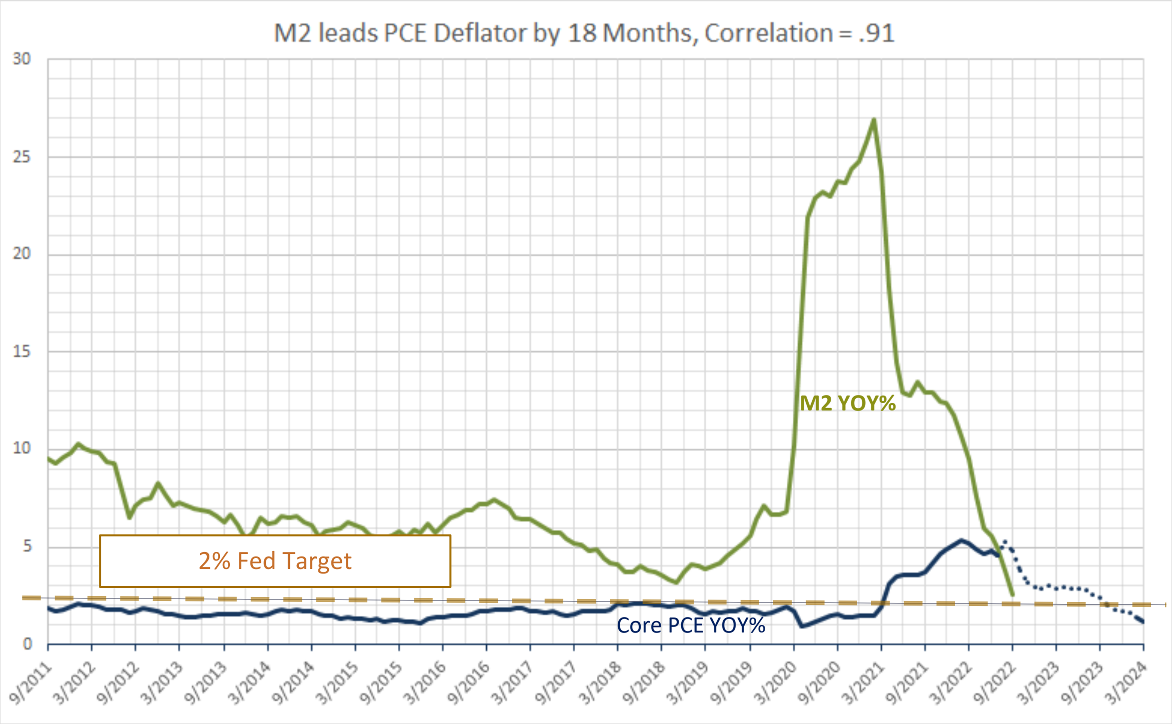


Grey areas denote recessions.

Source: Bloomberg, Federal Reserve, NBER, CLA Wealth Advisors

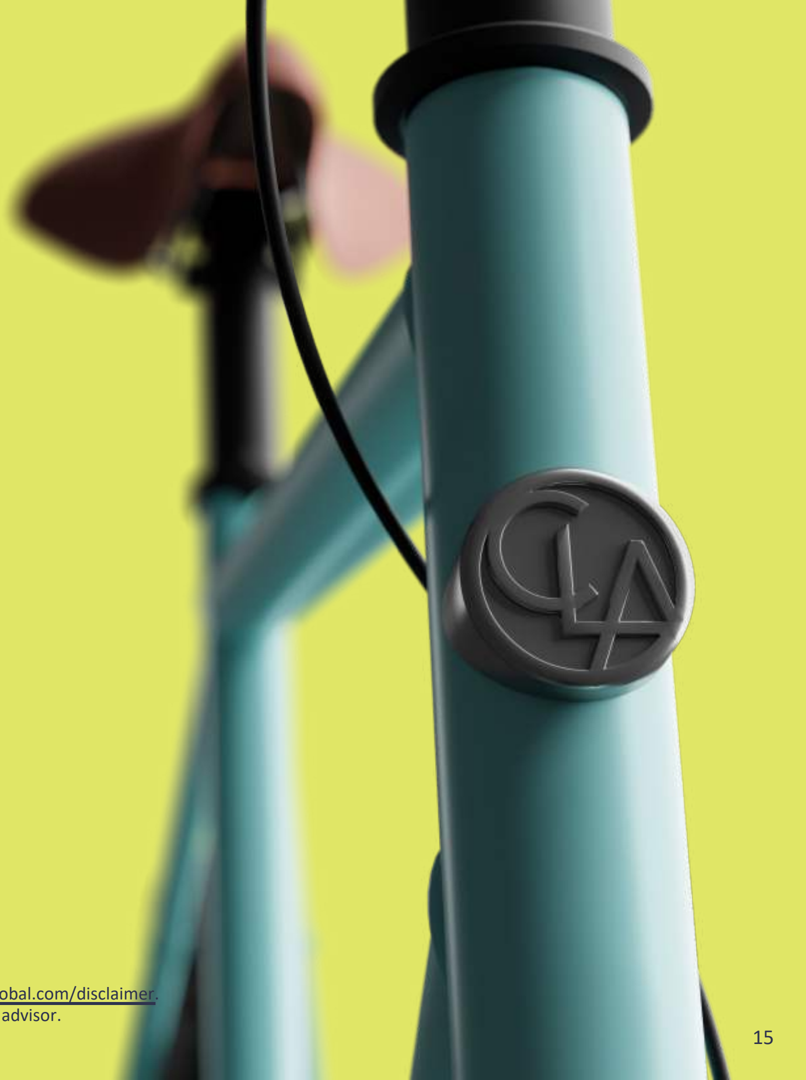
Federal Reserve Policy

Inflation has likely peaked and should normalize by early 2024



Source: Bloomberg, CLA Wealth Advisors

2023 Lending Credit Risk Outlook



Current Credit Conditions

STRONG ASSET QUALITY

LOAN GROWTH OPPORTUNITIES

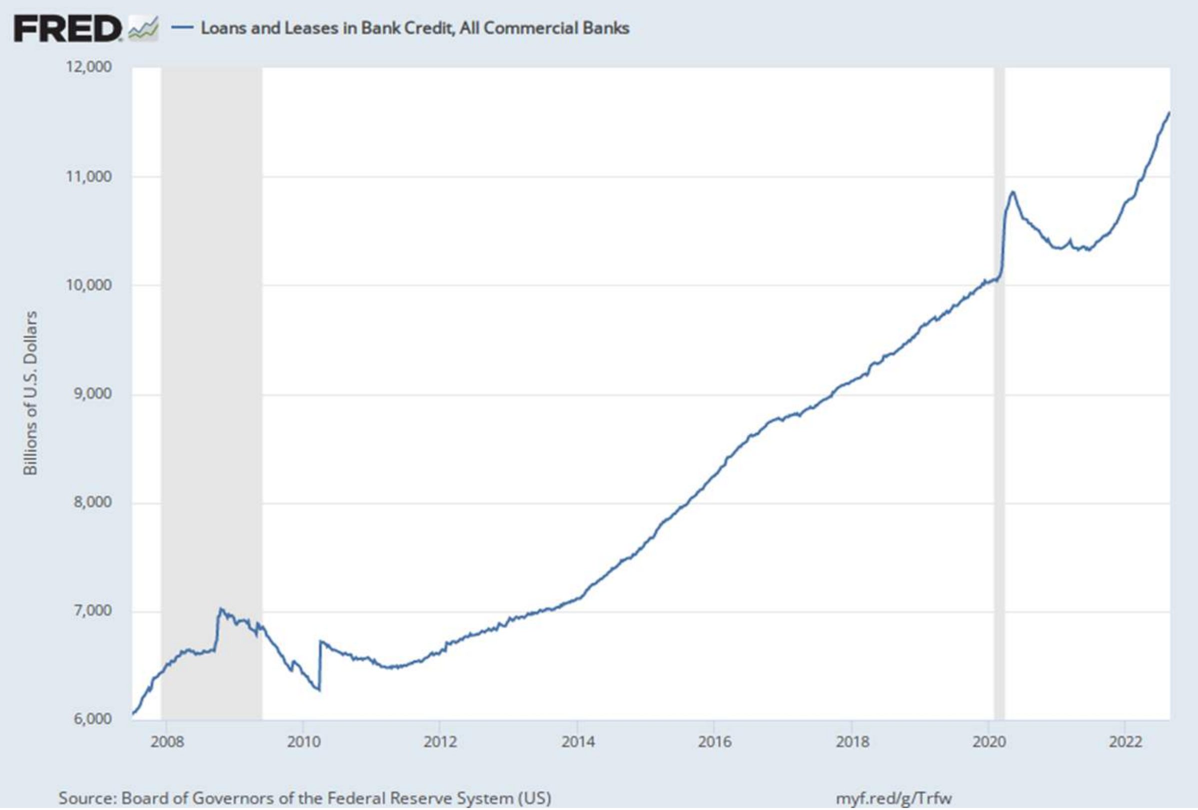
ADEQUATE CAPITAL LEVELS

STAFFING CHALLENGES

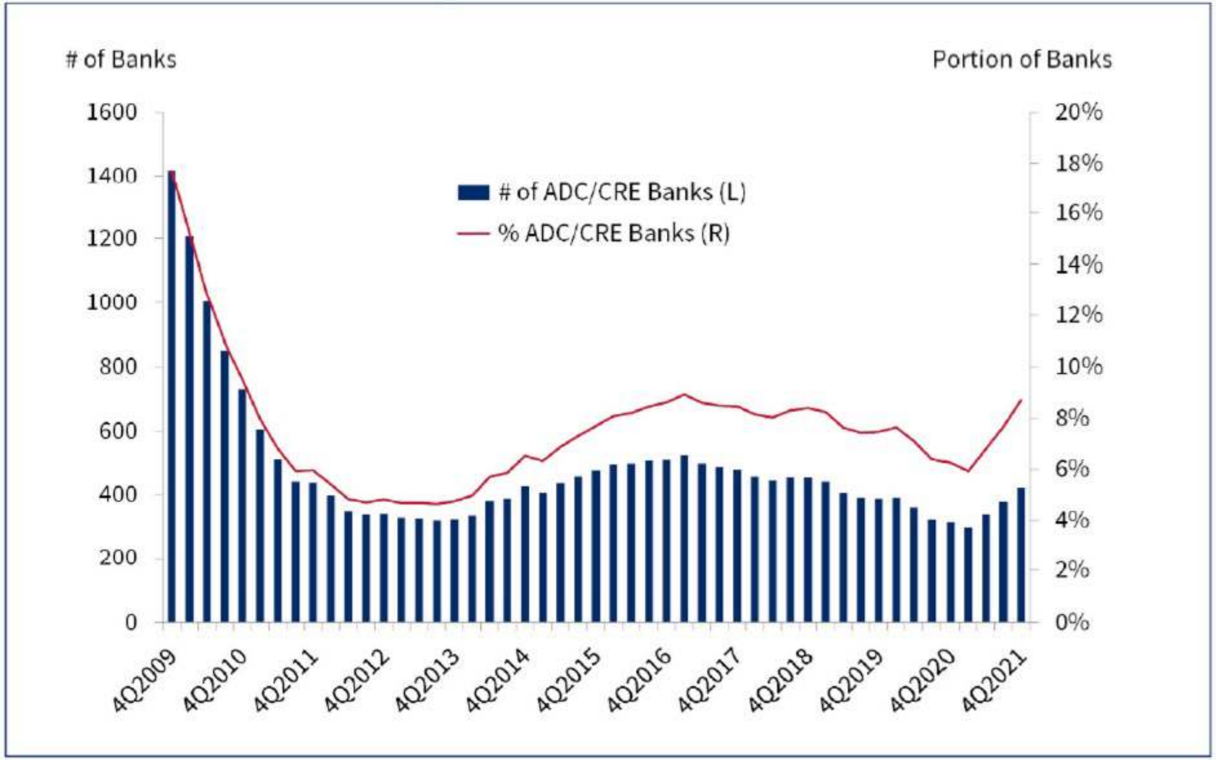
Credit Cycles: Where are we now?

Expansion	Downturn	Recovery	Repair
• Increasing Leverage • EBITDA Peak Growth • Narrow Credit Spreads; Greater Risk Tolerance	• Increasing leverage • Decreasing EBITDA Growth • Widening Credit Spreads; Reduced Risk Tolerance • Downgrades/Defaults	• Decreasing Leverage • Stable EBITDA Growth • Narrowing Credit Spreads	• Decreasing Leverage • Increasing EBITDA Growth • Narrowing Credit Spreads • Increased Refinance Activity

Loan Growth: 2007 – 2022 (United States)

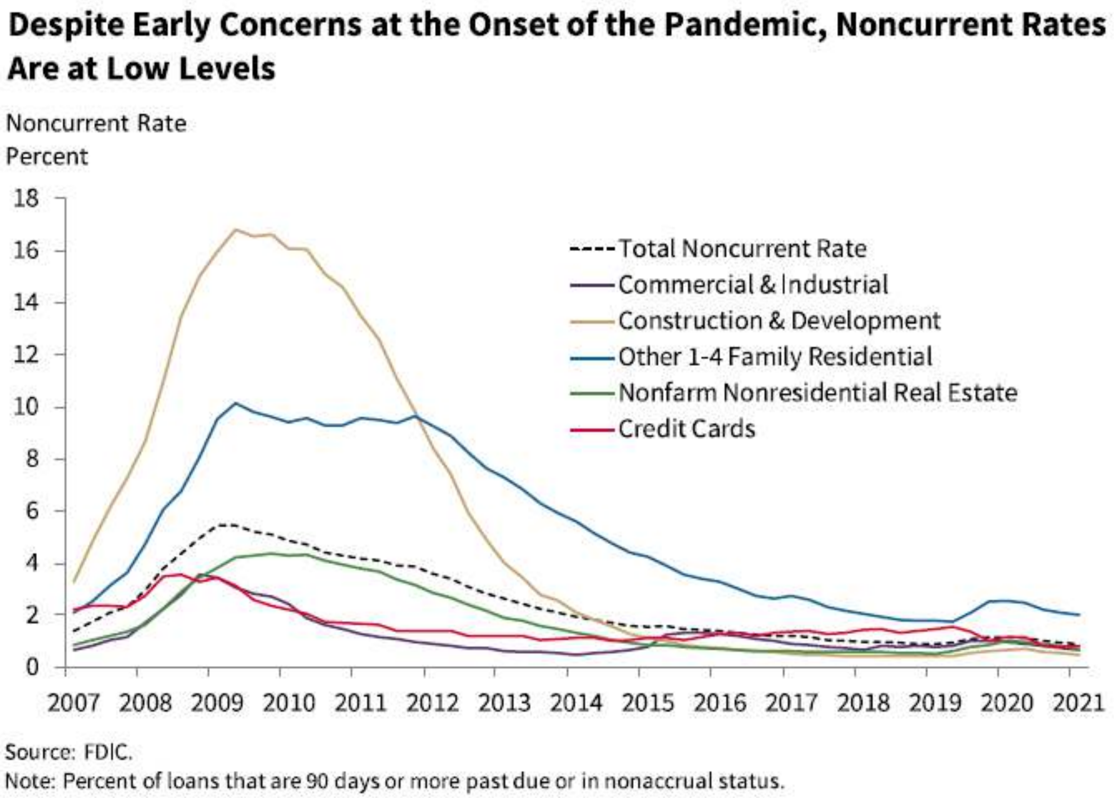


Banks Exceeding CRE Supervisory Criteria



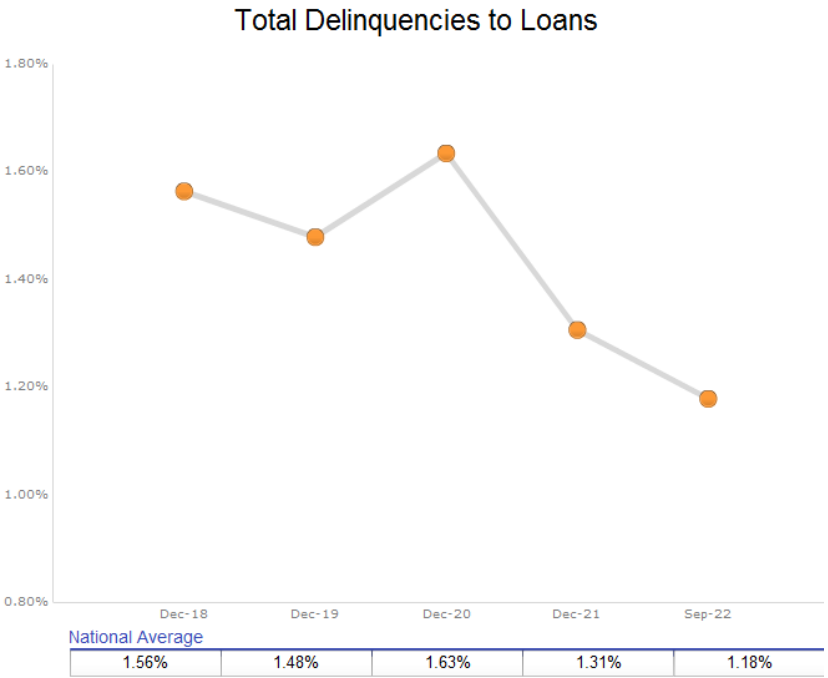
Source: FDIC; Consolidated Reports of Condition and Income.

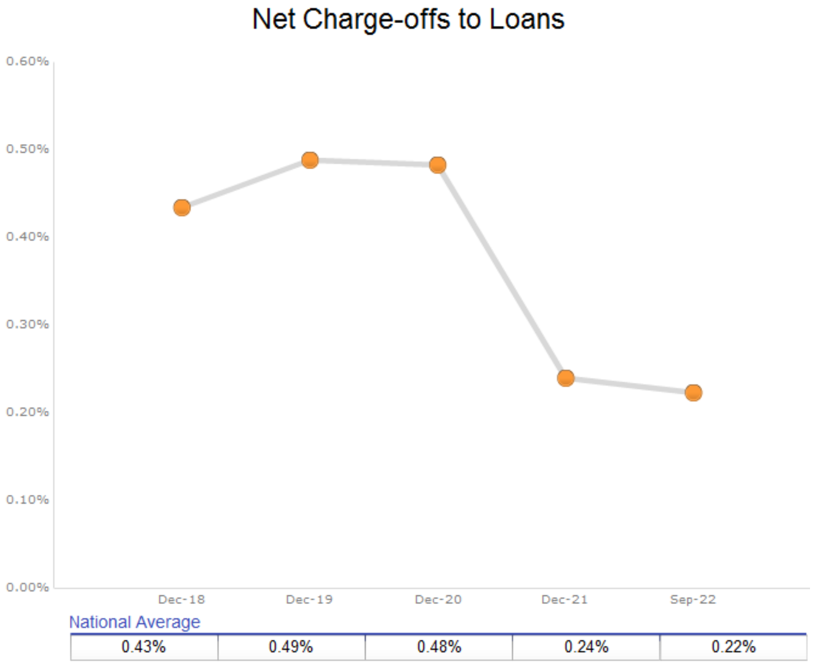
Nonperforming Loans by Loan Category



"The best credit quality we've ever experienced"

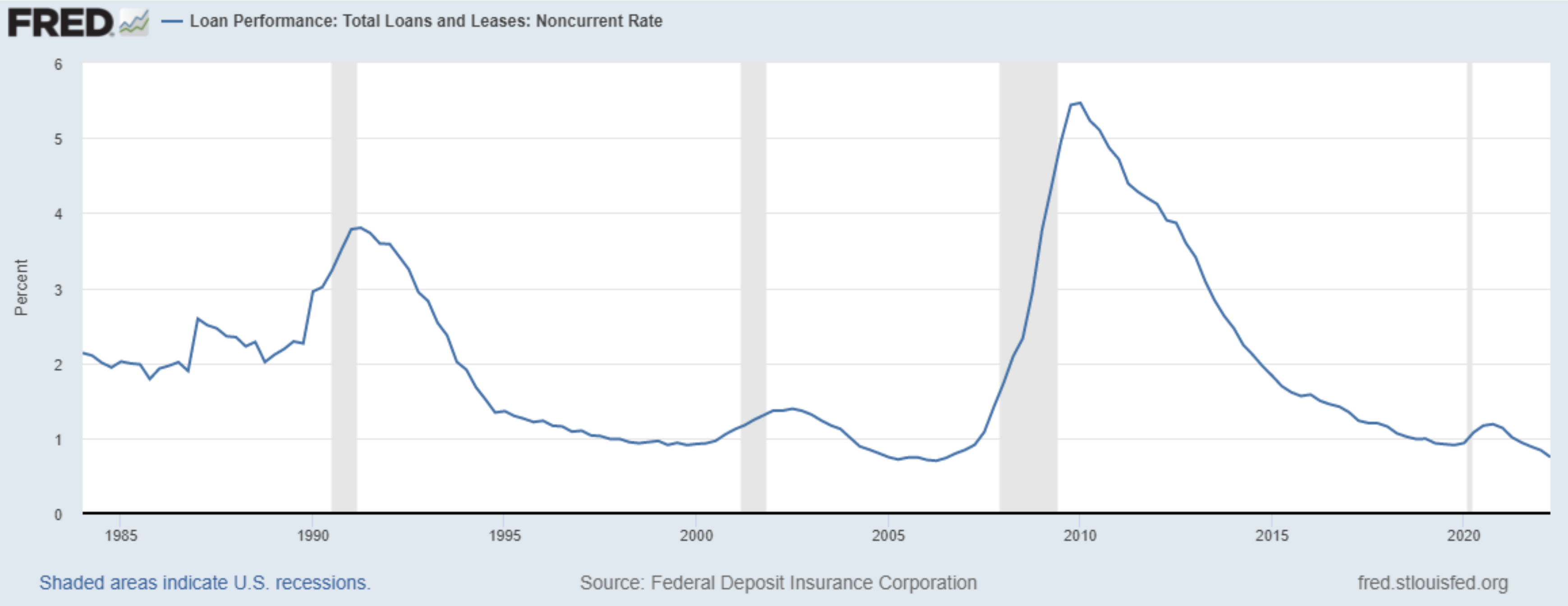
Delinquencies and Net Charge-offs





Then & Now: Crisis & Credit Stress

Historical Credit Stress During Recession



Current Headwinds and Interest Rate Environment

- Inflation at highest pace in 40 years
- Interest rates increasing rapidly
- Rising rates, falling jobs

Additional Considerations for Credit Impact

Banks better postured for downturn

Credit staffing shortages

Collection of updated financials for ongoing monitoring – leniency from COVID gone; timely collection and review essential to identify red flags

Opportunities to identify where your bank can take on additional risk based on current portfolio composition

CRE concentrations – additional emphasis; growing or slowing?

Additional Considerations for Credit Impact

Decreasing liquidity of borrowers as rates increase, expenses balloon, and supply chain issues persist

Potential for repayment issues as cash flow constricts

Refinance risk increasing given interest rate fluctuations

Problem loan management – ready or not?

OCC 2023 Exam Priorities (Credit): focus on commercial real estate performance specifically regarding office, hotel, and retail properties

Actions You Can Take

Actions You Can Take

Reduce Risk

Communicate

Document

Monitor

Reduce Risk

1

Tighten lending standards

2

Diversify loan portfolios

3

Hedge against potential losses

Communicate

Reach out to your most vulnerable customers — commercial and consumer.

Consider forming an internal group and assign individual ownership of your critical lines of communication — regulators, auditors, customers, vendors, and employees

Document

Keep Notes

Keep notes from your conversations with borrowers. Listen to their needs and measure their reaction.

Assess

Assess your loan portfolio by industry type and/or risk characteristics. Utilize NAIC codes in the core system to evaluate your portfolio. Be cognizant of upstream and downstream impacts to industries.

Remain Aligned

Strive to remain aligned with your current policies. Document any changes in policies and procedures.

Monitor

Remain connected to higher risk customers.

Meet regularly, internally. Be prepared to react, as necessary.

Credit Risk Monitoring

- Rising rate environment – how will borrowers perform as interest rates continue to increase?
  - Stress Testing Model Review
  - Top Down vs. Bottom-Up Testing

- Stressed financial condition of borrowers may lead to liquidity crunch and credit performance issues
  - Underwriting Standards and Assumptions (Debt Yield calc, leverage, liquidity, financial covenants, etc.)
  - Problem Loan Management Assessment

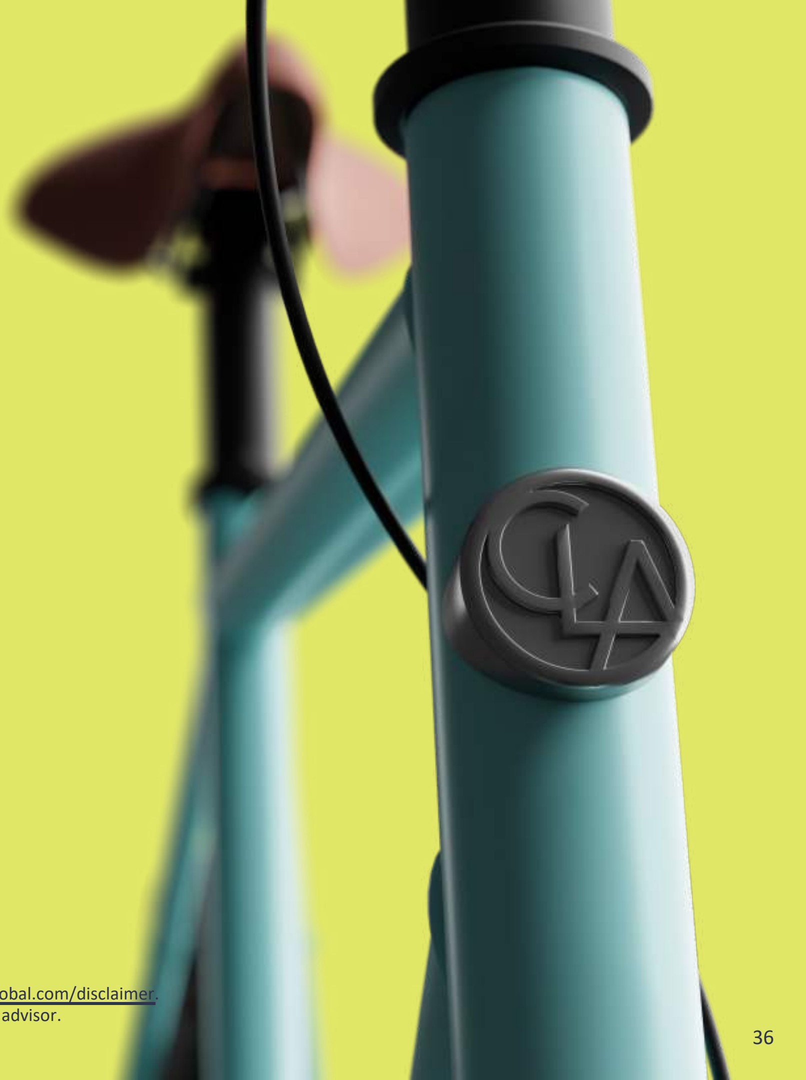
Additional Considerations for Recessionary Preparation

Steps to Prepare for a Recessionary Period

Strengthen	Strengthen capital and liquidity: Banks can build up their capital and liquidity buffers to help weather a potential downturn. This could involve retaining earnings, issuing new capital, or reducing dividends.
Stay Up To Date	Stay up to date on regulatory changes: It's important for banks to stay informed about regulatory changes that may impact operations, and to ensure that they are compliant with all relevant regulations.
Manage	Manage costs: Banks can also focus on cost management, for example by reducing expenses, streamlining operations, and increasing efficiency.

About CLA

Background and Knowledge



The **Four Essential Elements** of the CLA Promise

Our Purpose

CLA exists to create opportunities — for our clients, our people, and our communities.

Our Promise

We promise to know you and help you.

Our Family Culture

We're one family, working together to create opportunities.

Our Strategic Advantages

Deep industry specialization

Seamless, integrated capabilities

Premier resource for private business and owners

Inspired careers

Driven by **Our Values**

Curious

We care, we listen, we get to know you

Collaborative

We help you seamlessly, bringing innovative teams to the table

Transparent

We communicate clearly and authentically

Inclusive

We embrace all voices and create opportunities for you in an energetic and inspiring environment

Reliable

We respond in hours, not days; we follow through, protect our client data, and produce quality results

Creating Opportunities for Our Clients

232,000+
Active clients

120,000+
Private households served

73,000+
Private businesses served

10,300+
Nonprofit organizations served

4,200+
Government organizations served

640+
Higher education organizations served

4,800+
Financial institutions served

10,000+
Health care organizations served

7,700+
Clients engaged in global capabilities

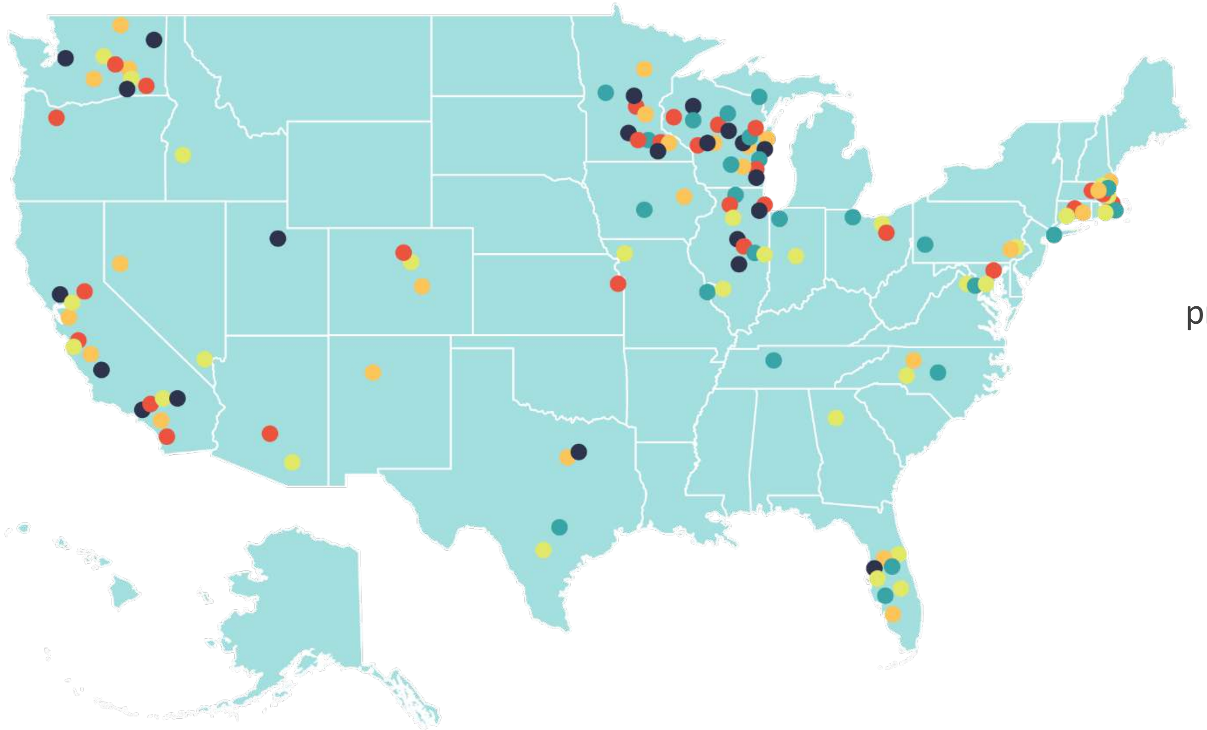
5,840+
Client engaging employee benefit plan capabilities

33,200+
Clients engaging outsourcing capabilities

6,850+
Clients engaging wealth advisory capabilities

9.1%
Organic growth

National and International Reach



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THANK YOU!

Erica Crain, Principal, National Credit Risk Leader

Susan Sabo, Managing Principal, Financial Services

CLA exists to
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for our clients, our people,
and our communities.