



2020 Directors' College

November 10, 2020

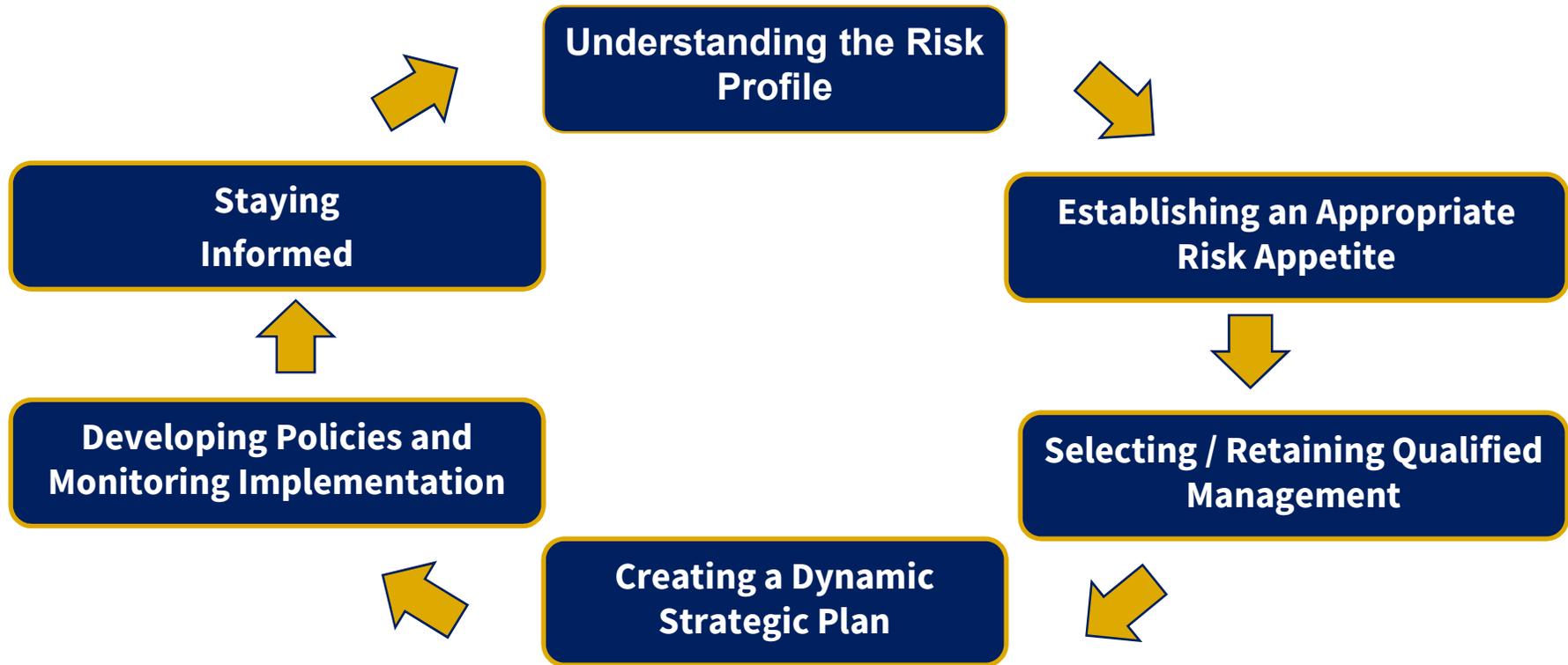
Board Governance During Uncertain Times

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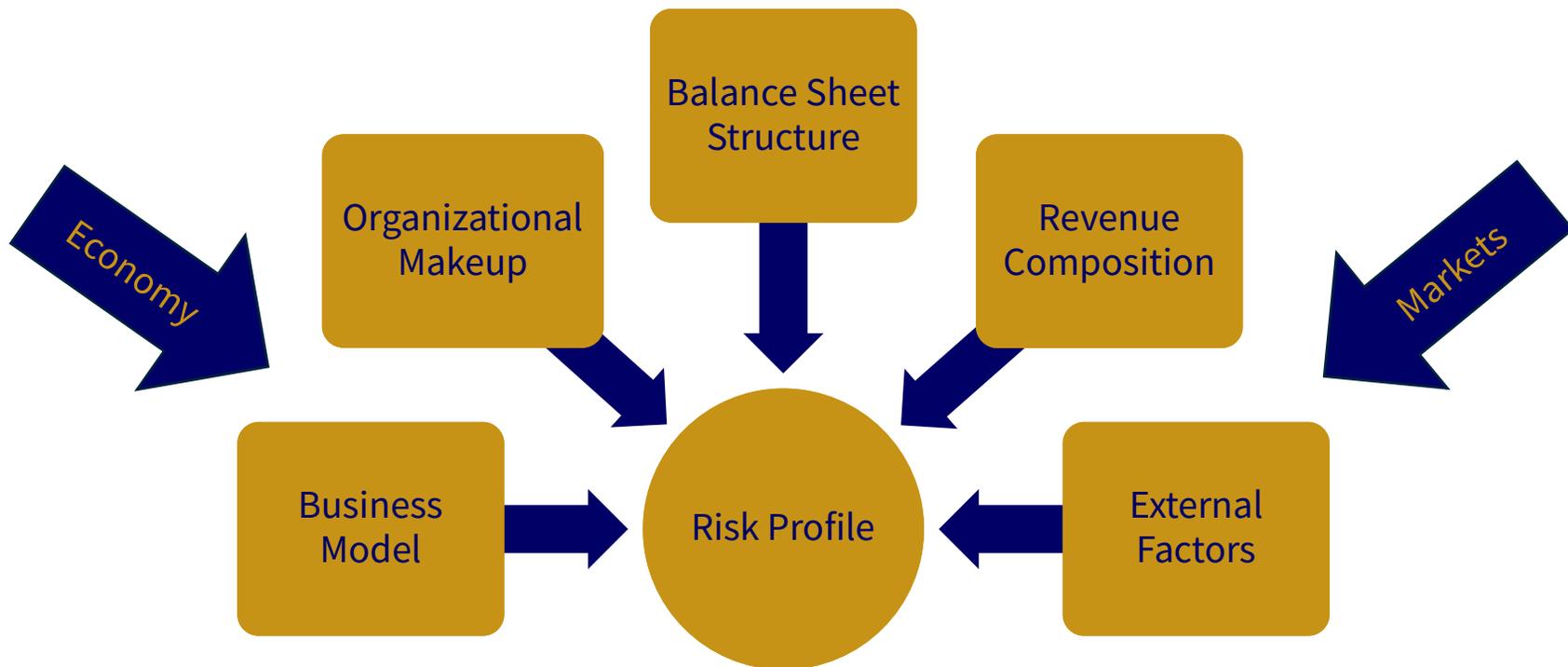
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Key Elements of a Corporate Governance Program



Assessing the Bank's Risk Profile

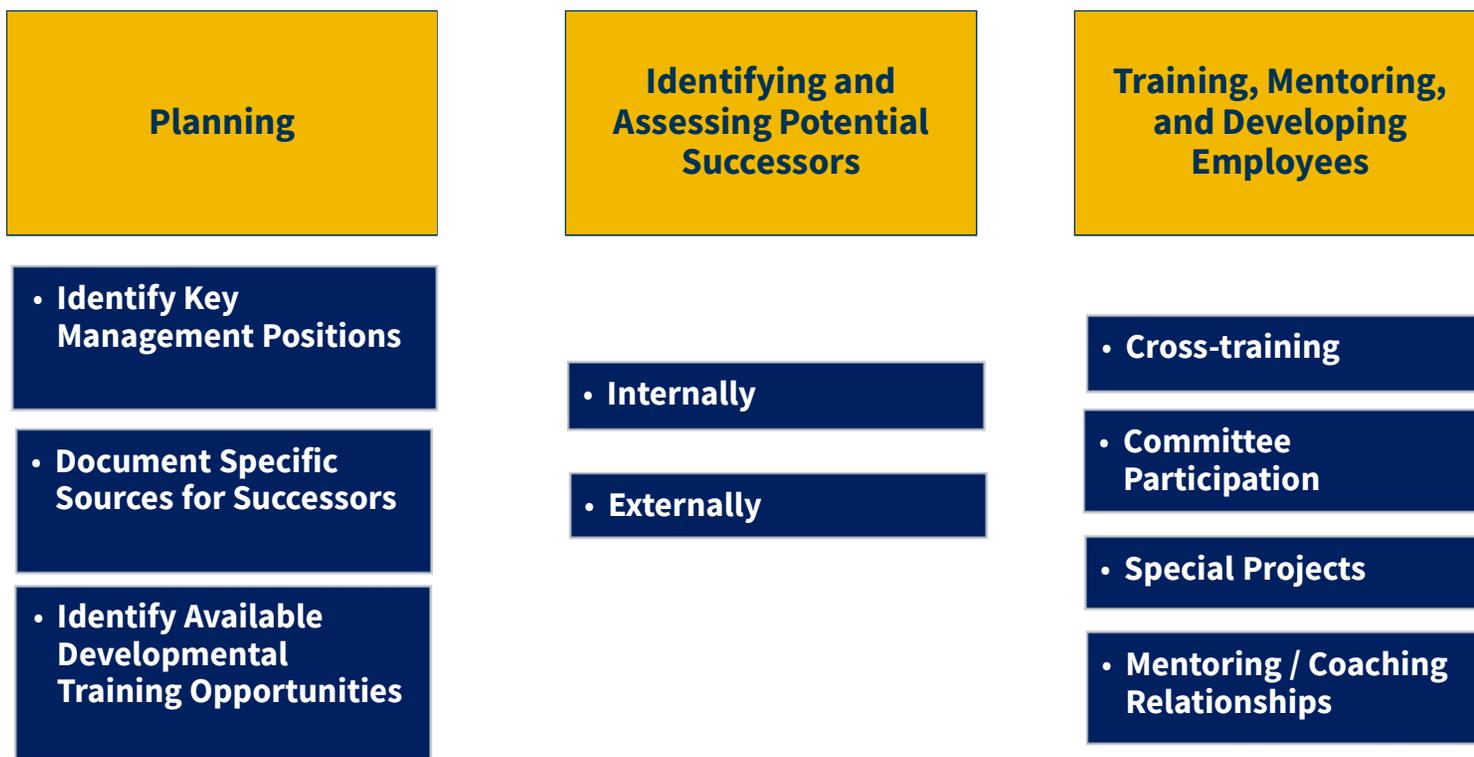


Risk Appetite

Risk appetite is the level of risk a board of directors is willing to assume in order to achieve its strategic objectives and business plan.



Strategies for Management Succession



Strategic Plan



Short

Is based on realistic assumptions;

Medium

Includes clear objectives, well-defined risk limits, and measurable goals; and

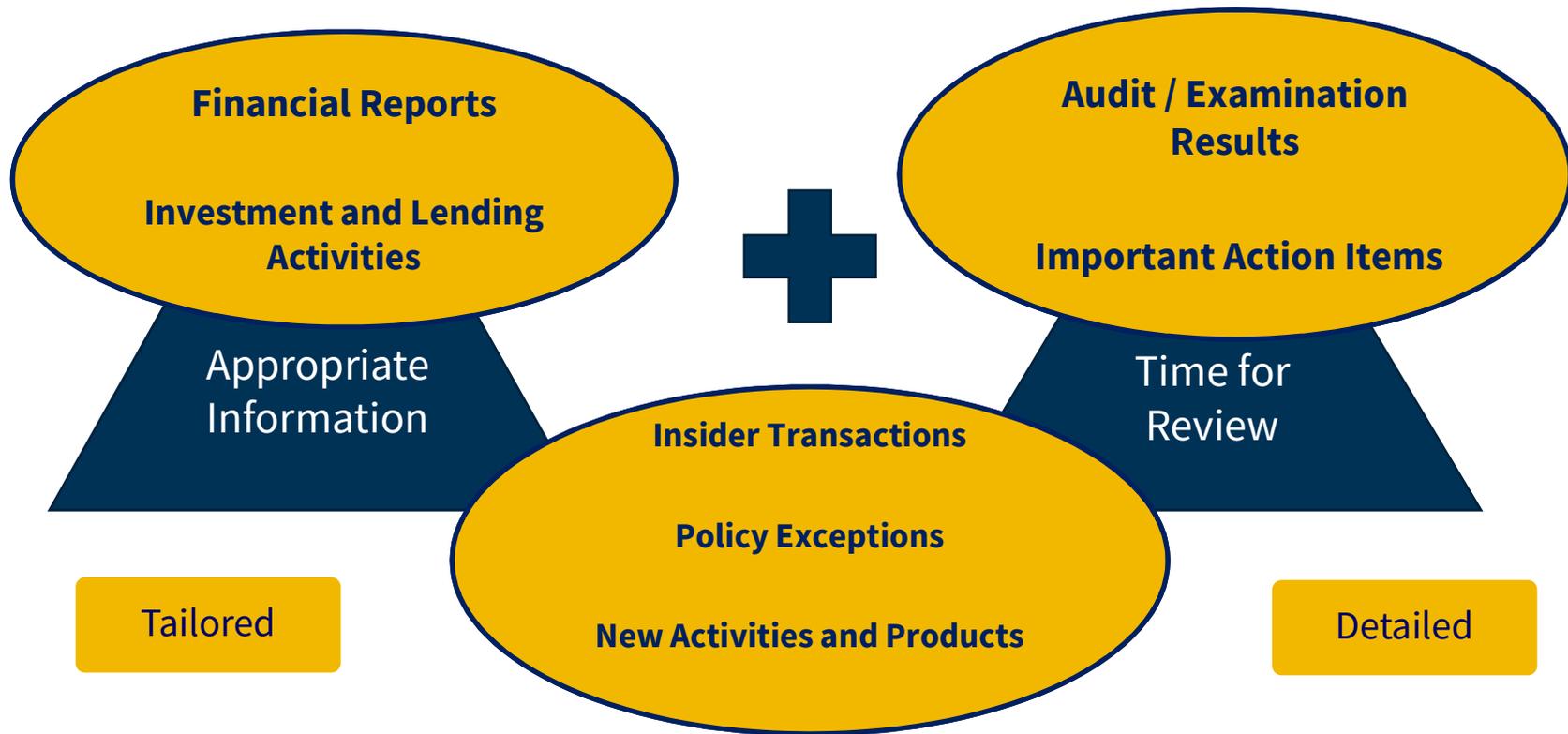
Long

Is periodically reviewed and updated to address changing circumstances or new strategies.

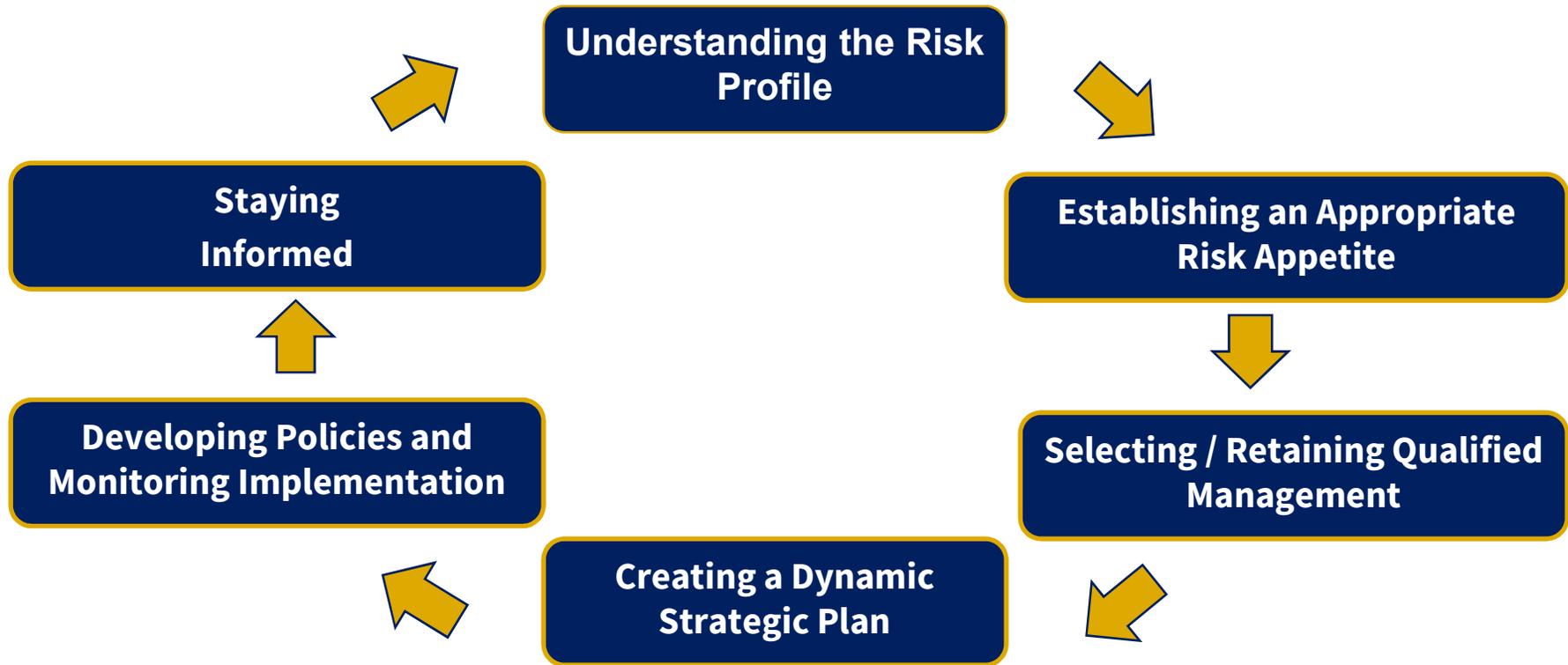
Effective Policies and Procedures

- **Internal Controls**
- **Profit Planning and Budgeting**
- **Code of Ethics**
- **Audit Program**
- **Investments**
- **Asset-Liability and Funds Management**
- **Conflicts of Interest**
- **Loans**
- **Compliance Activities**
- **Capital Planning**
- **Business Continuity**

Preparing for Board Meetings



Key Elements of a Corporate Governance Program



Resources

- The Pocket Guide for Directors (Originally issued in 1988)
<https://www.fdic.gov/regulations/resources/director/pocket.html>
- FDIC Rules and Regulations, including Part 364, Appendix A - The Interagency Guidelines Establishing Standards for Safety and Soundness
<https://www.fdic.gov/regulations/laws/rules/2000-8600.html>
- FDIC Statement Concerning the Responsibilities of Bank Directors and Officers (FDIC Statement of Policy) <https://www.fdic.gov/regulations/laws/rules/5000-3300.html#fdic5000statementct>
- Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions <https://www.fdic.gov/news/press-releases/2020/pr20072a.pdf>



Resources

- Corporate Codes of Conduct: Guidance on Implementing an Effective Ethics Program <https://www.fdic.gov/news/news/financial/2005/fil10505.html>
- Directors Resource Center <https://www.fdic.gov/regulations/resources/director/>
- Bankers Resource Center <https://www.fdic.gov/resources/bankers/>
- Supervisory Insights: Special Corporate Governance Edition (April 2016, Revised October 2018) <https://www.fdic.gov/regulations/examinations/supervisory/insights/sise16/sise2016.pdf>
- Technical Assistance Video Program at www.fdic.gov/regulations/resources/director/video
- Coronavirus (COVID-19) Information for Bankers and Consumers <https://www.fdic.gov/coronavirus/>



Questions?



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Problem Loan Oversight

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Objectives

- Loan Review System
- Loan Performance Assessment
- Problem Loan Considerations
- Fair Lending Risks
- Portfolio Oversight
- Key Takeaways

Loan Review System



Loan Review System

- Provide the Board and senior management with an objective assessment of loan quality
- Promptly identify loans with well-defined weaknesses to minimize losses
- Provide a basis to determine ALLL adequacy

Loan Review System

- Identify trends within the loan portfolio and isolate potential problem areas
- Assess adequacy of, and adherence to, loan policies and procedures
- Monitor compliance with laws and regulations
- Evaluate lending personnel

Loan Review System

- Policies approved annually by the Board. Guidelines include a description of the overall risk rating process and establish responsibilities and standards for the loan review process.
- Responsibilities rest with multiple areas – credit underwriting, loan administration, problem loan workout, loan review department, etc.
- Responsibilities may include:
 - Assigning initial credit grades
 - Implementing rating changes when needed
 - Compiling information necessary for ALLL

Loan Review System – Internal Risk Ratings

- Risk rating involves:
 - Assessment of credit quality
 - Identification of problem loans
 - Assignment of risk ratings
- Loan officers are typically involved, but ratings should be reviewed by peers, superiors, the loan committee, or by other internal or external review specialists

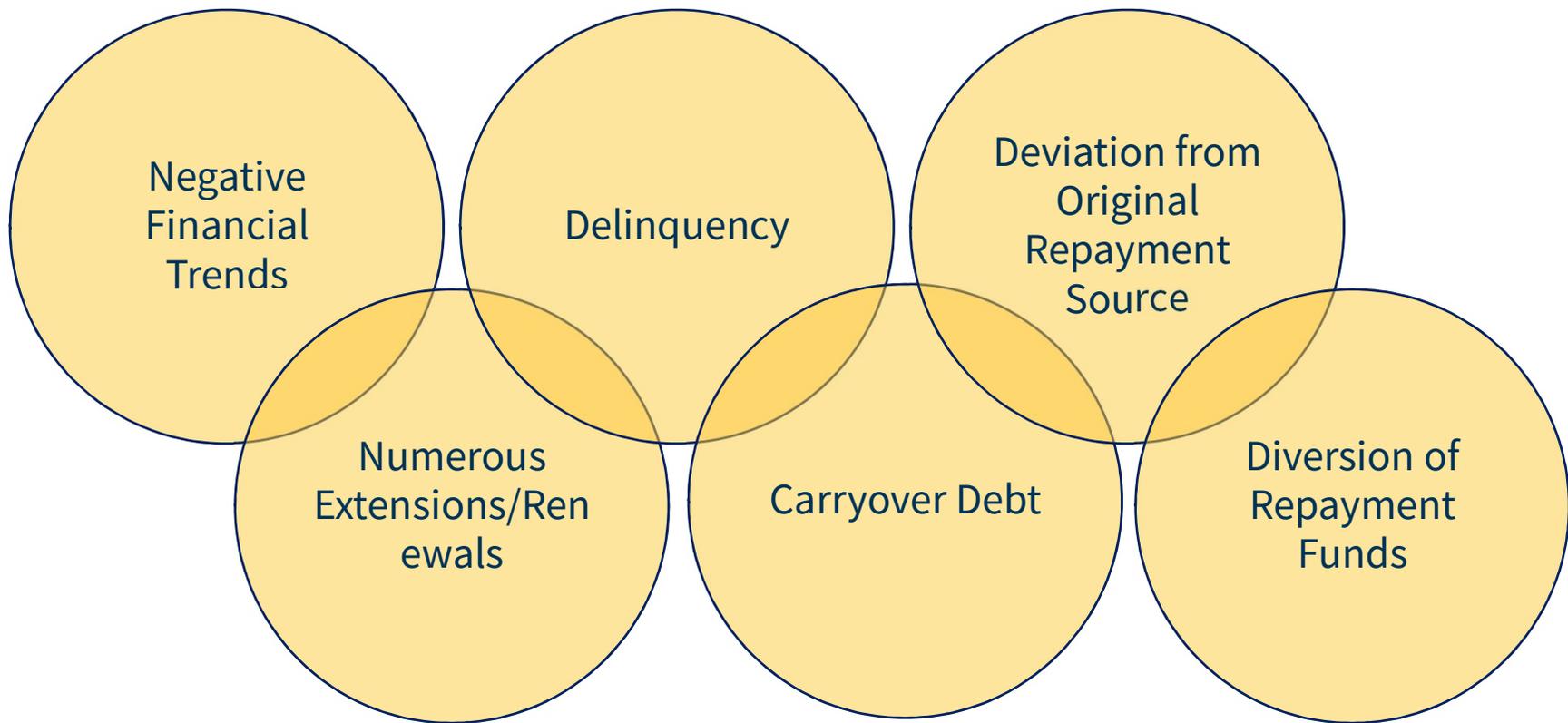
Loan Review System - Loan Review Program

- Loan review personnel should be qualified and independent.
- Frequency, scope may be based upon the complexity of the loan portfolio
- Loan reviews analyze important credit factors – credit quality, sufficiency of documentation, adherence to covenants, compliance with policies, accuracy/timeliness of risk ratings, etc.
- A report summarizing the loan review results should be submitted to the Board.

Loan Performance Assessment



Examples of Well-Defined Weaknesses



Contractual Performance

- Does the primary source of repayment support the debt?
- What is the likelihood that the payments from a secondary or tertiary source will continue?
- Are the use of extensions and renewals masking credit weaknesses?
- Does the use of a reserve on purchased loans mask a payment delinquency?

Credit Classifications

- Reassess loan rating definitions to ensure that constraints posed by the pandemic are appropriately factored in.
- Apply credit classification and charge-off standards where information indicates a loan will not be repaid under reasonable terms.
- Ensure reasonable plans for workouts and pursuing foreclosure on nonperforming assets.

Problem Loan Considerations



Non-Accrual Status

General rule for placing loans on non-accrual status:

Institution maintains a loan on a cash basis because of deterioration in a borrower's financial condition

Payment in full or principal or interest is not expected, or

Principal or interest has been in default for 90 days or more – unless the loan is well secured and in process of collection



Troubled Debt Restructuring

- Restructuring in which an institution, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.
- Under incurred loss methodology, loans determined to be TDRs are considered impaired loans. Impairment should be measured in accordance with ASC 310.

Collateral Valuation

- As the primary source of repayment declines, the importance of the collateral's value as a secondary repayment source increases
- Institution's policies and procedures should dictate when collateral valuations are updated

Appraisals or Evaluations

- A loan modification that does not adversely affect collateral protection would generally not require a new appraisal or evaluation.
- A loan modification that does adversely affect collateral protection would generally require a new appraisal or evaluation, such as:
 - a renewal or extension of loan terms,
 - the advancement of new monies, or
 - restructuring.

Impairment Analysis

- Collateral dependent loan to be measured using the fair value of collateral method
- Present value of future cash flows and observable market price are other methods under the incurred loss methodology
- Under CECL bank management determines the appropriate method

Interagency Statement Highlights

- Encourages institutions to work constructively with borrowers affected by COVID-19
- Describes accounting for COVID-19 related loan modifications
- Provides supervisory views on past due and nonaccrual regulatory reporting and regulatory capital considerations
- Provides the agencies' views on consumer protection considerations
- Describes prudent risk management and consumer protection principles to consider as loans near the end of initial loan accommodation periods

Banker Webinar

- Banker Webinar was held on Friday, April 24, 2020
 - Webinar is available for playback
 - FIL-46-2020
 - <https://www.fdic.gov/news/financial-institution-letters/2020/fil20046.html>

Fair Lending



Fair Lending Considerations

- Fair Lending is applicable through the life of the loan, including decisions about loan modifications, forbearances, collections, and foreclosures
- Creating uniform policies for processing loan modification will limit fair lending risk and ensure all consumers are treated consistently

Fair Lending Considerations

- Tracking and monitoring all modification requests will allow institutions to identify and correct discriminatory practices
- Failure to provide equal access to loan modifications may result in an enforcement action or fair lending violation

Portfolio Oversight



Key Elements of a Corporate Governance Program



Selecting / Retaining Qualified Management

- Assess staffing needs
- Evaluate workout personnel and qualifications
- Augment resources as needed
- Provide training

Assessing the Strategic Plan & Developing Policies and Monitoring Implementation

- Periodic reassessments, modifications, or reaffirmations of strategic objectives
- Establishment, re-evaluation, and revisions, if warranted, of loan policies and procedures
- Communication of any changes to staff

Staying Informed

- Market Conditions
- Portfolio Monitoring
 - Credit Metrics
 - Loan Accommodations
 - Policy Exceptions
 - Documentation Exceptions, including Outdated Borrower Financial Information
 - Portfolio Diversification
 - Scenario Analysis
 - Allowance for Loan and Lease Losses

Understanding the Risk Profile & Establishing an Appropriate Risk Appetite

- Understand if and how the bank's risk profile has changed.
- Critically determine the underlying cause(s) of an issue so that the most effective solution(s) can be implemented.
- Carefully consider if existing policies reflect the Board's risk appetite given changing conditions.

Key Takeaways



Key Takeaways

- Work prudently with borrowers impacted by the COVID event.
- Apply appropriate loan risk ratings and make appropriate accrual status and TDR decisions on loans affected by the COVID event.
- Assess the key elements of corporate governance and make adjustments as needed to ensure risks are properly measured, monitored, and controlled.
- Ensure policies and procedures are designed to provide the Board timely, sufficient information to fulfill oversight responsibilities.
- Remember fair lending laws are applicable through the life of the loan, including modifications/TDRs.



Questions



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Appendix A Resources

- Policy Statement on Prudent Commercial Real Estate Loan Workouts
 - <https://www.fdic.gov/news/financial-institution-letters/2009/fil09061.html>
- COVID-19 Loan Modification Decision Tree
 - <https://fdicnet.fdic.gov/content/dam/rms/documents/supervision/accounting/covid-19-loan-modification-decision-tree.pdf>
- Interagency Guidance Appraisal and Evaluation Guidelines
 - <https://www.fdic.gov/news/financial-institution-letters/2010/fil10082.html>
- Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Financial Institutions
 - <https://www.fdic.gov/news/financial-institution-letters/2020/fil20064.html>
- Frequently Asked Questions for Financial Institutions Affected by the Coronavirus Disease 2019 (Referred to as COVID-19) – As of May 27, 2020
 - <https://www.fdic.gov/coronavirus/faq-fi.pdf>



Appendix B COVID-19 Loan Modifications

March 22, 2020, the agencies issued a statement that:

- Encourages institutions to work prudently with borrowers affected by COVID-19 and describes the agencies' interpretation of how accounting principles apply to certain COVID-19 related loan modifications

March 27, 2020, the CARES Act was signed into law:

- Section 4013 of the CARES Act provides financial institutions the option to suspend the requirements to categorize certain loan modifications as troubled debt restructurings (TDRs)

April 7, 2020, the agencies issued a revised statement that:

- Describes accounting for COVID-19 related loan modifications and provides the agencies' views on consumer protection considerations

August 3, 2020, the agencies issued a statement that:

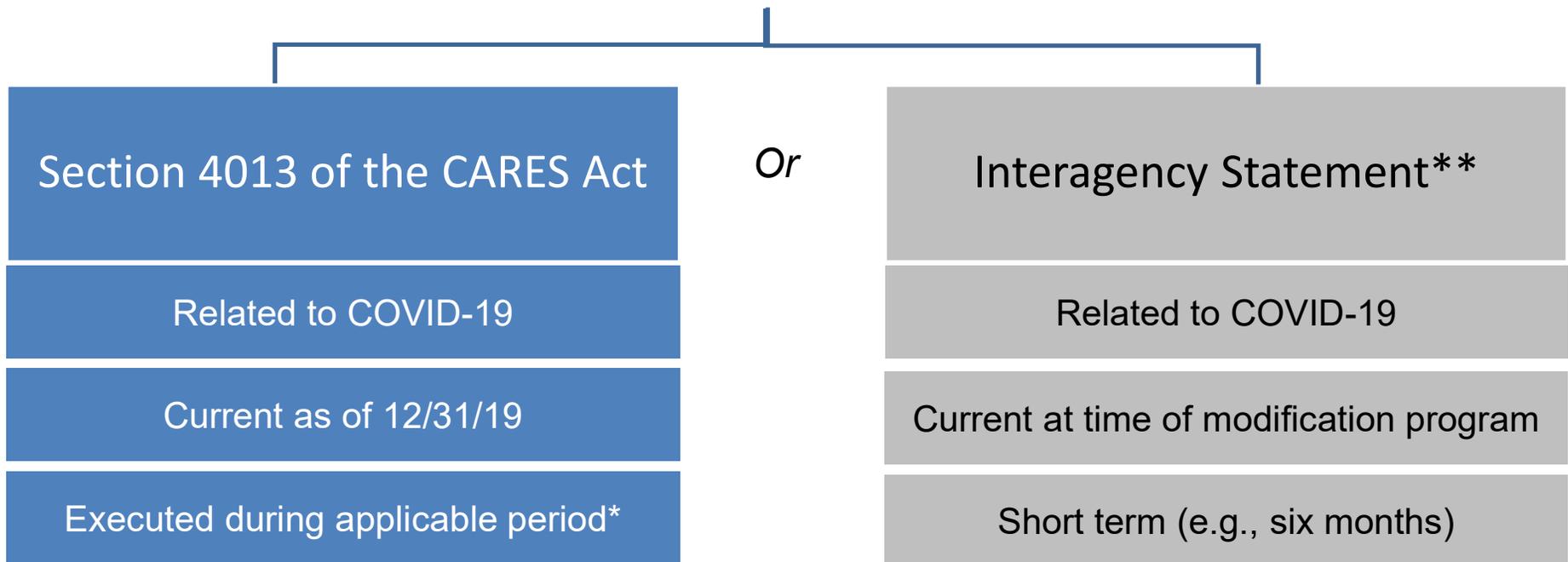
- Describes prudent risk management and consumer protection principles for financial institutions to consider while working with borrowers as loans near the end of initial loan accommodation periods during the COVID event.



Appendix C

Accounting for Loan Modifications

Financial institutions may elect to account for an eligible loan modification under



*Applicable period: Between March 1, 2020 and **earlier** of 1) 60 days after the date of termination of the National Emergency or 2) December 31, 2020

**Interagency statement is an interpretation of ASC Subtopic 310-40, Receivables—Troubled Debt Restructurings by Creditors, in the context of COVID-19.





Break: 10:30 am – 10:45 am

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Conversation with the Regulators

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Pennsylvania Directors College Economic Update

Division of Insurance and Research

November 10, 2020



Disclaimer

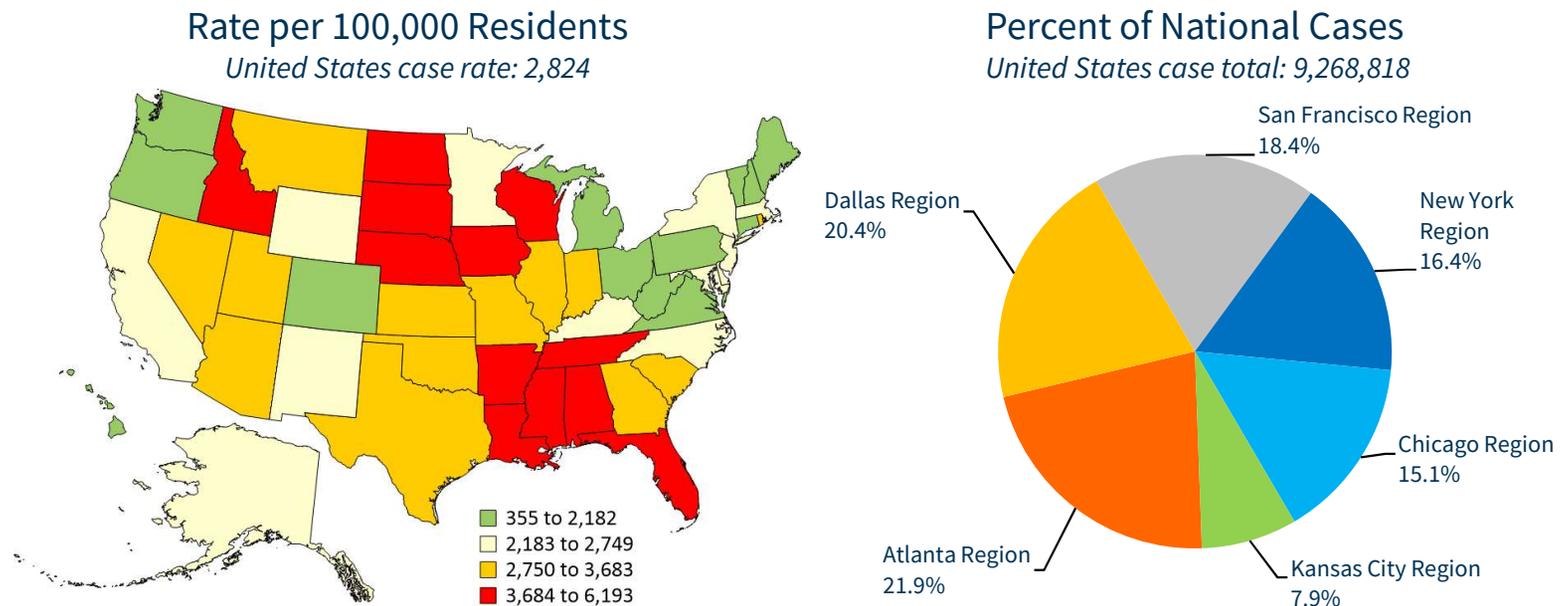
The views expressed in this presentation are those of the presenters and do not necessarily reflect official positions of the FDIC. Some of the information used in the preparation of this presentation was obtained from publicly available sources that are considered reliable. However, the use of this information does not constitute an endorsement of its accuracy by the FDIC. This presentation and comments are not for attribution, quotation, or distribution.

Discussion Points

- **The economic recession and recovery are functions of the pandemic.**
- **Pennsylvania may recover a bit more slowly.**
- **Labor market recoveries may be drawn out.**
- **Housing market activity has picked up.**
- **Commercial real estate industry faces headwinds.**
- **Credit quality was favorable heading into the pandemic.**

Total COVID-19 Cases Have Migrated Around the Country

COVID-19 Cases by State and FDIC Region January 2020 to Present



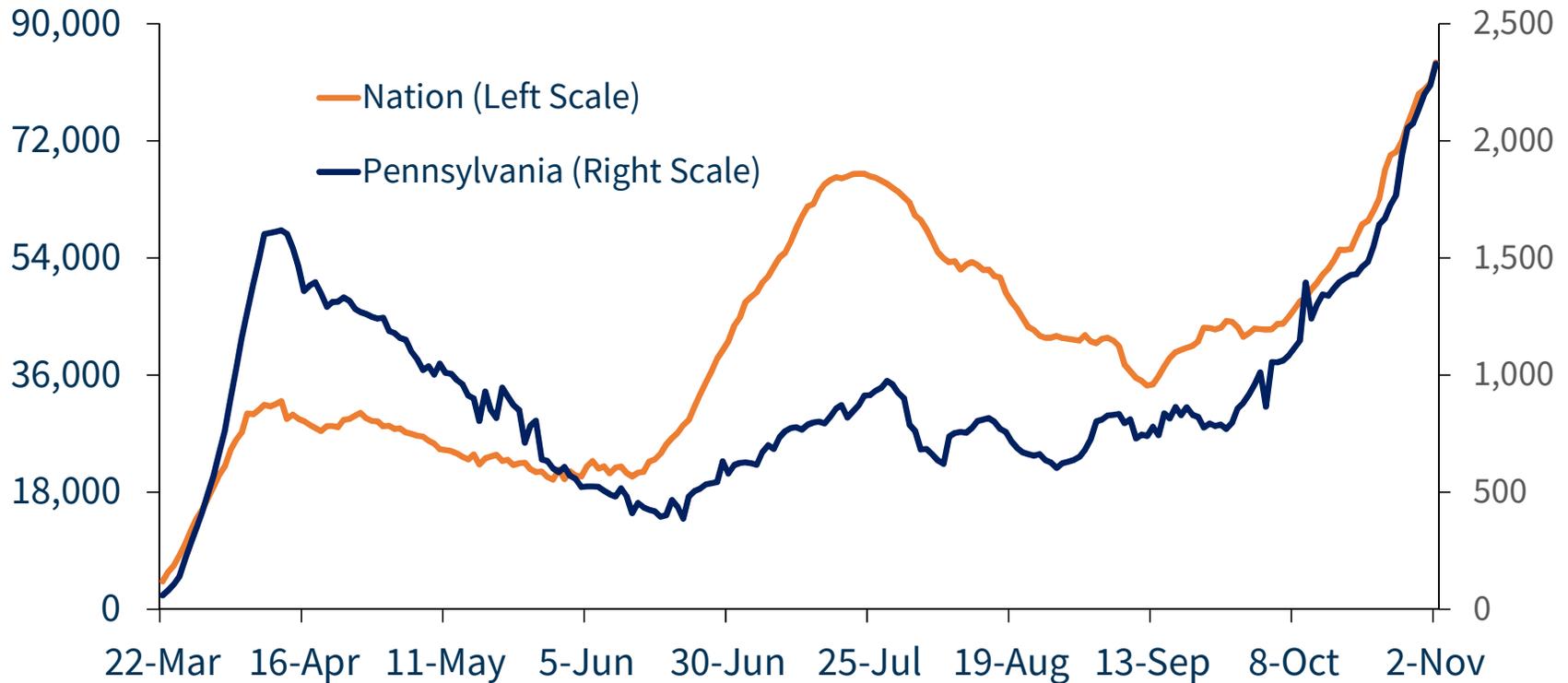
Source: U.S. Centers for Disease Control and Prevention (Moody's Analytics).

Note: Data as of November 2, 2020. Map breaks are quartiles.

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New Cases Show the Virus' Resilience

Number of New COVID-19 Cases Per Day (7-day moving average)

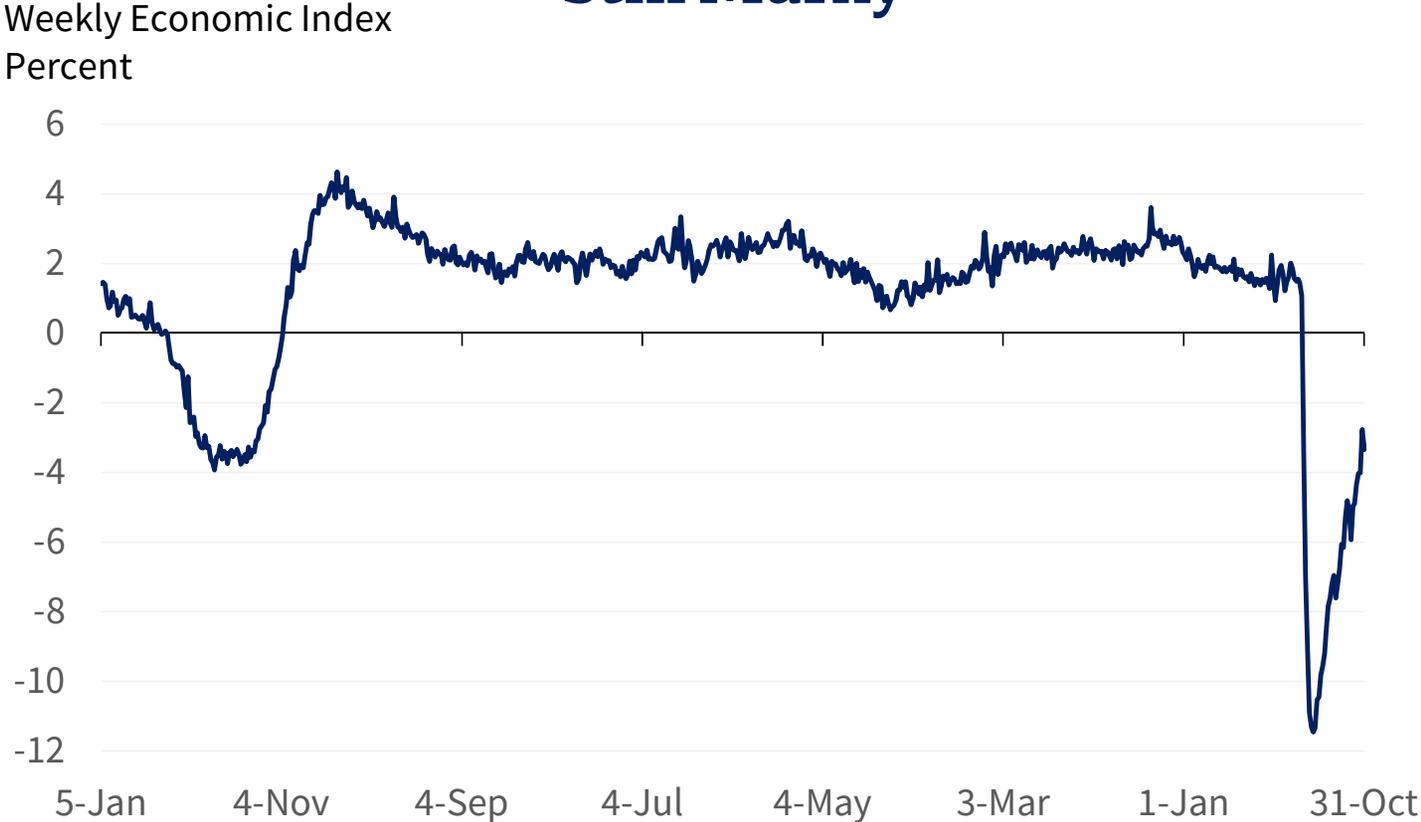


Source: U.S. Centers for Disease Control and Prevention (Moody's Analytics).

Note: Data as of November 2, 2020

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The Economic Contraction Has Been Severe; the Recovery Path Is Still Murky



Sources: Lewis, Daniel J., Mertens, Karel, and Stock, James H., Weekly Economic Index, <https://www.newyorkfed.org/research/policy/weekly-economic-index>.

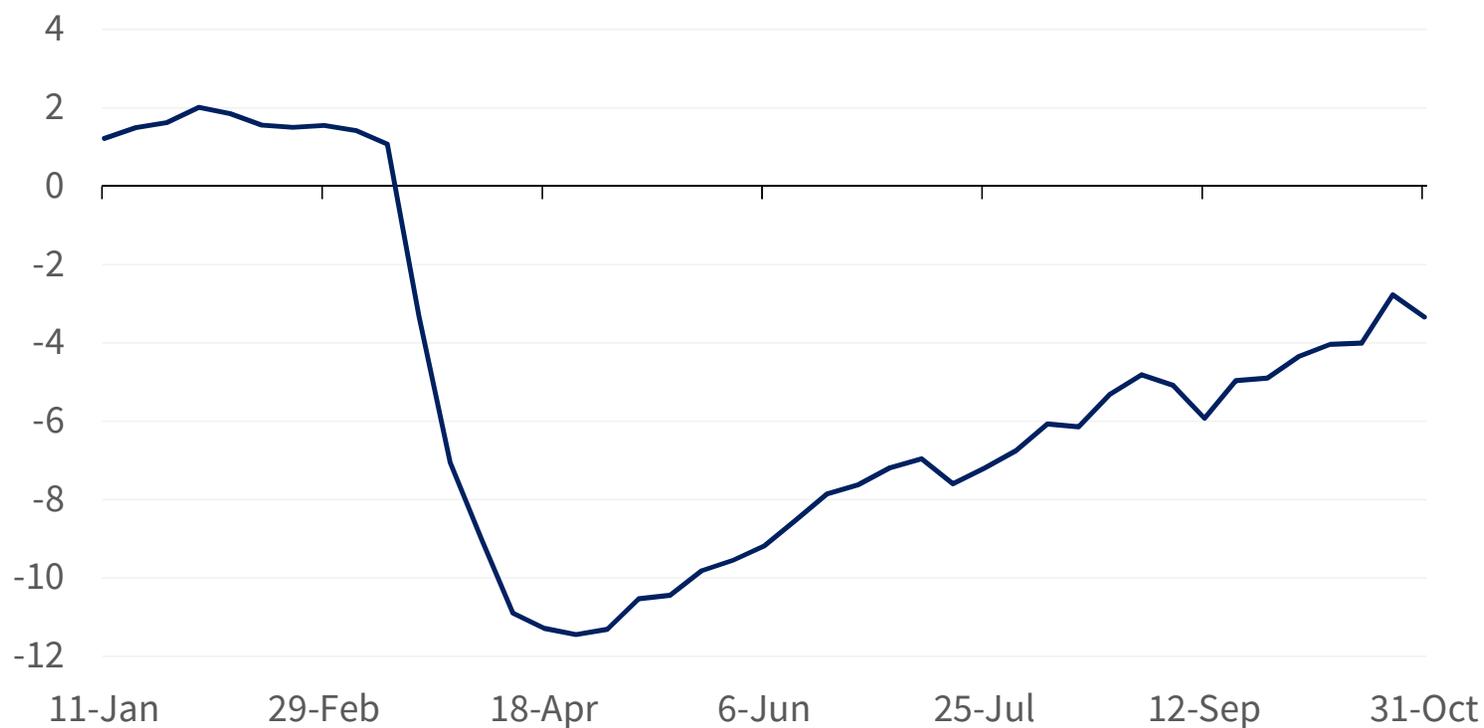
Note: The WEI is scaled to align with the nation's four-quarter GDP growth rate.

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The Recovery Path Is Not Exactly V-Shaped

Weekly Economic Index

Percent



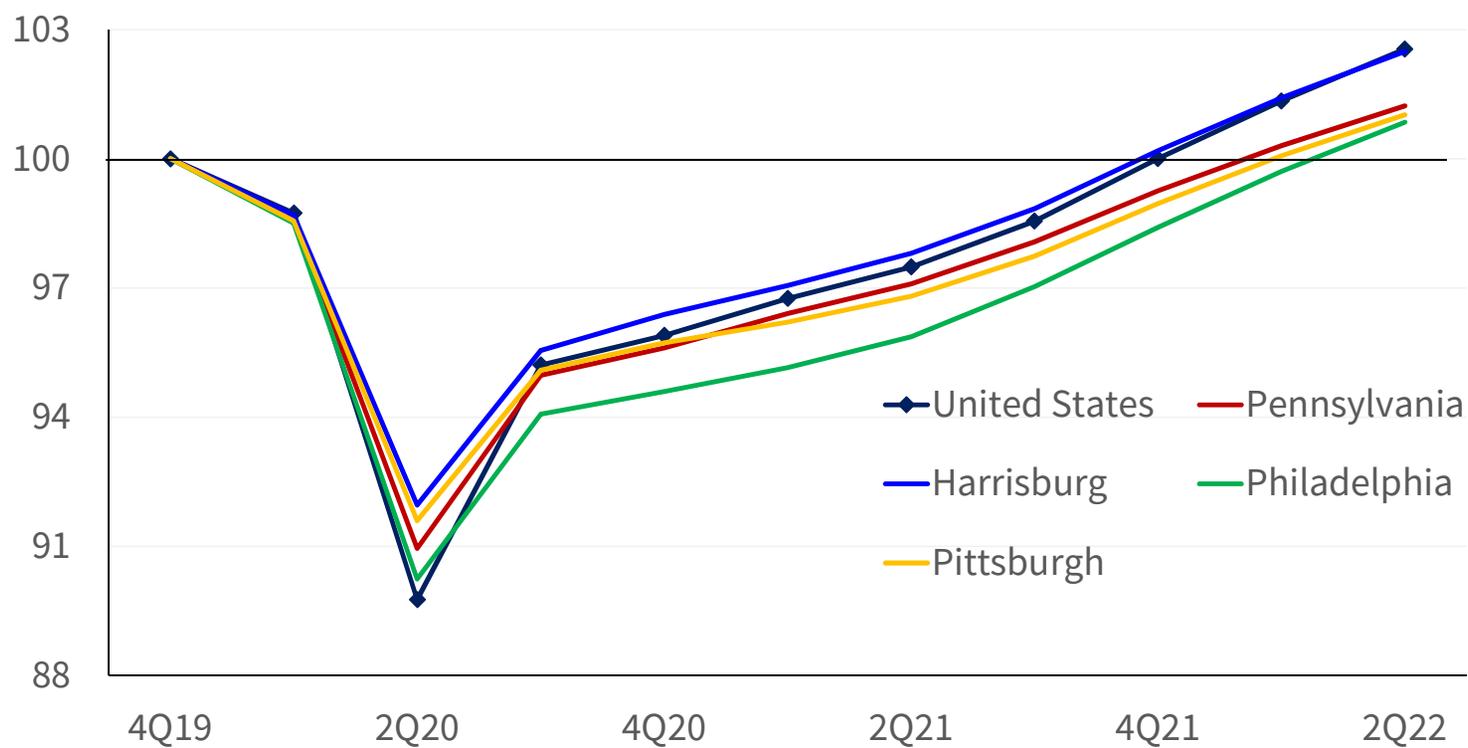
Sources: Lewis, Daniel J., Mertens, Karel, and Stock, James H., Weekly Economic Index, <https://www.newyorkfed.org/research/policy/weekly-economic-index>.

Note: The WEI is scaled to align with the nation's four-quarter GDP growth rate.

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Pennsylvania's Recovery Paths Lag the Nation's Only Slightly

Gross Domestic Product Index (100 = 4Q19)



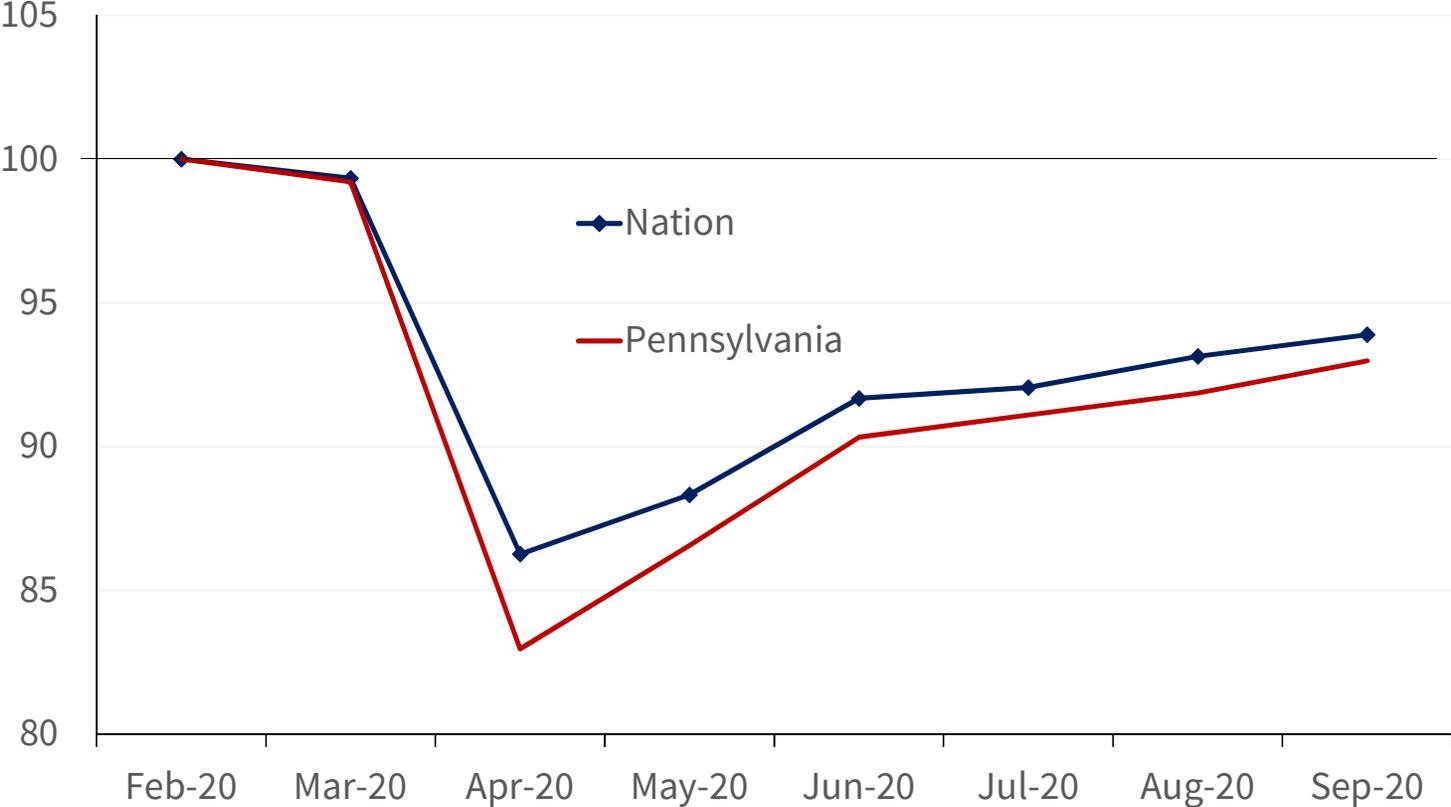
Source: Moody's Analytics.

Note: Data are quarterly estimates as of September 2020.

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Labor Market Recoveries May Lag As Well

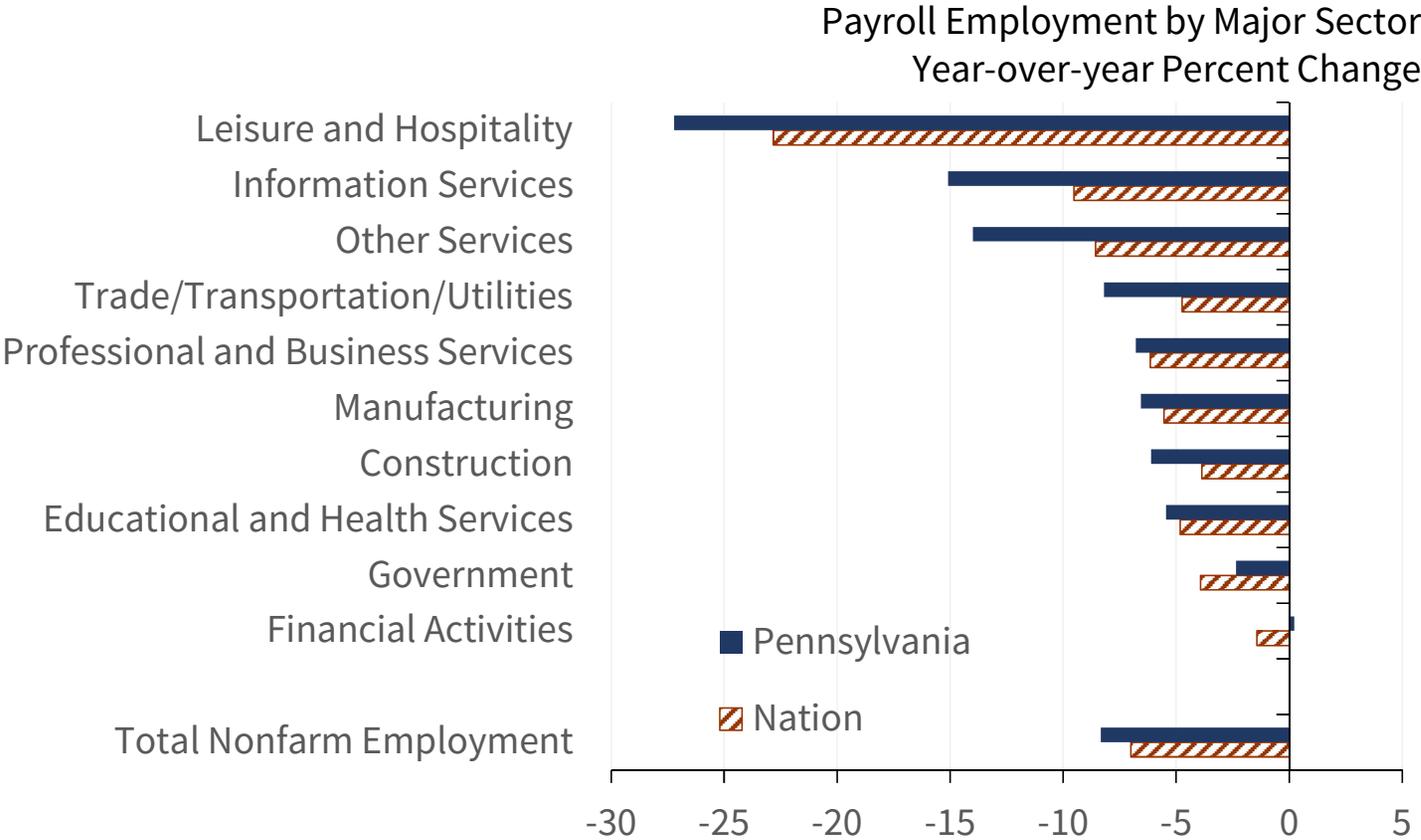
Employment Index (100 = February 2020)



Source: BLS (Haver Analytics), FDIC.
Note: Data are as of September 2020.

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Leisure and Hospitality Employment Has Been Decimated

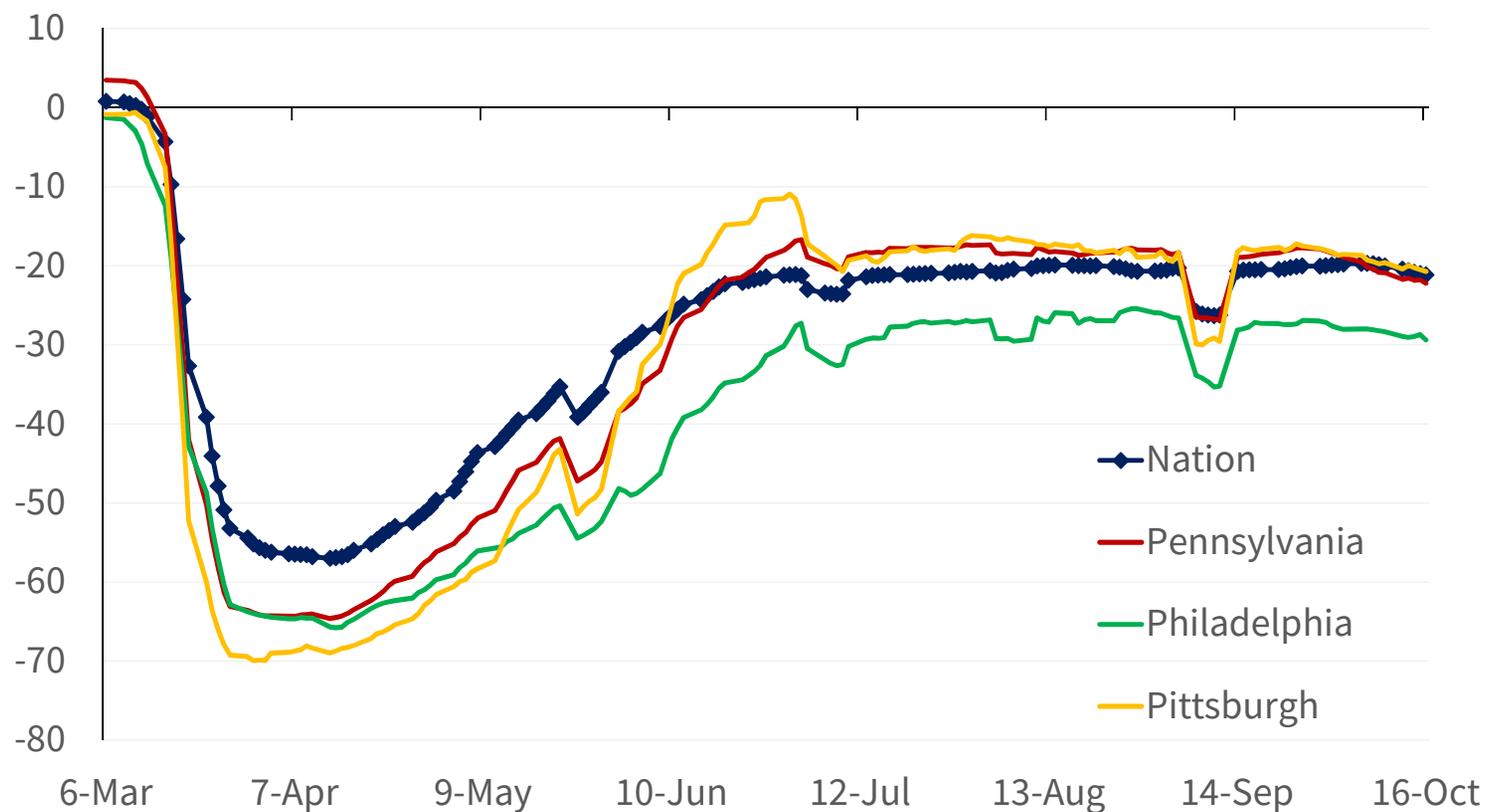


Source: BLS (Haver Analytics).
 Note: Data are as of September 2020.

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Recovery Momentum May Be Fading

Number of Hourly Employees Working Compared to January 2020 Average
Percent

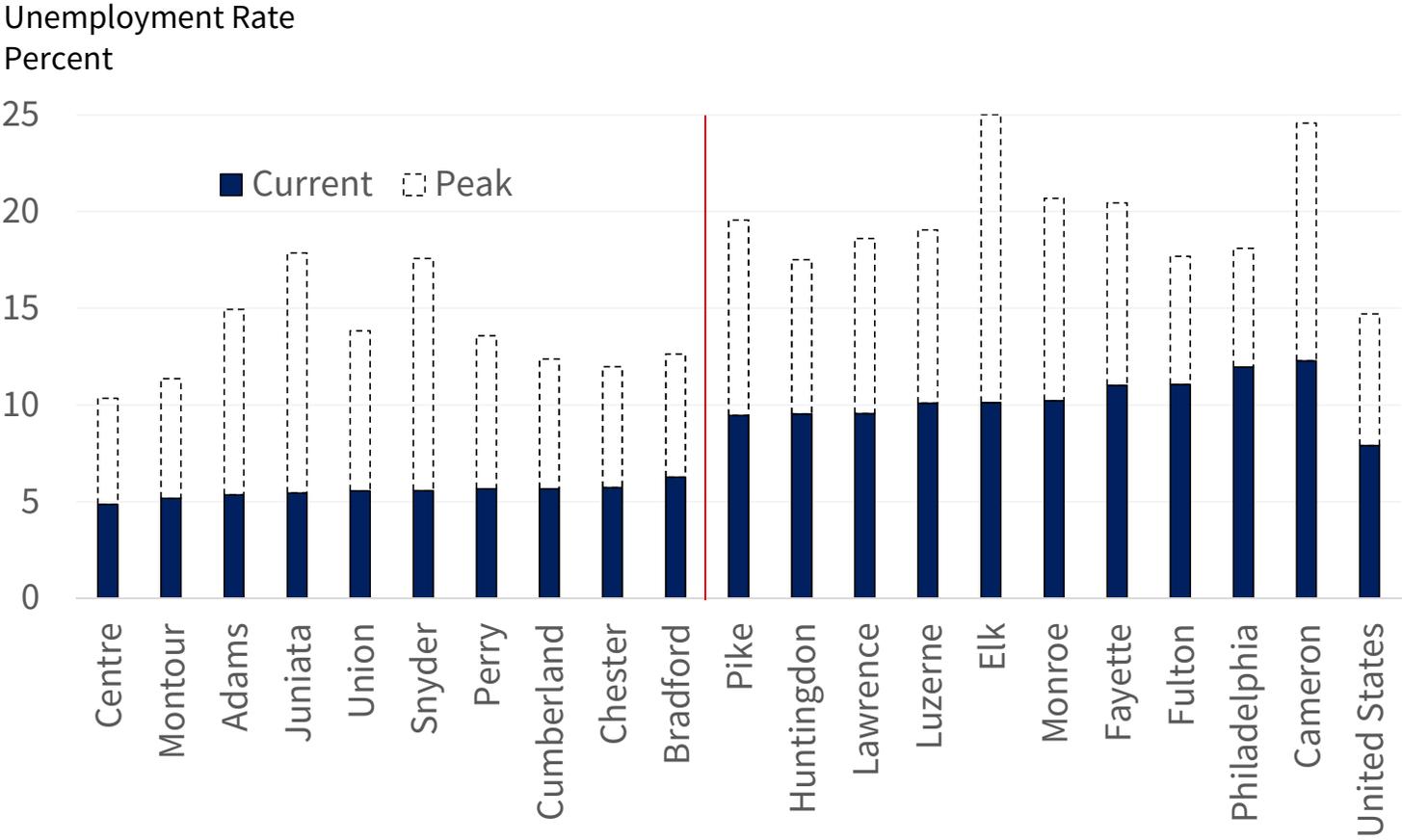


Source: Homebase (Haver Analytics).

Note: Data are 5-weekday moving average.

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Central PA County Unemployment Rates Are Lower



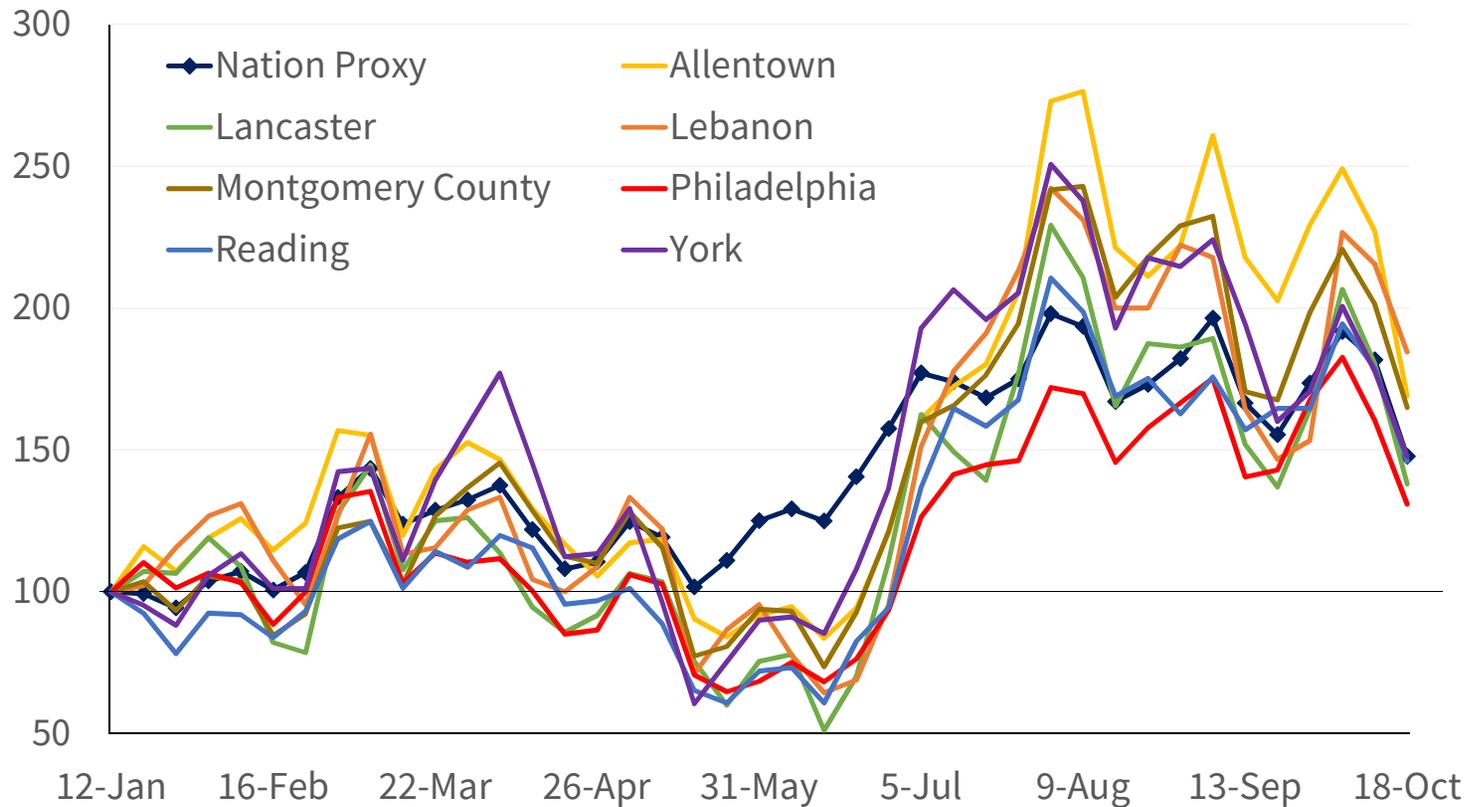
Source: BLS.

Note: Data are as of September, 2020.

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Home Sales in the Eastern Part of the State Rebounded

Home Sales Index (January 12, 2020 = 100)



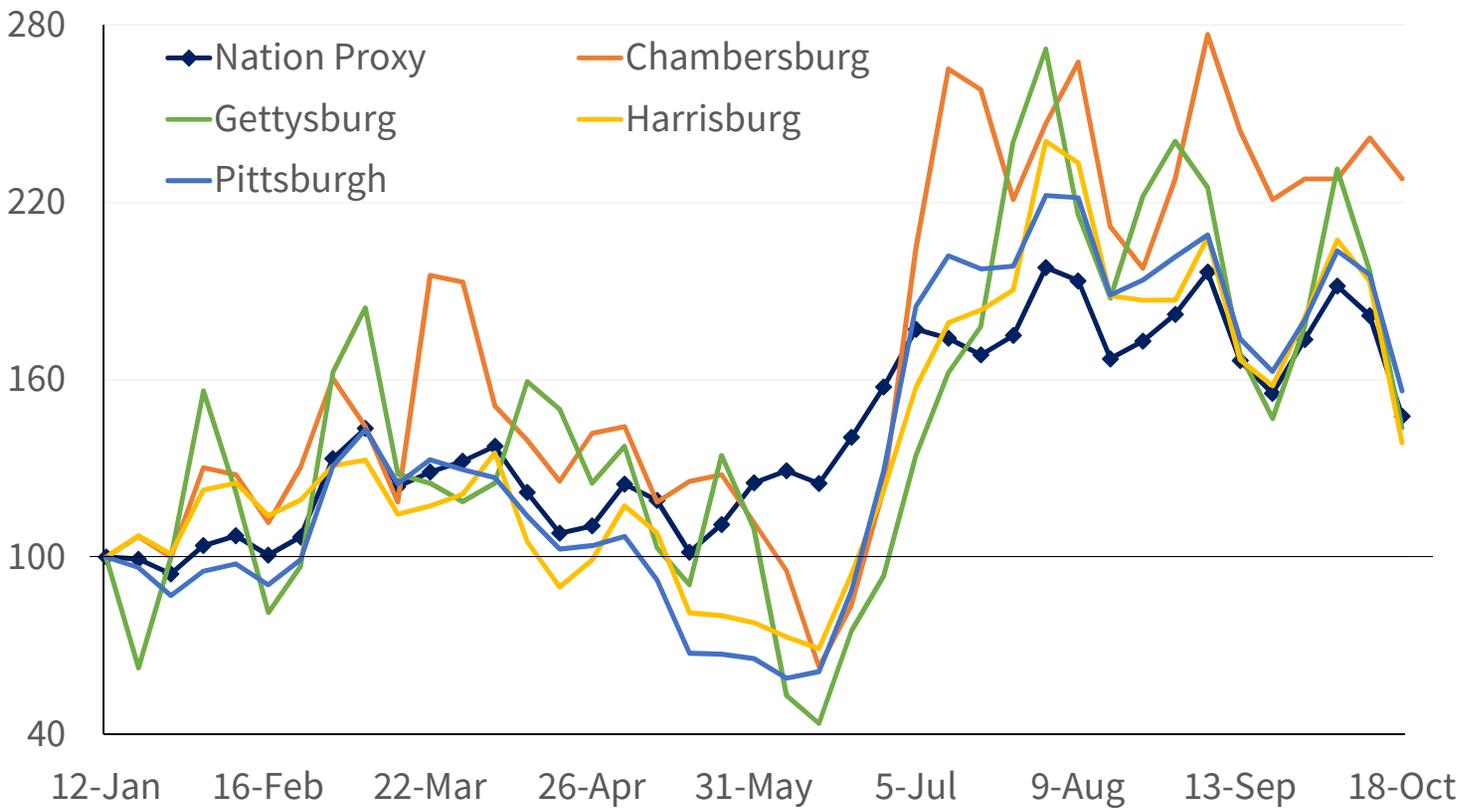
Source: Redfin.

Note: Indexed data are two-week moving average of weekly data.

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Home Sales Also Picked Up Across Western Pennsylvania

Home Sales Index (January 12, 2020 = 100)



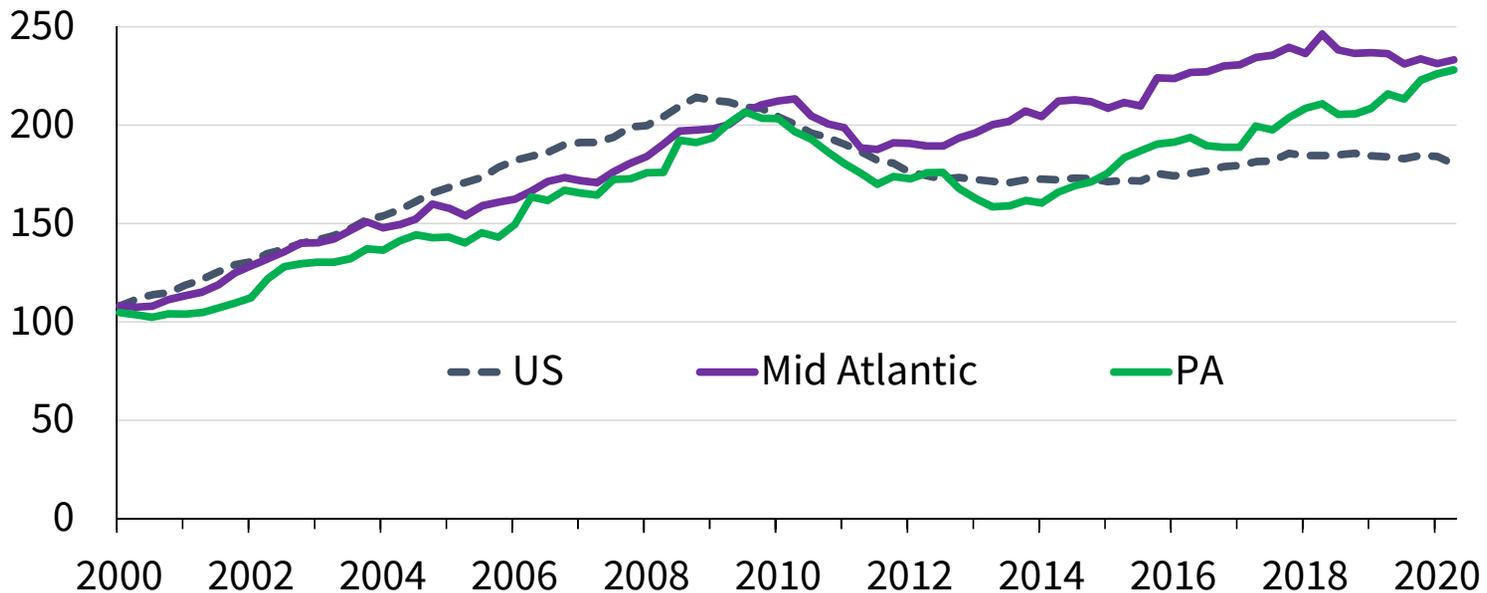
Source: Redfin.

Note: Indexed data are two-week moving average of weekly data.

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CRE Loan Concentrations Have Risen Among Banks in Pennsylvania in Recent Years

CRE to Capital
Median percent



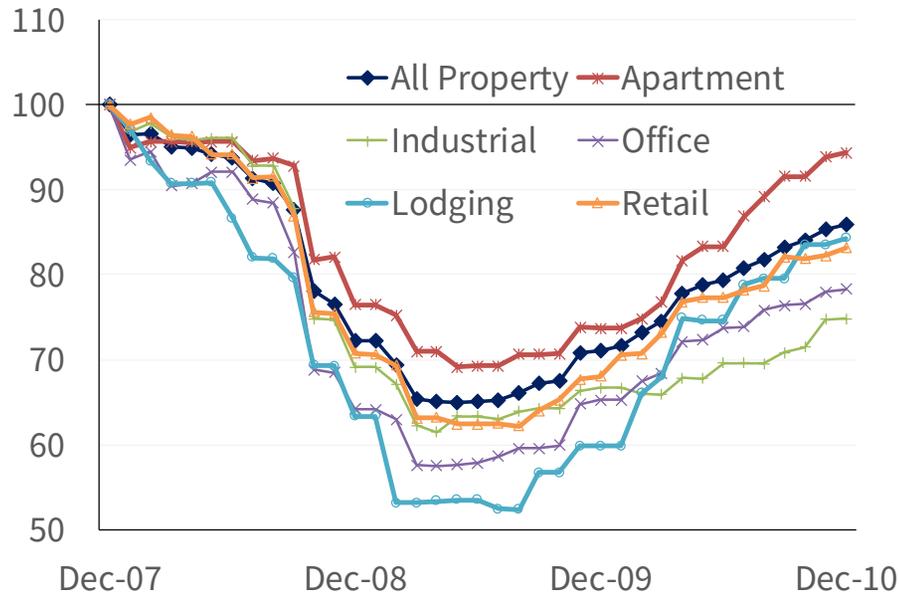
Source: FDIC.

Note: Data are quarterly figures through June 30, 2020. CRE to capital is the ratio of commercial real estate loans to tier 1 capital plus the allowance after accounting for changes caused by current expected credit loss model elections.

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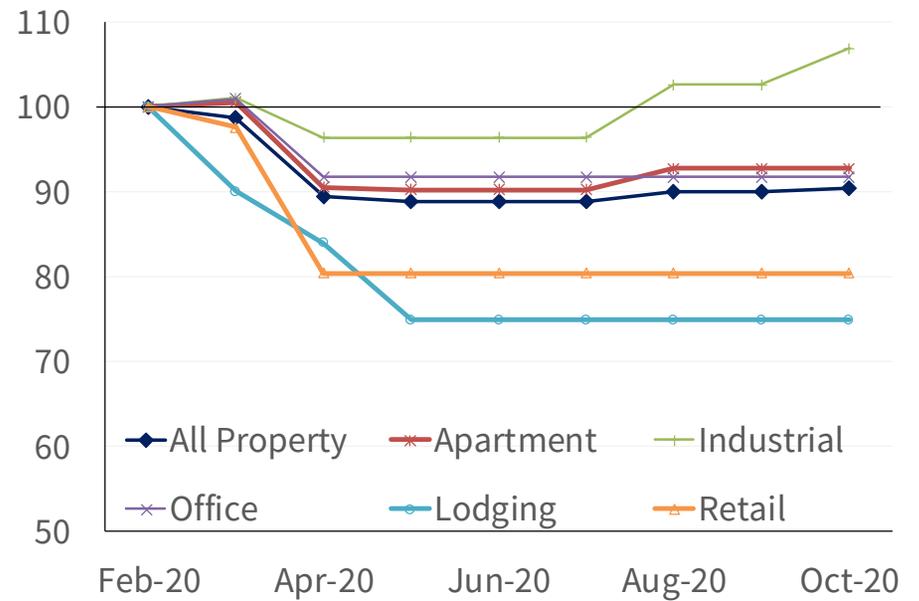
National CRE Property Prices May Prove More Resilient in This Cycle

Indexed Price Change from the Onset of the GFC
Dec. 2007 = 100



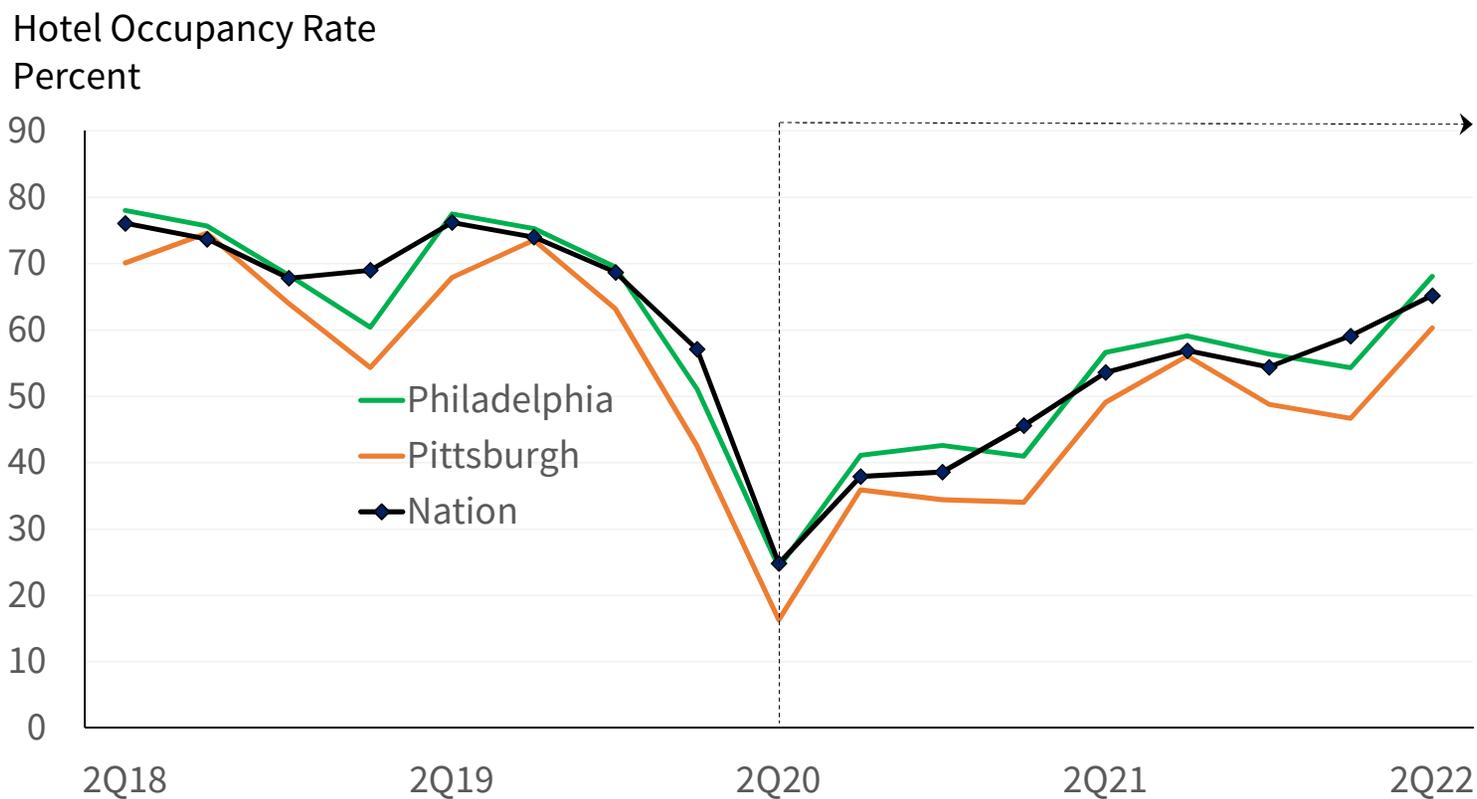
Source: Green Street Advisors.
Note: Data are monthly as of October 2020.

Indexed Price Change from the Onset of the Pandemic
Feb. 2020 = 100



Source: Green Street Advisors.
Note: Data are monthly as of October 2020.

Lodging was among the most immediately and severely affected segments



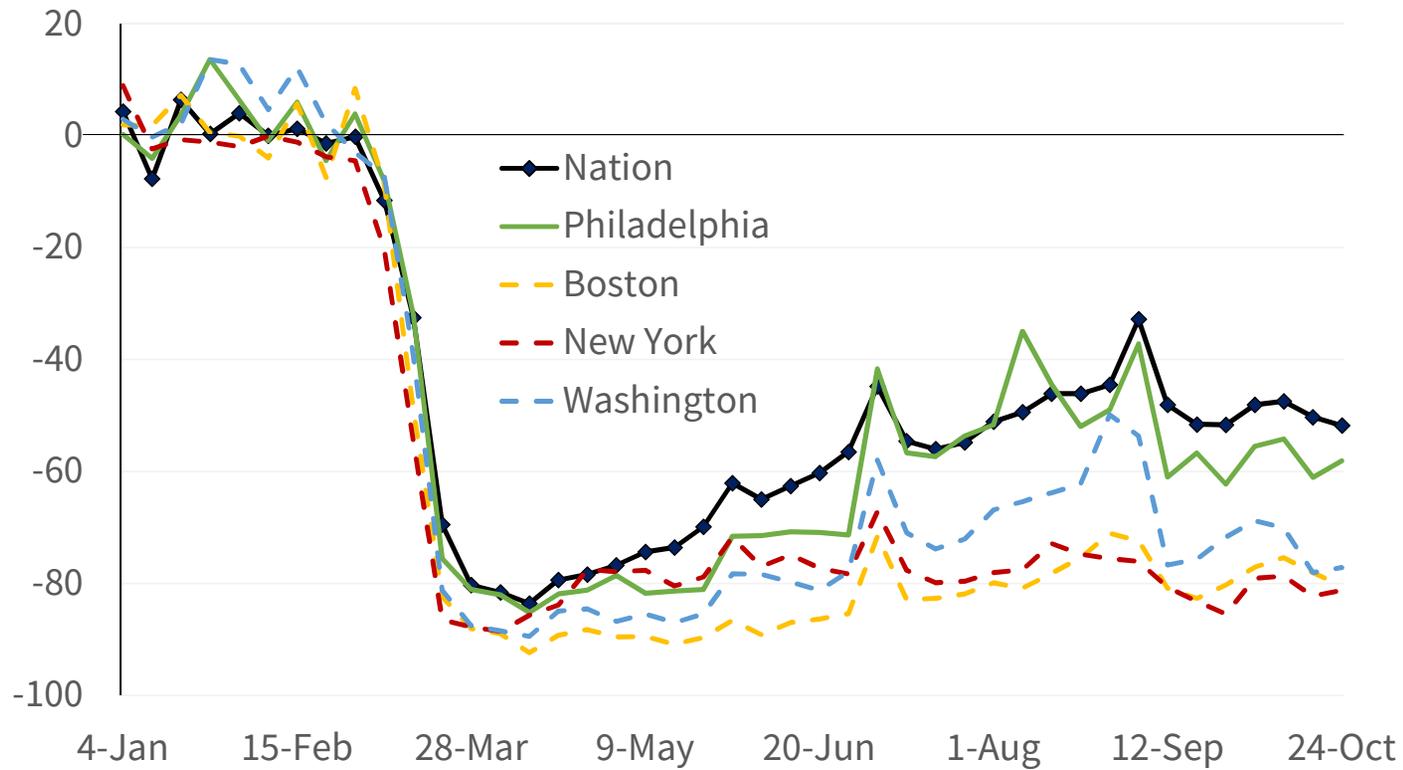
Source: CBRE.

Note: Data as of second quarter 2020.

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Recovery in Hotel Revenues Is Slowing

Year-over-year Change in Revenue Per Available Room
Percent

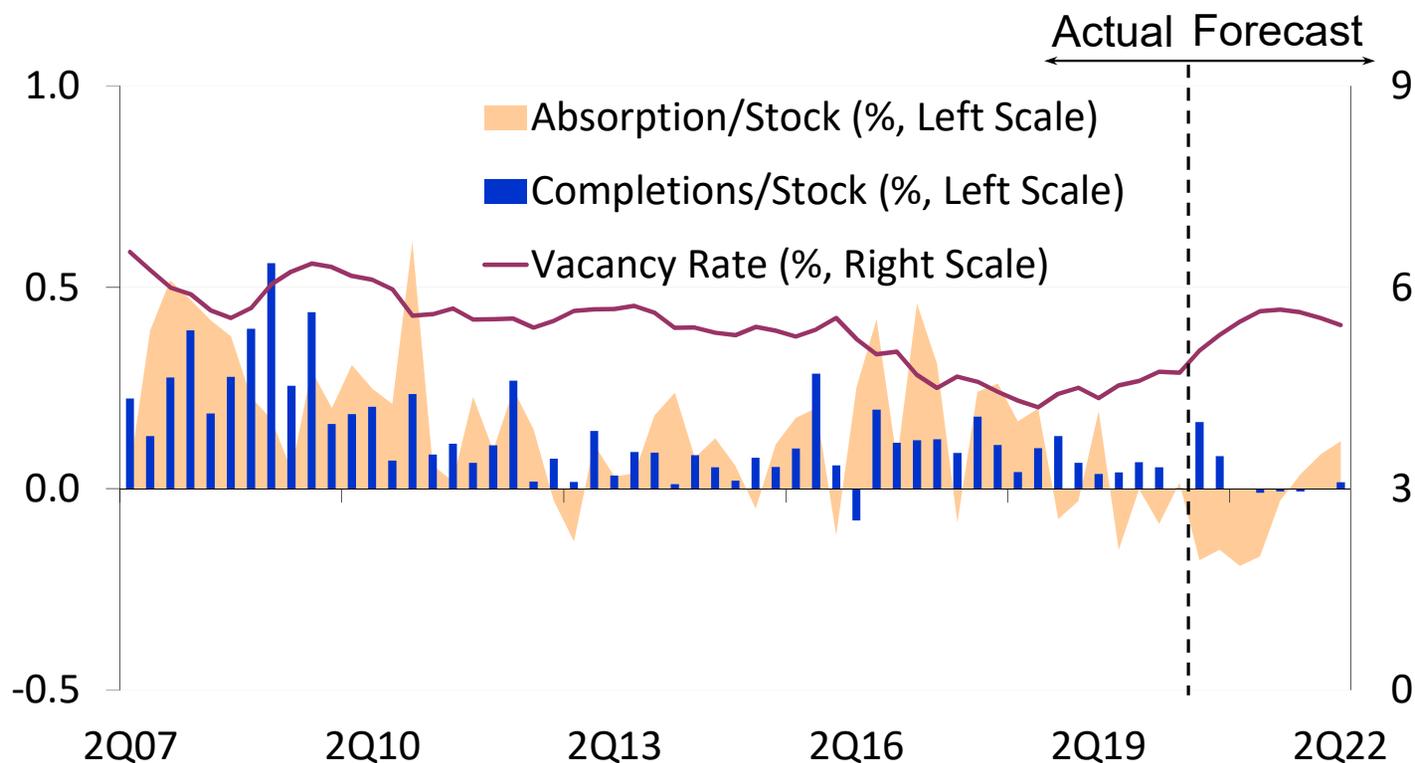


Source: STR, JP Morgan.

Note: Weekly data are specific to Hyatt and Host hotels.

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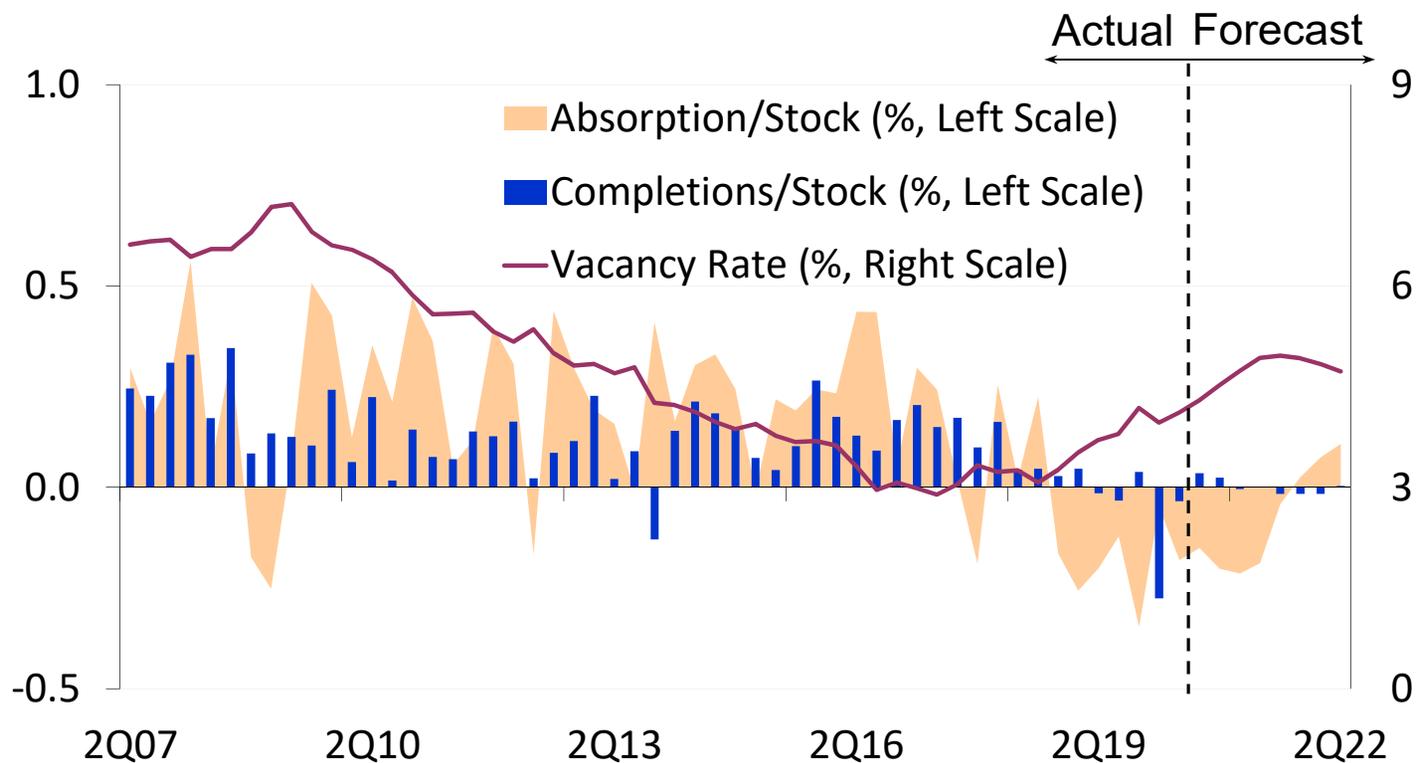
Philly's Retail Sector Was Weakening Going Into the Pandemic



Source: CoStar, data are as of second quarter 2020.

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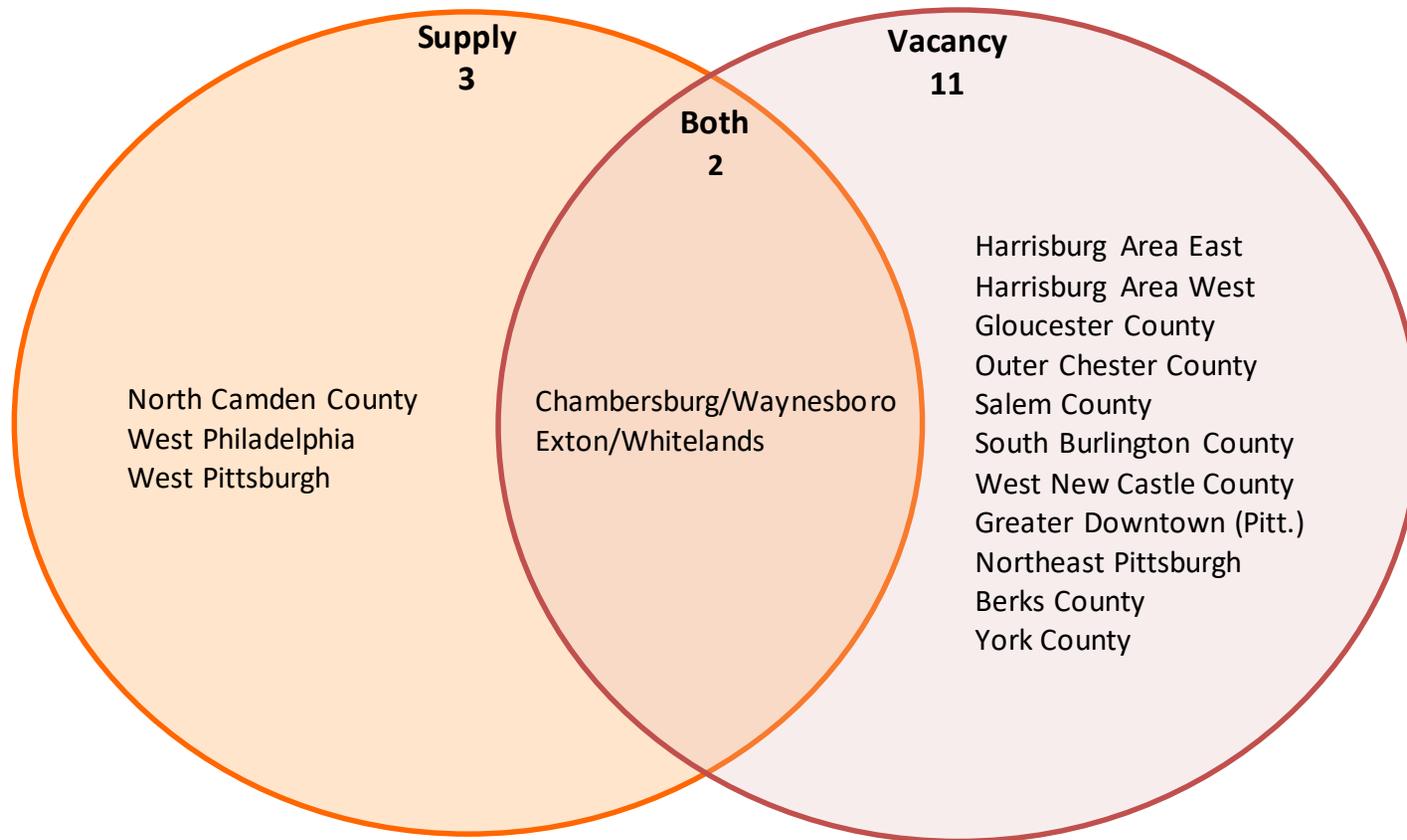
Pittsburgh's Retail Sector Was Weakening Going Into the Pandemic



Source: CoStar, data are as of second quarter 2020.

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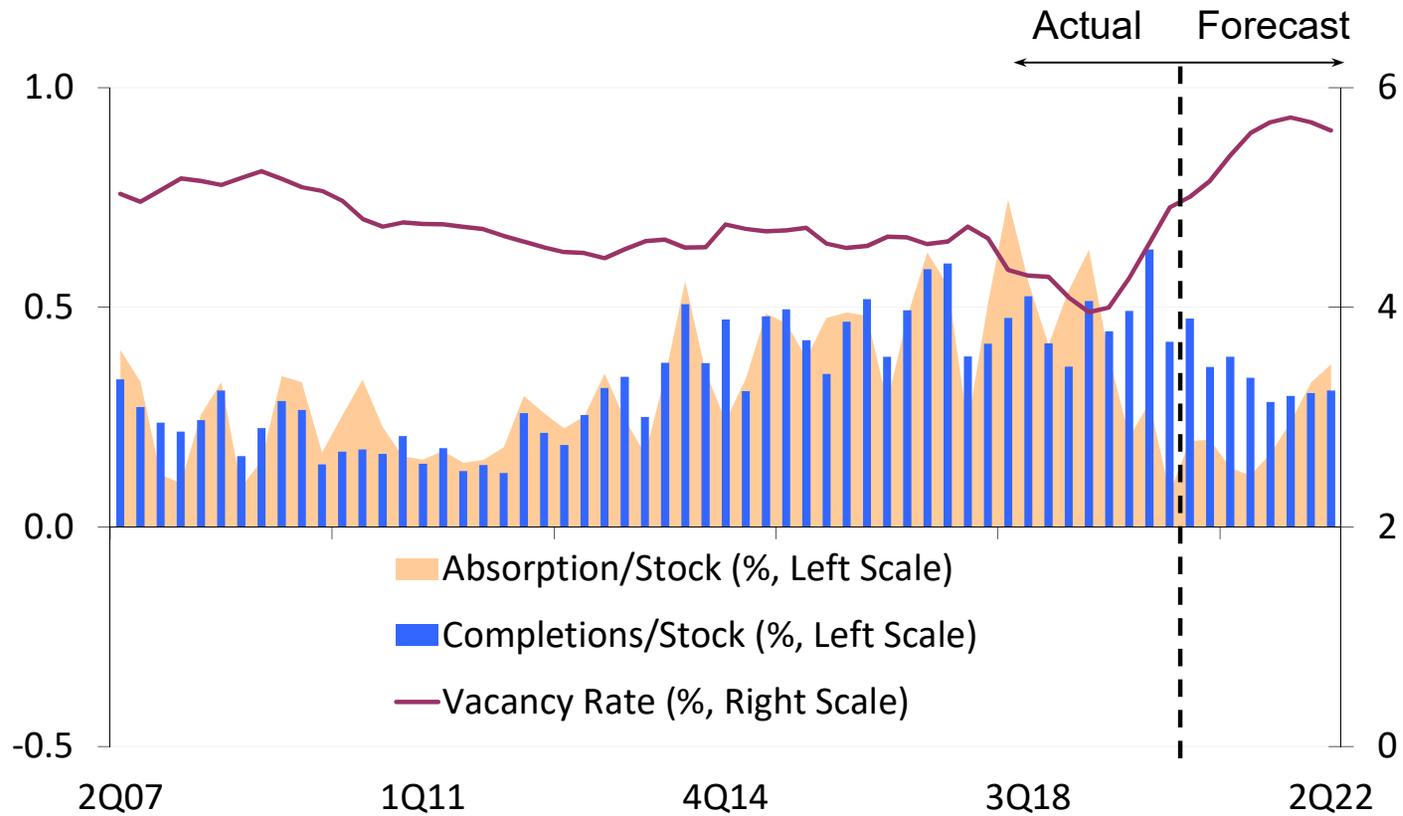
Retail Vacancy is an Issue in Parts of Pennsylvania



Source: CoStar, FDIC.

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Apartment Demand in the Northeast Had Already Begun to Weaken

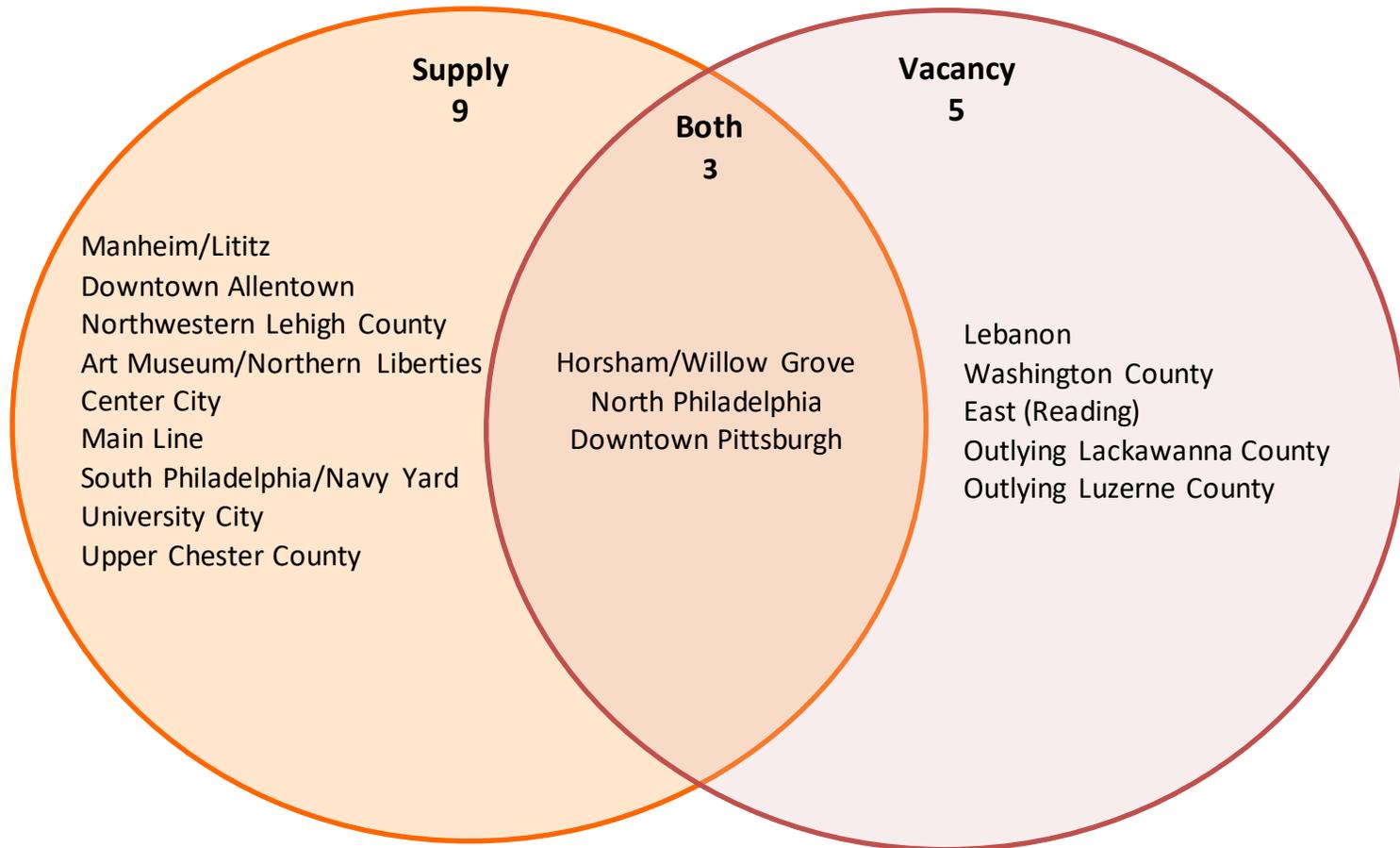


Source: CoStar.

Note: Data are as of second quarter 2020.

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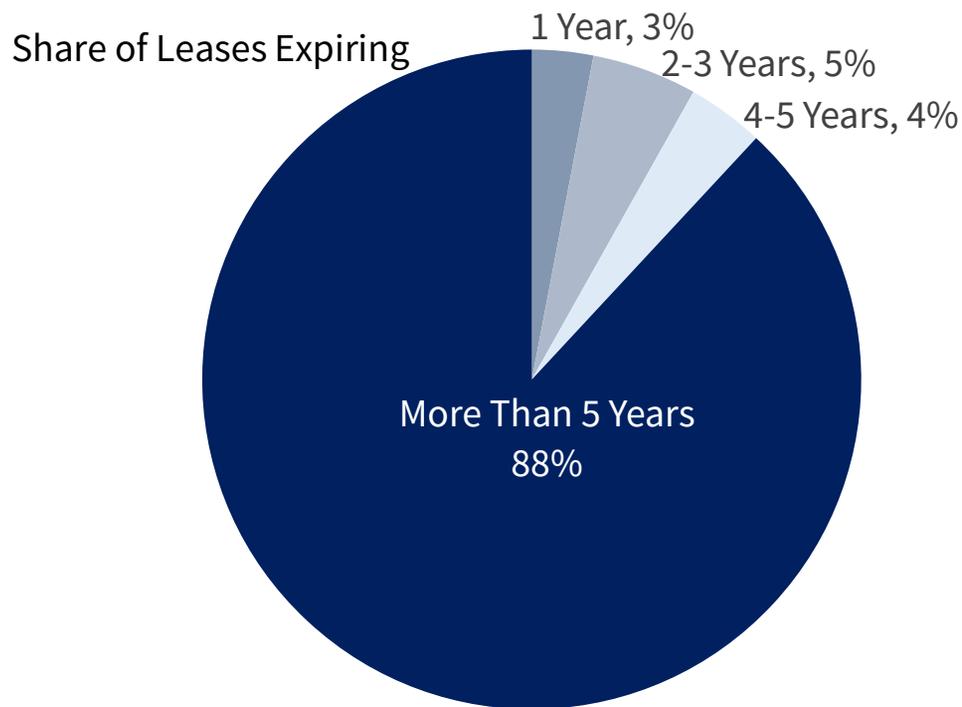
Multifamily Construction Was Strong In Pennsylvania



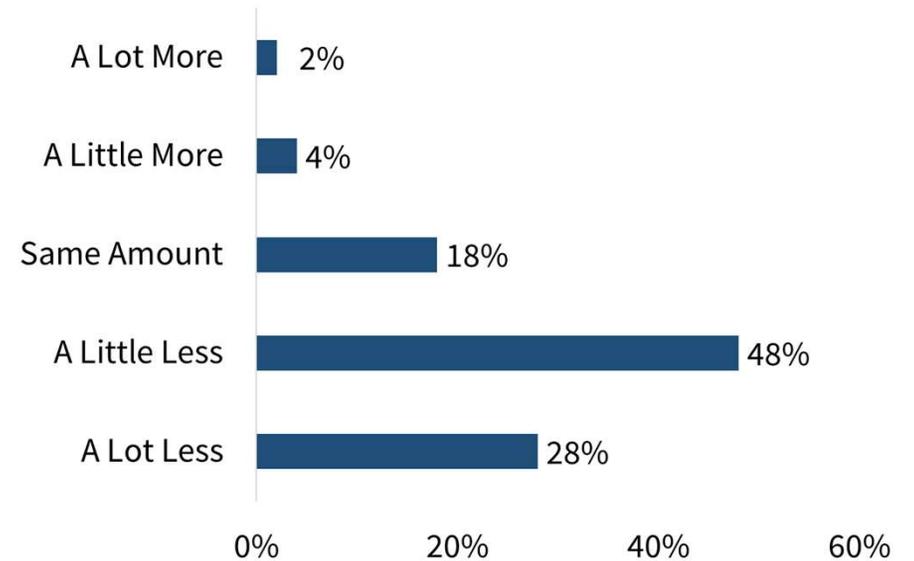
Source: CoStar, FDIC.

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Longer Office Leases May Forestall The Immediate Impact of Increased Telework



How Much Future Office Space CEOs Say They Will Need
Percent of Respondents

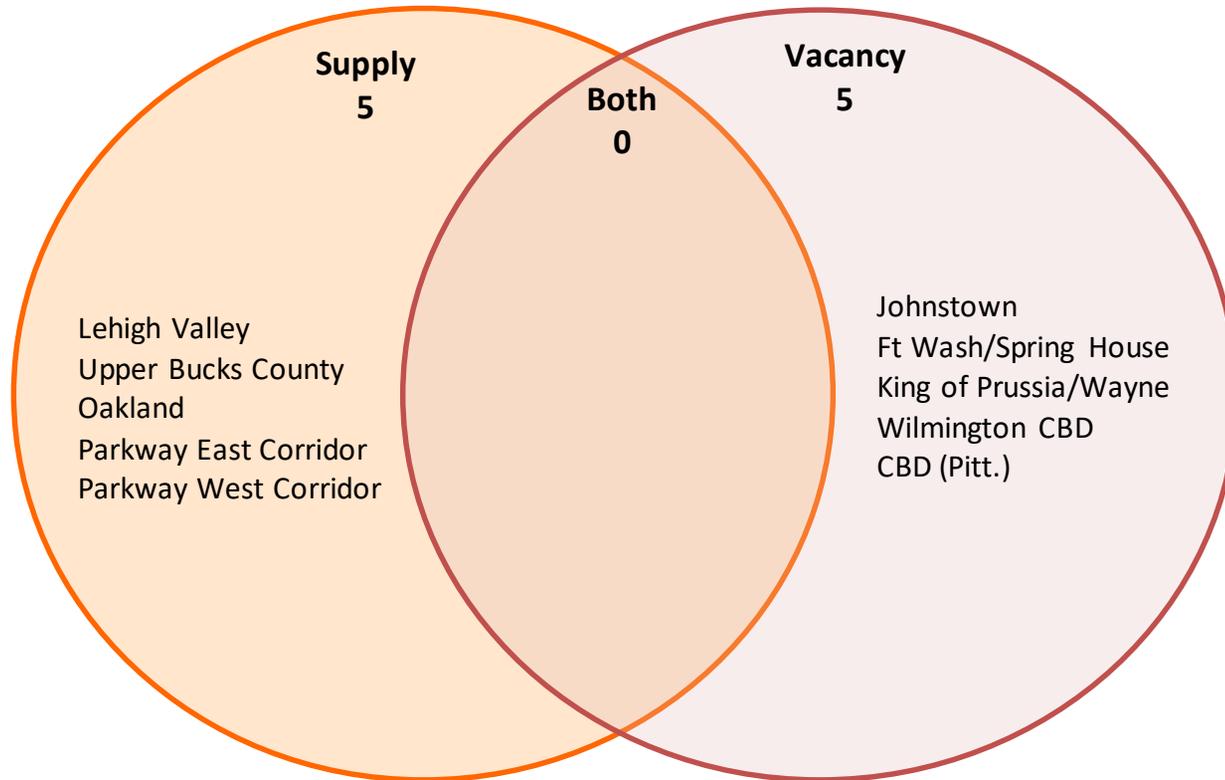


Source: Fortune/Deloitte CEO Survey.
Note: 171 CEOs surveyed. October 2020.

Source: CoStar.

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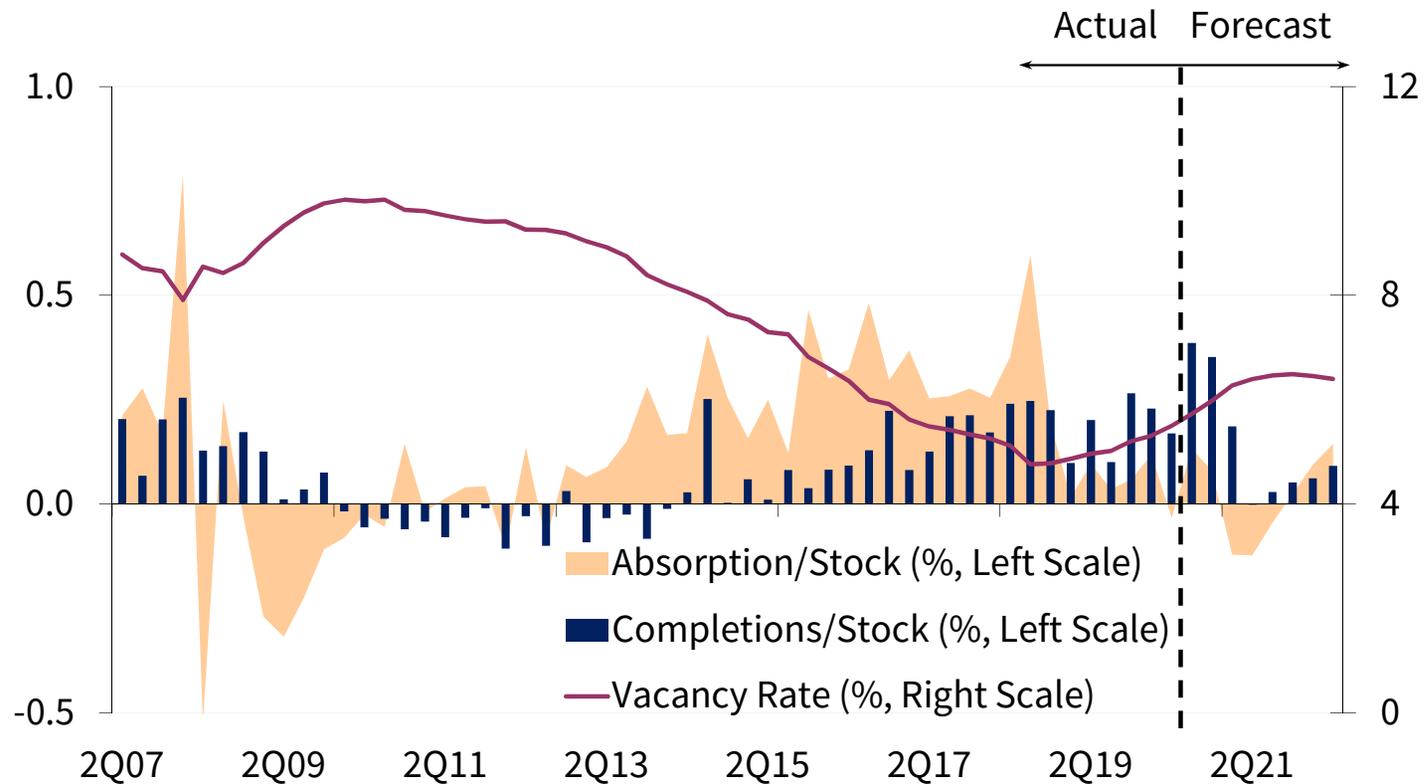
Pennsylvania's Office Submarket Concerns Appear Balanced



Source: CoStar, FDIC.

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Regionally, the Industrial Sector Is In the Process of Digesting New Supply

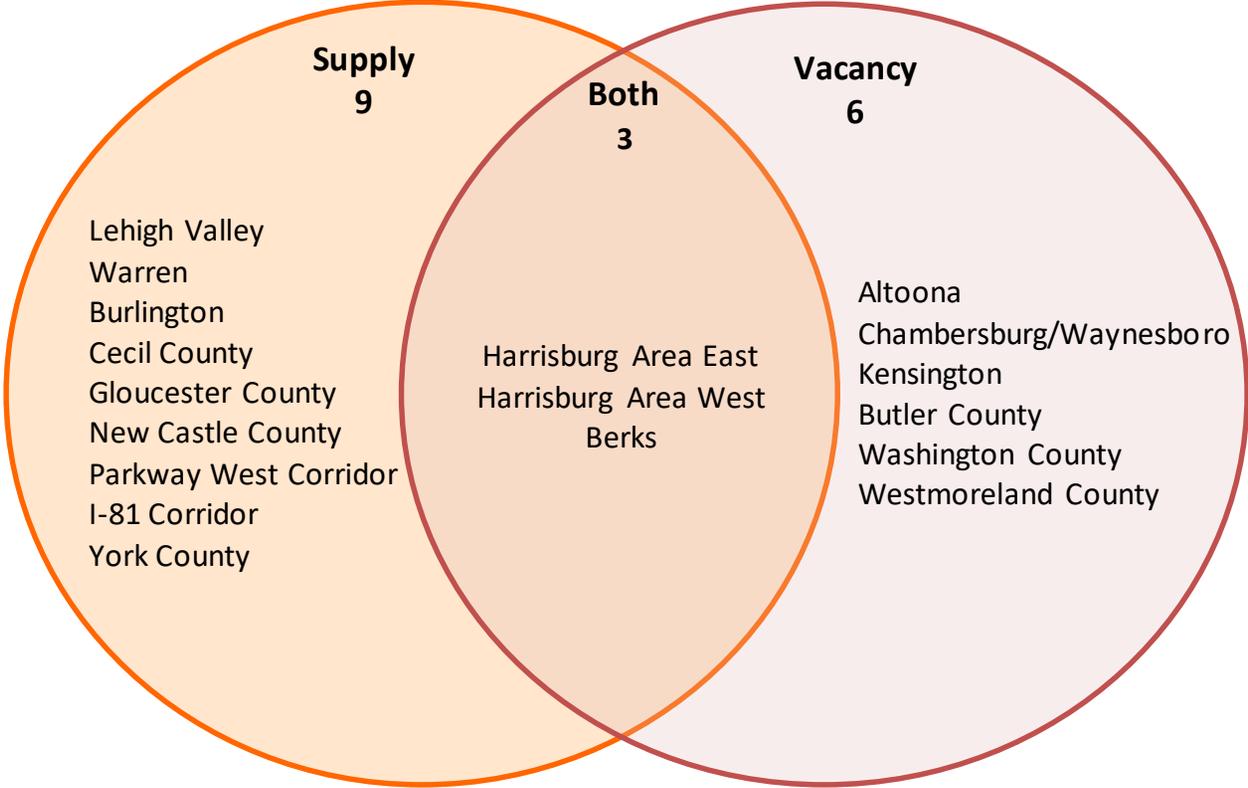


Source: CoStar.

Note: Data are as of second quarter 2020.

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Pennsylvania is the Core of the Region's Industrial Market

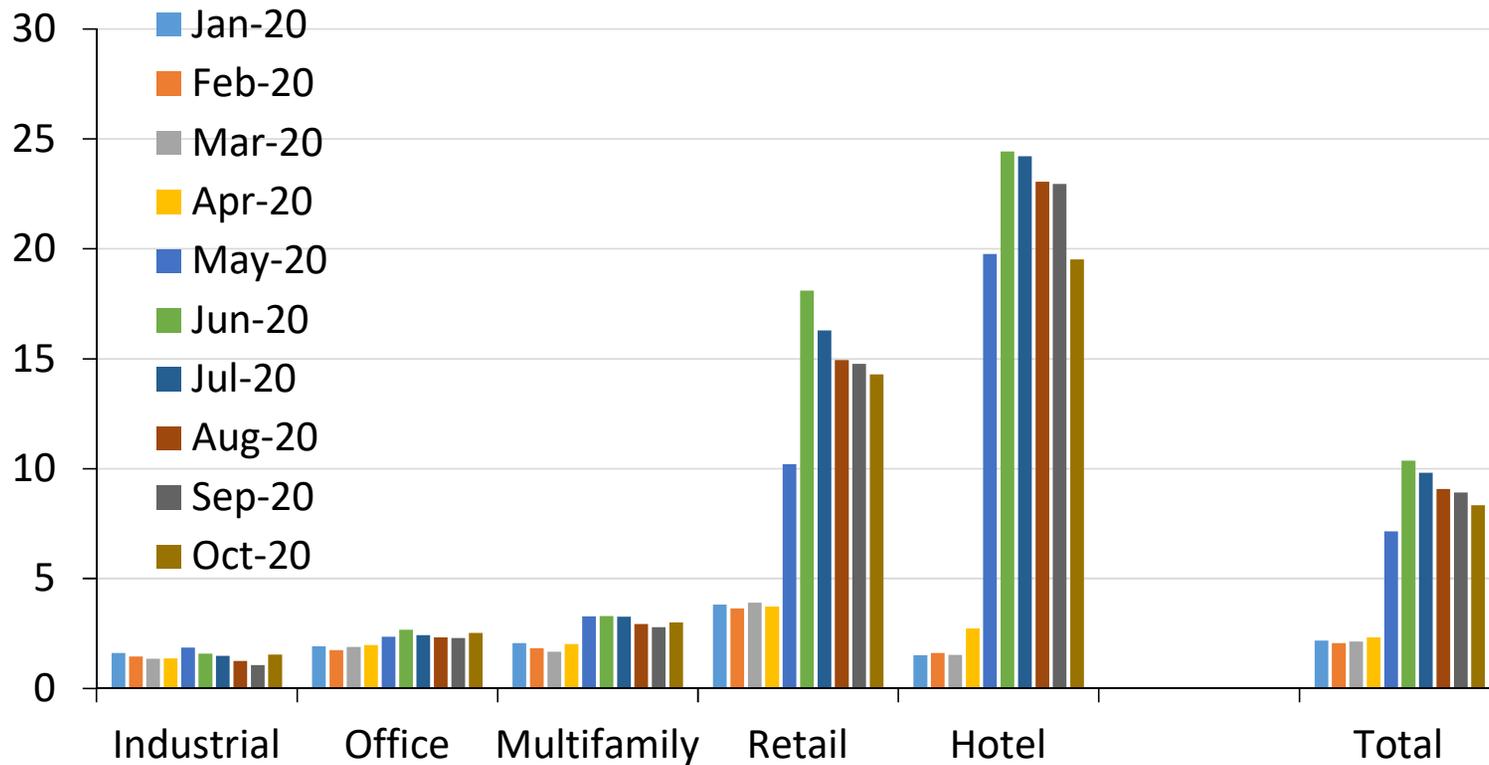


Source: CoStar, FDIC.

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CMBS Delinquencies Increased, Particularly Among Hotel and Retail Sectors

CMBS Delinquency Rate
Percent

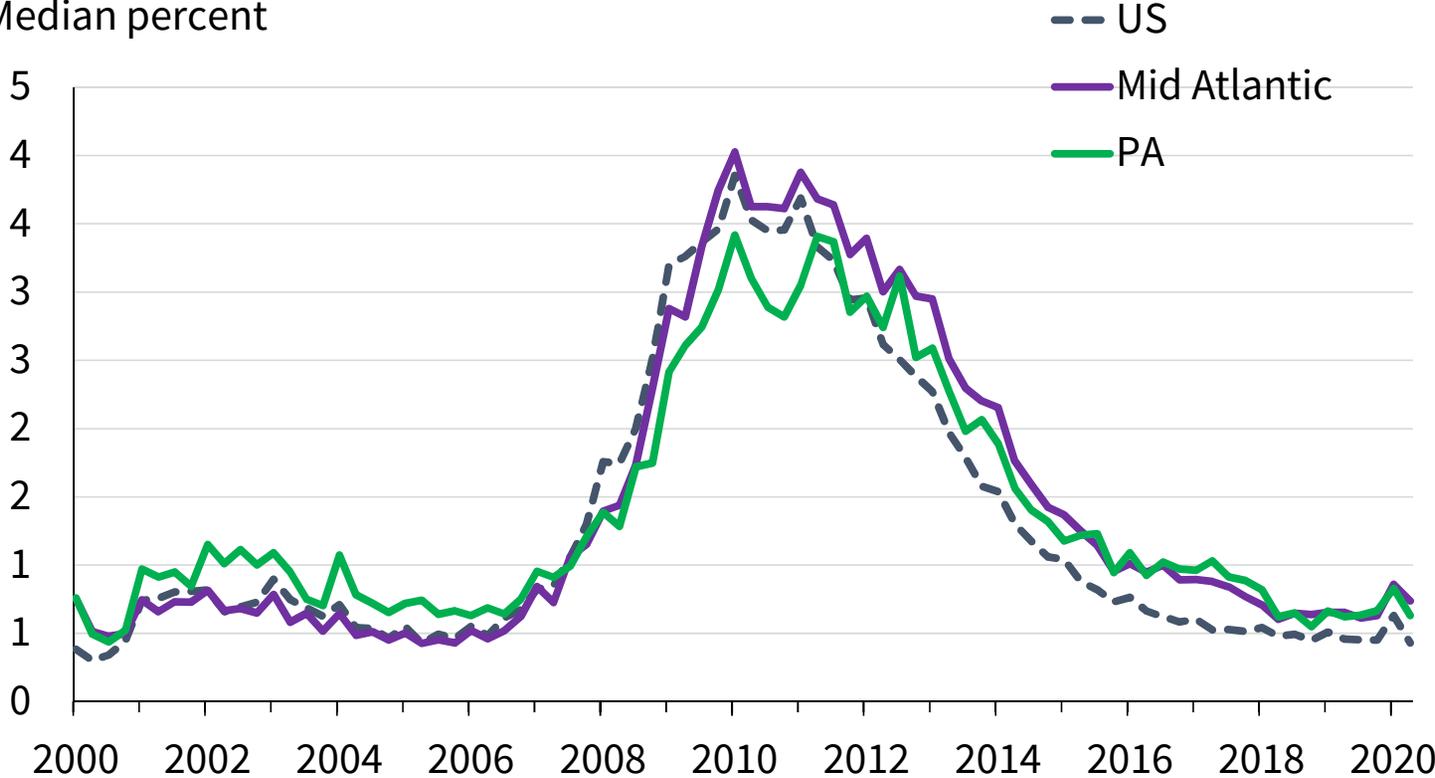


Source: Trepp Loan.

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Delinquency Rates Among CRE Loans Remain Low in Second Quarter 2020

CRE Delinquency Rates - FDIC Insured Banks
Median percent



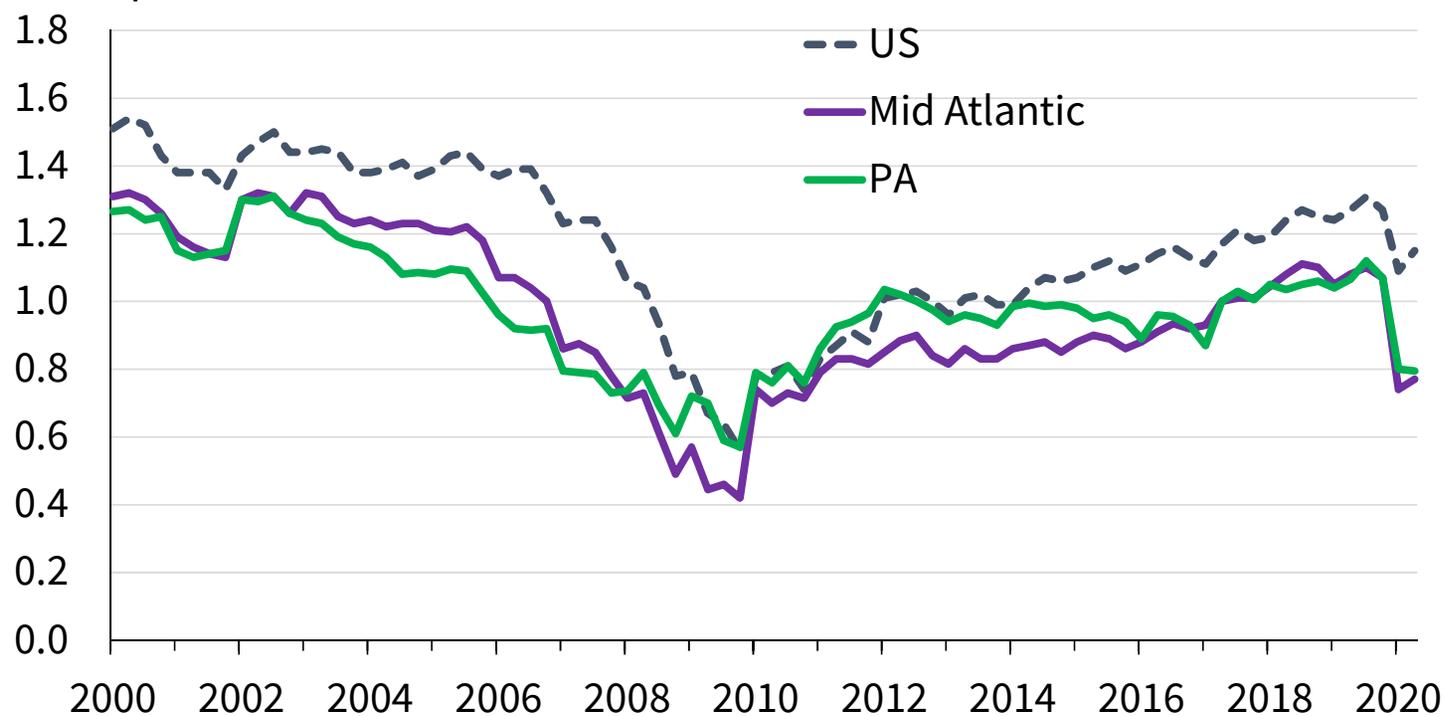
Source: FDIC.

Note: Data are quarterly figures through June 30, 2020.

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Profitability Has Declined Sharply Amid Loan Growth, Higher Provision Expense, and Declining Loan Yields

Pretax Return on Assets
Median percent



Source: FDIC.

Note: Data are quarterly figures through June 30, 2020.

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Questions?

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