



# Emerging Credit Risk

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**2018 Directors' College**

# Session Objectives

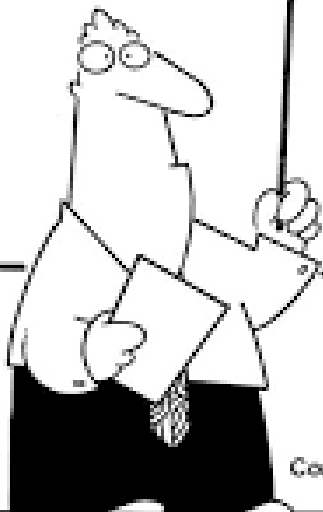
- **Share and discuss emerging credit trends and risks identified during recent regulatory examinations**
- **Review and discuss a real life credit risk identification case study**



# Ineffective Risk Management

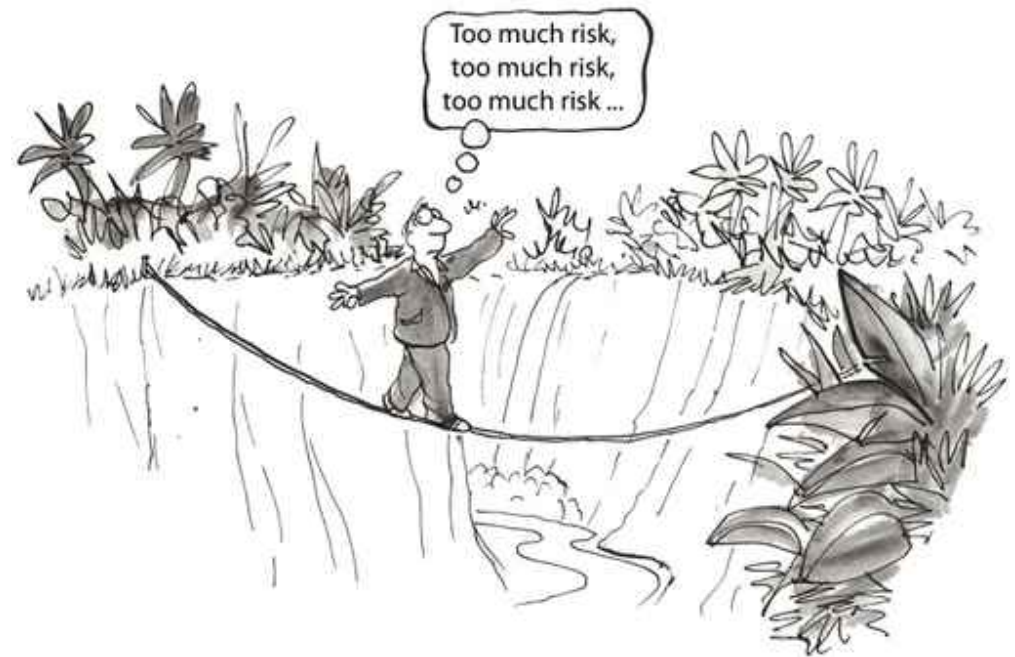
## ESSENTIALS OF RISK MANAGEMENT:

1. DON'T DO ANYTHING WRONG TODAY.
2. DON'T DO ANYTHING WRONG TOMORROW.
3. REPEAT.



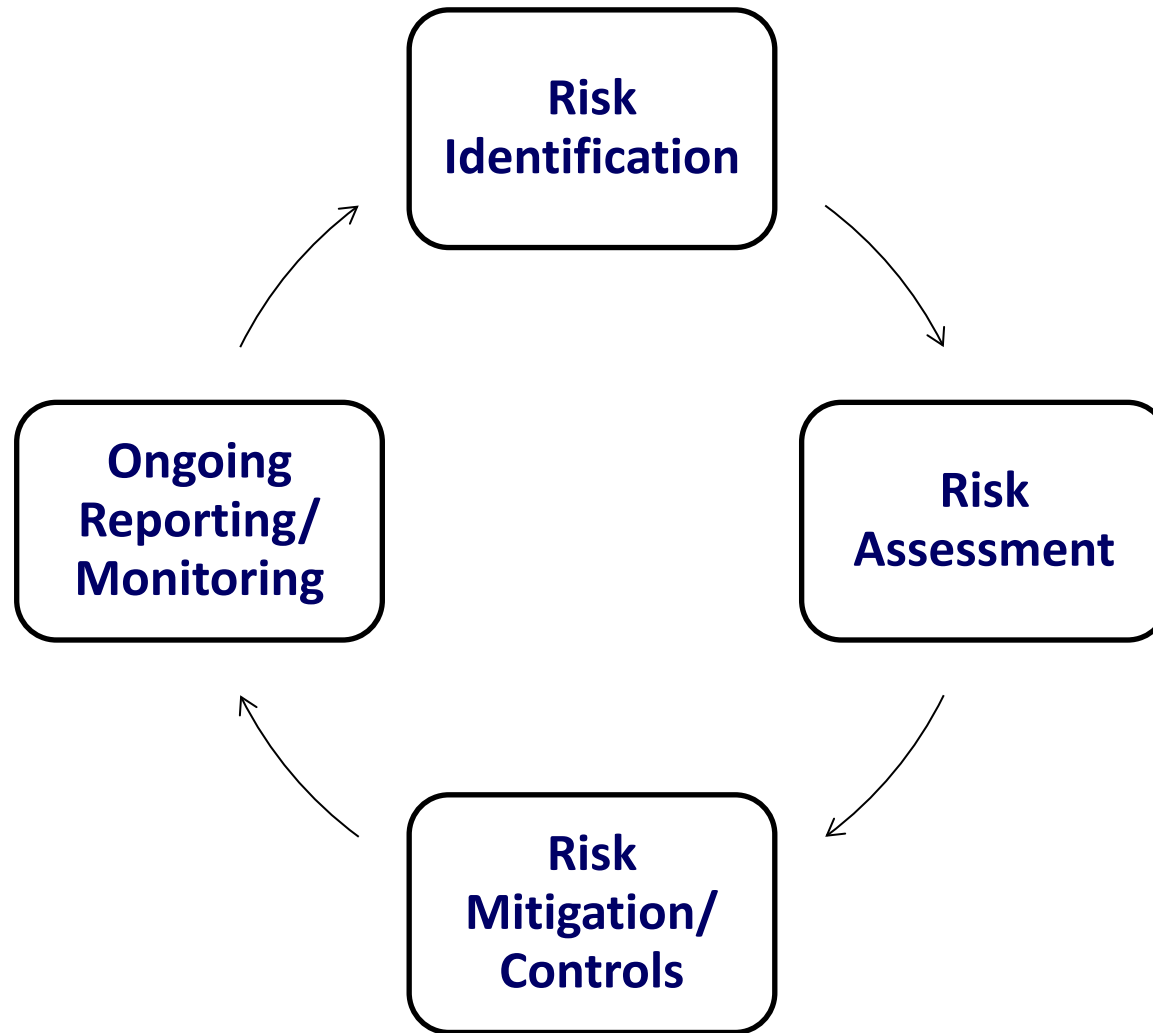
Complex Discovery

SHARBERGEM



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# Effective Risk Management Cycle



# Commercial Lending Risk Trends

- **Loan Underwriting and Risk Survey results from 2016 and 2017:**
  - **13% of surveys indicate banks adding new products/activities that could pose additional risks;**
  - **Overall credit risk noted as low risk (17%), moderate risk (72%), and high (11%);**
  - **Underwriting trends noted as generally conservative (20%), about average (70%), and generally liberal (10%);**
  - **Changes in lending activities noted as immaterial (19%), low (36%), moderate (41%), and high (4%) (moderate was 34% prior)**

# Commercial Lending – Emerging Risks

## ➤ **Out-of-Territory lending is rising**

- ❖ **Inadequate due diligence**
- ❖ **Unfamiliarity with credit markets**
- ❖ **Overreliance on lead bank**

## ➤ **Increasing concentrations**

- ❖ **Credit concentrations**
- ❖ **Potentially Volatile Funding concentrations**
- ❖ **Layered concentration risk (both)**

# Commercial Lending – Emerging Risks (Continued)

- **Common underwriting criticisms for banks with increasing CRE risks include:**
  - ❖ **Weak underwriting**
    - ❖ Excessive Loan Policy exceptions, inadequate tracking/reporting
    - ❖ Cash flow analysis based on unsupported projections
    - ❖ Lack of global cash flow analysis of guarantors
    - ❖ Excessive interest-only periods
    - ❖ Nonrecourse and/or limited recourse
  - ❖ **Lack of or insufficient stress testing**
  - ❖ **Inadequate independence/expertise of appraisal reviewers**
  - ❖ **Insufficient internal loan review**
  - ❖ **Outdated market analysis**

# CRE Lending – Regulatory Resources to Consider

- **FDIC Rules and Regulations Part 365 – Real Estate Lending Standards**
  - ❖ Appendix A – Interagency Guidelines for Real Estate Lending Policies
- **FIL-104-2006 “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices”**
  - ❖ Frequently Asked Questions for Commercial Real Estate Concentration Risk Management
- **FIL-22-2008 “Managing Commercial Real Estate Concentrations in a Challenging Environment”**
- **FIL-62-2015 “Statement on Prudent Risk Management for Commercial Real Estate Lenders”**
- **Interagency Policy Statement on Allowance for Loan and Lease Losses**
  - ❖ Attachment #1 – Loan Review Systems
- **Interagency Appraisal and Review Guidelines Statement of Policy**



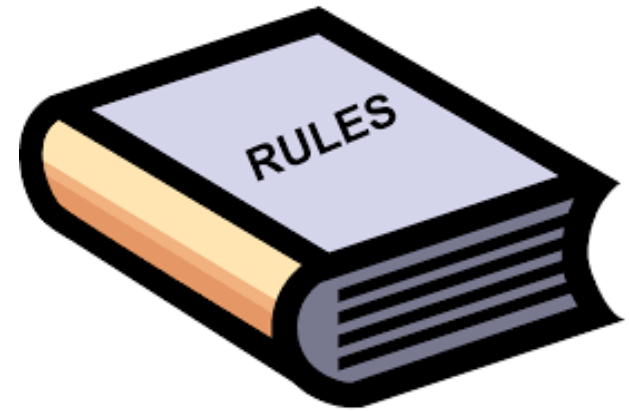
# Potential Concerns for Banks Acquiring Loan Participations

- Excessive loan growth without additional management/personnel and/or capital support
- Inadequate underwriting and/or ongoing credit administration practices
- Incorrect internal risk ratings
- Overreliance on lead bank
- Unable to change terms/conditions or prevent changes
- Violations of laws/compliance issues
- Elevated credit risk
- Fraud



# Loan Participations - Regulatory Resources to Consider

- **FDIC FIL-44-2008 “Managing Third-Party Risk”**
- **FDIC FIL-49-2015 “Advisory on Effective Risk Management Practices for Purchased Loans and Purchased Loan Participations”**
- **Interagency Information on Leveraged Lending**
- **Frequently Asked Questions - Interagency Information on Leveraged Lending**



# Questions?



# Case Study

## ■ Your Role

- You are a Director of State Bank and are being asked to review and decide on a credit proposal for a new borrower to this institution.

## ■ Institution Background Information

- \$800 million financial institution
- Commercial loan growth goal 20% per year starting 2017
- 2017 ROA 0.36%, 2018 ROA goal 0.50%

## ■ Assignment

- Review the Credit Proposal document (loan already approved by management loan committee), identify any potential concerns and/or follow-up questions for lending personnel, and prepare to vote on credit approval (Approve, Deny, More Info Needed)

# Final Questions?



# Contact Information

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