Directors' Symposium

The Case for Credit Risk Management

April 18 & 19, 2023

David Ruffin,
Principal

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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We make them simple, easy to use
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Loan Review and Credit Intelligence Solution

IntelliCredit Solution			Loan Review Services
Annual Review (for use by your team)	**Smart Loan Review™** (for use by your team)	**Portfolio Analyzer** (for use by your team)	**Smart Loan Review™** (performed by our experts)
Move to an automated process that makes annual reviews easy, organized and repeatable – with everything right at your fingertips	Revolutionary online solution that expedites your entire loan review process, making it simple, retrievable online – and fast	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	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 is at generationally high metrics . . . so let's take a look.

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VA, Southeast, and National *4Q '22* Credit Performance Metrics

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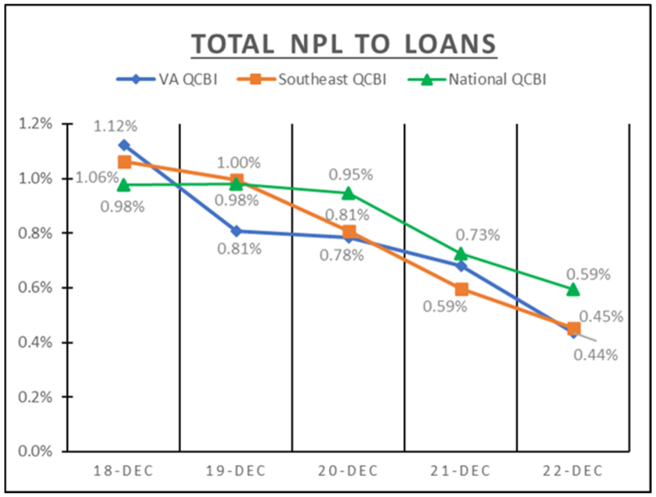
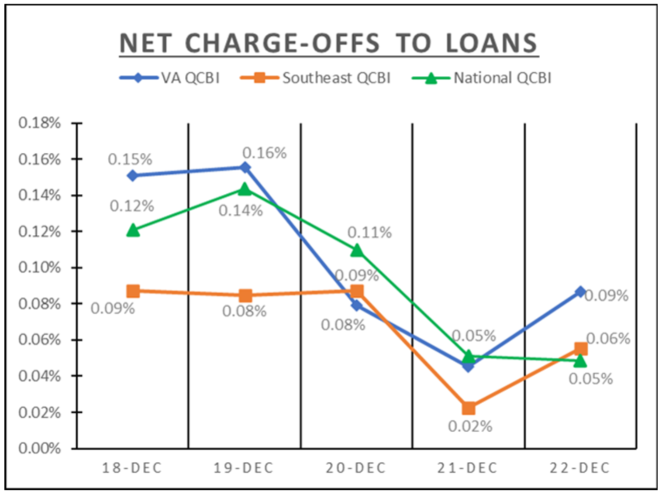
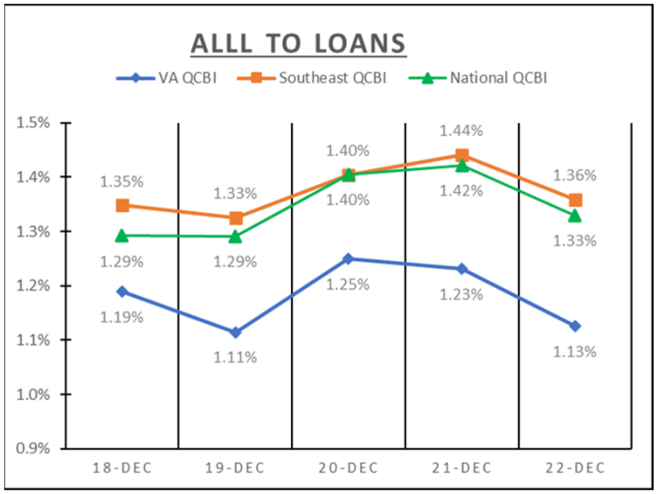
Trifecta of Loan Quality: Banks <$10B

Q4 '22 Call Report Data QwickAnalytics®

VA <$10B / Southeast <$10B* / National <$10B







*Southeast: VA / NC / SC / GA / FL

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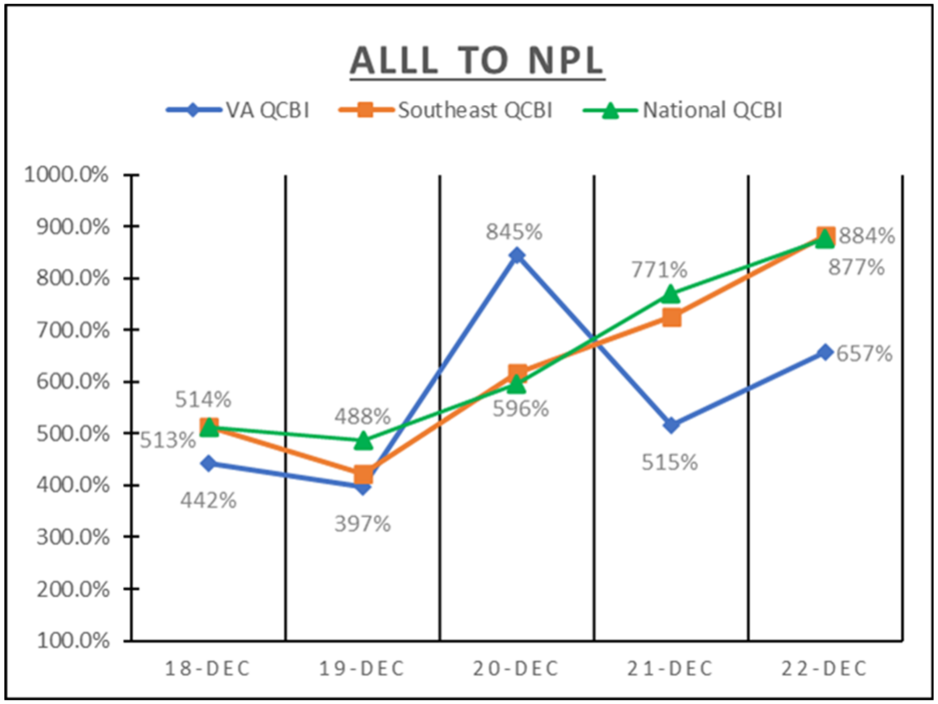
Trifecta of Loan Quality: Banks <$10B



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Q4 '22 Call Report Data

VA <$10B / Southeast <$10B / National <$10B

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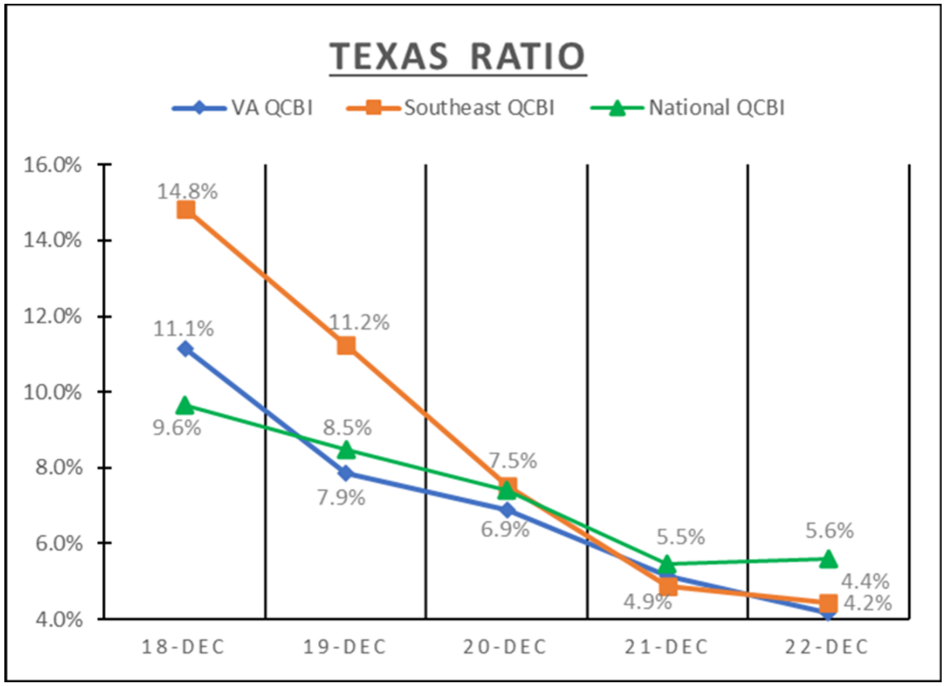
Texas Ratio: Banks <$10B

Q4 '22 Call Report Data QwickAnalytics®

VA <$10B / Southeast <$10B / National <$10B



IF and WHEN this curve turns upward, remember the smaller banks' conundrum:

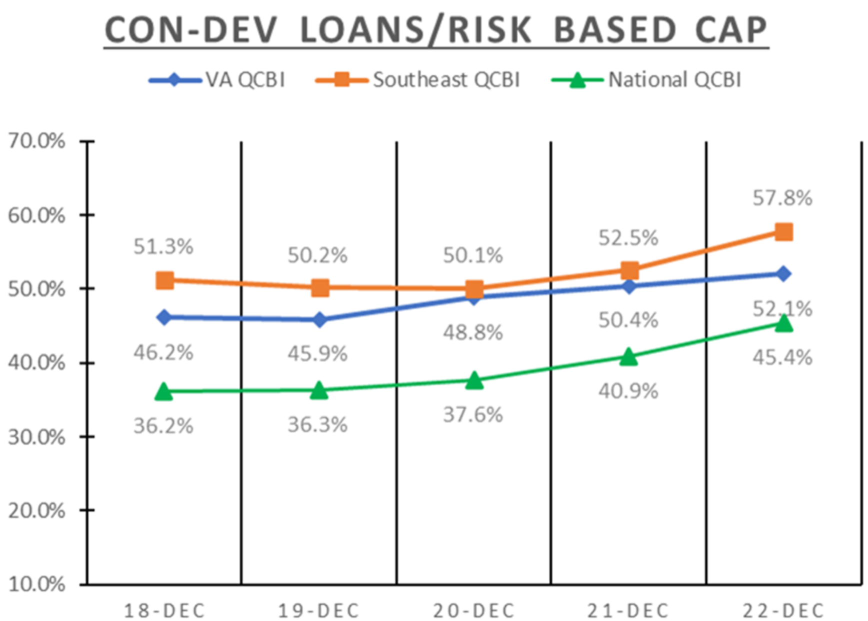
- Reluctance to move against known borrowers
- Disproportionate capital/reputational impact of losses
- High dependence on real estate (the most illiquid of problem assets)

CRE Concentrations: Banks <$10B

Regulatory Guidance:
≤ 100% RBC

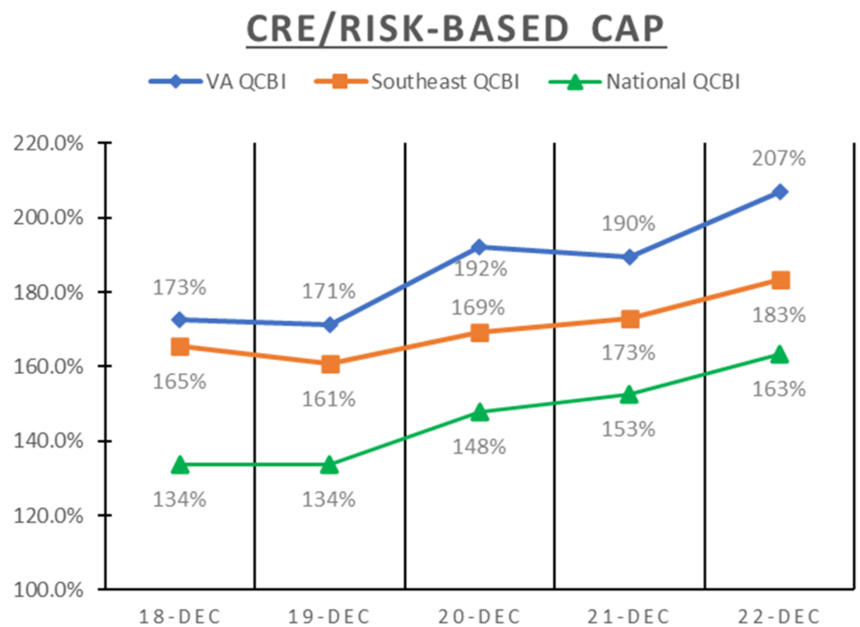
Q4 '22 Call Report Data*

Regulatory Guidance:
≤ 300% RBC



VA: 5 / Southeast: 39 / National: 277

↑ 100%



VA: 7 / Southeast: 32 / National: 330

↑ 300%

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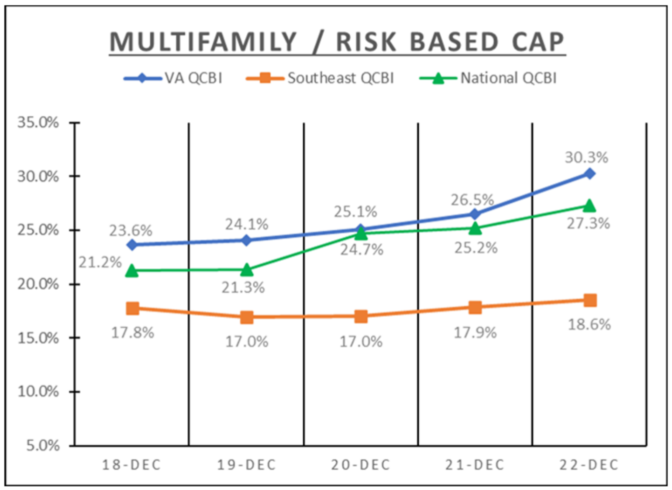
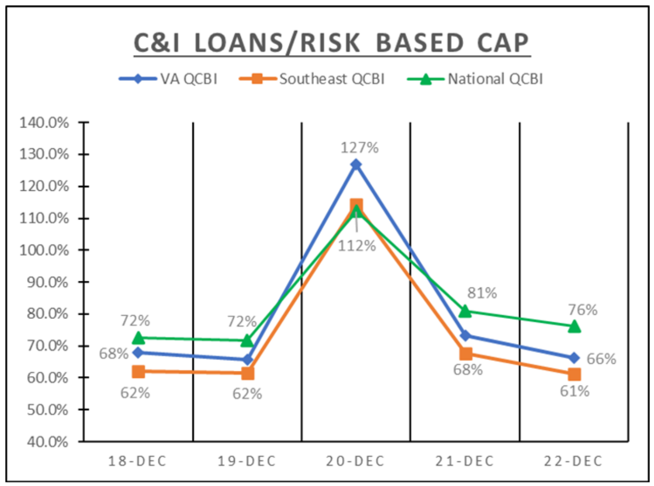
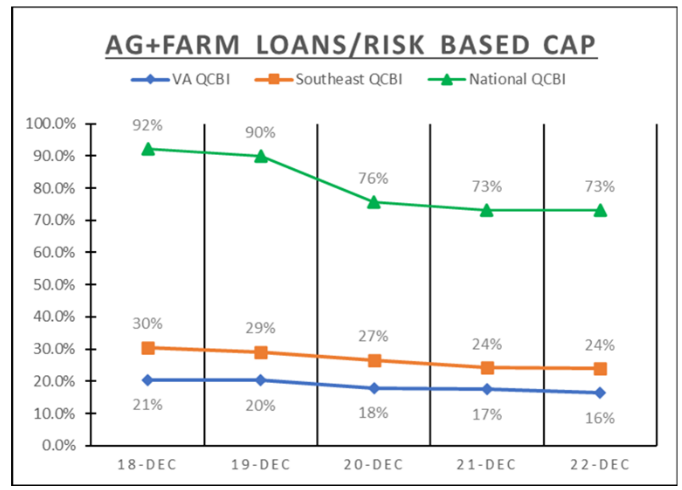
Other Concentrations: Banks <$10B

VA <$10B / Southeast <$10B / National <$10B







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Q4 '22 Call Report Data*

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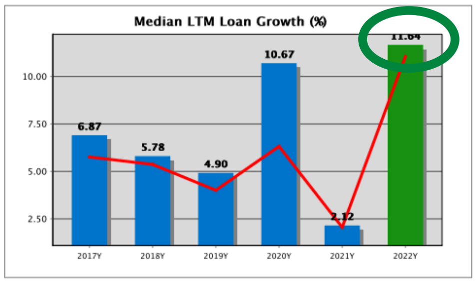
VA Loan Growth Trends: Banks <$10B

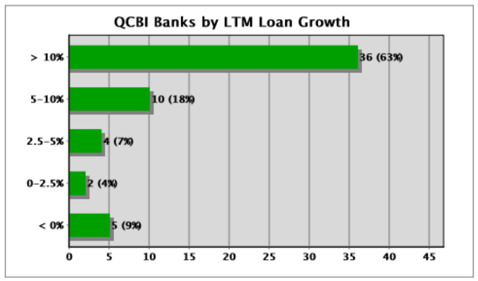
Q4 '22 Call Report Data

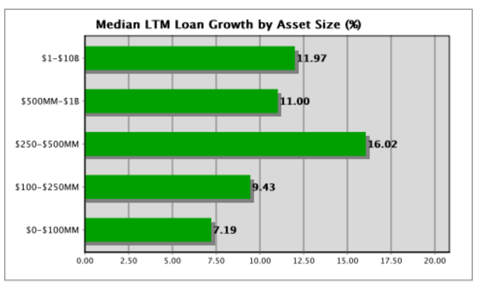
QwickAnalytics State Performance Trends

Loan Growth Trends

Virginia
Banks
December 31, 2022







National Trend

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

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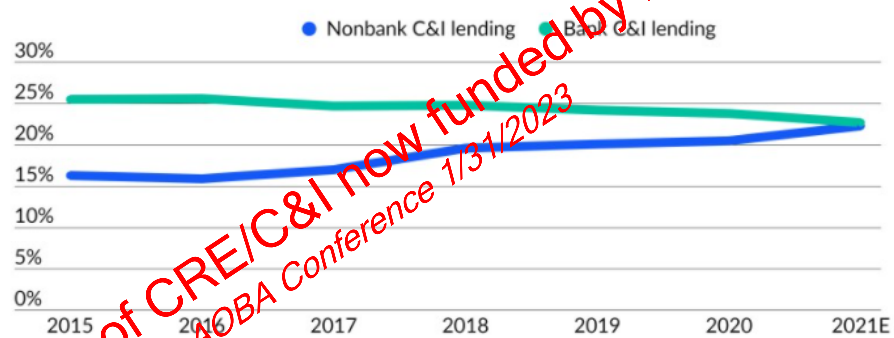
Banks losing ground to nonbanks
--American Banker article 10-4-2021

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



Source: Autonomous Research

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

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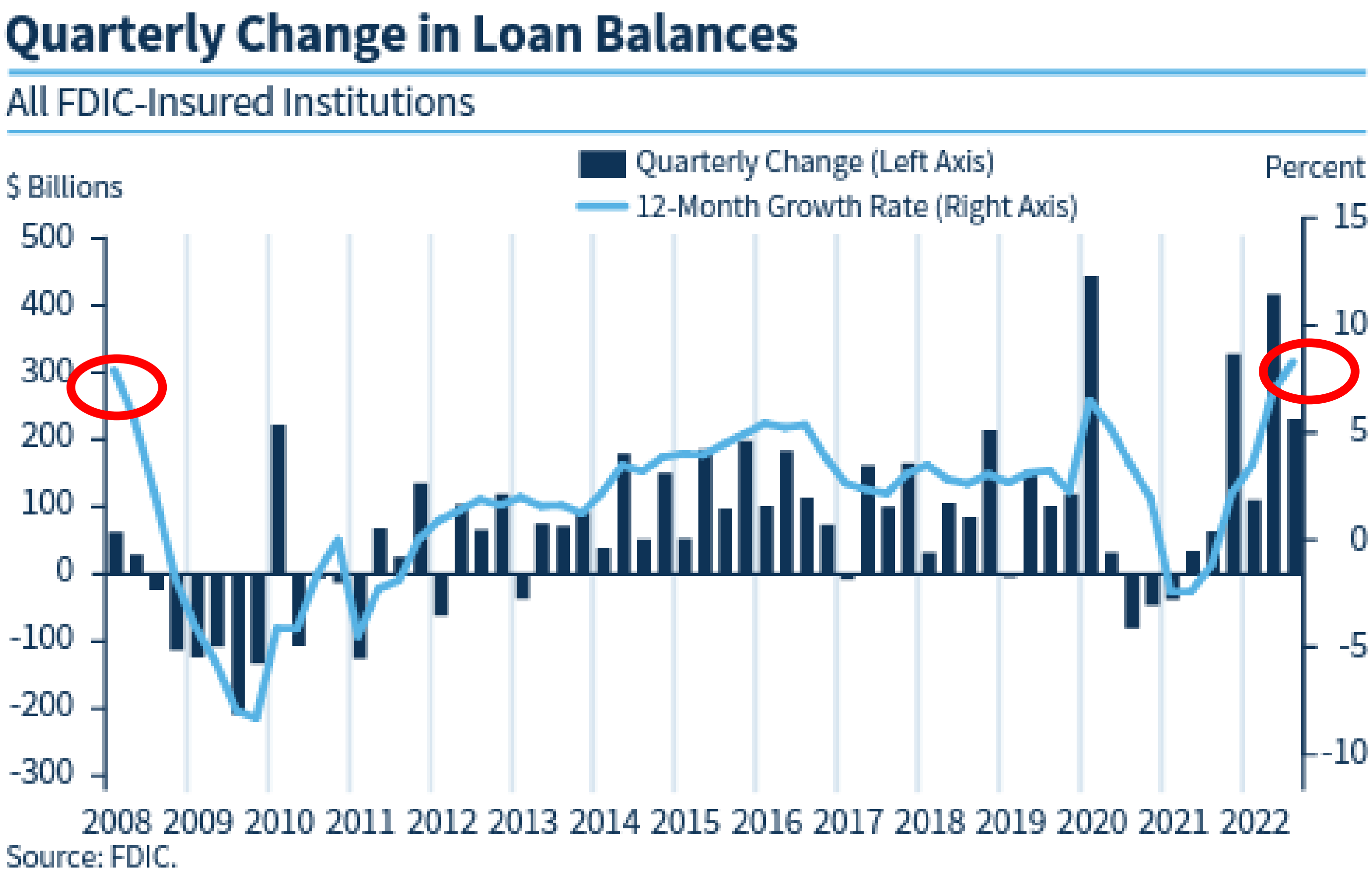
National Loan Growth Trends: All Banks



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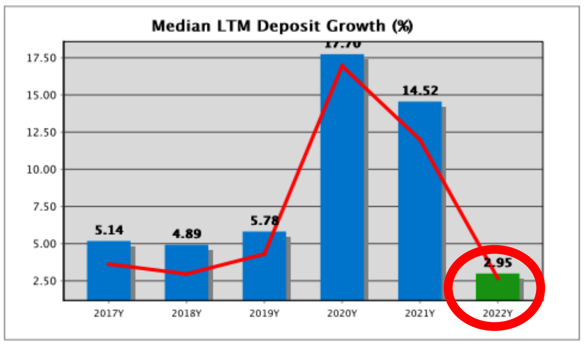
VA Deposit Growth Trends: Banks <$10B

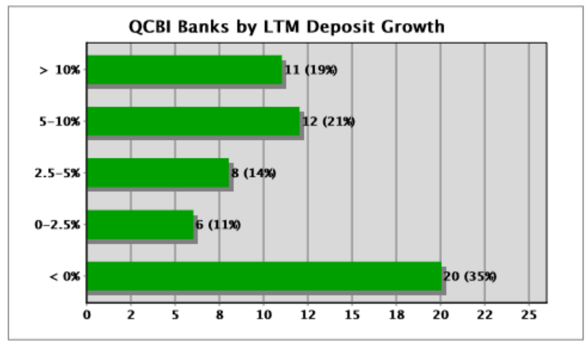
QwickAnalytics State Performance Trends

Deposit Growth Trends

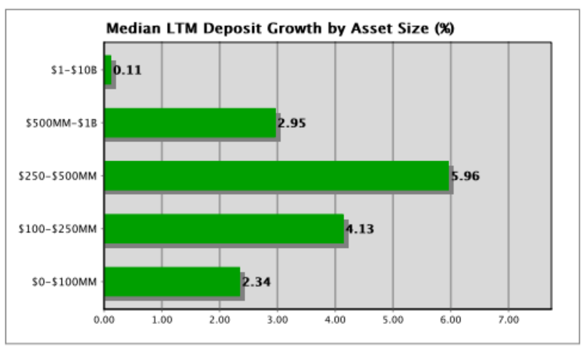
Virginia Banks

December 31, 2022





Q4 '22 Call Report Data



— *National Trend*

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

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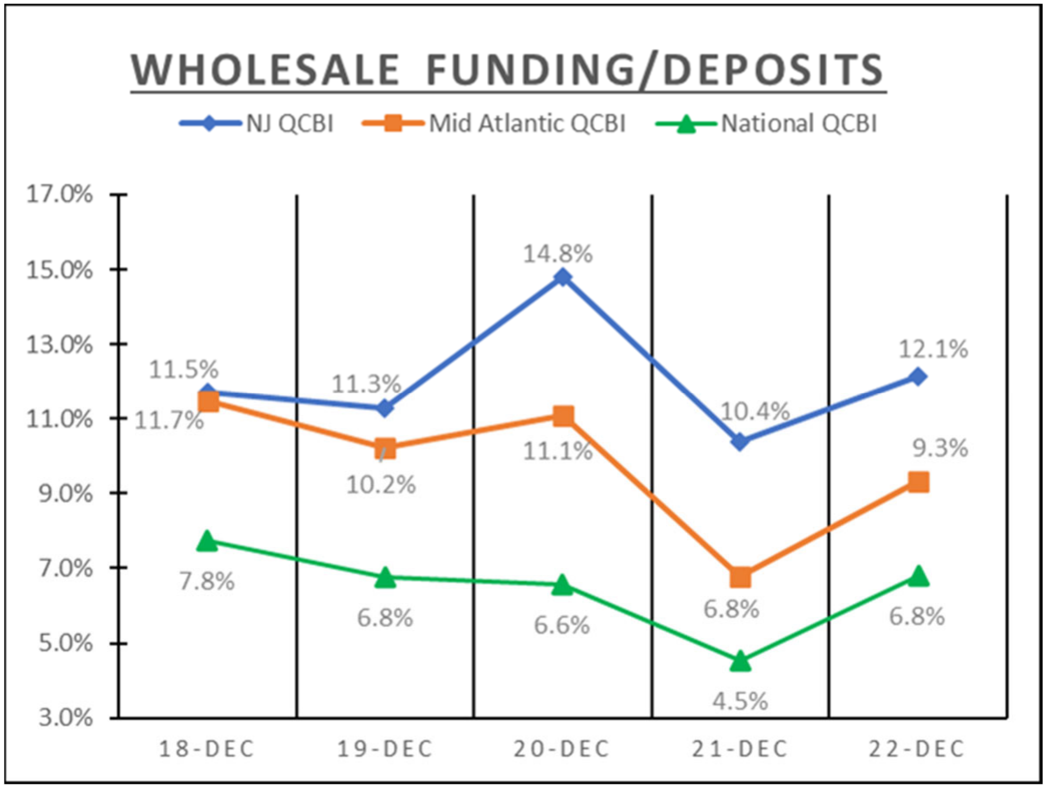
Wholesale Funding: Banks <$10B



Q4 '22 Call Report Data

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NJ <$10B / MidAtlantic <$10B / National <$10B

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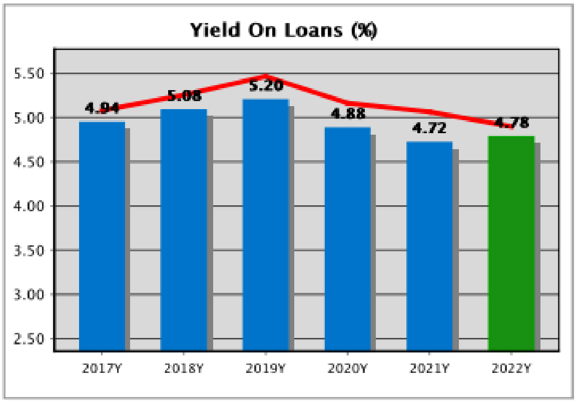
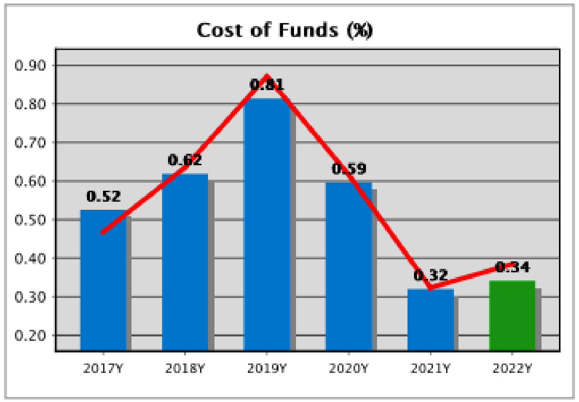
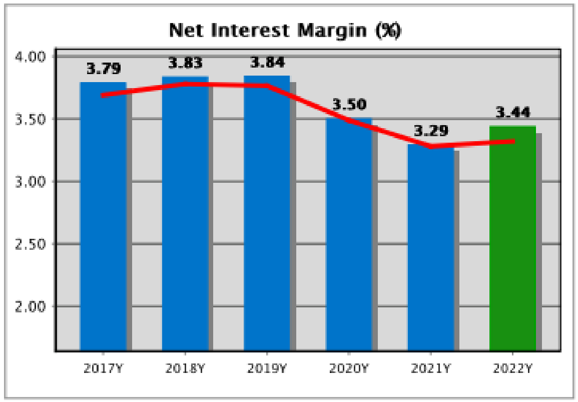
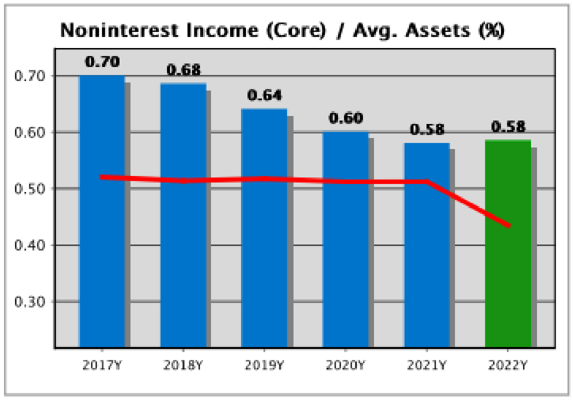
VA Performance Trends

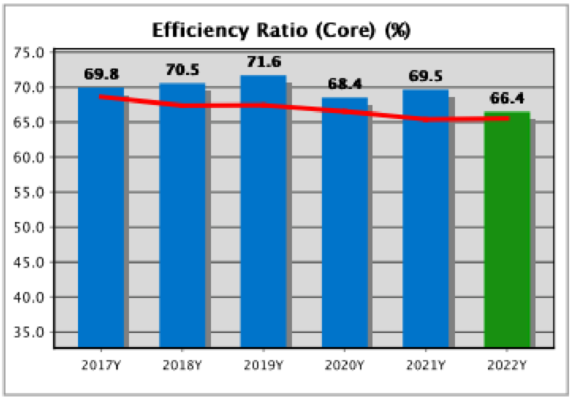
Mostly Stronger than National Averages











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Reasons For Concern

Credit Cycles Over The Last 50 Years Hold A Pattern

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

1970's – Stagflation

- US off gold standard
- Two Arab oil embargoes
- Vietnam/Watergate malaise

1980's – High Rates / Tax Cuts

- 21% prime rate
- Mid-decade boom
- Trickle-down economics
- S&L Crisis emerges

1990's – RTC / Recession / Boom

- '80's hangover recession
- Interstate banking
- Balanced budget by end of decade

2000's – Dotcom Bust / 9-11 / Great Recession

- Roller coaster economics
- "Irrational exuberance"
- Mortgage / housing crisis

2010's – Recovery / Low Rates

- Bank failures slow
- Monetary policy (quantitative easing)
- Fiscal policy disfunction

2020's – COVID-19 / Government Stimulus / Inflation / ⇧ Rates

- Pandemic largess becoming a hangover
- Supply chain disruptions
- Russia/Ukraine war

Current Credit Observations (General)

The COVID "sugar high" has turned sour (inflation / rates).

Inflation and rates slowing the economy.

Recent bank failures have spooked markets, regulators.

Chasing loan growth now may be risky.

Much exotic credit risk moved to non-bank lenders last decade.

Loan Pricing: managing to *your* margins.

Current Credit Observations (General) cont'd

Benign credit quality metrics almost certainly cannot last.

Post-booking credit servicing is struggling.

Term RE payments showing impacts of rate increases.

Fear of regulatory / investor overreaction.

Current Credit Concerns (Specific to Due Diligence* / Loan Reviews)

Large recent run-ups in loan growth, generally.

Disparities in risk grade distributions.

Sub-par post-booking credit servicing.

Specialty / exotic lending without equivalent risk protocols.

Disproportionate exposure to consumer-purpose lending.

Over-reliance on LTV's (collateral) v. DSC's (cashflow).

*Portfolio *yield* marks more attention than *credit* marks in '22.

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Current Credit* Concerns (By Industry)

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

Moderate Risk: CRE Hospitality / Specialty Lending

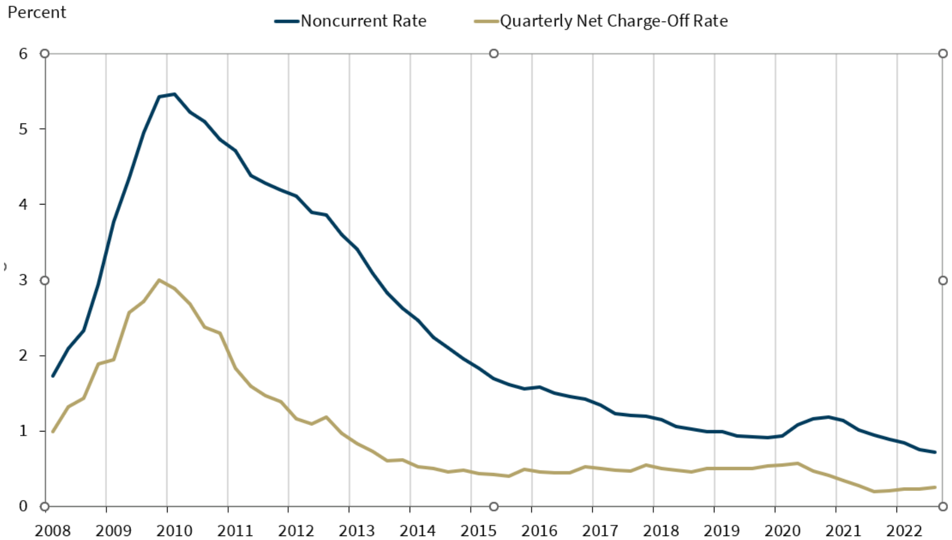
Lowest Risk: Agriculture

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

***Susceptible Consumer*

Source of the Complacency

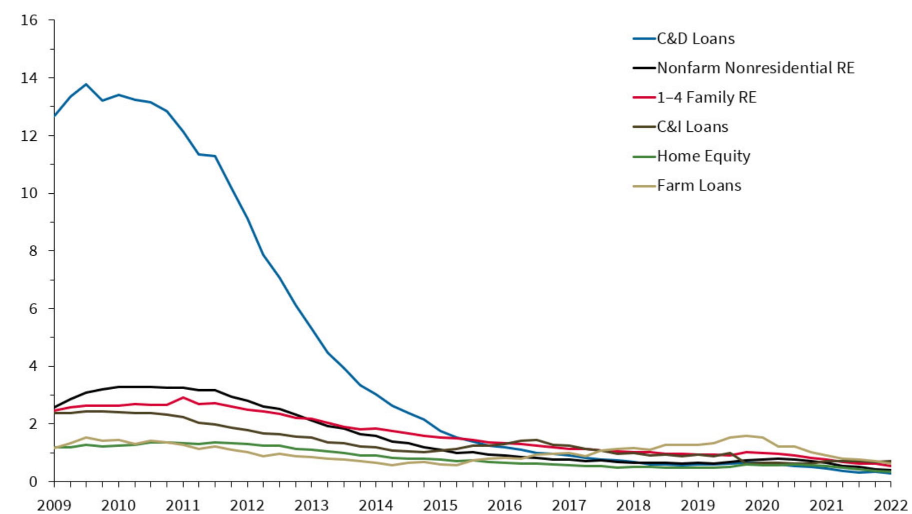
Noncurrent Loan Rate and Quarterly Net Charge-Off Rate



Source: FDIC.

Noncurrent Loan Rates for FDIC-Insured Community Banks

Share of Loan Portfolio Noncurrent
Percent



Source: FDIC.

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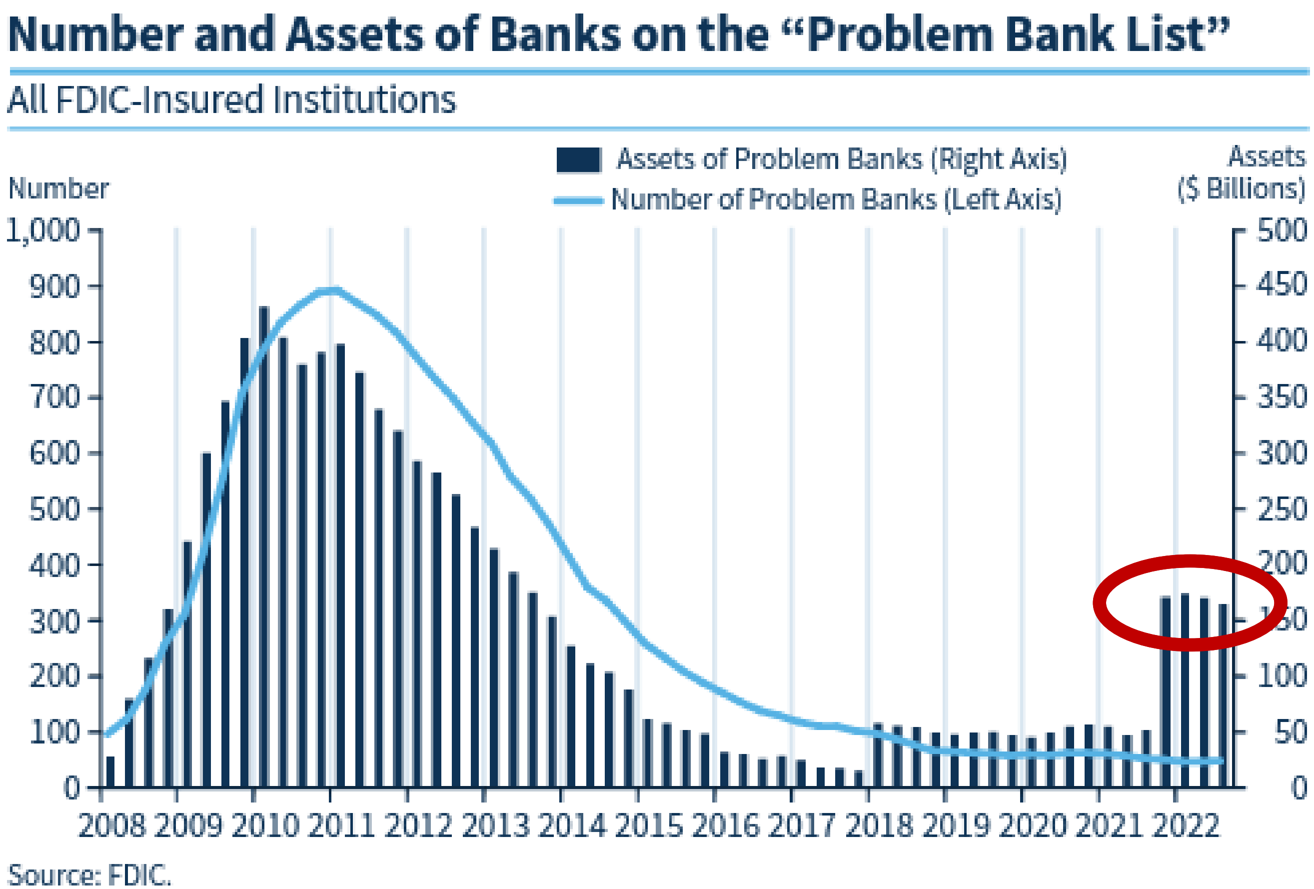
Early Signs of Stress…



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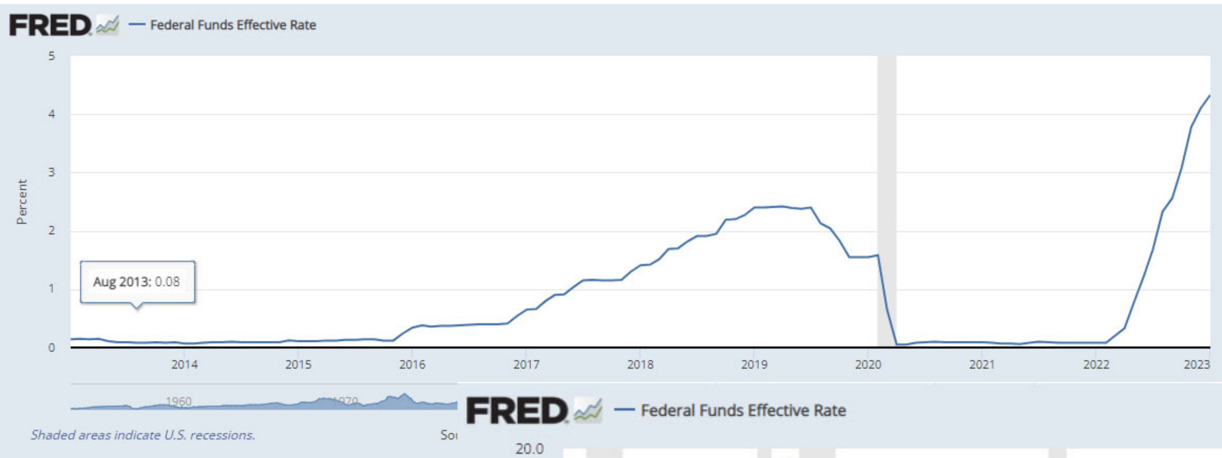
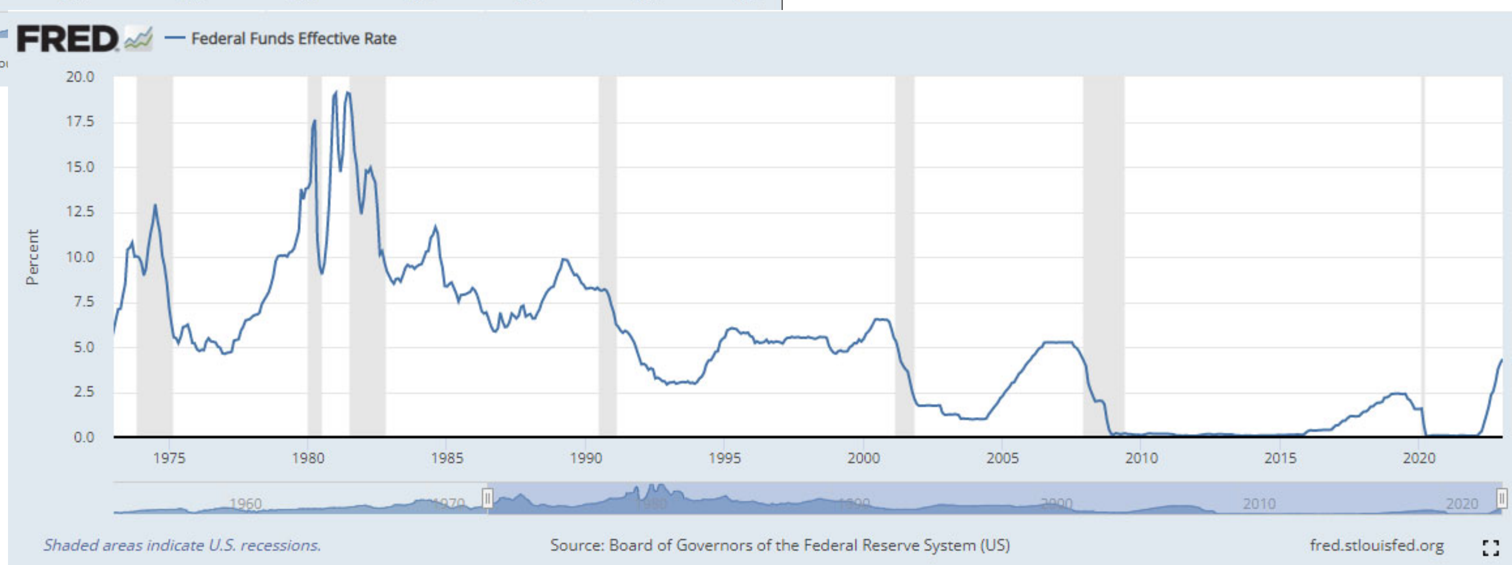
Fed Funds Rate (Last 10 years / Last 50 years)



Last 10 Years



Last 50 Years

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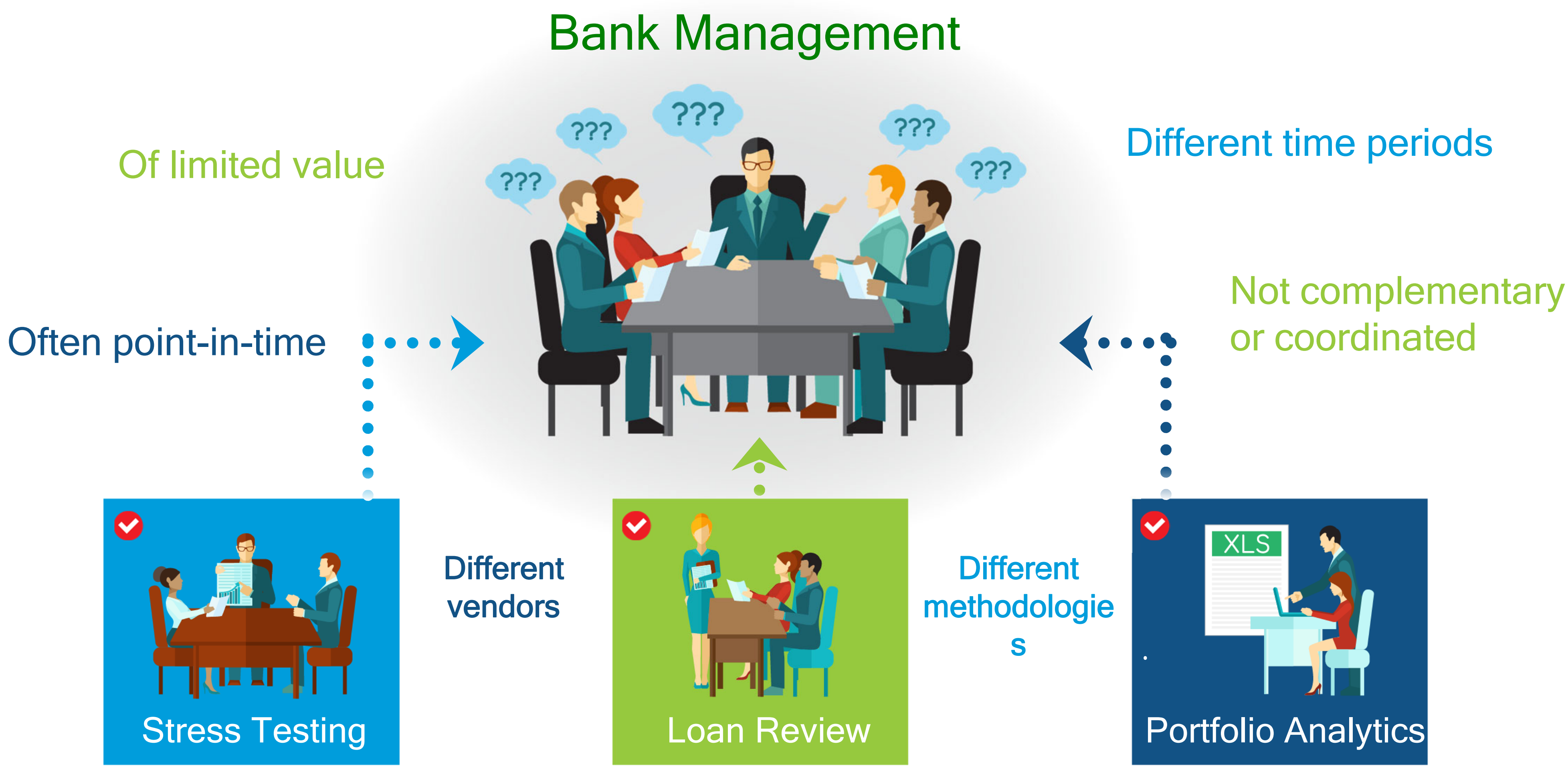
Moving from *Typical* to *More Optimal* Credit Risk Management

Typical, Non-synced, Credit Management Input



Optimal, Coordinated, Credit Management Input

Bank Management

Informed, Educated Decision Making

Shared methodologies and corporate values

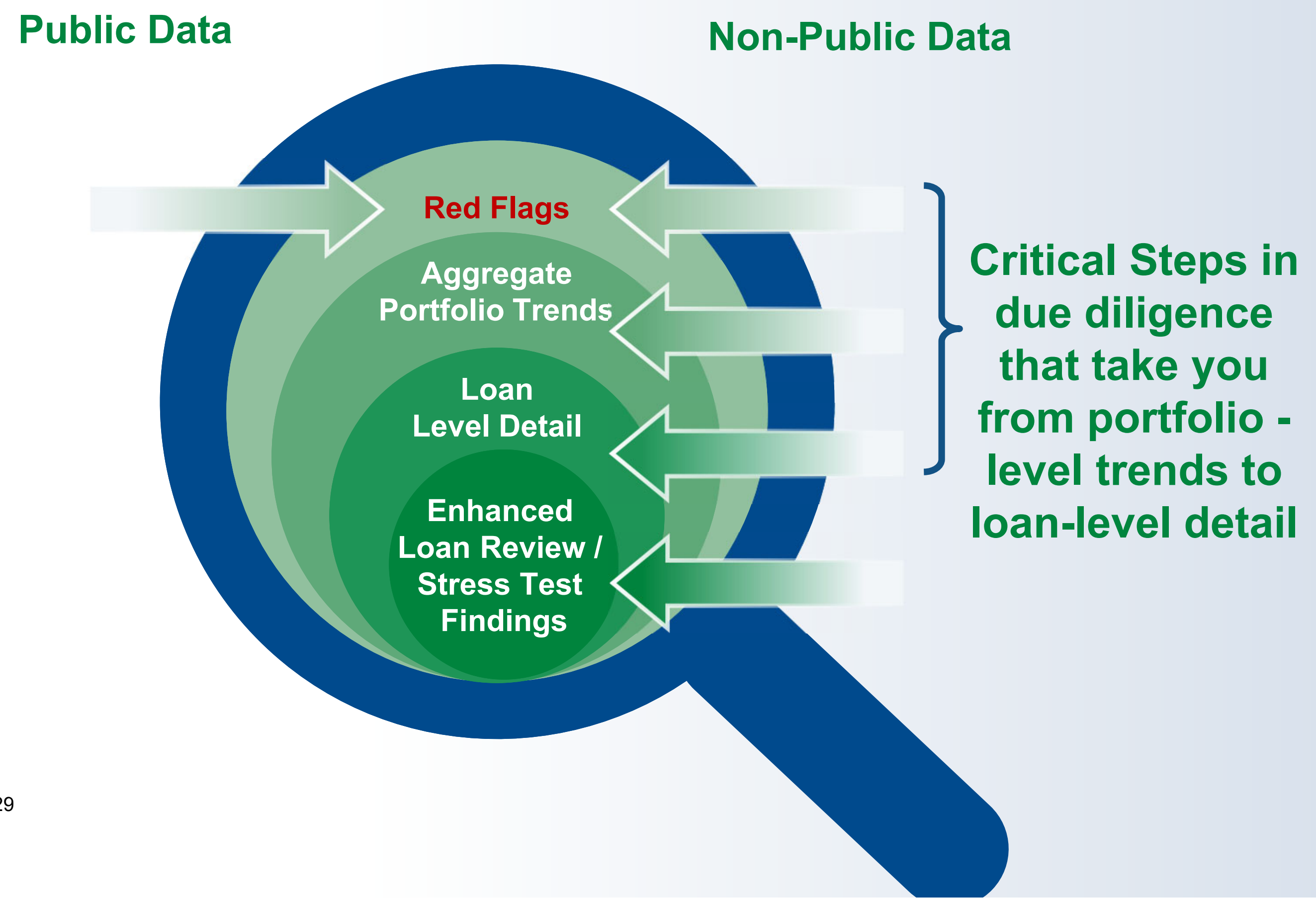
Of optimal value

Prescriptive of risk appetite

Ongoing and interactive

Complementary and coordinated

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



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.

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Loan Review: *Emphasize Experience*

Credit Analysis / Decisioning / Review Pyramid

- Utilize reviewers that have *been there / done that*
- The power of *persuasion*
- Require bios during RFP process

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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

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

Goal: Write your own credit quality script!

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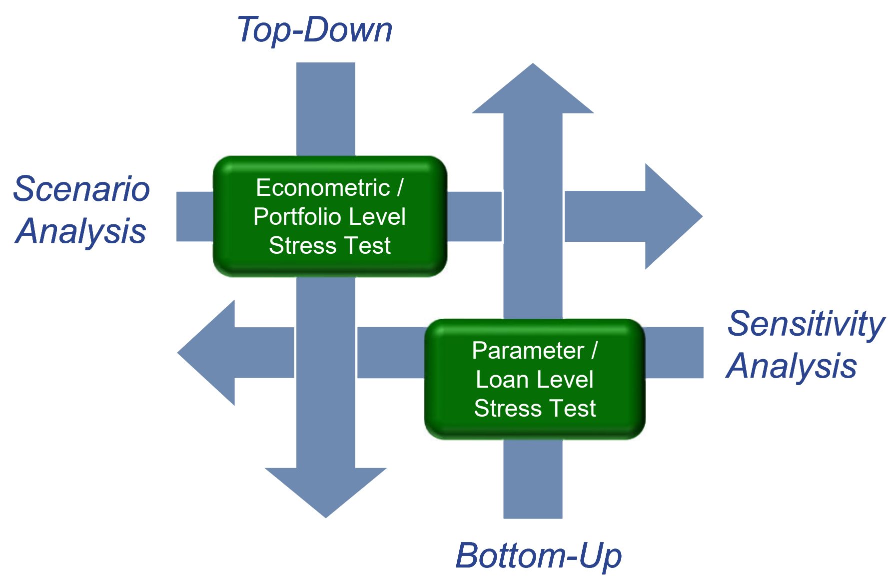
Stress Test: Companion With Loan Review

- 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

Debt-Service Coverage	CRE Loan-To-Value 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

Debt-Service Coverage	CRE Loan-To-Value 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.

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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Q & A