WEBINARS

Thursday, August 6 @ 11:00 AM

Risk Levels & Bank Behavior During COVID-19

FEATURING

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Key Questions

1. How has the U.S. economy been affected so far?
2. How has the U.S. banking industry been affected?
3. How have commercial banks responded to the shift in conditions?
4. What are some ways banks can better mitigate the risk they're facing?

Methodology

- The data presented in this webinar is focused on the period from **March to June 2020** – from the time when COVID-19 first began to impact the U.S. economy, through to the end of the second quarter

- Primary data source: **PrecisionLender's proprietary database**, covering **active opportunities** plus **actual commercial relationships** (loans, deposits and other fee-based business) from **over 150 banks** in the U.S.; supplemented with **public data sources**

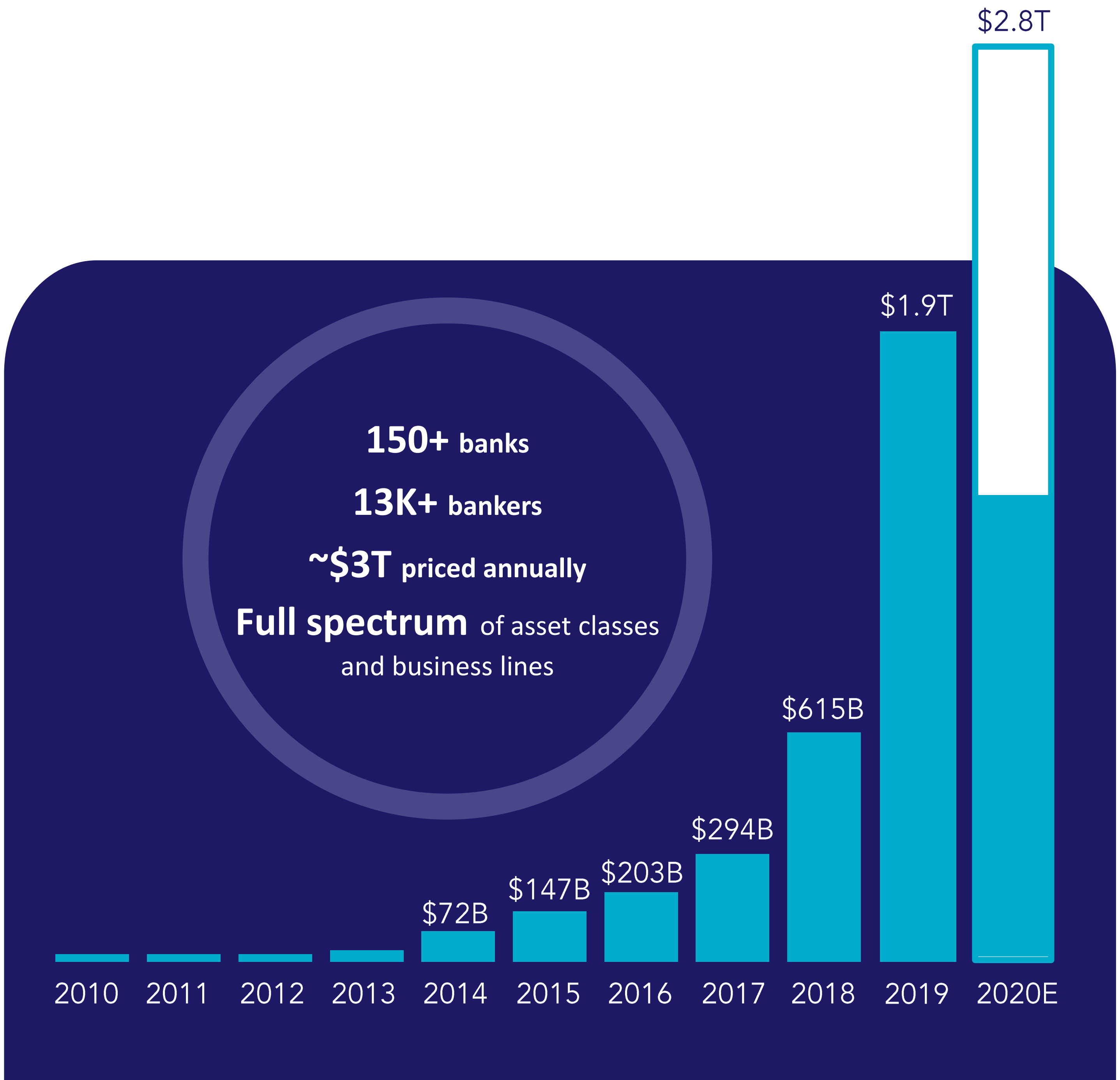
- The banks in this data set are **geographically diverse** and range in size from **community banks** to **top 10 U.S. institutions**

- In order to provide an apples-to-apples comparison across banks, PrecisionLender has **aligned the risk rating systems** of all banks to a common scale based on Probability of Default, and has also build concordances **across products**

Methodology – Data Set

Booked Deals & Pipeline

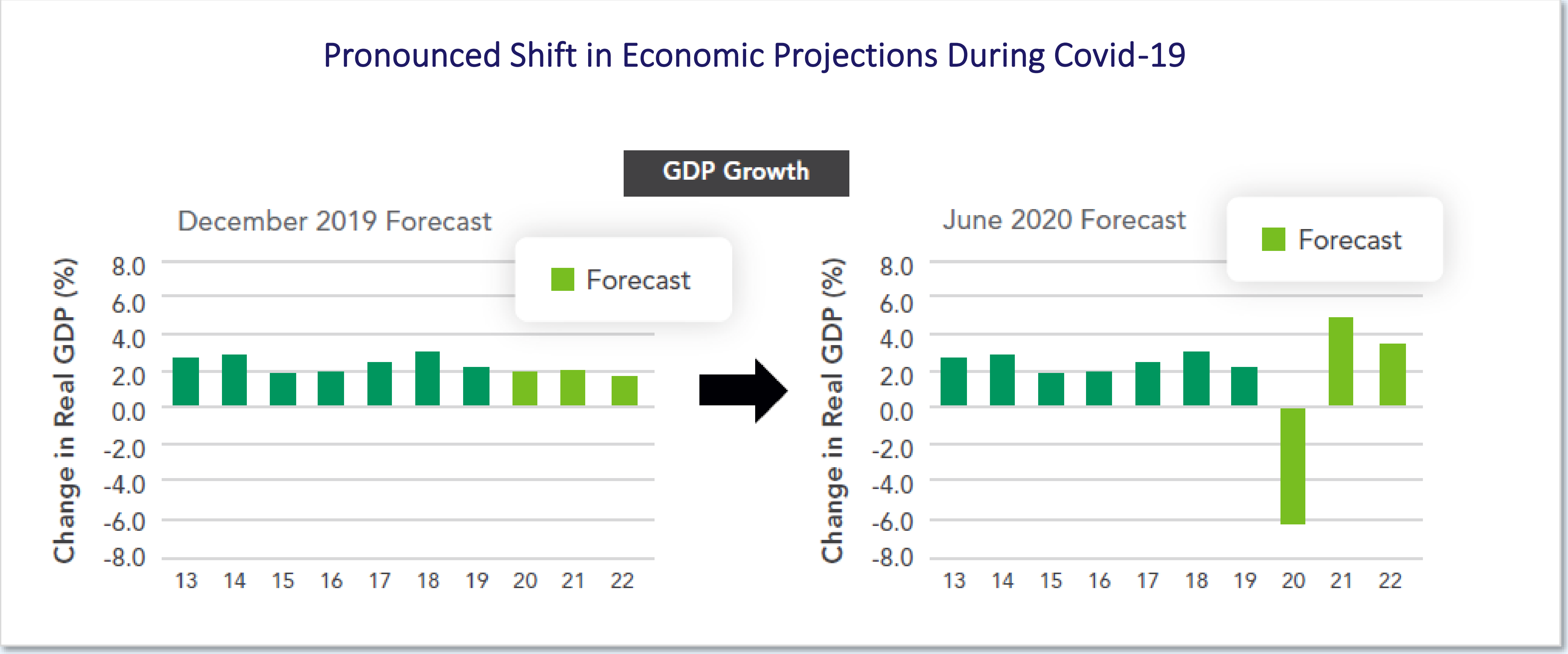
- 10+ years of U.S. data
- 150+ unique banks
- Run rate of $2.8 trillion priced in 2020
- Over 15% (and growing) of the commercial loan market
- Deals in all 50 states, covering a wide range of industries and borrower sizes



Summary Points

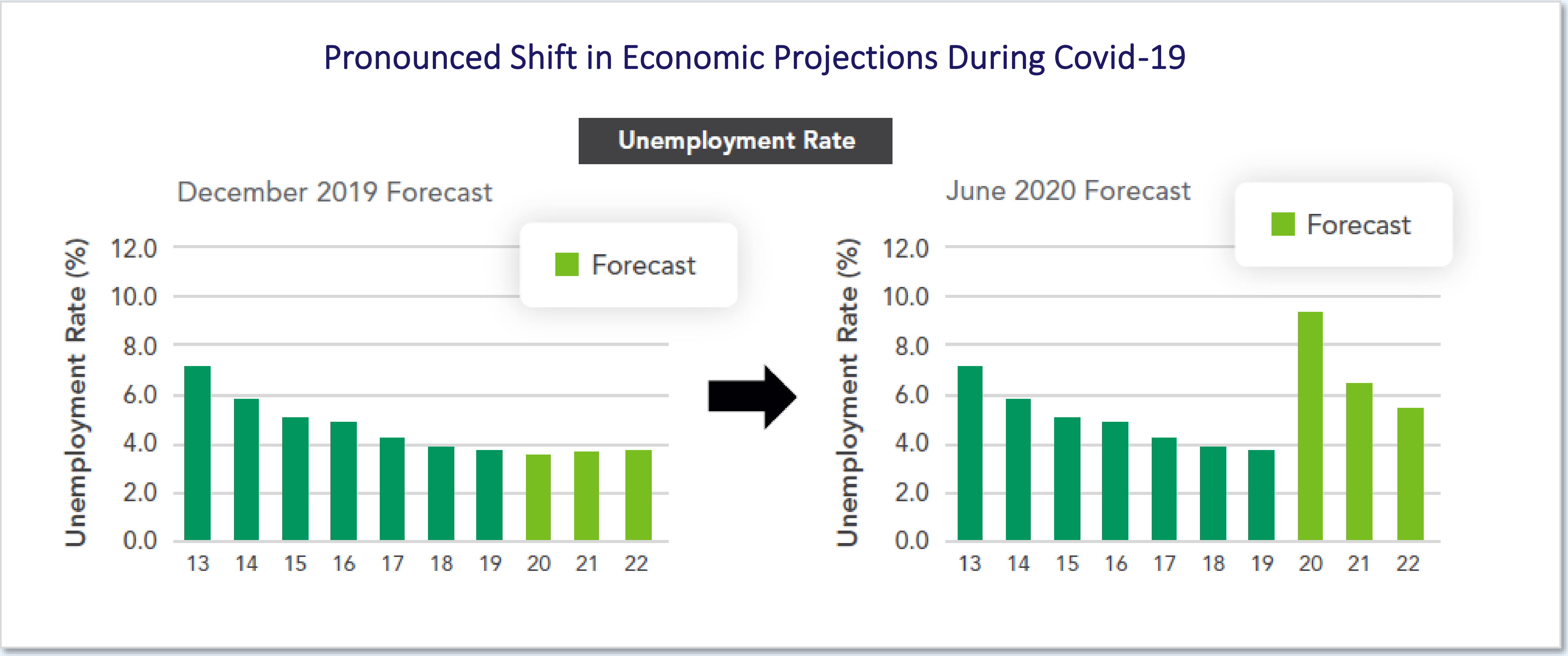
1. Credit risk now at the forefront of commercial banks’ focus
2. Early signs of risk deterioration exist
3. Evidence of credit stress in line usage and deposit balances
4. Sea change in market sentiment around credit structure and pricing
5. Banks can employ numerous tactics to maximize risk-adjusted returns

Shifting Forecasts



*Source: Federal Reserve.

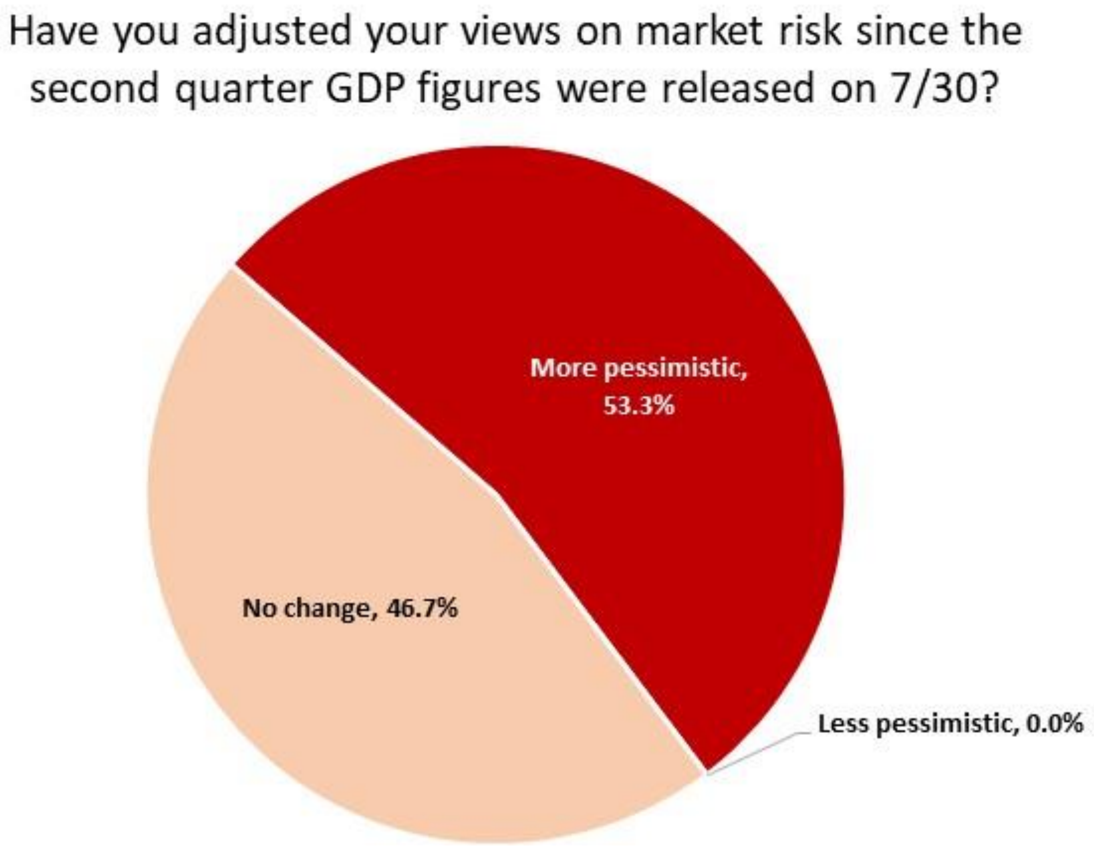
Shifting Forecasts



*Source: Federal Reserve.

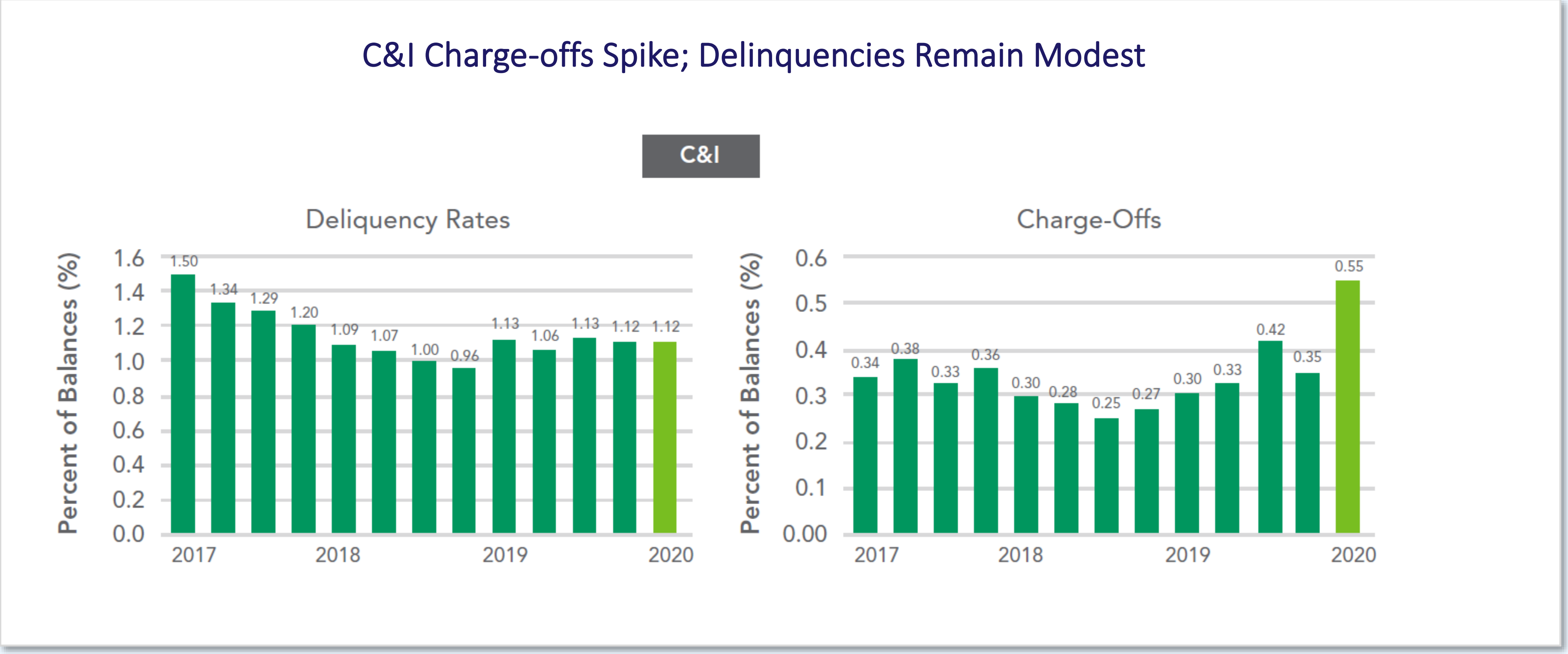
PrecisionLender Survey: Market Sentiment

Increased pessimism following Q2 GDP release



*Source: PrecisionLender. Survey conducted August 2020.

Mixed Signals in Q1 2020 Charge-Offs and Delinquencies



*Source: Federal Reserve. Figures are seasonally-adjusted and reflect all U.S. commercial banks.

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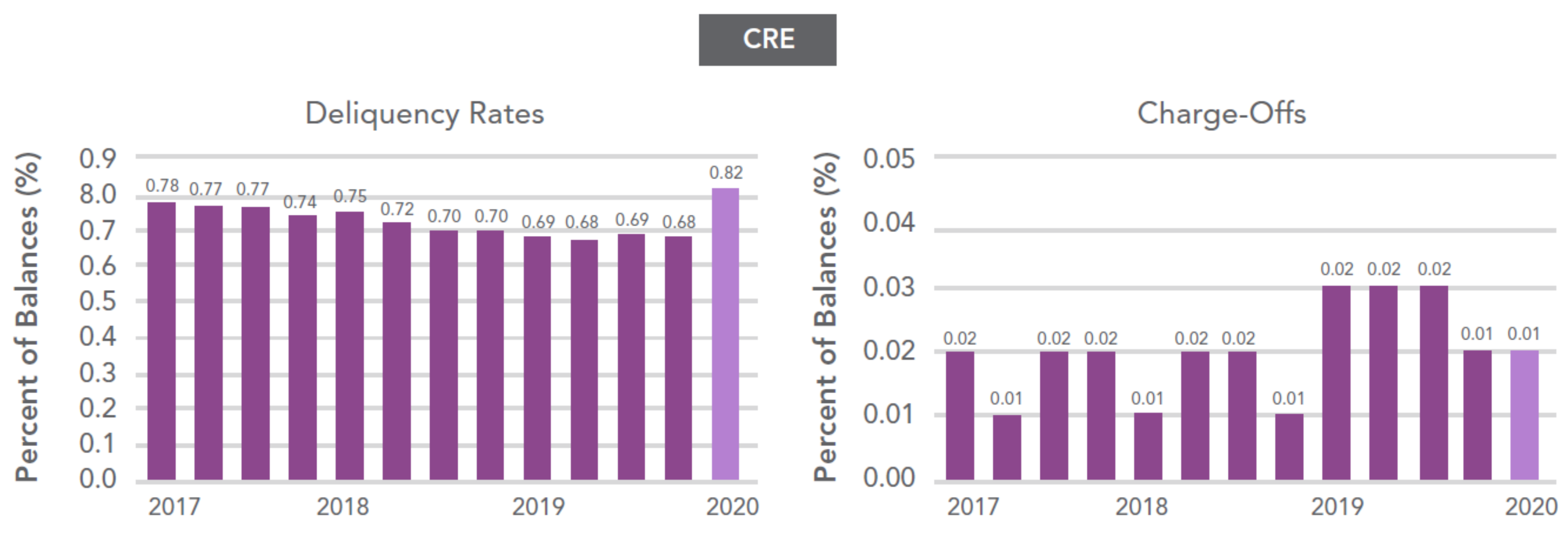
Mixed Signals in Q1 2020 Charge-Offs and Delinquencies

CRE Charge-offs Minimal; Delinquencies Trend Higher



*Source: Federal Reserve. Figures are seasonally-adjusted and reflect all U.S. commercial banks.

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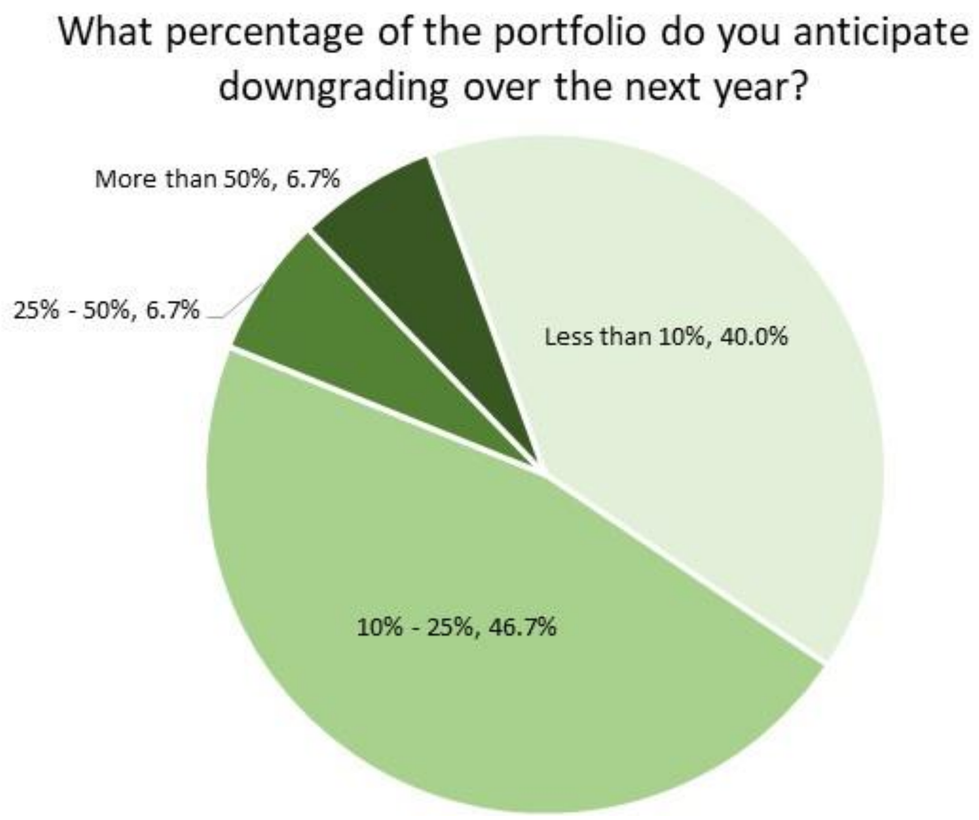
Rating Downgrades: Early COVID Survey

At outset of renewal season, bankers expected 10-25% downgrades

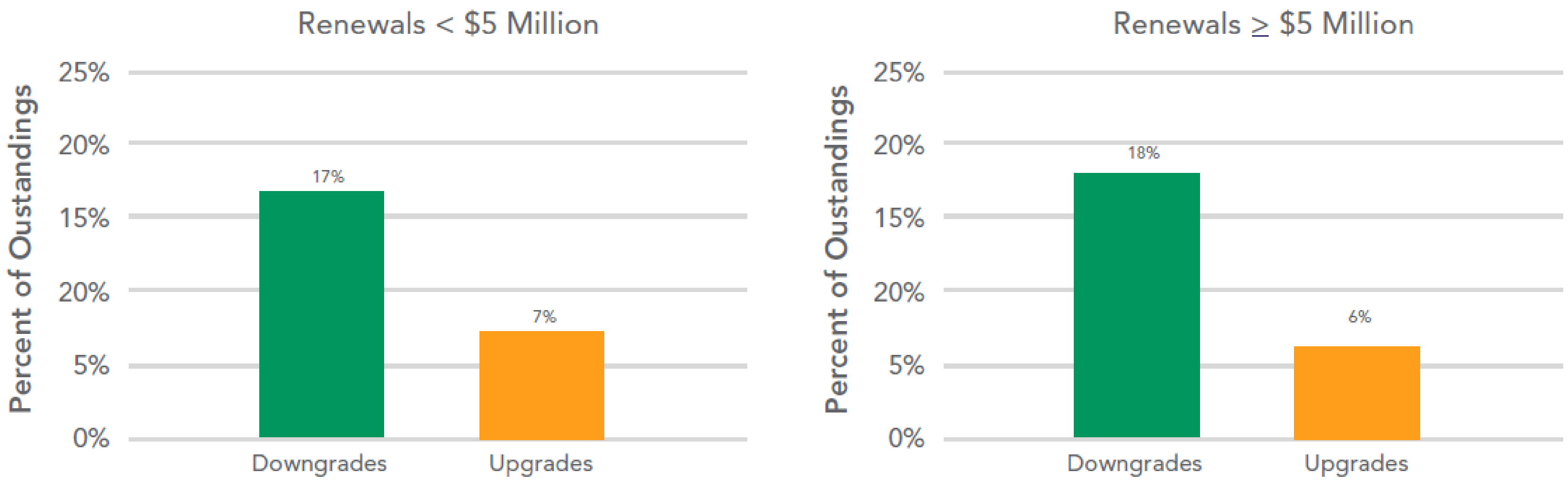


*Source: PrecisionLender. Survey conducted mid-April 2020.

Downgrades Outpace Upgrades on Q2 2020 Renewals

Up to 3x more downgrades relative to upgrades in second quarter

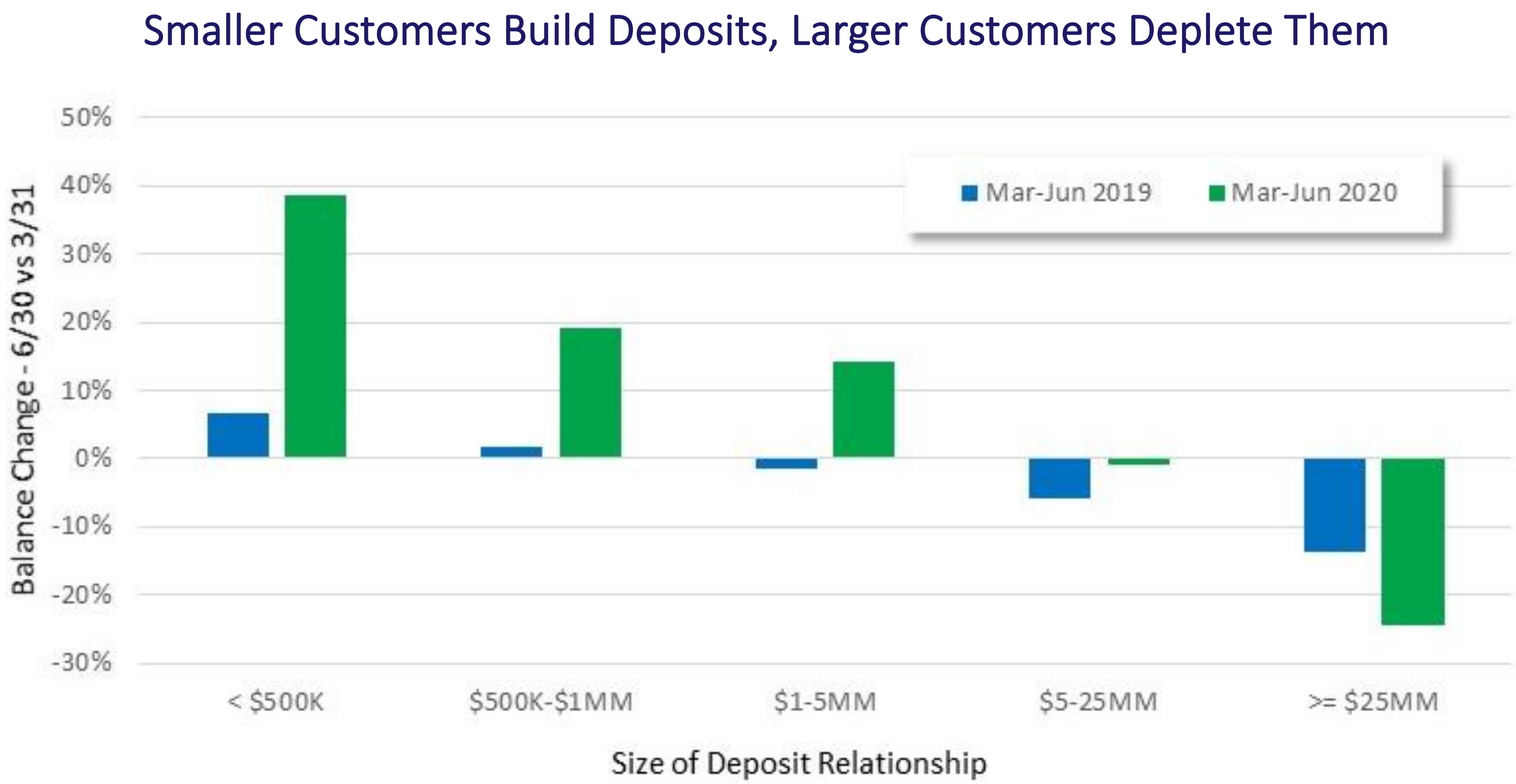
Renewals: Q2 2020



*Source: PrecisionLender. Analysis reflects credits which renewed from April to June 2020 and compares the internally assigned bank risk ratings with pre-renewal levels.

Early Warning Signals: Commercial Deposit Balances

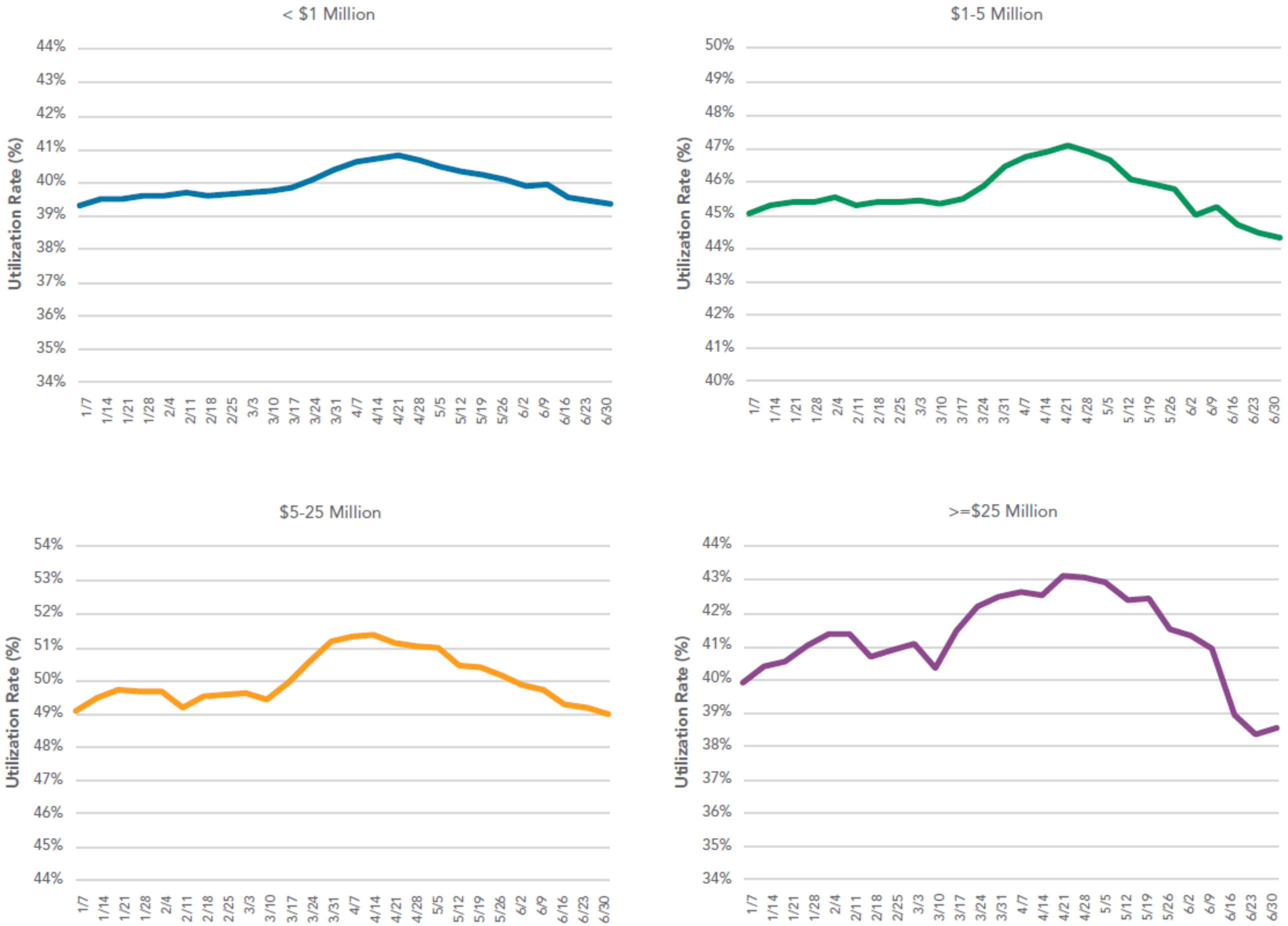
Dichotomy in Balance Changes by Customer Size



*Source: PrecisionLender. Analysis shows change in average commercial deposit balances across all deposit products from 3/31/2019 to 6/30/2019 and from 3/31/2020 to 6/30/2020, for a cohort group of customers who existed in PrecisionLender's data set throughout the period. Customers were grouped into the respective deposit categories based on balances at the outset of the period.

Early Warning Signals: LOC Usage

LOC Usage by Amount



*Source: PrecisionLender. Analysis reflect average utilization rate on lines of credit in the indicated size range, for a cohort group which existed throughout the period shown.

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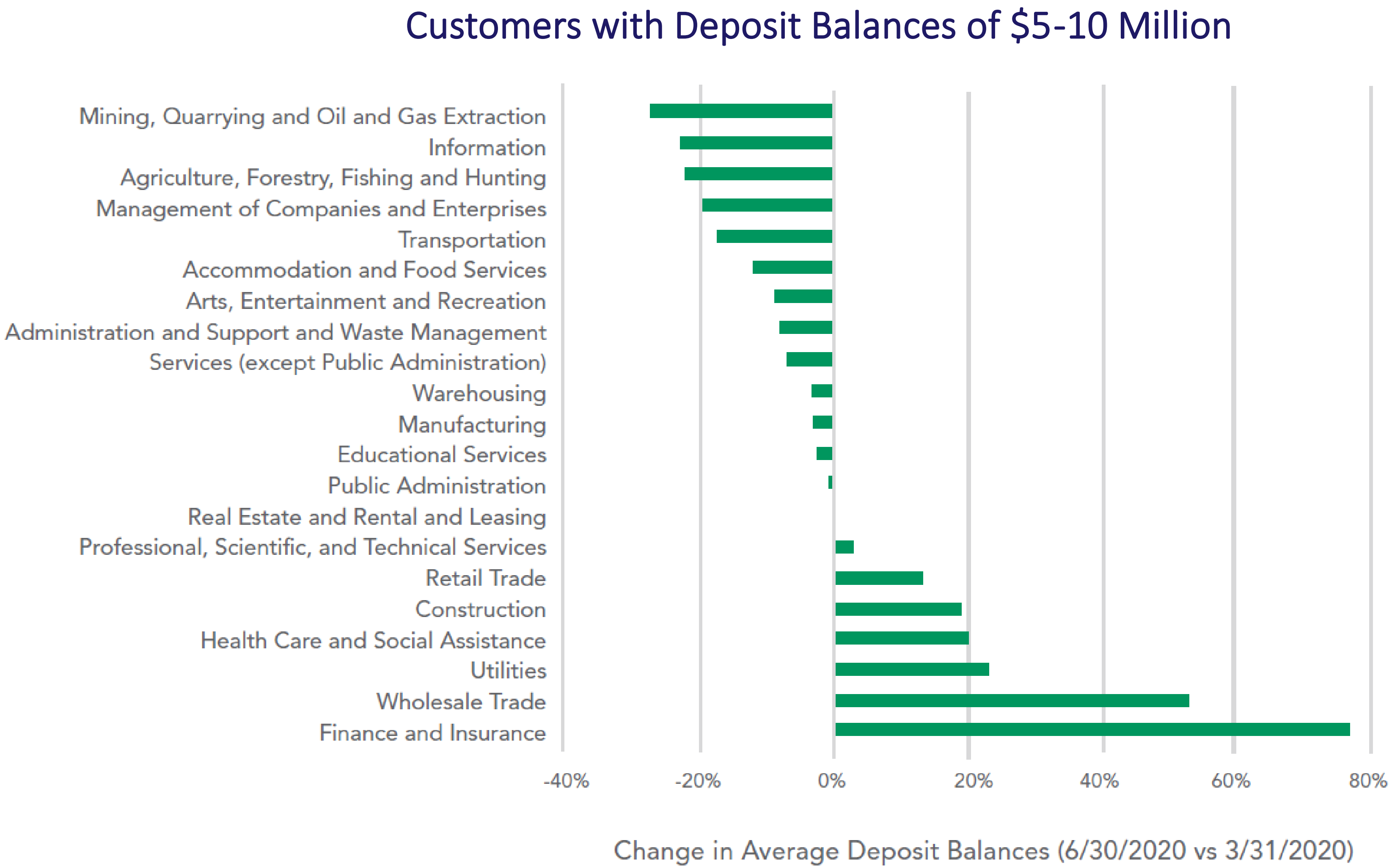
Pandemic Deposit Trends, by Industry



*Source: PrecisionLender. Analysis shows change in average commercial deposit balances across all deposit products, for a cohort group of customers whose aggregate deposit balances at the outset of the period ranged from $5-10 million.

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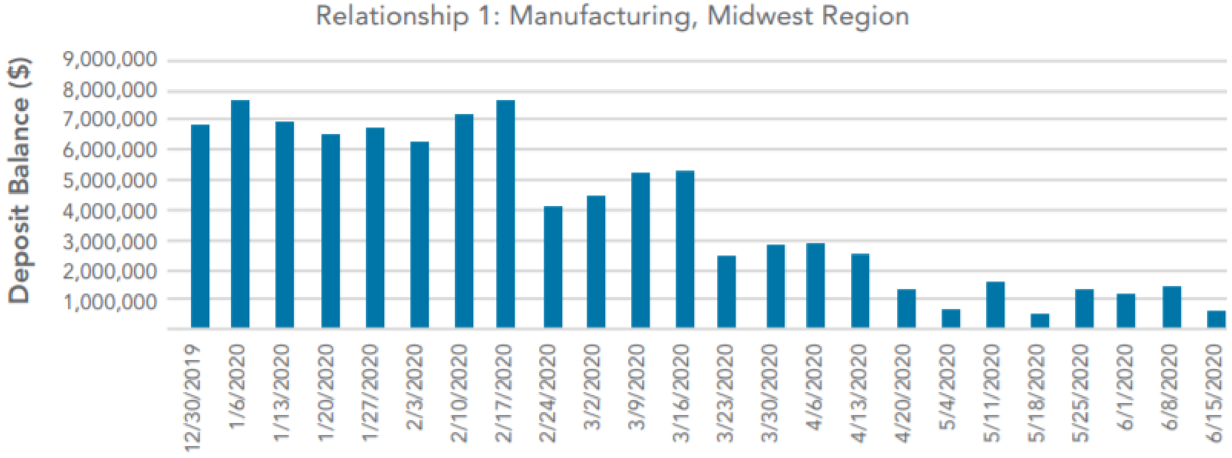
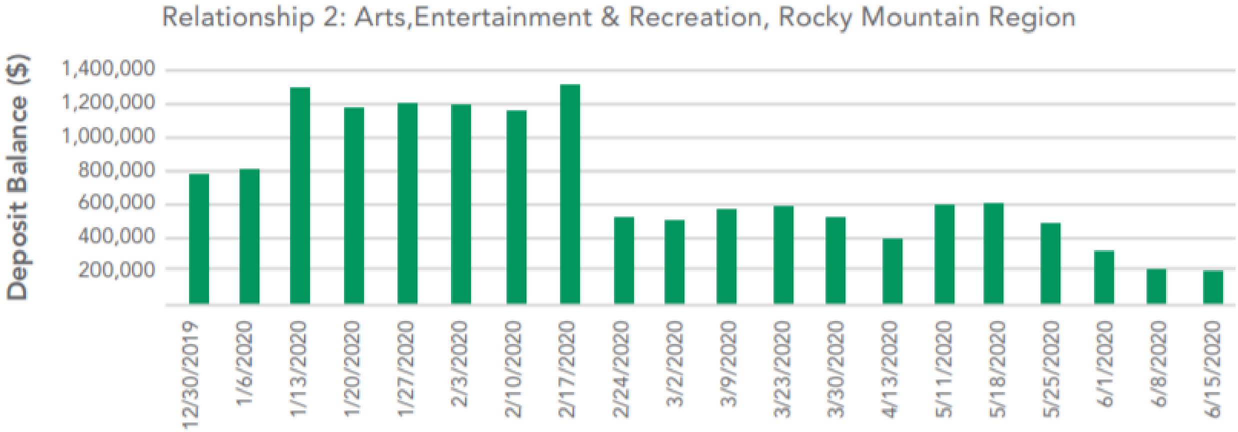
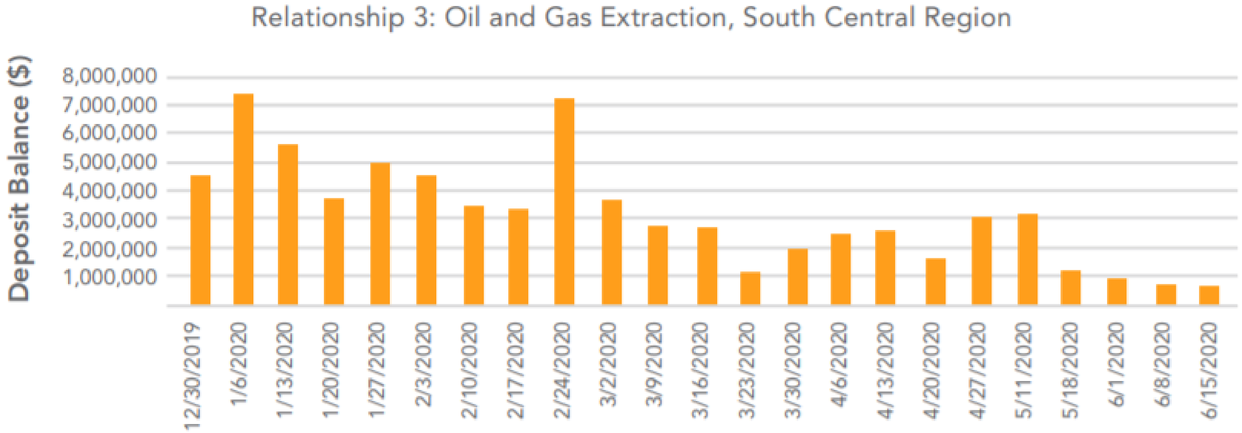
Depleted Deposits: Customer Cases

Declining Deposit Balances During Pandemic



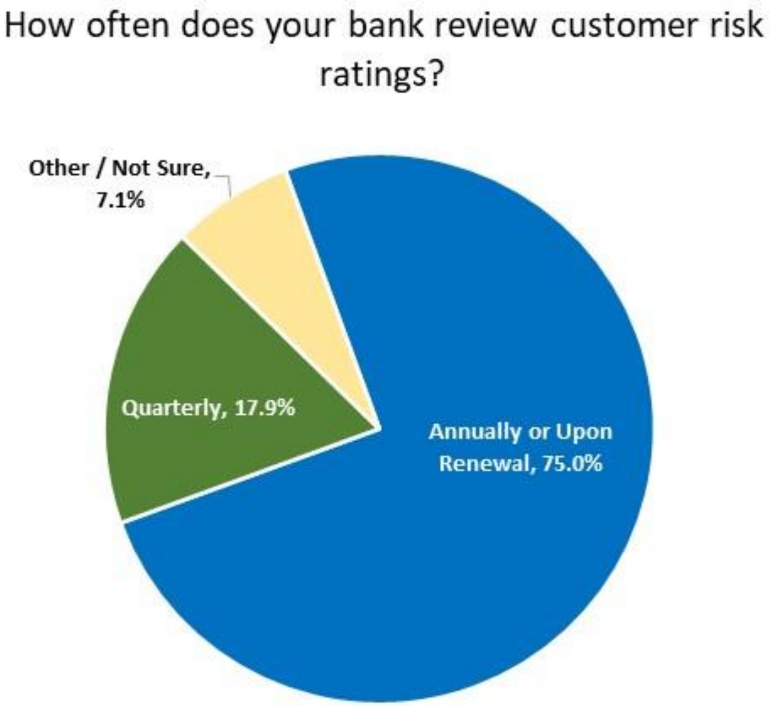


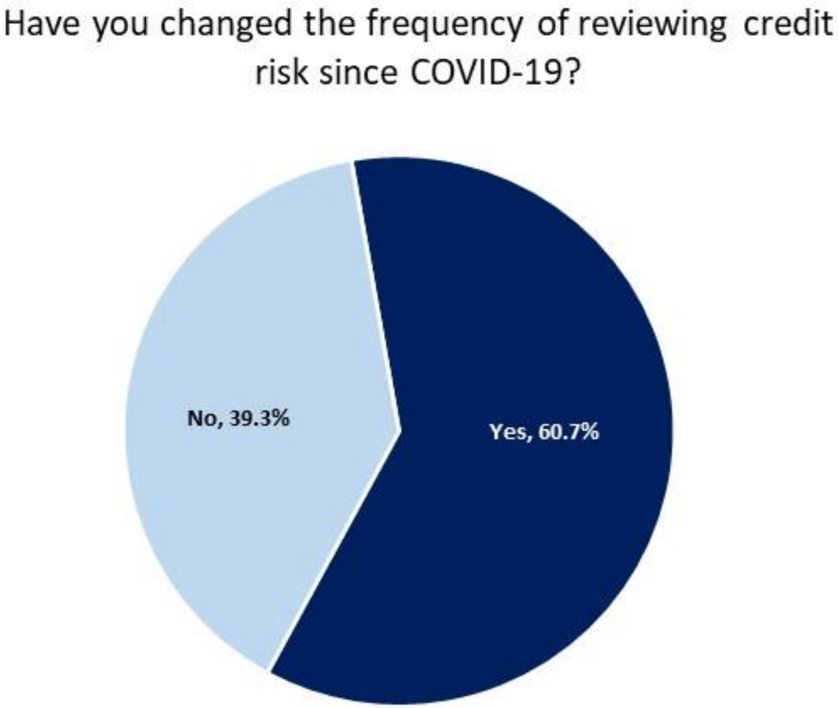


*Source: PrecisionLender. Analysis reflect selected customers who experienced notable shifts in aggregate deposit balances across all deposit products.

PrecisionLender Survey: Reviewing Risk Grades

Risk ratings still reviewed annually or upon renewal

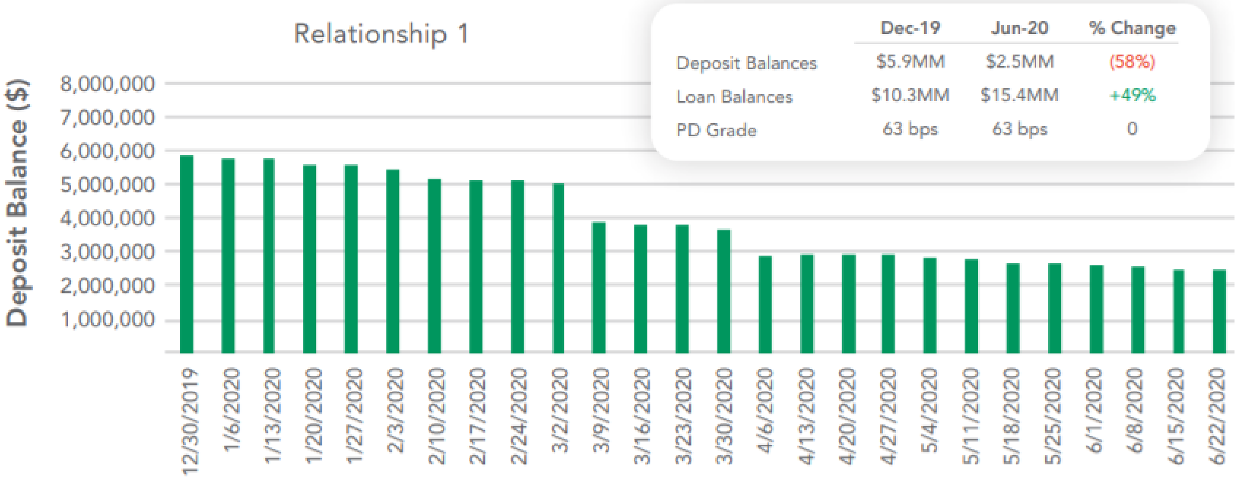




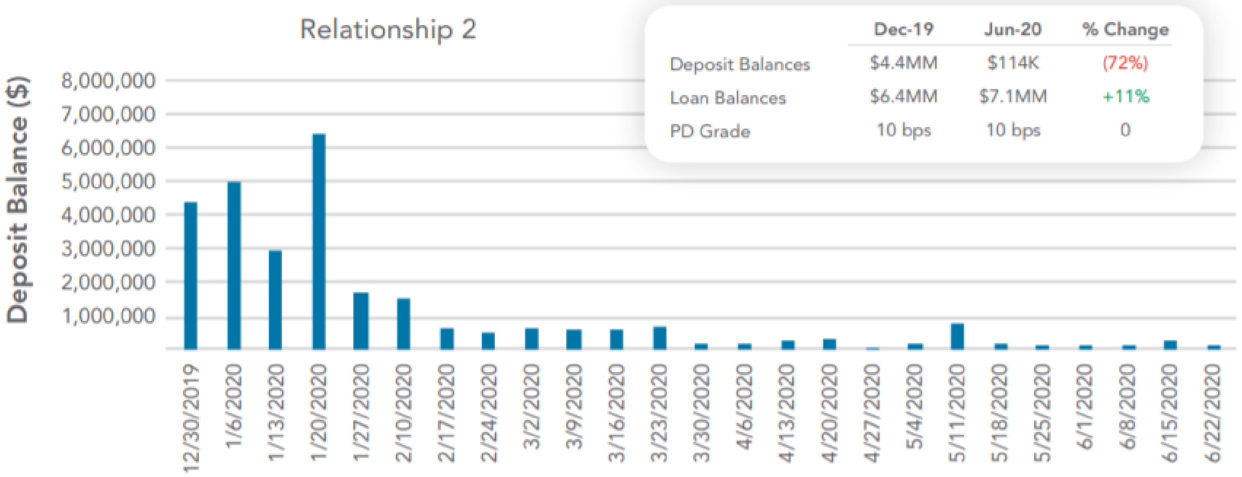
*Source: PrecisionLender. Survey conducted August 2020.

Slow to Downgrade Risk Ratings

Deposit Balances Dropping and Loan Usage Rising, but PD Grade Unchanged



	Dec-19	Jun-20	% Change
Deposit Balances	$5.9MM	$2.5MM	(58%)
Loan Balances	$10.3MM	$15.4MM	+49%
PD Grade	63 bps	63 bps	0



	Dec-19	Jun-20	% Change
Deposit Balances	$4.4MM	$114K	(72%)
Loan Balances	$6.4MM	$7.1MM	+11%
PD Grade	10 bps	10 bps	0

*Source: PrecisionLender. Analysis reflect selected customers who experienced notable shifts in aggregate deposit balances across all deposit products, and who also had loans outstanding.

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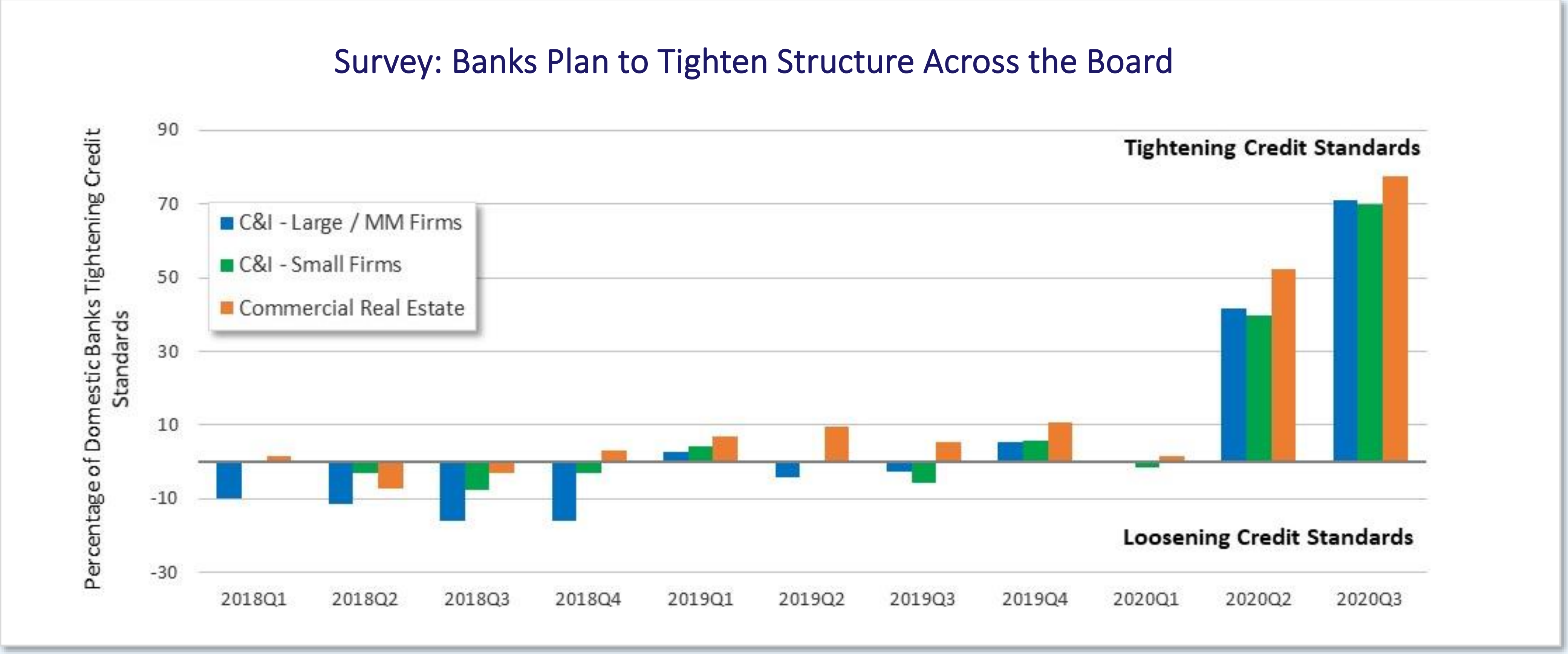
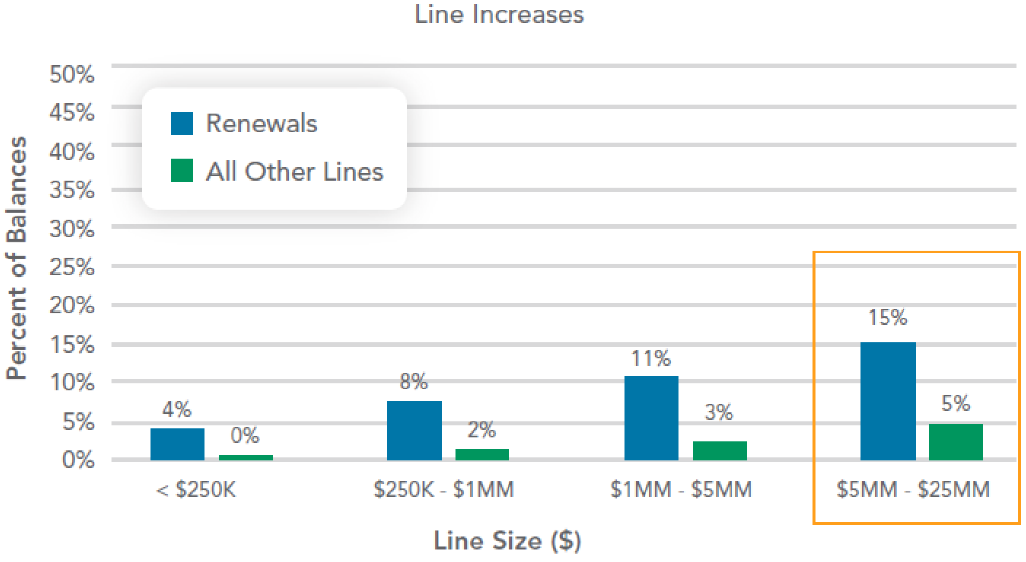
A Return to Conservatism

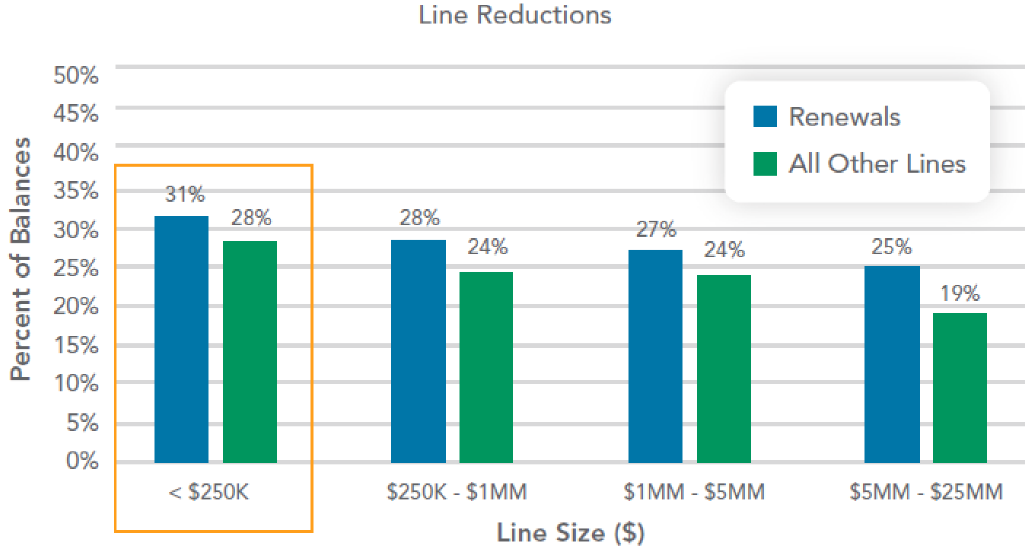


*Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices

Conservatism in Practice: Increases and Reductions, by Line Size

Smaller Borrowers Less Likely to See Line Increases, More Apt to Be Right-Sized





*Source: PrecisionLender. Analysis shows the volume of deals on which commitment sizes were adjusted in the second quarter of 2020. Credits which were reduced without a contractual renewal event include uncommitted lines.

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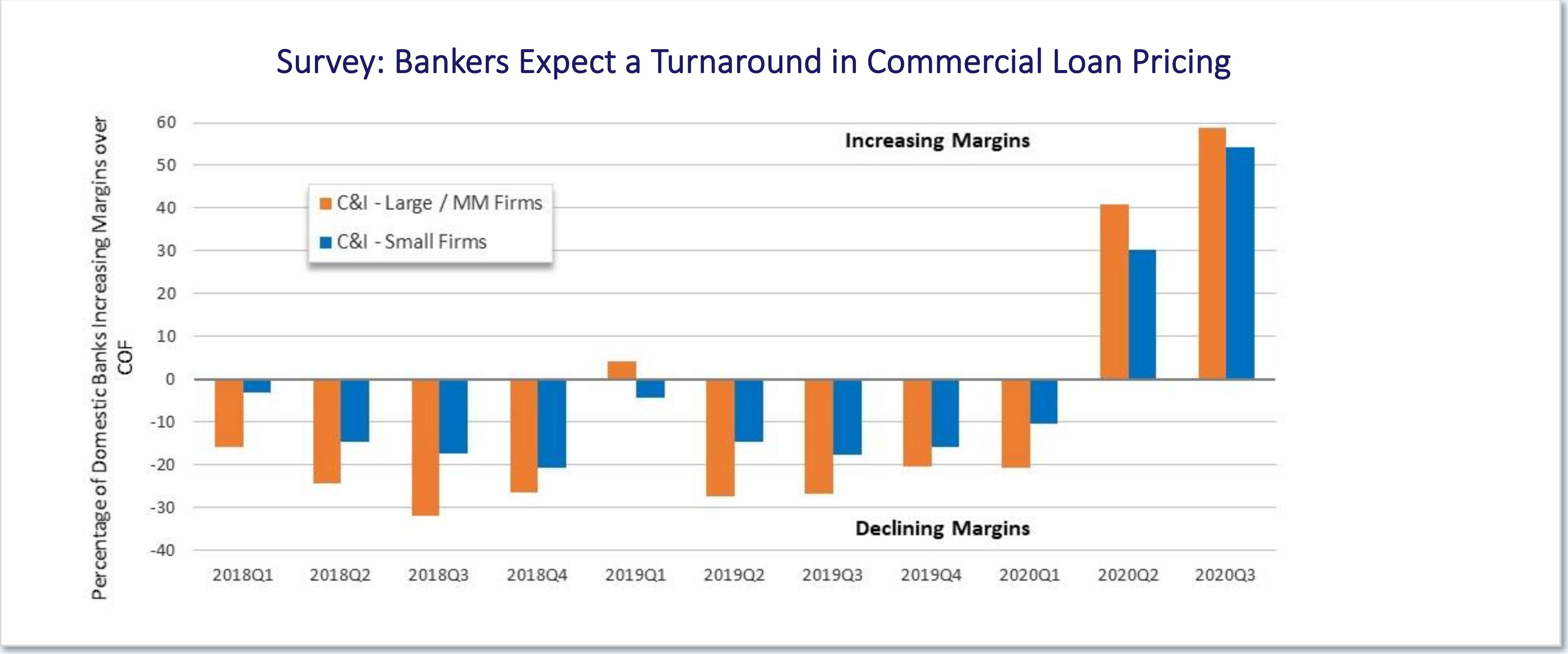
Fed Survey: Pricing Expectations

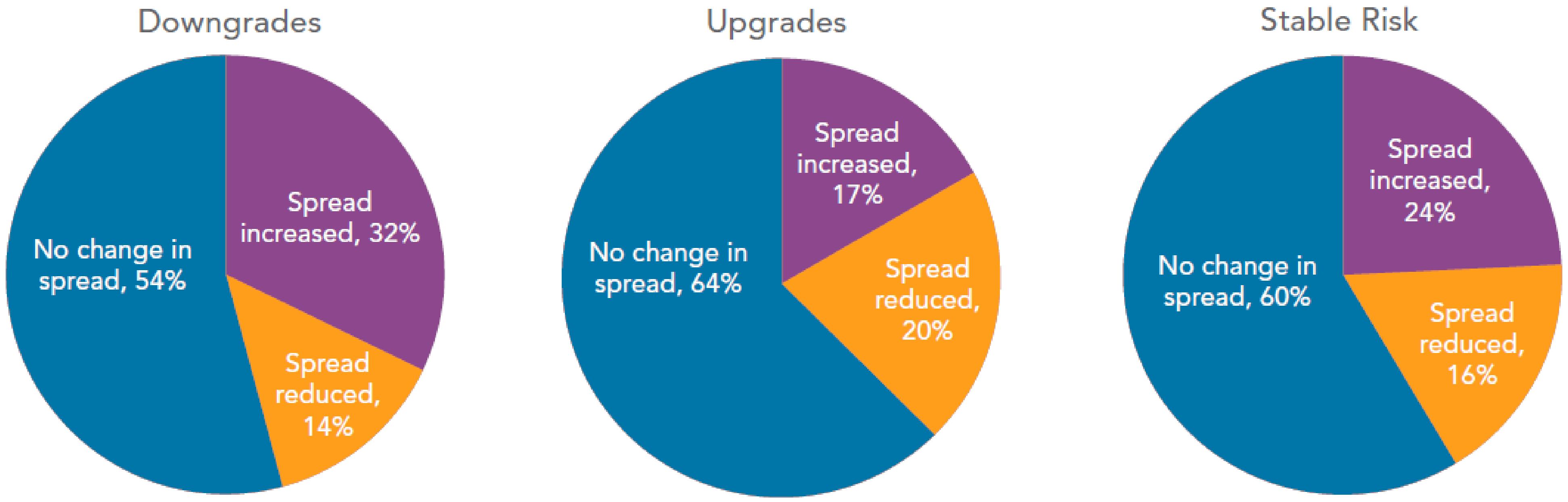


*Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices

More Renewals Repriced Higher Than Seen Historically

Nearly one-third of downgrades repriced higher; some deals repriced upward even where quality stable or improving

Renewals: Q2 2020

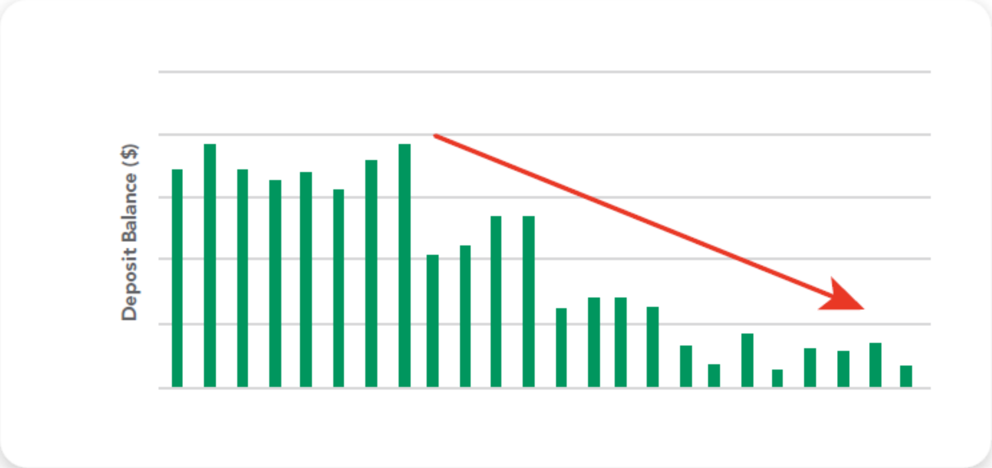


*Source: PrecisionLender. Source: PrecisionLender. Analysis reflects floating rate credits which renewed in the second quarter of 2020. Rating changes are relative to each bank's internal scale.

8 Ways to Mitigate Yield Erosion

1. Detect Anomalies

Look for sudden changes in usage patterns and deposit balances as early warning indicators of potential credit problems



2. Revisit internal risk ratings as needed

Don't wait for the annual review date. Adjust ratings and reevaluate risk-adjusted profitability when warranted.

8 Ways to Mitigate Yield Erosion

3. Get more granular with risk ratings

This is obviously not a quick fix, but banks utilizing broad rating scales should consider moving it up on the priority list

4. Explore creative ways of achieving target profitability

Increasing margins is not always the answer. In some cases, a modest change in structure, such as a shorter-term or lower LTV can have a more significant impact on profitability without placing an undue interest burden on the customer.

Here are ways to reach the target:

- Increase the Initial Rate by 5 bps
- Add $1,531 to the Initial Fees
- Add 0.153% to the Initial Fees
- Decrease amount to achieve an LTV of 78%
- Reduce Maturity to 68 months

Here are things to consider:

- I recommend our Lockbox Services to handle tenant rents.

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8 Ways to Mitigate Yield Erosion

5. Take a relationship view

While it may not be possible to achieve profitability on an individual, downgraded credit, consider it within the context of the broader relationship. Explore whether additional deposits or other ancillary business could be brought over to bolster relationship profitability.

This relationship appears to be credit only. Consider expanding the relationship to improve profitability. I recommend:

- DDA: $800K to $1.15MM
- CWI: $925K to $980K at 0.2% to 0.3% interest
- MMA: $75K to $85K at 0.4% to 0.6% interest
- Treasury Services: $30-45K
- Foreign Exchange: $10-20K

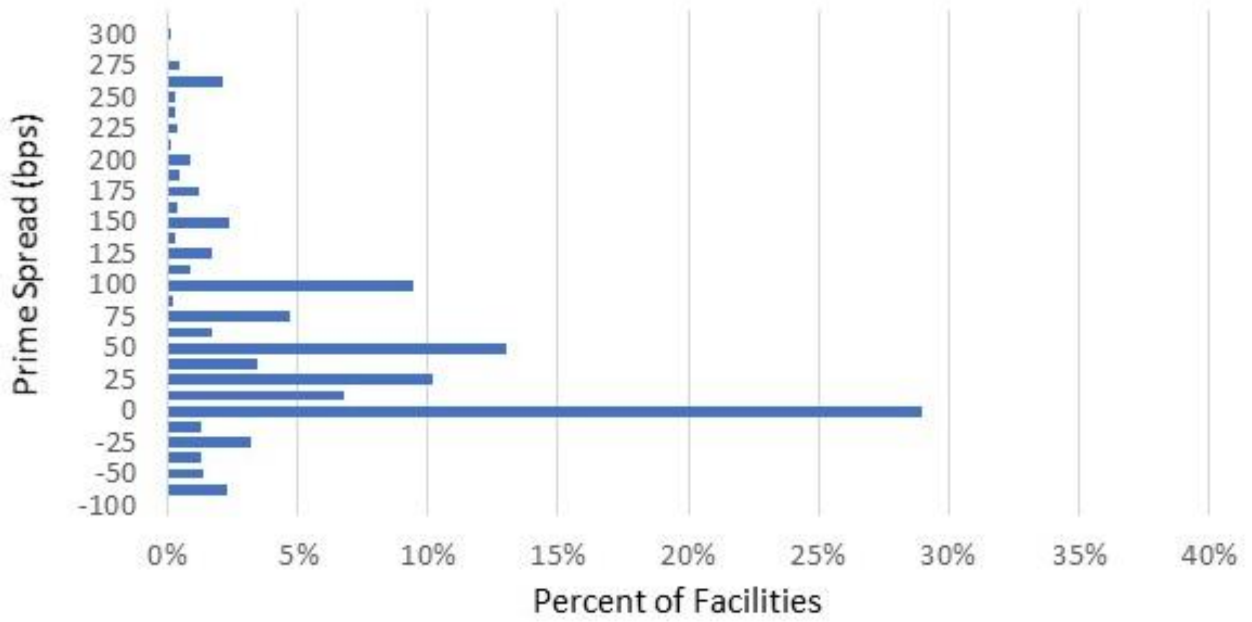
6. Set realistic targets

When targets are set too far above-market, they tend to be ignored, and bankers do not push for incrementally higher yields.

8 Ways to Mitigate Yield Erosion

7. Coach RMs to negotiate in small increments

Although it may not be realistic to expect to preserve profitability if quality suffers, bankers can move closer to target without jeopardizing customer retention when utilizing modest, non-standard pricing increments.



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8 Ways to Mitigate Yield Erosion

8. Get out ahead of renewal opportunities

Arm bankers with intel on maturing deals, including those that have suffered risk deterioration and/or weakening relationship profitability. Coach RMs to have a constructive conversation with borrowers well in advance of the scheduled renewal date.

Weekly Andi Insights

AR Andi Reports
To: Robert Banker

Dear Robert,
Here are your upcoming renewals with recent credit downgrades:

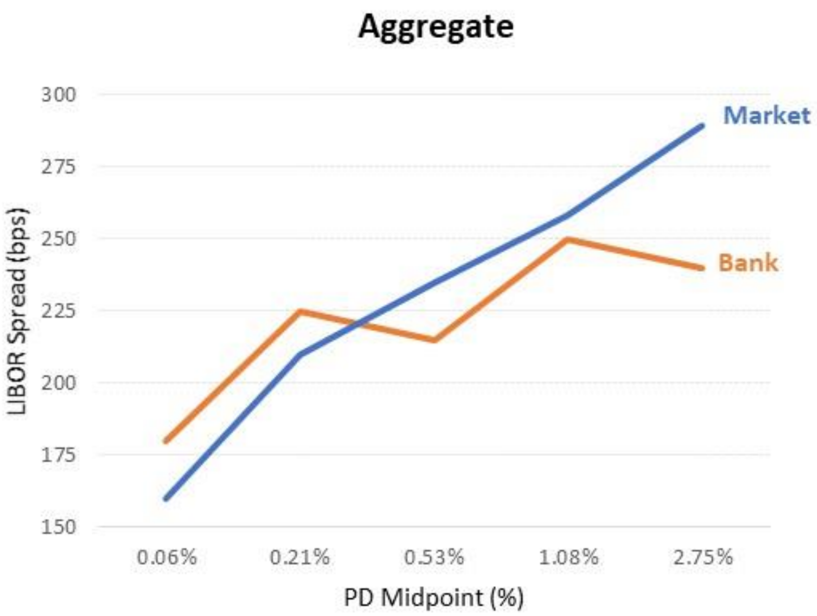
Client Name	Maturity	Renewal Amount	Prior PD	Current PD	Current ROE
JTM Company	5/31/2020	$5,250,000	8	10	4.30%
Loft Enterprises	7/15/2020	$1,675,000	8	12	-1.58%
Magna Inc	8/1/2020	$2,200,000	4	5	24.25%
New Retailers	10/10/2020	$3,250,000	11	12	5.36%
Preston Corp	9/15/2020	$1,320,000	7	9	11.26%
Restaurant Group	6/20/2020	$9,500,000	6	10	-4.68%

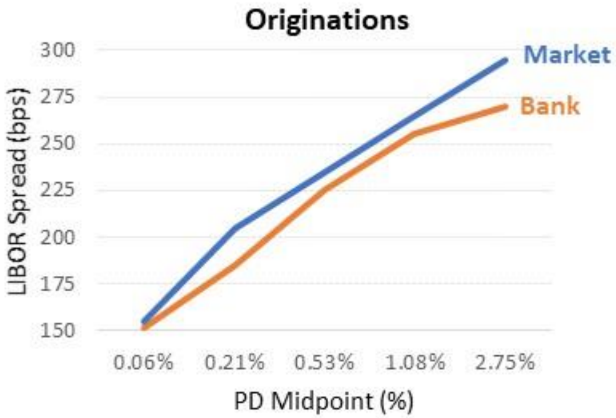
Cheers,
Andi

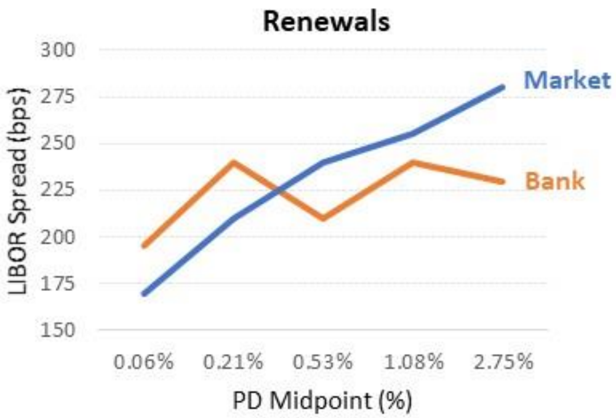
Click here for negotiation tips on repricing renewals

Performance Analysis – Risk/Return

How does our Risk/Return compare?



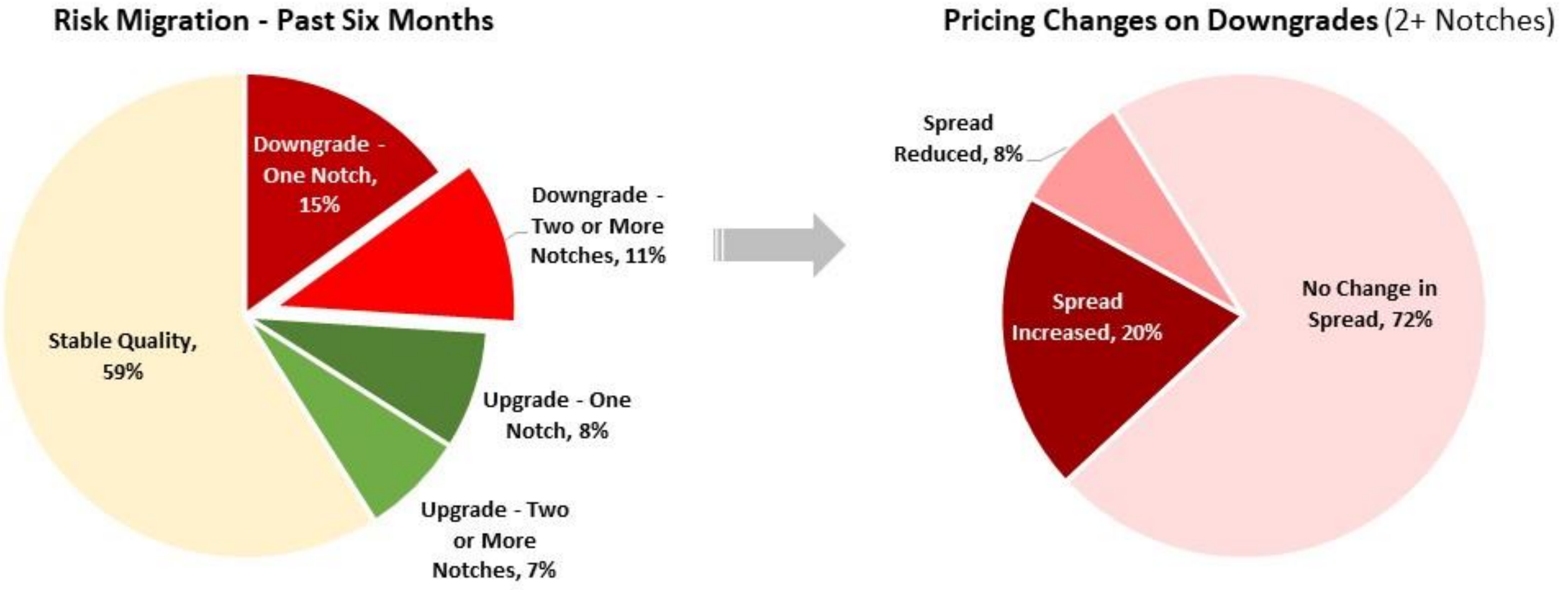




- Risk/return less differentiated than peers
- Results driven by renewal portfolio

Performance Analysis – Renewal Repricing on Downgrades

Are we pricing for changes in risk?



Limited repricing, even on severe downgrades

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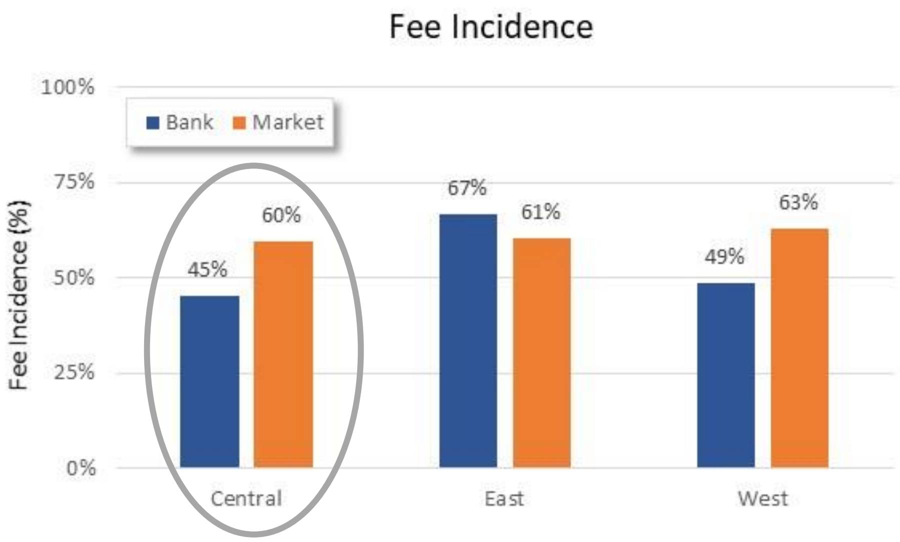
Performance Analysis – Fee Assessment

Are there regions, teams or RMs who are missing out on fee opportunities?



Bank assesses fees less often than peers in two of its three major regions

Low fee incidence not offset with higher fee levels

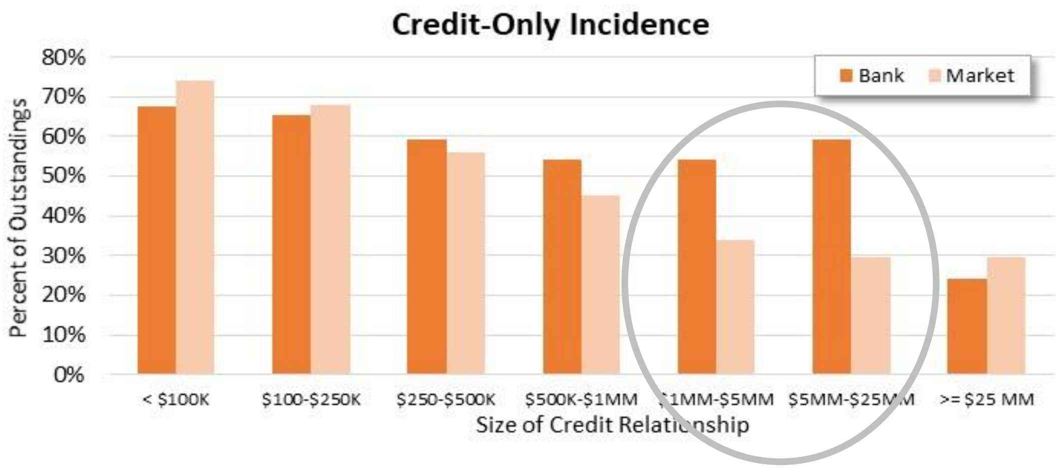
Potential tactics

- Close gap to peers in fee incidence 5 to 6 bps
- Close gap to peers in both fee incidence and level 6 to 10bps

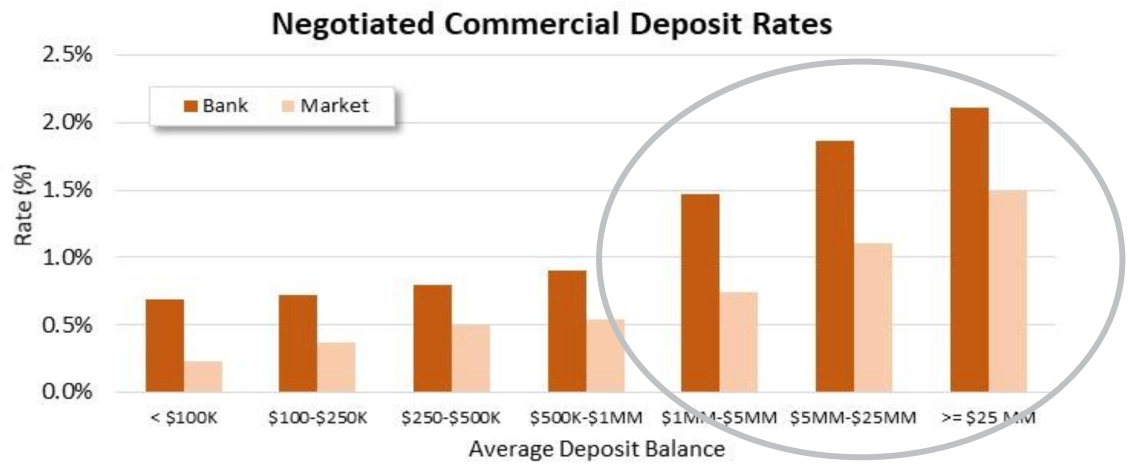
Performance Analysis – Deposits

Are we over-paying to attract commercial deposits and are we winning the business?

High % of credit-only relationships…



…despite offering above-average deposit rates



Potential tactics

- Implement target rate grid for commercial deposits
- Coach bankers when proposing higher rates

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