2021 CONVENTION | MEMBER BEST PRACTICES | EXCITING NEW PROGRAMS

GEORGIA COMMUNITIES FIRST

MARCH/APRIL 2021

YOUR COMMUNITY BANK ADVOCATES

Official Publication of the
CBA
COMMUNITY BANKERS ASSOCIATION OF GEORGIA

Member:
ICBA
Independent Community Bankers of America
The Nation's Voice for Community Banks

Overcoming Unprecedented Credit Risk Uncertainty

Most bankers know, intuitively, "the other credit-quality shoe" will inevitably drop. Despite federal stimulus initiatives, temporary regulatory relief, and the prospects for turning the corner on COVID-19, bankers realize that credit tails always extend longer than the economic shocks that precipitate them. Although the Wall Street rebound dominates U.S. business news — **our commercial bank credit lives on Main Street! And Main Street is in a recession.**

Unlike the previous crisis where one sector of the housing industry took us down, COVID's most vexing legacy is its effect on multiple, disparate businesses comprising portfolios. In what is a classic credit red flag, more emphasis is now placed on borrowers' survivability, rather than growing investment potential. While the government's actions averted an economic calamity, **they also masked the true nature of credit quality within our portfolios.** This has created unmatched UNCERTAINTY among all bank stakeholders — anathema to anyone managing credit risk.

We're now beyond the "it's-beyond-our-control" defense. All stakeholders — particularly the regulators — will expect that each bank write its own credible narrative quantifying its unique credit risk profile. In other words, being captain of your own ship. **Effectively reducing uncertainty (if not eliminating it) will be priority one this year.** The key lies within your own bank's idiosyncratic, non-public loan data. Only you are privy to this information; all external stakeholders, including peers, see your bank through the lens of public data such as call reports.

So how do you pull this off? I'd advise five orderly paths:

RECOGNIZE THE TRAP OF JUST FOCUSING ON THE PORTFOLIO AT-LARGE.

An overall perspective often ignores the divergent economic forces at work within subsets of your portfolio. You may be performing well on the whole, but there's risk you're focusing on the forest while overlooking groups of trees that may be diseased.

CREATE PORTFOLIO SUBSETS, IDENTIFYING CREDIT HOTSPOTS.

Employ practical, affordable tools that allow you to identify credit hotspots with the same analysis you'd use in evaluating the portfolio in total. For instance, where are you seeing troubling risk grade migrations within pass? What industries are showing more weaknesses? Such concentrated assessments of a subset are far more informative and predictive than the bluntness of the regulatory guidance on commercial real estate lending.

DRILL DOWN TO SUSPECT OR TROUBLED LOANS.

Any tool should provide the ability to instantly peel the onion down to the most potentially concerning loans and borrowers. It is the ultimate bridge between quantitative data and qualitative issues that need more urgent attention.

ADOPT AN ALTERNATIVE SERVICING PROCESS FOR THE TARGETED LOANS.

Given the non-ordinary times, redirecting credit servicing strategies to risk hotspots will prove beneficial. Regulators hold us accountable for our policies; therefore, I recommend nuanced and enhanced servicing, stress testing, and loan review protocols — adjusting our polices accordingly, if only temporarily.

WRITE YOUR OWN SCRIPT FOR ALL OF THE ABOVE — THE GOOD AND BAD.

All outside stakeholders, especially regulators, must perceive us as the experts on our own credit risk profile. Taking the above steps should enable us, credibly, to write our own scripts.

Correlation exists between the early detection of credit problems and two optimum outcomes: (1) reduced levels of loss; and (2) greater flexibility in moving problems out of the bank. The magnitude of today's credit uncertainties adds to the challenge of realizing this maxim — but they can be overcome.

David Ruffin
Principal
IntelliCredit™