

FALL 2020

CERTIFICATION NEWS



ICBA
**CERTIFICATION
PROGRAM**

QUARTERLY NEWSLETTER FOR ICBA CERTIFIED COMMUNITY BANKERS



COVID-19 SAFETY AND SOUNDNESS

NEW STANDARDS FOR FINANCIAL INSTITUTIONS

On June 23, 2020, the financial institution regulatory agencies jointly issued “Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions” (the June 2020 interagency guidance). Agencies will continue to evaluate financial institutions under the appropriate rating system—such as CAMELS—but examiners will also assess your management’s responsiveness to the stresses that have resulted from COVID-19. The June 2020 interagency guidance provides information to help prepare your financial institution for its upcoming safety and soundness examinations.

Financial institution regulators have consistently stressed the need for flexibility during this unusual time while still operating in a safe

and sound manner. Review our interpretation and key takeaways of the June 2020 interagency guidance to help transition your institution from normal to new normal.

ASSET QUALITY

Asset quality will likely be a major area of focus for all examiners. While examiners are aware of the burdens on financial institutions brought about by COVID-19 and new funding programs such as the Paycheck Protection Program (PPP), safety and soundness examination standards have not changed.

Examiners expect you to be reactionary to the needs of your customers, which means you should:

- » Assess and document the risk in your institution’s loan portfolio.

COVID-19 Safety & Soundness
continued on page 2 »

GET TO KNOW

MERRY WHEELER

An ICBA Certified BSA Officer,
Compliance Officer, and
Internal Auditor in Nebraska



What makes a community bank different from the larger banks?

Our bank is family owned and we only have one location. We tell our customers that the decisions are made by our local bank; not a corporate office somewhere.

Get to Know continued on page 2 »

- » Be responsive, timely, and methodical in the development of policies, procedures, and programs to help your customers, borrowers, and communities.
- » Decipher the issues caused by external economic problems versus those caused by risk management and governance issues.
- » Focus on objectivity as you evaluate your credit risk.

Credit Classification

The rise in credit risk due to COVID-19 has impacted communities, businesses, and consumers locally and globally. The June 2020 interagency guidance indicates that you should review your current credit classification definitions and make sure they align with management policies and practices.

Consider the following scenarios and actions:

- » Reevaluate existing credits and assigned ratings on the regulatory credit risk rating scale and assess if a change is necessary in light of pandemic-related challenges. Within each of the federal regulators' handbooks are definitions for credits designated as pass, special mention, substandard, doubtful, and loss.
- » If you only have varying degrees of pass credits and then a transition to adversely classified, reevaluate the regulatory rating definitions and determine if a special mention designation is appropriate for use. During the first two quarters of

this year, many institutions saw a dramatic increase in credits designated as special mention while borrowers pivoted in this environment to adjust business models and find a "new normal."

- » Overall, your financial institution's risk may have changed with many (if not all) borrowers, so consistent application of credit classifications is crucial. Implement strong controls around policy and practice to strengthen examiner opinions of asset quality and risk management practices.

Credit Risk Review

The "Interagency Guidance on Credit Risk Review Systems" (the May 2020 interagency guidance) emphasized the fundamental concept of credit risk review, which echoes the significance of the process. An objective assessment of credit risk at this time is critical and not something you want a regulatory examination to provide. While temporary delays in an established loan review schedule are understandable, focus on the word "temporary."

Examiners will evaluate the documented support for a delayed credit review and an established plan for the completion of the review in a "reasonable amount of time." "Reasonable" would not include a more-than-temporary delay in evaluating a credit to avoid a potential risk rating downgrade.

New Loans

The June 2020 interagency guidance clearly acknowledges that eased

What makes you most proud of your bank? The First National Bank of Gordon has been around since 1883. We have established long-term relationships with our customers for multiple generations.

How did you find your way into banking? I am a third-generation resident of Gordon who moved away after college and decided to move back in 1993 with my husband and kids. We had lived in two large cities in North Carolina and felt a small town was the place to raise our three boys. I had two years of banking experience from my college days and The First National Bank had an opening in their newly emerging Audit & Compliance Department....so I jumped in headfirst, not really knowing anything about the area.

Tell us your biggest and best accomplishment. I guess it would probably be getting out of my comfort zone to acquire three ICBA certifications. I am a person who is very comfortable with serving in supporting roles. I have had to "grow into" the roles of BSA Officer and Compliance Officer. It has been a painful process at times, but also rewarding.

What do you like best about the work you do? I love our staff and the comradery we share. Each day brings a lot of problem-solving opportunities and there is never a dull moment.

How do you train new staff in your area? We have used ICBA's online training for quite a few years for new and existing employees. We use the courses in group and individual settings. All new employees must take the BIG three the first two days of employment: Bank Security Act/Robbery Response training, BSA/AML training, and



underwriting standards during or after the pandemic are likely and may be needed to support your customers' new loans. While the underwriting standards may have eased, the need for proper documentation and support for customer loans has not.

Given the rapid change in the economy and the impact to borrowers, lenders may be forced to place some reliance on pro forma financial information from borrowers to make underwriting decisions going forward. Although these projections may not be final, with them you can more readily assess the likelihood of adaptability and gain a better sense of viability for the business and corresponding credit.

In addition, you should:

- » Review your underwriting standards and the new loans you have approved since the pandemic began, since weak and loose underwriting standards can expose you to risks.
- » Reevaluate any credits that had previously been reviewed but not yet originated and, if applicable, obtain new projections.
- » Document any changes to underwriting standards (whether strengthened or loosened) in the appropriate policies and support them with additional procedures, controls, or management oversight.

Paycheck Protection Program (PPP)

The PPP has provided a lifeline to many businesses across the country, and your institution may have been instrumental in that process. However, you may now face a longer-than-anticipated forgiveness period for

borrowers, which keeps these loans on your balance sheet longer.

Take the following steps if you've participated in the program:

- » Assess the impact that PPP participation left on your balance sheet and consider, where appropriate, using the Paycheck Protection Program Liquidity Facility (PPPLF) to negate the impact to your leverage ratio. (Note that the Federal Reserve Bank has recently extended the PPPLF from Sept. 30, 2020, to Dec. 31, 2020, which gives you more opportunity to use it).
- » Conduct an analysis of your PPP loan portfolios, including number of loans, amounts outstanding, estimated forgiveness, and the fees receivable.
- » Provide analysis on the forgiveness rates and trend analysis to examiners to support their assessment of your participation.

Although these loans are 100 percent guaranteed by the Small Business Administration (SBA) and should be considered as you evaluate your allowance for loan and lease losses, the risk of loss is not considered to be zero. Consider a small qualitative factor for this portion of your loan portfolio.

Credit Modifications and Nonaccrual Loans

Consider the various aspects of loan modifications, including documentation, length of modification, and the availability of multiple modifications. In early March, even before the regulators could issue a statement, many financial institutions worked diligently to assist borrowers affected by COVID-19. Regulators

Information Security (Gramm-Leach-Bliley Act) training.

What is your best advice to a new bank employee? Banking is an essential service that will be here in some form or another. There is a future in this field. I am a product of mentoring that has given me a career of 25+ years!

Why did you choose to become certified? I had a wonderful manager/mentor who encouraged me to get my first certification. I was reluctant, but with her guidance I took the first step.

What motivated you to obtain and maintain the three designations that you currently hold? In each case, it was succession planning for long-term employees who were thinking about retirement. I had worked in the three areas in supportive roles or on committees and they were areas that I had an interest in.

How has earning your certifications helped your career as a banker? I think it has built a framework of knowledge and given me tools to know where I can go to get answers. It is a confidence builder to go through the training and exams. The networking that happens at the certification training and also at the "Annual Certification Issues Conference" that I attend are invaluable. Finally, our regulators look very favorably on these designations. They enhance our bank's credibility. We have five employees who have ICBA certifications.

How will your bank plan for your successor? That is the next big question. I am looking at approximately five more years of working and am mentoring some very capable replacements!



stressed then—and continue to stress—their support for financial institutions to work prudently and in a safe and sound manner with borrowers through the pandemic.

Consider the following scenarios and actions:

- » The Federal Financial Institutions Examination Council (FFIEC) explores the need for additional accommodations for certain borrowers. It's generally expected that you actively engage with these borrowers and obtain current and projected financial information to assess the viability of additional accommodations. Document the systematic approach to loan modifications and what, if any, considerations are made to the credit risk rating as multiple modifications continue.
- » While loan modifications provide assistance and relief to borrowers affected by COVID-19, the level of problem loans will likely rise as the pandemic persists. Therefore, review and update your problem loan management policies and procedures.
- » You may not have experience with problem credits or it may have been several years since active collection efforts were necessary. In these scenarios, dust off old policies to test relevancy for this period of time and/or devise policies and strategies to handle what could become problem credits.
- » Regarding troubled debt restructurings (TDRs), the Coronavirus Aid, Relief, and Economic Security (CARES) Act temporarily suspended certain requirements under Generally Accepted Accounting Principles (GAAP). The regulators followed up with clarification but generally remain in support of this measure. Loan modifications made under Section 4013 of the CARES Act are excluded from TDR reporting, which means there is less operational burden and pressure on risk-based capital. The regulators will assess

your risk grading of these loans along with accrual status decisions.

- » Regulators have mentioned that most of these short-term modifications should not be reported as nonaccrual. However, you should actively monitor these loans and consider new information as it becomes available. Track loans that have been modified as a result of COVID-19, and document the number of loan modifications granted.
- » Nonaccrual and charge-off policies should be reviewed and practiced consistently. Prepare for questions regarding your problem loans and make sure:
 - There is regular communication with lending teams,
 - Loans modified during this time period are easily identified, and,
 - Notes or other documentation are provided in each file.

Furthermore, as stressed by the FFIEC, promote clear and consistent communication to borrowers throughout this entire process and adhere to applicable laws and regulations, which includes fair lending laws. Your ability to assess, document, and account for these risks and lead objectively is crucial.

Allowance for Loan and Lease Losses (ALLL)

Review of the ALLL (or ACL, if you have adopted CECL) methodology is routinely included as part of a regulatory risk management examination.

Since the ALLL represents one of the larger estimates on a financial institution's balance sheet, you should:

- » Evaluate your application of regulatory guidance, your understanding of the loan portfolio and inherent risks, and your use of qualitative factors to stay prepared.
- » Review COVID-19's impact on credit quality, then place appropriate emphasis on factors and indicators that arose from this pandemic.

What is your bank's customer service philosophy?

Our Executive Vice President who worked 30 years before semi-retiring drove home the idea that what sets our bank apart from our competitors is the customer service we provide. As our bank transitions with new faces as our long-term employees retire, we want to carry on the tradition of that personal touch wherever we can.

Merry Wheeler has held the following ICBA certifications since:

Sept. 2004: Certified Community Bank Internal Auditor (CCBIA)

May 2008: Certified BSA/AML Professional (CBAP)

Oct. 2015: Certified Community Bank Compliance Officer (CCBCO)

FAST FACTS

The First National Bank of Gordon

Headquarters: Gordon, Neb.

Retail Offices: 1

Bank Asset Size: \$230,000,000

Number of Employees: 34

Website: www.fnbngordon.com

Motto: "Part of the past. Part of the future. Independent and strong."

Have you accepted your digital credentials?

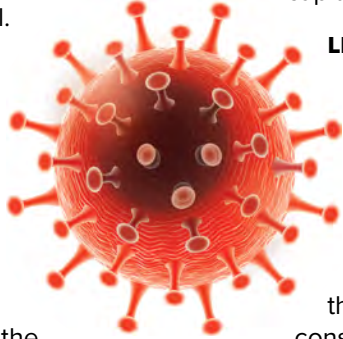
Community Banker University has issued digital certification badges for every banker who is certified through one of our certification programs. If you have not yet accepted your badge, look for an email from Credly/Acclaim. You may need to check your spam folder. If you cannot locate the email and would like to accept your digital badge, contact Julie Woida at julie.woida@icba.org.

- » Document your ALLL assessment, since it will be carefully scrutinized by the regulators.

EARNINGS

From a regulator's perspective, a financial institution's earnings are essential to absorb losses and augment capital.

While you may have experienced several years of strong earnings, the guidance clearly communicates a distinct possibility for reduced core earnings caused by the pandemic.



Take the following steps:

- » Analyze the pandemic's impact on current year earnings and how it will detract from or enhance your earnings potential.
- » Revise budgets to indicate what new expectations are more realistic.
- » Assess and evaluate your earnings through the lenses of the impact to asset quality, operational expenses, and trend analysis.

CAPITAL

A strong capital plan is one of the critical pillars of a sound financial institution, but dramatic balance sheet shifts have occurred over the last several months.

Loan growth, deposit growth, and inflows from government stimulus have happened quickly, without an opportunity to fully assess the capital impact, which means you should:

- » Reassess your current capital plan and objectively challenge the levers and limits within the policy.
- » Use capital buffers to promote lending activities in a safe and sound manner by assessing your overall risk profile and what forecasted risks are on the horizon.
- » Include strategies to address risk in your capital gains while you maintain an adequate capital position. For

example, if credit concentrations in industries largely affected by COVID-19 exist, and borrowers continue to suffer because of reduced or eliminated operations, assess the impact on a go-forward basis and plan accordingly for capital purposes.

LIQUIDITY

Most financial institutions have been liquid since the last recession and the lessons learned from that time period linger, with less dependency on third parties for funding. Also, like the last recession, there's an inflow of funds from consumer savings as the future remains unknown.

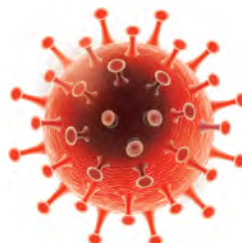
The guidance readily admits that significant uncertainty remains regarding liquidity profiles for financial institutions as a result of COVID-19. Yet, amongst the uncertainty, expectations remain to employ smart strategies to utilize any influx of liquid funds.

Conversely, you may experience significant outflows, which places greater emphasis on the overall funding strategy and contingency plans. Some funding sources, such as secured lines of credit with a third party, like the Federal Home Loan Bank, may be temporarily modified or even reduced as pledged assets (largely loans) may deteriorate in quality.

Stay informed of any changes that may occur to these funding sources and address this in the overall liquidity plan. Like the capital plan, review your current liquidity policy and objectively challenge its adequacy given the current operating environment.

SENSITIVITY TO MARKET RISK

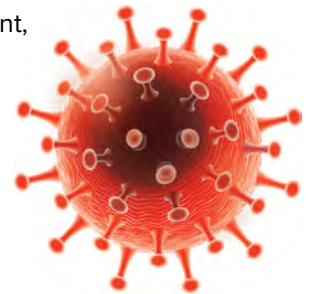
Evaluate the sensitivity to market risk (primarily in the form of interest rate risk) to



assess the impact to your institution's earnings or capital.

As previously mentioned, effective management over earnings and capital at this time is critical, so:

- » Reassess your asset liability management (ALM) policies and models.
- » Identify those changes to your interest rate risk profile that are temporary and those that will have longer-term effects.
- » Review and adjust the assumptions and data in these models to consider the impact of loan modifications and payment timing, as well as deposit growth experienced in response to the pandemic.
- » Identify industries at risk in your institution's loan portfolios and perform various stress scenarios, including partial and complete loss, fluctuations in unemployment, and the impact of possible future shutdowns.
- » Implement an independent review of this function, like a credit review, to confirm integrity, accuracy, and reasonableness.



MANAGEMENT

Management is the driving force to successfully navigate through this time. The guidance specifically states, "examiners should assess the reasonableness of management's actions in response to the pandemic."

Therefore, you should:

- » Assess how well-documented your efforts are in each of the core component areas and how that information will be conveyed during the next safety and soundness examination.
- » Refamiliarize yourself with the core component and composite risk

rating definitions put forth by the regulatory authorities.

- » Assess where you have been on the rating scale and where, if applicable, any change may occur.
- » Prioritize comprehensive documentation, which includes an assessment of what policies, procedures, and risk assessments need to be revised based on decisions made in response to the pandemic.
- » Foster open lines of communication between all departments on a day-to-day basis, and include the board of directors to lend a different perspective that could enhance your risk assessment process.
- » Complete risk assessments objectively and utilize existing or new third-party providers to help bolster an identified area of risk.
- » Partner with third-party providers to help you more fully explore risks that exist in the community and beyond, as well as to identify helpful strategies.
- » Engage your board of directors and keep them informed as global and local circumstances change, and always reevaluate what additional information should be communicated to keep your board well-informed.

Risk Management Considerations

The importance of an objective evaluation of a financial institution's risk management program during this time of uncertainty cannot be emphasized enough.

Unlike past recessions, the current environment has immediately shifted customer and employee interactions to virtual settings; so it's important to:

- » Recognize and document newly introduced risks of fraud, cyber threats, and weakened or lax internal controls.
- » Make appropriate adjustments to policies and procedures to mitigate those risks.
- » Review risk management from the perspective of the enterprise, operations, credit, and compliance.

Overall, COVID-19's impact on risk management programs could possibly include more new internal audits, new or revised controls, and expanded testing in financial statement audits.

The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, investment, or tax advice or opinion provided by CliftonLarsonAllen LLP (CliftonLarsonAllen) to the reader. Visit www.CLAconnect.com for more information.

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2020 CALENDAR OF EVENTS

Additional opportunities to earn CPEs!

OCTOBER

26–28 Risk Management InstituteSM

NOVEMBER

4–6 BSA/AML InstituteSM

16–18 Community Bank Marketing Seminar

With the uncertainty of COVID-19, Community Banker University is taking a precautionary approach by first planning our virtual schedule. The 2021 calendar of live-streamed events will be posted soon! Watch www.icba.org/education/live-events for details.



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