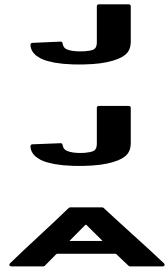


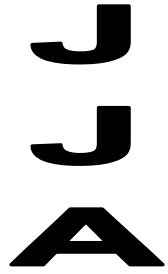
Commercial Credit Overview

Commercial Credit Risk Management
Issues/Activities



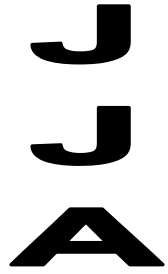
Risk Assessment/Management

- Anticipate Your Institution's Future
- Develop Risk Management Framework to Achieve Desired Future
- Implement Necessary Process to Execute for Desired Future
- Generate Action to Achieve Desired Future
- Role of Information



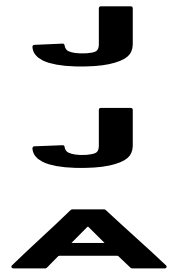
Financial Services Industry

- *Business Behaviors in Marketplace are Driven by the “Dumbest Competitor”*
- Competitors are everywhere
 - Brick & Mortar
 - Internet
 - FinTech
- Battleground is Too Big to Fail versus Community Banks; *Credit is Weapon of Potential Mass Destruction*



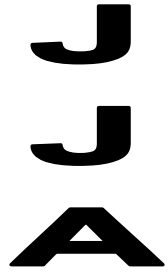
Financial Service Basics

- Exist To *FULFILL DREAMS*
- Provides → *MONEY/INFORMATION*
 - *Convenience* (Facilitate Payments)
 - *Wealth Management*
 - Build (Investments)
 - Protect (Insurance)
 - *Credit* (Replace Borrower's Cash Shortfall)
- Role in Economy as *RISK INTERMEDIARY*



Credit Risk Management Tools

- *Avoid the Risk (“Just Say No”)*
- *Take the Risk (“Just Do It”)*
- *Mitigate the Risk (Collateral/Derivatives)*
- *Transfer the Risk (Participations)*
- *Insure Against the Risk (Government Programs)*
- *Limit the Risk (Legal → House → Concentration → Lending Authority)*



Actions to Manage Credit Risk

- *Make Credit a Strategic Event, not a Tactical Event*
- *Return to Basics of Sound Credit Risk*
- *Understand Marketplace and Develop Institution's Response (Future Financial Performance)*
- *Inspect What You Expect*

Credit Basics

- Credit → Financing the borrowers ***CASH SHORTFALL*** (“Dreams”)
- Focus of credit activity is to assess ability to get the ***CASH BACK*** (“Repayment”)
- Credit Risk Involves Understanding
 - Where/Why Ran Out of CASH (6 Causes)
 - Determine Ability/Willingness to Repay
 - Monitor Behaviors to Repayment

Credit Risk Management

- *Commercial Credit* → Financing the Borrower's "**Cash Shortfall**" (**CAUSE**)
- *Commercial Loan* → Finance a *Self-liquidating Asset* (**REPAYMENT SOURCE**)
- *Properly Managed Credit ALIGNS the Cause with the Repayment Source*

Key Credit Concepts

- *“No one ever makes a loan decision; all decisions are **portfolio decisions!**”*
- *“You aren’t paid to make loan decisions; you’re paid to manage credit risk!”*
- *Yesterday’s Loan Repaid With Today’s CASH;
Today’s Loan Repaid With Tomorrow’s CASH!*

Key Credit Concept

*“No one ever makes a loan decision; all decisions are **portfolio decisions!**”*

Portfolio Issues

- Represents “pooling” of homogeneous risk
 - Ag
 - C&I
 - CRE
 - Private Banking
- Levels
 - Front Line Officer
 - Branch
 - Bank
 - Holding Company

Credit Risk Outcome

Marketplace Factors Impacting Institution

PLUS

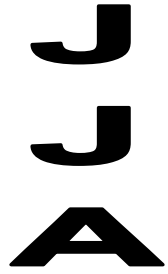
Institution's Response to Marketplace

EQUALS

Institution's Financial Performance

Credit Risk Activities

- *Understand Marketplace*
 - *Know Key Driver*
 - Manage to Key Influencers
- *Develop/Implement Response*
 - Establish Institution's **Credit Priority**
 - Communicate Expectations
- *Inspect What You Expect (MIS)*

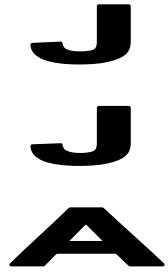


Assessing Risk—Marketplace

- *Risk=Probability X Consequences*
 - *Probability*= Likelihood that an event will occur
(Identify) →
 - *Consequences*= Impact if that event doesn't occur as intended (*Mitigate*) →
- *Challenges to Success*
 - External Factors (Opportunity/Threat)
 - Internal Factors (Strengths/Weaknesses)

Understand Marketplace

- *Institution's Outcomes are Result of Intersection of Marketplace Factors Impacting Institution and Institution's Response to those Factors*
- *Know Key Driver(s)*
 - Employer
 - Industry
- *Assess Key Influences (Internal/External)*
- *Determine **Level of Credit “Desirability”***
- *Manage **COVARIANCE***



Risk Assessment/Response

- *Marketplace → External*
 - Factors
 - **Opportunities** (Competitive Advantage → Leverage)
 - **Threats** (Competitive Disadvantage → Avoid)
 - *Uncontrollable, But Manageable*
- *Institution Response → Internal*
 - Factors
 - **Strengths** (Maximize)
 - **Weaknesses** (Minimize)
 - *Foster Appropriate Personnel Behaviors*
- *Perform on Ongoing Basis (“Rolling”)*

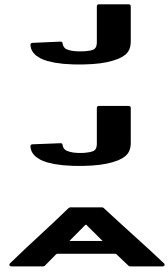
Risk—Response

- Utilize Assessment Analysis
 - Opportunity → External → Leverage
 - Threats → External → Avoid
 - Strengths → Internal → Maximize
 - Weakness → Internal → Minimize
- Develop/Implement Strategic Credit Risk Plan

Key is assessing potential outcome of External and Internal Factors (Future Financial Performance)

Credit Risk Basics

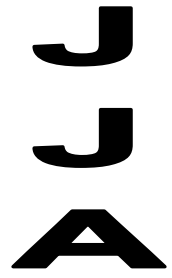
- *Manage as Strategic Activity*
 - “Lending” → *Tactical Focus*
 - “Credit” → *Strategic Focus*
- *Credit “Components”*
 - *Product (Lines of Business)*
 - Replaces Borrower’s Cash Shortfall (*Commercial Credit*)
 - Understand True Borrowing Cause (*Cash Shortfall*)
 - Understand Repayment Source (*Self-Liquidating Asset*)
 - *Process (Solutions to Cause of Shortfall)*
 - How to Manage Risks of Delivery (*Strategic Framework*)
 - How to Deliver Solution (*Credit Process*)



Credit Risk Focus—Portfolio

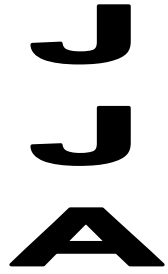
- *Establish Clear Credit Priority*
- *Establish/Communicate Expectations for Front-line Behaviors*
- *Inspect What You Expect*

No one ever makes a “loan decision”; every decision is a “portfolio decision”



Manage Credit Risk—Portfolio

- *Determine How to Manage Credit Paradox (Credit Priority)*
- *Determine Credit Activities to Achieve Priority (Credit Risk Management Strategy)*
- *Manage for Long-term/Consistent Earnings (Credit Policy)*
- *Establish/Manage Credit Priority Control (Credit Process)*



Risk Management Framework

- *Determine Credit Priority*
- *Implement Appropriate Credit Culture*
- *Determine Risk Strategy*
- *Implement Necessary Risk Controls*

Corporate Objectives

- Philosophy=***Credit Priority*** (*Determine Level of Risk to be Managed*)
 - Growth
 - Profitability
 - Quality
- Action=***Credit Policy*** (*Establish Risk Management Control*)
 - Role=*Communication Of Priority*
 - Focus=*Board Expectations*
 - Outcome=*Personnel Behaviors*

Goal is Long Term Consistency of Earnings

Role of Credit Policy

- ***Credit Policy***, NOT Loan Policy
 - *Strategic versus Transaction Outcomes*
 - Credit Risk
 - *Primary Exposure—Direct Risk*
 - *Secondary Exposure—Indirect Risk*
- Establishes ***Credit Priority***
 - Soundness/Quality
 - Profitability
 - Growth

Ensure to make Credit Policy YOURS!!!!

Role of Credit Policy

- Generates *Desired Behaviors* for Front Line Personnel (***Credit Culture***)
- Determines Criteria for Credit Review (***Inspect What You Expect***)
 - *Policy Compliance*—Doing the Correct Things
 - *Procedure Adherence*—Doing Things Correctly
 - *Risk Rating Reliability*—Monitoring/Level of Credit Administration

Manage PROACTIVELY

Credit Culture

- Culture is Determined by ***ALIGNMENT***
 - Management ***OBJECTIVES***
 - Personnel ***BEHAVIORS***
- Outcome
 - *Loose*
 - *Tight*
- Approach (*Develop/Foster*)

Risk Strategy Actions

- *Utilize appropriate activities/tools to achieve desired priority to generate long-term, consistent earnings regardless of marketplace situation*
- *Proactively Manage COVARIANCE*

Risk Controls

- Focus → *Achieve Credit Priority*
- Action Needed → *Achieve Alignment*
 - Management Objectives
 - Personnel Behaviors
- Results Needed → *Manage Covariance*
- Outcome → *Measure Against Priority*
(Adjust as Appropriate)

Risk Controls

- *Can't Manage What You Can't Measure*
- *Tools*
 - *Underwriting Process* (Standards versus Guidelines)
 - *Structure* (Alignment—Cause/Repayment Source)
 - *Risk Rating System* (Potential Volatility to Repayment)
 - Banker →
 - Bank →
 - *Approval System* (Affirmation of Decision)
 - *MIS/Reporting* (Inspect What You Expect)

Strategic to Tactical Risk Response

- *Be Aware of Marketplace*
 - Challenges to Success
 - Rolling Assessment
- *Develop/Implement Strategic Credit Plan*
 - Credit Policy
 - Credit Priority
 - Short and Long Term Outcomes
- *Execute Strategic Credit Plan—Credit Process*
 - Credit Risk Activities
 - Actions to Achieve Strategic Credit Plan

Credit Risk—Activities

- *Process—What Needs to be Done to Manage Credit Risk?*
- *Systems—How Will Credit Risk Be Done?*
- *People—Who Will Do Credit Risk?*

Process=“What”

- Provides Credit Risk Framework—***Credit Priority***
- Key element is *Credit Policy (Strategy)*
- Provide linkage between Management Objectives and Personnel Behaviors (***Credit Culture***)

Systems=“How”

- Provide for Credit Delivery Activities
- Key element is *Procedures (Tactics)*
- Execution must be customer/employee friendly
- Enable banker to provide value added for customer and bank
 - Credit Risk Management
 - Customer Relationship Management

People=“Who”

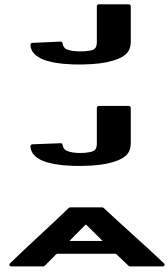
- Must *understand what is expected* to accomplish job responsibilities (***Process***)
- Must *have/use correct tools* to achieve desired outcomes for customer and bank (***Systems***)
- Must *receive correct training* to achieve desired outcome for customer and bank (***People***)
- Must be *given the opportunity* to apply skills successfully for customer and bank (***Incentive***)

Credit Risk Concept

*“You Aren’t Paid to Make
a Loan Decision; You
Are Paid to Manage
Credit Risk!”*

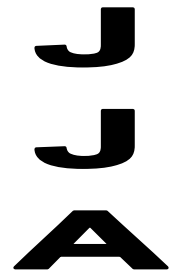
Credit Process Components

- *Portfolio Management—What Are We Trying to Achieve with Credit?*
- *Portfolio Acquisition—How Are We Going to Do Credit?*
- *Portfolio Maintenance—What Do We Do With the Credit Now That We Have It?*



Credit Process Components

- *Portfolio Management*
- Portfolio Acquisition
- Portfolio Maintenance

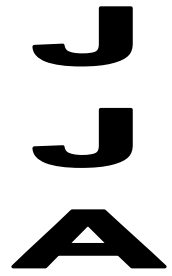


Process—Portfolio Management

- *Philosophy/Objectives*
- *Portfolio Management*
- *Credit Planning*
- *Relationship Planning*

Credit Process

- Portfolio Management
- *Portfolio Acquisition*
- Portfolio Maintenance



Portfolio Acquisition

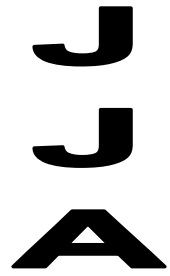
- *Borrower Analysis*
- *Risk Assessment*
- *Structure*
- *Pricing*
- *Approval*
- *Documentation*
- *Relationship Administration*

Credit Risk Defined

Probability

Times

Consequences



Risk Management—Transaction

- Credit Risk *Issues*
 - Probability → *Identifying* Risks
 - Consequences → *Mitigating* the Risks Taken
- Credit Risk *Activities*
 - Probability → *Analysis*
 - Consequences → *Structure*

Credit Risk Management— Transaction

- Credit Risk *Actions*
 - Identify Changes (*Questions*)
 - Anticipate the Future (*Cash Results*)
- Credit Risk *Outcome*
 - ***ALIGN*** the *Probabilities and Consequences* to Achieve Institution's Desired Financial Results
 - ***GET THE CASH BACK***
 - Borrower → Ability to ***REPAY***
 - Guarantor → Ability to ***PAY***

Risk Assessment

- *Financial Analysis → Identify Change*
- *Credit Analysis → Reason/Impact of Change*
- *Anticipate the Future*
- *Credit Decision → Make Recommendation*

Yesterday's Loan Repaid With Today's CASH, Today's Loan Repaid With Tomorrow's CASH!

Credit Process

- Portfolio Management
- Portfolio Acquisition
- *Portfolio Maintenance*

Portfolio Maintenance

- *Credit Review*
 - Policy Compliance
 - Procedures Accuracy
 - Risk Rating Reliability
- *Problem Loan Administration*
 - Philosophy
 - Policy
 - Procedures

Credit Risk Concepts

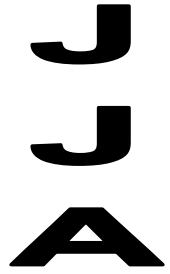
- ***Focus on the Future***
“Yesterday’s loan repaid with today’s cash;
today’s loan repaid with tomorrow’s cash!”
 - ***Be Strategic***
“No one ever makes a loan decision; all
decisions are portfolio decisions!”
- “Credit Policy is your Strategic Plan for your
credit business.”

Credit Risk Concepts

- ***Operate Within Your Competency***
“Bank performance is intersection of its marketplace and its response to that marketplace.”
- ***Balance the Credit Paradox***
“Bane of credit risk is finding the sweet spot between appropriate amount of growth with appropriate amount of quality.”

Credit Risk Concepts

- ***Understand Institution's Credit Culture***
“Maintain alignment between *Management Objectives* and *Front Line Personnel Behaviors*.”
- ***Reinforce Through Ongoing Communication***
“Its about the Message!”
- ***Manage to Desired Outcome***
“Inspect What You Expect””



Credit Quality Management

- *Must Reinforce Business Strategy*
- *Must Be Broadly Communicated*
- *Must Be Proactively Managed*
- *Will Have Significant Impact On Organizational Performance*

Role of Information

- Institution Sources
 - Annual Report
 - Call Report
 - Uniform Bank Performance Report
- Focus of Credit Risk Assessment
 - ALLL/Reserves
 - Provision
 - Non-Performing
 - Charge-offs

Action Plan

- ***Be PROACTIVE***
 - Know Marketplace
 - Know Institution
 - Know Customers
 - Know People
- ***Anticipate the FUTURE***
 - Consider Probabilities/Consequences
 - Manage to Strategy