Navigating the Headwinds of Change

Lessons Learned From The Great Recession

IBANYS

Annual Lending Conference

June 29, 2016

Presenter: Karl Nelson

National Perspective

	2007	2008	2009	2010	2011	2012	2013	2014	2015
INSTITUTIONS	8,534	8,305	8,012	7,658	7,357	7,083	6,812	6,509	6,182
TA	$13 T	$13.8 T	$13.1 T	$13.3 T	$13.9 T	$14.5 T	$14.7 T	$14.7 T	$15.97 T
TL	$7.8 T	$7.7 T	$7.05 T	$7.1 T	$7.3 T	$7.5 T	$7.8 T	$7.76T	$8.72 T
EQUITY	$1.3 T	$1.3 T	$1.4 T	$1.5 T	$1.57 T	$1.63 T	$1.65 T	$1.65 T	$1.80 T
P (L)	$100 B	$4.5 B	($9.9 B)	$85.5 B	$120 B	$141 B	$155 B	$154.7 B	$163.7 B
OREO	$13.2 B	$27.6 B	$41.4 B	$52.7 B	$46.2 B	$38.5 B	$30.2 B	$30.2 B	$14.7 B
NON CURRENT LOANS	$112 B	$233.4 B	$396 B	$359 B	$305 B	$277 B	$207 B	$207 B	$137.8 B
FAILURES	3	25	140	157	92	51	24	18	8

New York Perspective

	2007	2008	2009	2010	2011	2012	2013	2014	2015
INSTITUTIONS	195	196	193	186	178	167	165	159	150
TA	$492 B	$750 B	$624 B	$644 B	$769 B	$839 B	$859 B	$903 B	$996 B
TL	$260 B	$272 B	$241 B	$242 B	$279 B	$304 B	$332 B	$373 B	$434 B
EQUITY	$57.3 B	$69.6 B	$76.1 B	$83.5 B	$89.5 B	$95.5 B	$97.4 B	$100.6 B	$110.9 B
P (L)	$2.4 B	$1.1 B	$3.0 B	$5.5 B	$6.6 B	$6.4 B	$6.3 B	$5.5 B	$7.8 B
OREO	$152 M	$296 M	$452 M	$706 M	$662 M	$476 M	$444 M	$398 M	$430 M
NON CURRENT LOANS	$2.5 B	$4.0 B	$8.0 B	$7.0 B	$6.8 B	$5.6 B	$4.7 B	$3.6 B	$4.2 B
FAILURES	0	0	1	3	0	0	0	0	0

A Closer Look

- New York Banks include five large institutions with Total Assets and Net Income of:
  - BNY Mellon=$319B / $1.874B
  - Goldman Sachs Bank=$135B / $1.682B
  - Manufacturers & Traders=$122B / $1.076B
  - Morgan Stanley Private Bank=$42B / $220M
  - NY Community Bank = $46B / ($59M).

- This leaves 145 NY Banks with Total Assets of $332B and Net Income of $3.007B …
  - ROA =91 bps, ROE = 7.39%, L/D = 80%, ALLL = .85%,
  - C/A=12.26, Cushion = 13.11 and Loan Growth Rate = 11.6%

Industry Loan Portfolio Performance

Average Outstandings

Loan Type	2007	2008	2009	2010	2011	2012	2013	2014	2015
Real Estate	$4.78T	$4.71T	$4.46T	$4.27T	$4.13T	$4.09T	$4.07T	$4.17T	$4.29T
C & I	$1.44T	$1.49T	$1.21T	$1.18T	$1.35T	$1.49T	$1.57T	$1.72T	$1.80T
Credit Card	$422 B	$445 B	$421 B	$702 B	$688 B	$696 B	$691 B	718 B	$713 B
Auto Loans	-	-	-	-	$300 B	$320 B	$353 B	$385 B	$402 B
Consumer Other	$637 B	$644 B	$636 B	$614 B	$620 B	$628 B	$662 B	$700 B	$726 B

Industry Loan Portfolio Performance

Net Charge-Off Experience

Loan Type	2007	2008	2009	2010	2011	2012	2013	2014	2015
Real Estate	.24%	1.20%	2.10%	2.00%	1.36%	1.02%	.48%	.20%	.13%
C & I	.67%	1.24%	2.73%	2.07%	1.03%	.59%	.37%	.26%	.26%
Credit Card	4.13%	5.53%	9.40%	9.93%	5.48%	3.90%	3.41%	3.13%	2.94%
Auto Loans	-	-	-	-	.55%	.52%	.52%	.54%	.58%
Consumer Other	1.53%	2.28%	3.00%	2.05%	1.29%	1.02%	.85%	.76%	.53%

Industry Loan Portfolio Performance

Real Estate Net Charge-offs

Loan Type	2007	2008	2009	2010	2011	2012	2013	2014	2015
Const/Dev	.37%	2.89%%	5.79%	5.66%	3.48%	1.82%	.52%	.03%	(.05%)
1-4 Res Const	.51%	4.07%	7.37%	7.15%	4.37%	1.59%	.55%	.11%	(.01%)
Other Const/Land	.31%	2.39%	5.29%	5.28%	3.28%	1.88%	.52%	.01%	(.06%)
RE Sec Farmland	.01%	.10%	.34%	.43%	.37%	.31%	.10%	.04%	.01%
RE Sec Multi-Family	.26%	1.27%	2.07%	1.84%	.77%	.32%	.11%	.02%	.0025%
RE Sec O-O NF Non Res P	.09%	.22%	.59%	.89%	.74%	.53%	.33%	.10%	.0075%
RE Other NF Res P	.01%	.29%	.95%	1.56%	.98%	.58%	.23%	.07%	.0675%

You Too Can Be A Nerd!

https://www2.fdic.gov/qbp/index.asp

Then search Loan Portfolio Performance Indicators

What Does It All Mean?

- This was our second major failure period …
  - 1982 – 1992 → 2,808 Failures or 255/Year
  - 1989 → 534 Failures
  - 2005 – 2006 → 0 Failures
  - 2007 – Present > 521 Failures

What Does It All Mean?

- This kind of failure period is difficult for all …
- Our Regulators are especially concerned given their role in safeguarding the industry.
- What would you do to limit the possibility of another crisis?

Regulator Response

- We have two lines of defense against failure…
  - The Allowance For Loan and Lease Losses (ALLL)
    - Do You Miss 5%, 10%, etc??
  - My History of the ALLL … 1972 – 2015
    - .25% to 1.36%

Regulator Response

- The Second Line of Defense…
  - Capital

- My History with Capital…
  - Leverage Ratio – 5.00% To 11.28%

- Cushion has increased from 5.25% to 12.64%

The JPMorgan Chase Story

The ALLL Progression

	2007	2008	2009	2010	2011	2012	2013	2014	2015
ALLL	1.60	2.63	4.20	4.07	3.59	2.77	2.12	1.76	1.47
TA ($T)	$1.3	$1.7	$1.6	$1.6	$1.8	$1.9	$1.9	$2.1	$1.9
NET($B)	$10.7	$10.4	$8.4	$11.8	$12.5	$14	$15.4	$14.8	$16.9
S&P	3.5%	(38%)	24%	13%	0%	13%	30%	11%	(1%)

So What?

- In addition to simply expanding the cushion against failure, our regulators have also begun the discussion about Enhancing Risk Management – sometimes called Enterprise Risk Management (ERM).

- Truthfully, based on our experience, we see the Fed and OCC as more interested in a formal ERM structure than either the state or FDIC.

- But, all four are interested in how we avoid another crisis and the single largest issue in all of this continues to be managing Credit Risk.

What Does It Mean For Credit Risk Managers?

- From the ERM Perspective, you should be aware of the kinds of credit stress testing that is going on under both CICARS (Comprehensive Capital Analysis and Review) and DFAST (Dodd-Frank Act Stress Testing).

- Covers About 80% of the Industry Assets and can limit growth and compensation plans for those banks.

- Basic Idea – Subject your loan portfolio to a 2-year adverse economic environment to understand your potential loan losses and their impact on Capital.

What Does It Mean For Credit Risk Managers?

- Is your regulator asking for something in the way of a credit stress test?

- How many are already conducting some kind of stress test, perhaps on your real estate portfolio?

- An analogy … GAP is to Simulation in the IRR arena as Loan Review is to Credit Stress Testing in this arena.

A STRESS TEST IS DIFFERENT – Key ?

Back to Basics

- Some Basics To Think About

  - Separate Sales From Credit – it is too difficult to be responsible for growth and quality.

  - Outsource appraisal process or make sure it is independent.

  - When doing project lending, always have a time-line for the project – it is your way of knowing when a re-grading is needed.

  - Grading our loans is one of our biggest challenges – someone other than the lender should confirm grading.

  - Conduct frequent loan reviews (External at least annually and Internally as needed).

Back to Basics

- Have a credit approval process that is independent of the sales force – stick to the facts of the credit and discourage "marketing" of the credit by the lender.

- Beware of Lines of Credit to real estate entities – they will likely turn into term credits.

- All credit is a function of who you are dealing with, how successful they have been, and how likely are they to repay your loan. Don't be confused about your role – you are not an investment banker.

- Trends are always key in a credit decision – three years financials to observe consistency in revenues, profitability, leverage.

Back to Basics

- Don’t be misled by a “Board” Committee process – typically, they can provide local knowledge but few have ever made a loan.
- If you don’t have a pricing model, look into one – too often we price off the competition and one bad competitor can create real damage to a market.
- Beware of the idea that we can all avoid real estate concentrations issues by doing C & I lending.
- It may be wiser to convince your Board and your regulator that you have the expertise and infrastructure to go outside the guidelines.
- Plan for entry into new lending areas – the strategic planning process has never been more important!