Newsletter of the RMA New England Chapter February 2016

2016 - New Beginnings, New Opportunities

Greetings and welcome to the New Year! This year is poised to be different than what we have grown accustomed over the past several years. The Federal Reserve has increased interest rates for the first time in about nine years; signaling the possible start of a raising interest rate environment. At the moment that I am drafting this message, the impact has not been significant, but we all know that can quickly change. We know there will be more increases to come if our economy continues to expand.

As bankers we need to ask ourselves, how will this impact my customer? How will it impact my portfolio? In an economy that is integrated more globally than it ever has been before, is there a clear path to follow or are we blazing new trails? How do I train my staff for this environment?

There's a saying that I have found useful over the years, "I don't need to have all the answers; I just need to know what my resources are." That is where I have come to depend upon Risk Management Association (RMA) over the years. RMA is a not-for-profit, non-lobbying, member-driven professional association serving the financial services industry. Its sole purpose is to advance the use of sound risk principles in the financial services industry.

RMA's New England Chapter has hundreds of members throughout the State of Massachusetts and beyond. They serve in a wide range of banking roles at institutions, both large and small, and work together in their local communities providing education, training and networking. RMA tackles the most current issues in the industry while contributing to the growth of its members throughout all stages of their career.

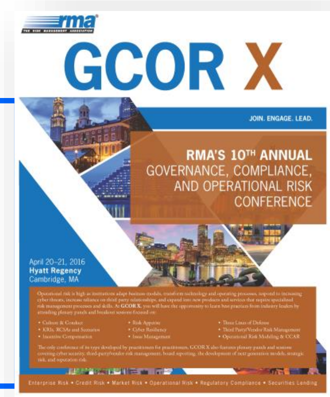
The New England Chapter of RMA is responsible for coordinating and facilitating locally based roundtables, seminars and webinars. We also continue to offer our Commercial Credit for Lenders / Analysts or CCL (usually in October of every year) and our much acclaimed Loan Officer Resident Seminar or LORS (usually in April of every year) for banking professionals who want to further their credit and lending knowledge. Our Enterprise Risk Management, Rising Professionals and Women-in-Banking affinity groups also host targeted educational and networking events. To find more information, visit our website at www.rmanewengland.org.

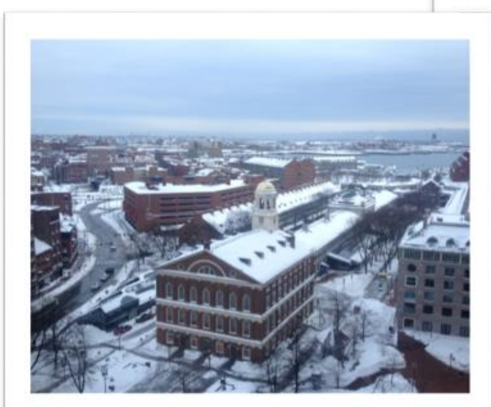
Best wishes for 2016!
Richard Labrecque, *RMA New England Chapter President*

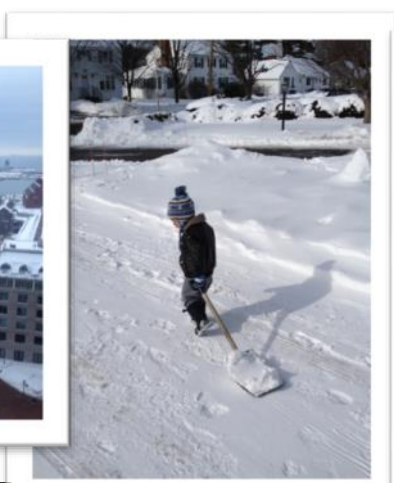
RMA's 10th annual Governance Compliance & Operational Risk conference in Boston

April 20-21

See page 3 for details and for a 10% discount to register







In This Issue

Special Thanks to Our Sponsors

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Hackett Feinberg P.C. is a mid-sized Boston law firm specializing in the representation of national, regional and community banks, institutional and governmental lenders in commercial lending and commercial real estate lending activities. Our lawyers are experienced in enforcement of creditors' rights in state and federal courts, including bankruptcy court. We also counsel small and mid-sized businesses throughout New England, including formation of entities, real estate related transactions, business disputes and employment matters. HF offers sound, attentive and practical legal services to our clients at reasonable rates.

Our Chapter appreciates the support of our Silver Sponsors

The oldest business development corporation in the United States, **BDC Capital** has been recognized locally and nationally as a leader and innovator in business lending and capital investment. Many of New England's leading financial institutions invest in BDC to help promising companies expand. Over 60 years, we have invested more than $1 billion in thousands of companies in New England.

CDC New England is a private, non-profit corporation originally started in 1981 as a Certified Development Company to provide SBA 504 Program loans to small businesses for the acquisition of fixed assets in Massachusetts. Three decades later, CDC has assisted companies throughout New England and now maintains five offices in the region. We are consistently ranked among the top 10% of all CDC's in the country.

Chaston Associates, Inc. is the leading independent loan review company in New England. Established in 1984, our firm has provided outsourced credit risk review and other consulting services to more than 200 banks located across the Northeast and points beyond. Currently, our customer base approximates 100 institutions reporting total assets ranging from $50 million to more than $5 billion.

CEIS Review is an independently owned consulting firm serving the needs of the commercial and savings bank communities as well as those of other commercial lending institutions. Our services include loan review, loan loss reserve methodology and validation, CRE portfolio stress testing, portfolio acquisition review, CRE concentration analysis, credit risk management process review, structured finance review, credit loan policy maintenance, problem loan advisory, credit analysis, regulatory relations, credit database formation, and loan and credit seminars.

PayNet, Inc. is the leading provider of credit ratings on small businesses, enabling lenders to achieve optimal risk management, growth and operational efficiencies. It serves as trusted, strategic advisors to banks and commercial finance institutions. Its data analytics provides these C&I lenders accurate, exclusive credit insights derived from its proprietary database, the largest database of small business loans, leases, and lines of credit in existence. Its database encompasses over 23 million contracts and more than $1.3 trillion in obligations.

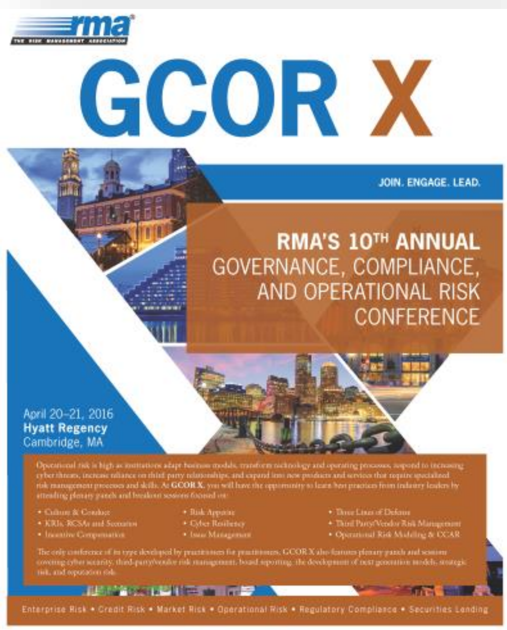
Meet Our New Board Member!

Jim Horrigan began his career in banking twenty-six years ago with Fidelity Bank, a predecessor bank to Wachovia Bank in Philadelphia. While in Philadelphia, Jim was a member of the RMA of Philadelphia. Jim held roles from asset recovery specialist to commercial lender and credit officer

In 2003, Jim moved to the New England area, and joined Brookline Bank in 2012 as a Vice President in Commercial Lending. In addition to the lending roles, he is a member of the bank's Compliance Committee and is responsible for a portfolio of customers from Connecticut to New Hampshire.

Jim has been a volunteer for many organizations in the New England area including as an instructor for Junior Achievement, an instructor for robotics and FLL robotics team leader for St. John's School in Canton . Jim will be utilizing his experience in running classrooms / teams to help develop programming for the RMA.

Exclusive 10% Discount for RMA New England Members



GCOR X, RMA's 10th annual Governance Compliance & Operational Risk conference, will be held on **April 20-21, 2016 in Boston**.

You will learn how operational risk is impacted by heightened regulatory standards, as well as the increasing demands being made upon practitioners in today's increasingly complex, low net interest rate environment. This year's program focuses on cyber risk and third party/vendor risk management but also includes breakout sessions on Risk Appetite; the Three Lines of Defense; Scenario Analysis; KRIs; RCSAs; Incentive Compensation.

Other topics include:

- The linkage between Culture, CFPB Enforcement Actions and Operational Risk
- The Basel Committee's soon to be released Consultative Document regarding the New Standardized Approach for calculating operational risk capital
- Sessions on CCAR and operational risk modelling
- Transformation risk, which will examine the compounding effect of aggregate and significant changes across an organization.

Confirmed speakers include:

- J. Tol Broome, President, BB&T Mortgage
- Tom Hunley, EVP and Retail Risk and Operations Executive, PNC
- Joe Iraci, Managing Director, TD Ameritrade
- Dave Keenan, Managing Director, Morgan Stanley
- Spyro Karetsos, Director of Enterprise Risk Management, Vanguard
- Marco Migueis, Federal Reserve Board of Governors Banking Supervision and Regulation – Quantitative Risk
- Hema Parekh, Principal Examiner/Senior Professional, Risk and Policy, Richmond Federal Reserve Bank
- Jodi Richard, Chief Operational Risk Officer, US Bank

Click here to register. Use Code **GCORNEC** for a 10% discount.

Upcoming RMA New England Events

Sources of Fraud and What to Watch + Implications to Loan Underwriting

Friday, March 18, 2016
11:30 AM – 1:30 PM luncheon
The Conference Center at Bentley
175 Forest Street, LaCava 300, Waltham, MA 02452
Registration Link

RMA Rising Professionals Committee Presents: Downtown Networking Night

Thursday, March 24
5:30 p.m.
Warehouse Bar & Grille
40 Broad Street, Boston, MA 02109
Registration Link

Loan Officer Resident Seminar (LORS)

April 24 – April 29, 2016
The Exeter Inn, Exeter, NH
Registration Link

For over 35 years, LORS has served as a resource for RMA Banks throughout New England by providing Commercial Lending training to bank Credit Analysts and Junior Commercial Lending Officers.

The seminar teaches fundamental credit skills and practical lending techniques using daily seminars in conjunction with related case studies. The week concludes with the popular "Mock Loan Committee," where students apply what they have learned to a presentation in front of seasoned credit and lending professionals. Each instructor during the week is either an experienced lender or credit professional from an RMA member bank or a recognized expert in their field. Based on feedback from previous classes and in recognition of changing trends in the industry, the program is constantly updated to fit the needs of the next generation of commercial lenders.

RMA National Training Courses Held in New England

Lending to the Long-Term Care Industry (Boston) - March 30, 2016

Construction Loan Management:
Administering the Construction Loan Process (Boston) - April 8, 2016

Analyzing Construction Contractors (Boston) - April 15, 2016

Understanding and Interpreting Real Estate Appraisals (Boston) - April 28, 2016

Building Small Business Loan Relationships (Boston) - May 4-5, 2016

Asset-Based Lending for Non-Asset-Based Lenders (Boston) - June 2, 2016

If Interest Rates Continue to Rise - What Does That Mean for Banks?

By William Montague and Marilyn Tressel

Due to the historically slow recovery of US economy during the seven years following the Great Recession (12/2007 – 6/2009), the Federal Reserve held the federal funds rate, the rate banks charge each other for overnight loans, in a range between 0.00% - 0.25% to encourage lending and promote growth. With persistent shortfalls in economic output and below-target inflation rates, the Fed stayed its course with a zero percent interest rate policy, but as both the US and world economies began to recover beginning in Q2 2014, all bets were on when inflation would kick in and the Fed would raise rates. Seven quarters later on 12/16/15 the Fed increased this key rate to a range of 0.25% - 0.50%, the first increase since June 2006.

Fed policy makers indicated in December that they expect to increase the rate four times in 2016. Yet, less than three weeks into 2016, economic issues in China, falling prices of crude oil, and trouble in the high-yield bond market have contributed to "the worst start of any year on record" for US equity markets according to a *Barron's* article by Randall Forsyth on 1/16/16. *Barron's* 2016 Roundtable panelists expect that the Fed "won't hike four more times during 2016, notwithstanding stated intentions…because the market simply won't allow it." One of the panelists, Jeffrey Gundlach, indicated his belief that the Fed "might even be forced to ease again after lifting rates one more time." It seems to go without saying – it is unclear what path future hikes and the shape of the yield curve will take from here, but assuming that the US economy remains healthy and Fed does continue to raise rates, what does that mean for commercial banks and their clients?

Bankers have rightfully noted over the past several years how low interest rates have been dampening their institution's profitability, and as such look forward to rising rates. As described in an *Economist* article from June 2013, the "net interest margin at banks supervised by the Federal Deposit Insurance Corporation has fallen to its lowest level since 2006 (itself a 16-year low for small banks)." While acknowledging the fact that rising rates do bring the potential for an improving net interest margin (NIM), the spread between what banks earn on loans and what depositors are paid, increasing rates can pose some challenges for banks as well.

The initial impact of rising rates on a particular bank's profitability depends on the mix of its assets and liabilities. Banks with a higher proportion of variable rate loans will fare better, whereas banks with a higher proportion of fixed rate loans could actually see a further decline in NIM as rates on liabilities (i.e. deposit accounts) may increase more quickly than on their assets. Institutions which do a significant amount of fixed rate lending utilizing variable rate deposits, and those that stretched for yield in this low rate environment by providing long term loans with fixed rates without interest rate swaps, collars or caps, must be particularly careful right now. An additional layer of complexity related to technological advances is the increasing ease with which customers can switch banks. Historically banks were able to increase rates on loans faster than they increased rates on deposits because of how "sticky" those deposit accounts were – it was difficult and time consuming for customers to switch banks. However, in today's world of online and mobile banking platforms, banks may not be able to take advantage of that lag time in the same way. The loss of this cheap funding base may dramatically alter banks' balance sheets and profitability going forward.

While increasing interest rates will eventually improve the amount of income generated by a particular loan portfolio, a less obvious impact of rising rates is on the value of fixed income assets (such as US Treasury bills and bonds), to which most bank balance sheets have at least some exposure. Interest rates and bond prices are inversely related, and as rates rise holders of fixed rate instruments will see the market value of their investments decline. This could spell trouble for banks that have large holdings of fixed income instruments, as an *FT* article from Sept. '15 notes that this "could hurt banks' book values … [which] matters because banks are often valued by shareholders in relation to their book value."

It is clear to any lending or credit professional that the market for both CRE and C&I loans has become increasingly competitive over the last several years. In part due to the extreme margin compression, banks have stretched and made riskier loans in search of yield. As interest rates rise, borrowers -- especially the recipients of these "stretch" loans -- will find it increasingly difficult to service their debt. An article in the *FT* from Sept. '15 cautioned that "bankers say bad debts start to rise 18 to 24 months after rates start to increase." Borrowers using variable rate loans will feel the impact in the near term, but eventually it will impact all borrowers. Additionally, for loans collateralized by real estate, LTVs may deteriorate as interest rates and cap rates are closely related. Potentially compounding the risk to banks posed by the strain higher rates will place on the cash flow of borrowers is the fact that many market observers believe the business cycle has peaked and is approaching a trough within the next two years. The net result of this is that banks, which for the most part have been systematically reducing loan loss provisions over the last several years as the economy improved, will likely need to begin increasing reserves again, which will reduce profitability.

Another potential hit to profitability related to rising rates is

If Interest Rates Continue to Rise - What Does That Mean for Banks?

Cont'd

By William Montague and Marilyn Tressel

wage inflation. To the extent that increases in interest rates are a response by the Fed to inflation, there will be pressure on banks to increase wages of employees. Compounding it is the need to attract the next generation of bankers which may require salaries more competitive with Wall Street or technology markets. Given that increasing interest rates may not immediately translate to higher NIM, and that banks will face the potential need to increase reserves due to deteriorating loan quality, the last thing that banks will want to see is upward pressure on personnel expenses.

While increasing interest rates should prove to be beneficial for well-run banks with good asset quality and well managed balance sheets (i.e. a favorable mix of variable and fixed rate loans as well as intelligent management of funding sources) for banks that have stretched to chase yield by taking interest rate risk and making loans to riskier borrowers, a rising rate environment could make the next few years significantly more challenging.

BOSTON PRIVATE

CEO Series Event with Clayton G. Deutsch, CEO of Boston Private Financial Holdings, Inc.

RMA New England Chapter's Rising Professionals group organized its 11th annual CEO Series event, featuring Mr. Deutsch. This annual event brings together the most experienced and distinguished bankers in Massachusetts with the next generation of banking professionals. It was a unique opportunity to learn firsthand about Mr. Deutsch's successful career in banking, including its challenges, crossroads, and successes. Below is a summary of takeaway points.

Most Durable Career Advice:

- Networking – The better networked you are, and the stronger your relationships with your business partners are, the further you will go.
- Surround yourself with great people – It's more important than what firm you're with and what group you're in, as you're likely to play to the level of those around you.
- Credit skills and balance sheet expertise – Combining the expertise of a credit officer and a treasury officer put you in a good position to play a leadership role within the bank.

Keys to Success as a Commercial Banker:

- Great Commercial Bankers are credit people first, everything else is second. Focus on the credit issues and defense of the Bank first, even in the hard times, and the Bank will do well.
- Lending is about risk management and client selection first, then structure and pricing. Good clients pay you back, collateral doesn't. Understand and choose the good clients, not just a good loan opportunity.
- Clients and businesses repay loans, not assets and collateral. Don't focus on collateral as much as who will be repaying the loans. Make business analysis and cash flow analysis your primary concern.
- Always think of credit and risk dynamically. Don't rely on static financial statements to tell the whole story of a company and assume that's all there is. Everything is cyclical. The biggest complicating factor in lending is unexpected changes—try to be as prepared as you can be for them.
- First level thinking in banking is understanding the basics of financial analysis. Second level thinking is the ability to understand what happens when everything goes wrong. To see and understand, and possibly predict, the impacts of massive change is what it takes to lead a bank.
- Lending and credit standards define the reputation of the bank. Take courage to draw the line somewhere and not cross it. Be credit driven, not lender drive. Lender driven institutions do not succeed as well as credit driven ones.
- Credit people will never overcome bad lenders and bad management. If you're in a credit function and lenders are constantly overriding you, it's a toxic situation and you should move on from it.
- Some of your best, lifelong clients come from challenging situations. Know when to work with clients that have fallen on tough times. It is worth taking calculated risks to help clients through tough times as those that survive may well turn out to be some of your best relationships down the road.
- Be proud of what you do every day. Embrace the role that you as a banker play in the health and vitality of your local community as well as the greater economy. Banks and financial institutions are huge job creators, provide a critical function in the local and national economy, and often add tremendous value to their communities.

Street Chatter

Interview with Jack D'Ambrosia of Chaston Associates

By (Dima) Neil Berdiev

A few years ago, we invited Jack D'Ambrosia of Chaston Associates to share his thoughts on then current trends and recent lessons learned. Jack was eager to accept our second invitation to offer advice and insight that our readers will find of value. Below is a summary of the conversation that took place in January 2016.

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Mr. D'Ambrosia noted that lending at near credit policy underwriting thresholds and approaching lending limits is the result of highly competitive environment and the pressure to deploy assets. This is quite common among many banks in today's market place, including the largest national lenders. As risk profiles rise at the top of the lending curve, Mr. D'Ambrosia recommended that banks put in perspective where we are presently in the economic cycle. There is pressure to push debt service, LTV, advance rates, facility terms, pricing, and other parameters to their limits in an economic environmental that is less robust and certain than before the Great Recession. Mr. D'Ambrosia urged all commercial banks to think where we would be 1, 2, or 3 years from now. If you are pushing DSCR to 1.20x or less, LTV toward 80%, and approve increasing number of policy exceptions, stress test individual deals and loan portfolios for potential economic downturns. If you have portfolio concentrations, whether CRE or other portfolios, now it is even more critical to identify, measure, monitor, and manage credit risks.

The U.S. economy appears to be doing quite well. Yet, China, Europe, negative interest rates in Europe and Japan, struggling commodities' markets, Latin America, and expensive U.S. dollar all pose significant risk to the stability of the domestic recovery. Even locally, while the Boston market and the 128 Belt may largely be doing well, there are communities that struggle north and south of Boston, on the Cape, in western parts of the state and other parts of New England. A recent Bloomberg article highlighted that economies of some states are already faltering, raising questions of whether the contagion will spread to other parts of the country. All this data is a reminder that we can't forget the lessons of the last and prior recessions and need to focus on sounds credit analysis and risk management. Booking deals today has to take into account an assessment of how borrowers will be impacted by the economic challenges that are on the horizon.

Our guest discussed the possibilities of a disconnect between lending to a particular entity and the financial condition of the entire group of related companies. If your deal does not work on its own merits and you rely on the financial strength of related entities, global CF and other covenants do not have much meaning if you do not have control of other entities. By the time the global covenants get triggered and by the time you find out about it (sometimes months later), it is usually too late. Think whether your reliance actually makes sense and can be enforced. Run through scenarios when it is too late and you are truly relying only on your direct borrower. You may find yourself in the situation that you have nothing else left.

It is also important to think in reverse. If your immediate borrower is doing well but under the global umbrella there are many entities at risk, what if this deck of cards forces your borrower into distress? Does your deal make sense when affiliated entities are in the red? What would happen if the economy is in a rapid decline, as it happened in 2008 and similar to what happened to oil and other commodities?

The discussion also touched upon the need for talent, especially experienced credit professionals and managers. There are opportunities to develop your talent internally, but you need a sound strategy, a vision on how to develop your talent pipeline, and consistent implementation (as opposed to intermittent, if-time-permits efforts).

Mr. D'Ambrosia noted a trend and interest in bringing automation to underwriting and portfolio management workflow and processes. However, he cautioned that technology in itself is not a solution to commercial banking challenges. It needs to work for your organization, which means that you need to spend time and efforts to develop robust frameworks that technology will automate and will make more efficient, as opposed to buying fintech solutions and trying to "cram" your teams into them. Lack of proper planning may cost you thousands of dollars and waste valuable resources in such projects.

Lastly, Mr. D'Ambrosia recommended looking closely at CRE appraisals, more than just the bottomline number. Understand what appraisal tells you about property's background and trends. Do adjustment rates make sense? Critical underwriting is important at this juncture. Our guest emphasized that lending per policy does not automatically mean lending at your policy limits. Make sure you adjust your credit risk management approach as the economy and other factors change. Operating on the edge of your policy will likely have its costs in the near future in an environment where commercial lending maybe overheating.

You may reach Jack D'Ambrosia at JDAmbrosia [at] ChastonAssociates.com or at 978-686-3688.

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WE WANT TO HEAR FROM YOU!

We are a group of high energy banking and non-banking professionals who put together educational, networking, panels and various other events and programs. We work within our business community to bring value to our peers through a wide range of services and products.

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