THE RISK MANAGEMENT ASSOCIATION
Serving the Financial Services Industry

New England Chapter Newsletter

From the Chapter President

To my fellow RMA Members,

On behalf of your Chapter's board of directors, Happy New Year! This past year presented challenges that none of us could have imagined when we raised our glasses to toast New Year's Day 2020. I'm proud of our chapter, and our entire RMA organization, for the ways in which it met these challenges through enhanced virtual programs including new and timely topics. We are working with our members to develop programming and we have created a new monthly Lunch and Learn series to address current topics and concerns. Thus far, these programs have been well-received and well-attended. The Chapter looks forward to continuing to develop the series and asks for your continued feedback. You will find descriptions of our upcoming programs within these pages.

Our **Chapter Sponsors** are the lifeblood of our chapter. They provide financial support as well as guidance on topics critical to the banking industry in these unprecedented times. Each of our sponsors is a well-respected thought leader in their industry. We have created a section of our newsletter that we call ***And Now, a Word From Our Sponsors***. Within these pages you will find articles from our Gold Sponsor Crowe LLP, and Silver Sponsors BDC Capital/CDC New England and ORMS. Stay tuned for new thought leadership content in each of our upcoming quarterly editions of the newsletter.

Lastly, thank you for your support of our organization. RMA has served the banking industry for over 100 years, since its founding in 1914, and it currently services approximately 1900 Institutional Members, and 18,500 RMA Associate Members. RMA welcomes all personnel involved in lending and risk management in member organizations to become RMA Associates.

We look forward to seeing you at our virtual monthly programs, and in hearing from you with your ideas on future topics, and also how RMA can better serve you.

Sincerely,

John Pratt
2021 RMA New England Chapter President
jpratt@lowellfive.com

Upcoming Chapter Events

Lunch & Learn Zoom Webinars

CEO Series
With David Glidden, President and CEO of Liberty Bank

Tuesday March 16, 2021
12:00 – 1:00 p.m.
via Zoom

Free for RMA members
Questions for panelists welcome within the Zoom chat

Please join us for a Fireside Chat with David Glidden, President and CEO of Liberty Bank headquartered in Middletown, Connecticut. Dave will discuss a broad range of issues facing regional banks today. He will be moderated in this forum by Paul Flynn, Jr., President and CEO of BDC Capital and CDC New England.

Topics may include:

- Future risks and opportunities in commercial lending
- Industry trends

Register in advance for this webinar:
https://rmahq.zoom.us/webinar/register/WN_qKUMyXHuRkOBfEW_tspizg

After registering, you will receive a confirmation email containing information about joining the webinar.

Our chapter presents opportunities for individuals to get involved. Chapters rely on the talents of volunteers to stage many of their programs, conduct membership development efforts, and promote the ideals of the Association. To find out more about how you can get involved in our chapter, contact:
Julie Conroy, Julie@rmanewengland.org.

RMA Publishes M&A Playbook

The Risk Management Association has published an M&A Playbook to assist member institutions in navigating the complexities of an M&A transaction. The Playbook was conceived by RMA's Mid-Tier Bank Council and was drafted under the auspices of the Operational Risk Council. The RMA Bank M&A Playbook provides checklists, frameworks, data, and insights for financial institutions to reference as they navigate the M&A process, from initial consideration to closing.

The Playbook is divided into four sections, an Introduction, which provides historical data from 2015—2019, as well as general M&A considerations, followed by Parts I-III described below:

Part I, "Applying Judgment to Bank Merger Checklists," covers questions executives and directors should ask and answer before beginning merger discussions. For example: "Why do we believe the merger will not put at risk the acquiree's most profitable current customer/client relationships?"

Part II, "Merger Checklists," includes checklists regarding objectives and concerns covering due diligence, credit quality, legal, and regulatory issues.

Part III, "Synergy Risk and Disruption Risk During Mergers: Bank Merger Data 2014-2019," puts into context data and metrics from recent M&A transactions, and what they mean for your institution's experience.

RMA institutional members interested in purchasing the M&A Playbook should contact their Regional Manager.

December, 2020 ABL Event Summary

The RMA New England Chapter hosted a Zoom Webinar on Asset-Based Lending (ABL) on Dec.3rd, 2020 which was attended by over 100 RMA members. The Chapter's Women's Affinity Group planned the event.

Panelists included:

Caitlin Martell, Assistant VP, Asset Based Lending, BDC Capital
Jessica Melching, Senior Vice President, Senior Commercial Credit Officer, Rockland Trust Company
Yvonne Kizner, Senior Vice President, Asset Based Lending, Cambridge Savings
Kate Brunelle, VP, Team Leader, Workout Dept., TD Bank

The event was moderated by Carol Brennan, Director of Business Development, BDC Capital, an RMA New England Chapter sponsor.

The 1 ½ hour event discussed all aspects of ABL from the perspective of an ABL relationship manager, a credit officer, a workout officer, and a field auditor. Topics included a comparison of ABL with conventional lines of credit and factoring, monitoring frequency and field audits, ineligible receivables and insurance, and a credit profile of typical ABL borrowers.

A post-event survey of the attendees found that the event was very well-received, with an overall ranking of 4.9 stars (with 5 being perfect).

Attendees' comments included:
"The entire discussion was very informative and I learned a lot about ineligibles and why certain items are included/excluded from a workout perspective."

"The panel provided excellent insight from their experience in the field. This panel provided explanation of asset-based lending for all stages of the lending process."

"Terrific program - very experienced professionals who openly shared their knowledge."

View the recording of the event at:
https://rmahq.zoom.us/rec/share/glh3SF6Br1zGjW7yLmEwWzroLJxYqu1PmT6ZeBBItEWwWi6qyzUbLMf6pmJ2dfgc.INqMdn_A9jygMMwm

Passcode: D.ceK=9V

And Now, A Word From Our Sponsors

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Are You Ready For Loan Review 2.0?

By Giulio G. Camerini, CRC

Lending institutions face unique challenges in 2021. Leading up to 2020, regulators and industry professionals voiced growing concerns related to the easing of underwriting, prolonged increasing of commercial real estate (CRE) values, risk tolerance complacency, and how much longer the good times could continue – which the ongoing public health crisis answered.

COVID-19 propelled businesses and borrowers into a liquidity crisis like most have never experienced. Economists already identified the start of a recession in early 2020, but as lending institutions we have been assessing closely if – or when – the liquidity crisis will transitioned to a credit crisis for our unique institution. The first and second quarter of 2021 will be very telling. Never has a bank's loan review function been more important .

On May 8, 2020, interagency guidance was released on credit risk review systems. The guidance was well-timed given the pandemic but wasn't impulsive, as the regulatory agencies began their review process in October 2019. The guidance focused on two key pieces of the puzzle needed for effective credit risk systems: a solid credit administration function and independent credit review.

The guidance highlighted the importance of a loan review policy and how it should incorporate the following areas:

- Qualifications of credit risk review personnel
- Independence of credit risk review personnel
- Frequency of reviews
- Scope of reviews
- Depth of reviews
- Review of findings
- Communication and distribution of results

These policy areas are highlighted to help drive a successful function that provides the right level of independent challenge to the organization on issue identification, risk rating accuracy/timeliness, policy adherence, policy depth, trends, and management effectiveness. Independently reporting these observations to the board and all stakeholders provides an in-depth independent assessment to help verify the strength of internal controls and the timeliness of grading. It also provides assurance that management's reporting and allowance levels are reasonable.

Fast forward one month to June 2020, and loan review was top of mind for these same regulatory agencies, which released "[Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Financial Institutions]" (FDIC PR-72-2020). This guidance looked to address the unique challenges to consider when conducting safety and soundness assessments in these unprecedented times. The guidance memorialized how examiners will consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and exercise appropriate flexibility in their supervisory response. It speaks specifically to credit risk review (loan review) by stating the following:

- **Credit risk review.** Examiners will recognize that the rapidly changing environment and limited operational capacity might temporarily affect an institution's ability to meet normal expectations of loan review (such as a schedule or scope of reviews). Examiners will assess the institution's support for any delays or reductions in scope of credit risk reviews and consider management's plan to complete appropriate reviews within a reasonable amount of time.
- **Classification of credits.** The assessment of each loan should be based on the fundamental characteristics affecting the collectability of that particular credit, while acknowledging that supporting documentation might be limited and cash flow projections might be highly uncertain.

Loan portfolios are a lending institution's lifeblood. Portfolios drive earnings but also can be the largest threat to an institution's ongoing viability. In this rapidly moving environment, it is key to have a loan review function that is up to the challenge.

Operating an effective loan review function

Large- and medium-sized financial institutions often opt to maintain an in-house loan review department. While this decision makes sense for some institutions, establishing and maintaining an effective and credible internal loan review operation can present significant challenges.

Credit department responsibilities have grown increasingly complex in recent years, not only due to regulatory demands but also because of a rapidly changing credit environment and new types of credit products. With these heightened expectations, loan review functions are being pressured by regulators and external auditors to raise the bar. Is it time to step back and assess whether your loan review function has adjusted to the changing environment and the products you offer?

Answer these questions to help take a step back and determine if your institution has a robust loan review function that not only meets the demands of the regulatory guidance but is built to meet the demands of the future as well.

Taking stock: How effective is your loan review function?

Does your loan review meet the demands of regulatory guidance? Answer these questions to perform a high-level assessment of your loan review area.

Oversight, structure, and governance

- How effective are board reporting and oversight procedures?
- Is there adequate oversight by the institution's executive management?
- Is the loan review function fully independent of the lending process?
- Are findings and reports presented directly to the board or board committees?
- Is the loan review function evaluated regularly by an independent party?

Loan review charters, policies, and procedures

- Are there compliance and regulatory gaps or deficiencies within the loan review section of the institution's loan policy and procedure manuals?
- What additional enhancement should be made to the loan review policy and procedure manuals based on industry best practices?
- What are the key findings from interviews with members of management and on-site reviews of the loan review processes?

Scope of loan review

- How often is the scope of the loan review function revisited?
- What is the process for reviewing the scope? Does the organization do a risk assessment to review scope?
- What new lending products have been added, and are non-loan investments part of scope?
- What are the areas of concentration? Have they changed over time?

Content of work papers

- Do work papers provide proper detail and show how conclusions are calculated?
- Are risk-rating assignments accurate, timely, well-supported, and consistent with policy guidelines?
- How accurate and timely is credit analysis?
- Do work papers adequately capture credit administration issues or trends and identify lapses in monitoring or documentation?
- Is problem loan management adequately assessed and documented?
- Is there adequate tracking of trends such as policy exceptions, documentation, and credit administration concerns?
- Is there sufficient credit and collateral documentation?

Reporting

- Do scheduled reports adequately reflect content and trends from work papers?
- Are policy exceptions tracked and verified?
- Is there an adequate process for following up on issues? Are management responses well-thought-out, with specific actions and timelines?
- Are issues from prior reports followed up on subsequent reviews?
- Does the audit committee maintain adequate involvement?

Staffing

- Is there enough staffing to meet the annual loan review plan?
- How effective are training and continuing education in the department?
- Are the competencies, qualifications, experience, and depth of personnel adequate?
- Are the qualifications of third-party providers or contractors reviewed and confirmed?

Want to learn more about how we can help you strengthen your loan review function?

BDC CAPITAL Financing Solutions

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Mezzanine Capital: Royalty-Based Private Equity Financing
A New Investment Alternative for Private Companies

BDC Capital, the oldest business development corporation in the United States, has been providing capital to private companies throughout New England for more than 65 years. When planning a fund raise for a new mezzanine investment fund in 1999, we struggled to find an alternative to the classic subordinated debt with warrant structure that most mezzanine firms use. BDC recognized that valuations in 1999 were high and warrant positions could very well prove to be worthless in the event of a downturn in valuations. This position proved to be well thought out in retrospect when valuations subsequently declined driving IRRs on vintage year 1999 funds to negative territory five years later.

BDC was also looking for a way to obtain appropriate mezzanine returns without having to rely on an exit “event” at some point in the future that may or may not happen. Drawing from our experience on the lending side of their business, we created a new model for royalty-based mezzanine financing. Royalty-based mezzanine financing is also a good fit with closely-held or family businesses where there is no sale of the business planned during the investment timeframe of the mezzanine debt. BDC can also utilize the traditional mezzanine structure if that is a better fit with the needs of a customer.

Since developing the model and raising our first institutional fund in 1999, BDC Capital has now raised four funds. Both demand for capital and returns have been strong. These funds are for growth-oriented private companies, located in New England, needing capital from about $1 million to $5 million.

A royalty-based mezzanine investment is structured as subordinated debt, usually carrying a fixed interest rate, and an additional equity feature in the form of a royalty, based upon a certain percentage of sales. The percentage varies for each company but usually falls in a range of one tenth of 1% to one half of 1% of annual sales. The unique features of this type of financing are:

- No ownership dilution and no loss of control. BDC does not take any ownership interest and does not take Board seats.
- No back-end payouts. The subordinated debt and the royalty are amortized and repaid over a five-year period. Once repaid, there are no further amounts due.
- Very inexpensive equity capital versus alternatives. Warrant positions for classic mezzanine funds are usually repurchased using a company's after-tax dollars. With a royalty-based, subordinated debt structure, both the royalties and the interest are tax-deductible expenses to the company, thereby allowing the company to repay its capital in pretax dollars. For profitable companies, this form of private equity financing can cost as little as 12-14% when converted to an after tax dollar equivalency.

This form of financing produces win/win results for both the company and for their bank. While the company obtains low-cost subordinated debt, the bank views this financing as part of the equity capital due to the subordinated feature which allows the bank to trigger a standstill on payments to BDC in the event an expansion plan goes awry.

This type of financing is not for everyone. Companies need to possess strong management teams and a well thought out business proposition. BDC seeks companies with unique and defensible product or market niches with those qualities reflected in strong gross profit margins. BDC also looks at the ability of management to scale the business and to generate strong future cash flows.

For more information, visit our web site at bdcnewengland.com, call us at 781-928-1100, or contact:

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In 2021, Outsourcing Your Environmental Risk Management Makes Perfect Cents

By Derek Ezovski,
President of Outsourced Risk Management Solutions LLC

The risks related to environmental exposure have always kept real estate lenders up at night. Now, as the pandemic crisis causes loan delinquency and foreclosures to rise, environmental and other collateral risks are moving to the forefront of lenders' concerns. To meet this challenge head-on, lenders must ensure they keep their environmental and other collateral due diligence policies and procedures current and follow their guidelines to the "T".

To address this challenge, big national and regional banks have the resources to establish dedicated internal risk management departments. They often can afford to hire and train environmental compliance specialists well-versed in reviewing questionnaires, ordering and analyzing environmental reports, and ensuring the institution is fully compliant with the latest standard operating procedures and guidance from regulators and agencies such as the Small business Administration.

But smaller community-focused banks and credit unions don't have the same flexibility. Stretched thin by miniscule profit margins and rising labor and overhead costs, small- to mid-sized financial institutions typically delegate crucial environmental due diligence tasks to internal staff working in unrelated areas. Such staff are often overworked, undertrained, and forced to handle multiple responsibilities. Environmental due diligence naturally falls to bottom of their list. This is a recipe for failure, exposing the bank to the substantial but avoidable risks of liability and collateral loss.

Many community institutions are choosing a different path. They outsource their environmental and collateral due diligence functions to an experienced third-party firm, in essence creating a "virtual risk management" department. Here are five reasons why the outsourcing approach makes perfect "cents":

1. Reduces Overhead Expense: Outsourcing the risk management function transforms an expensive fixed cost to a reasonable variable cost that can be passed on to the borrower. Instead of covering salaries, benefits, and FF&E for an internal risk management department, you pay only for the services you need, when you need them.
2. Reduces Lender Liability: Most reputable third-party risk management firms will agree to assume the

liability associated with any pre-existing environmental conditions that were not documented during the initial due diligence process. Although lending is a game of calculated risk, this will help you sleep better at night!

3. Leaves Your “Aces in Places”: Your loan officers and business development officers are paid to generate loan volume and grow client relationships. Their time shouldn’t be wasted on ordering and tracking down environmental reports and conducting internal reviews. By outsourcing environmental due diligence to a virtual risk management department, your lenders can focus on what they do best: working with their clients, developing business opportunities, and closing deals!
4. Provides Ready Access to Experts: Small lenders struggle to find and hire experts well-versed in current environmental laws and regulations, with the credentials and experience to understand and manage the many risks associated with real estate lending. Outsourcing provides anytime access to the best in the business, at a fraction of the cost of hiring in-house. Some consultants also provide entrée to an extensive network of specialist providers, including environmental engineers and appraisers.
5. Gives You All the Tools You Need: Lenders also get access to a proprietary set of proven tools for the effective and efficient management of the environmental due diligence process. And because one size never fits all, leading vendors like ORMS will tailor your toolbox to ensure you get and pay for only what you need, and nothing more.

When selecting the best environmental risk management firm for your needs, experience, expertise, and a record of accomplishment should rank high on your list of criteria. Outsourced Risk Management Solutions, LLC (ORMS) specializes in working with community and regional lenders. ORMS’ leadership team comes armed with degrees in civil and environmental engineering and environmental science, and years of internal and external risk management experience working at large nationwide lenders and consulting firms. Best of all, ORMS has an unmatched reputation in the industry for providing outstanding, responsive service and the personal touch.

Outsourcing your real estate risk management program to a firm like ORMS is also the most cost-effective approach. Through ORMS’ unique staged fee structure — the ORMS Escalation program —duplicate charges are avoided when additional levels of due diligence are required. You pay only for the due diligence services you need, when you need it.

Isn’t it time to consider the “cents-ible” choice?

Derek can be reached at 877.407.ORMS or via email at dezovski@orms.com.

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