Comptroller of the Currency
Administrator of National Banks

Presents:

Concentrations of Credit Web Conference

A Web and Telephone Seminar

Thursday, April 12, 2012

2:00 PM – 3:30 PM Eastern
1:00 PM – 2:30 PM Central
12:00 PM – 1:30 PM Mountain
11:00 AM – 12:30 PM Pacific

Presented By:

Jennifer Kelly
Darrin Benhart
Francis Plonkey
Brent Spencer
Timothy Ward
Matt White

19003

Comptroller of the Currency
Administrator of National Banks

US Department of the Treasury

A Web and Telephone Seminar

Concentrations of Credit
Comptroller's Handbook

Thursday, April 12, 2012

2:00-3:30 p.m. EDT

Speaker Biographies
PowerPoint Presentation
Evaluation Form

Jennifer C. Kelly

Senior Deputy Comptroller
Midsize and Community Bank Supervision

Jennifer C. Kelly is the Senior Deputy Comptroller for Midsize and Community Bank Supervision at the Office of the Comptroller of the Currency (OCC). In this capacity, Ms. Kelly is responsible for supervising more than 2,000 national banks and federal savings associations, as well as 2,000 OCC employees. She is a member of the OCC's Executive Committee and the Committee on Bank Supervision. She assumed these duties in April 2008.

Previously, Ms. Kelly was Deputy Comptroller for Midsize and Credit Card Bank Supervision and was in charge of the supervision and oversight of the OCC's Midsize and Credit Card Bank Supervision programs. Before that, she was the Deputy Comptroller for Continuing Education, overseeing the training and development of the OCC's examining staff.

Ms. Kelly joined the OCC in 1979 as an Assistant National Bank Examiner in San Francisco, Calif. She was commissioned as a National Bank Examiner in 1983. She has extensive experience in bank supervision, including problem banks, and policy development. She also completed a yearlong assignment in the bank supervision department of the Bank of England.

She holds a bachelor of arts in economics from Mount Holyoke College in South Hadley, Mass.

Darrin Benhart

Deputy Comptroller for Credit and Market Risk
Credit and Market Risk

Darrin Benhart is Deputy Comptroller for Credit and Market Risk at the Office of the Comptroller of the Currency (OCC).

Mr. Benhart serves as a principal adviser on emerging systemic risks that face the banking system. His office oversees agency-wide credit risk analysis projects and sets OCC policies for commercial and retail credit risk. He has served in this role since August 2011. He is also co-chair of the agency's National Risk Committee, which coordinates OCC risk identification practices.

Previously, Mr. Benhart served as the OCC's Director of Commercial Credit Risk where he oversaw a team responsible for commercial credit policy issues and commercial credit analytics. Since joining the OCC in 1992, Mr. Benhart has served in numerous technical and managerial roles, primarily as a field examiner. He directed the OCC's credit-related supervisory activities and managed a staff of commercial and retail credit examiners based in many of the largest banks that the OCC supervises.

Mr. Benhart holds a bachelor of arts in finance from the University of Northern Iowa. He is a commissioned National Bank Examiner.

Franc Plonkey

Commercial Risk Specialist
Credit and Market Risk

Franc Plonkey is the Commercial Risk Specialist in the Credit and Market Risk Division at the Office of the Comptroller of the Currency (OCC). As Commercial Risk Specialist, Mr. Plonkey provides expert guidance and technical assistance to the OCC's field staff and bank supervision operations staff on commercial credit policies, regulations, and emerging credit risk issues. He assumed these duties in February 2012.

Previously, Mr. Plonkey served as a National Bank Examiner in Denver, Colo., and as a problem bank analyst in Washington, D.C. He joined the OCC in 1998 as an Assistant National Bank Examiner in Denver.

Mr. Plonkey received a bachelor of arts in economics from the University of Montana.

Brent Spencer

Acting Director, Commercial Credit Risk
Credit and Market Risk

Brent Spencer is the Acting Director of Commercial Credit Risk at the Office of the Comptroller of the Currency (OCC). He is responsible for providing information and policy guidance on emerging commercial risks and supervisory issues confronting national banks and federal savings associations. Mr. Spencer develops and communicates the OCC's commercial credit risk policies, guidance, and examination procedures to industry and examiners. He assumed this role in January 2012.

Previously, Mr. Spencer served as a community and midsize National Bank Examiner, a midsize national bank commercial credit team leader, an Examiner-in-Charge, and a bank information-technology specialist. He joined the OCC in 1990 in the Fort Worth, Texas, field office.

Mr. Spencer graduated magna cum laude with a bachelor of arts in finance from the University of Texas at Arlington. He also holds several information-technology industry certifications.

Timothy T. Ward

Deputy Comptroller for Thrift Supervision
Midsize and Community Bank Supervision

Timothy T. Ward is the Deputy Comptroller for Thrift Supervision at the Office of the Comptroller of the Currency (OCC). In this role, Mr. Ward is dedicated to the OCC's supervision of federal savings associations. The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 mandated the integration of the Office of Thrift Supervision (OTS) into the OCC and created the position of Deputy Comptroller for Thrift Supervision. Mr. Ward assumed this new position in November 2010. He was responsible for planning and overseeing the OCC's integration of the OTS examination and supervision functions.

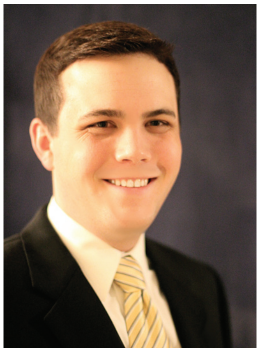
Before assuming his current position, Mr. Ward was the OCC's Deputy Comptroller and Senior Advisor to the Senior Deputy Comptroller for Midsize and Community Bank Supervision. In this role, he was involved in a wide range of bank supervision issues since February 2010, when he joined the OCC. Before joining the OCC, Mr. Ward served in many thrift supervision and leadership roles during his 26 years with the OTS and its predecessor agency. His federal career began in 1983 with the Federal Home Loan Bank of Atlanta.

In 1998, he moved to OTS headquarters, where he coordinated the agency's regional information systems functions. In 2000, he assumed the role of OTS's Chief Information Officer (CIO). From 2002 to April 2007, Mr. Ward served as CIO while also serving as Chief Financial Officer (CFO). He was responsible for establishing OTS policy in a number of other areas, including corporate applications, consumer affairs, international operations, economic analysis and research, interest rate risk management, and Basel II capital accord implementation. From 2007 to 2009, Mr. Ward was the OTS's Deputy Director for Examinations, Supervision, and Consumer Protection, and was responsible for the supervision of four regional offices and hundreds of savings associations and their holding companies.

Mr. Ward graduated magna cum laude with a bachelor of science in business administration/finance from Auburn University.

Matthew White

Commercial Credit Lead Expert Support
Midsize Bank Supervision



Matthew White is the Commercial Credit Lead Expert Support for Midsize Bank Supervision with the Office of the Comptroller of the Currency (OCC). As the lead expert support, Mr. White assists in the supervision, quality assurance, portfolio monitoring, and examination of midsize national banks and federal savings associations. He has served in this position since August 2011.

Previously, Mr. White served as the Acting Commercial Credit Lead Expert for the OCC's Southern District. He is one of the lead developers of the OCC's income-producing commercial real estate portfolio stress-testing tool. He joined the OCC in 2005 as a National Bank Examiner in the San Antonio, Texas, field office.

Mr. White graduated from Auburn University with a bachelor of science in finance.

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Office of the Comptroller of the Currency Web Conference

Concentrations of Credit

Comptroller's Handbook

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Agenda

- Background

- Concentrations of Credit Handbook – December 2011

- Key Concepts
  - Definitions
  - Governance
  - Identification
  - Correlation
  - Mitigating Risk
  - Management Information Systems (MIS)
  - Supervisory Expectations
  - Stress Testing

Background

- Excessive concentrations of credit have been key factors in banking crises and failures.
- Identifying, measuring, monitoring and controlling concentrations risk are critical parts of sound risk management.
- Credit concentrations combined with concentrations in volatile funding increased stress for some banks during recent downturn.

Concentrations Handbook

- Applies to national banks and thrifts
- Replaces Comptroller’s Concentration Handbook dated March 1990 and OTS Asset Quality Examination Handbook Section 201.4-5
- Reinforces and enhances interagency guidance from OCC Bulletin 2006-46 which addressed CRE Concentration Risk Management
- Focuses on concentration risk management, including various types of credit concentrations beyond CRE concentrations

Key Concepts

- Defining Concentrations
  - Pools of Transactions with Similar Characteristics
- Governance
- Identifying Concentrations
- Correlation of Pools
- Mitigating Concentrations Risk
- Management Information Systems
- Stress Testing

Defining Concentrations

- Existing regulatory guidance defines concentrations as direct, indirect or contingent *obligations* exceeding 25% of capital
  - *Obligations* include both outstanding balance and unfunded commitments
  - OCC uses Tier 1 Capital plus the ALLL to measure concentration exposure

Defining Concentrations

- Pools of individual transactions may perform similarly:
    - Pools of individual transactions may result in layered risk, due to **common characteristic** or **common sensitivity** to economic, financial or business developments
    - **Even if each individual transaction within a pool is soundly underwritten**

Defining Concentrations

- Credit concentrations can adversely impact balance sheet beyond the loan portfolio
    - Investment and trading portfolios
    - Off-balance sheet activities
- Credit concentrations are evident beyond industry types
- Credit concentrations can increase interest rate risk, liquidity risk, price risk, operational risk, compliance risk and strategic risk

Governance

- Board should ensure that concentration risk management systems effectively identify, measure, monitor and control concentration risks
    - Also discussed in OCC Bulletin 2006-46 concerning CRE
- Objective is to measure
    - Potential impact on capital and earnings
    - Potential impact on operating strategy

Governance

- Concentration analysis should be an important consideration used to develop:
    - ALLL pools and qualitative adjustments
    - Contingency Funding Plans
    - Strategic Planning
    - Capital Planning

- Management reports to the board should include:
    - Well supported analysis of concentration risk
    - Reliable estimates of the impact on Asset Quality, Earnings, Capital and Liquidity
    - Results of any back-testing such as comparison with loss history
    - Any independent review of management's assumptions

Governance

- A sound internal governance function includes:
  - Policies and procedures
  - Risk management practices
  - Loan review
  - Audit oversight

- Examiners will consider conclusions about concentration risk management when assigning Capital, Asset Quality and Management component ratings

Identifying Concentrations

- Not all meaningful concentrations should be measured at the 25 percent of T1 + ALLL level
- Different concentrations represent different levels of risk and require different levels of supervision
- The level of risk is a function of **both** portfolio size **and** performance volatility
- OCC expects risk management resources to be allocated based upon degree of risk, not size alone

Identifying Concentrations

- Management needs to consider the underlying volatility of each potential concentration:
    - Depends on how narrowly or broadly a bank defines a concentration pool
- Potential loss estimates might be based on a combination of:
    - Historic loss ranges
    - Economic Projections
    - Any Stress Testing Results
    - Management Judgment

Identifying Concentrations

Examples:

- Geographically diversified and soundly underwritten first mortgages may have predictable losses even though broad pools represent a large percentage of capital

- Narrow pools of geographically concentrated construction and development loans may equal a lower percentage of capital but have more unpredictable performance

Identifying Concentrations

- Combine size thresholds with credit risk benchmarks
- Static Metrics
  - Special Mention or Classified levels with capital exposure exceeding a specific level
- Dynamic Metrics
  - **Change** in Special Mention or Classified levels with capital exposure over a given level

Identifying Concentrations

- Concentration limits should be set by fully considering the pool's risk characteristics

- Consider potential loan loss levels that:

  - Equal a certain earnings percentage
  - Would reduce the ALLL by a certain percentage
  - Equal a certain percentage of capital
  - Would force a dividend reduction/suspension
  - Would cause a credit rating downgrade
  - Would increase funding costs, damage reputation or limit strategic opportunity

Identifying Concentrations

- Other useful credit risk benchmarks include:
  - Net loss rate
  - Non-accrual/non-performing rate
  - Delinquency rate
  - Growth rate
  - Weighted Average Risk Rating, Credit Score or Probability of Default
  - Expected/unexpected loss

Correlation of Pools

- Different loan pools may perform similarly during periods of economic stress
- As addressed within OCC Bulletin 2006-46 (portfolio management)
- Credit risk from concentrations may increase other risk areas
- Evaluate larger and riskier concentrations of credit for performance correlation between the pools
- Use experience and judgment to help identify potentially correlated pools

Correlation of Pools

Examples:

- Exposure to **both** mortgage backed securities and construction and development loans
- Oil/Gas and Agriculture crises in 1980's
- Simultaneous credit and liquidity strains experienced by many institutions during most recent recession

Mitigating Concentrations Risk

- Strategies for mitigating concentration risk include:
  - Tightening underwriting standards
  - Increasing credit monitoring, collection efforts and/or implementing exit strategies
  - Develop Strategic growth initiatives that focus on non-correlated credit products
  - Reduce maximum exposure limits and/or credit risk benchmarks
  - Obtain insurance or guarantees
  - Sell loan participations or whole loans
  - Hold additional capital

MIS

- Effective concentration risk management is dependent on accurate concentration reporting:
  - Active and timely dialogue between the Board and management regarding concentration exposures
  - Accurate and timely data capture to identify, measure, monitor and control risk
  - Meaningful portfolio analysis consistent with lending strategies, underwriting standards, and risk tolerance
  - Clear indicators of changes in the concentration risk within the loan portfolio

MIS

- The accurate and timely capture and analysis of data is of paramount importance:
  - o The board should establish clear responsibility for data quality
  - o Scope of data elements should be proportional to the bank's complexity and risk profile
- Risk management program should be periodically assessed for adequacy given changes in size, risk profile and complexity of concentrations
- OCC expects MIS credit data and reports are periodically reviewed by Loan Review, Credit Administration or Audit
- Previously discussed in OCC Bulletin 2006-46 concerning CRE

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Supervisory Expectations

- Credit concentrations are evident with most banks
  - Incumbent on management and the board to ensure that the institution has an effective process to identify, measure, monitor and control concentration risk
- Although each transaction may be prudently underwritten, collectively the transactions are sensitive to the same events
  - Different pools of the same size may represent different levels of risk
  - OCC expects the institutions will build their concentration management process based on **the risk a pool represents**

Supervisory Expectations

- Identifying, measuring and appropriately mitigating concentration risk depends on the accurate and timely receipt **and** analysis of data
    - o OCC expects that concentration risk management systems and MIS will be accurate and timely
    - o OCC expects that the scope of data collected and analyzed will be proportionate to the amount of risk to the bank's earnings and capital
- When concentration risk management is weak, examiners will require management to take corrective action:
    - o Concentration risk management is considered in rating conclusions

Supervisory Expectations

- OCC identified correlation between concentrations and high losses and bank failures during the recent economic downturn
- OCC developed a basic stress testing tool to measure potential risks when critical variables are negatively impacted
- OCC will make the CRE stress testing tool available to institutions to aid in evaluating sensitivity to economic changes

Stress Testing

- Stress testing can be integrated into the concentration risk management system to:
  - o Understand relationships between assets
  - o Identify correlated pools of assets
  - o Measure loss exposure
  - o Evaluate ALLL adequacy
  - o Develop effective strategic and capital planning to control current and emerging risk
  - o Enhance liquidity planning
  - o Assess capital and earnings adequacy

Stress Testing

- Scope of stress testing can be based on the risk characteristics of the concentration and potential capital and earnings exposure
- Board of directors and management are ultimately responsible for measuring, monitoring and controlling the level of risk undertaken by their institution
- Institutions can build on existing stress testing platforms

Stress Testing

- Fundamental stress testing techniques include:
    - o Measuring the sensitivity of concentrated pools with ***common risk characteristics*** to potential market conditions
    - o Focusing on ***more vulnerable segments*** of the portfolio, considering current market conditions and the institution’s business strategy
    - o Stressing multiple variables simultaneously
- Previously discussed in OCC Bulletin 2006-46 concerning CRE

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CRE Portfolio Stress Testing Tool

- Objectives
  - Develop a simple tool for performing portfolio level stress tests on income-producing CRE in community and midsize banks
  - Facilitate discussions with bankers by providing an example of one approach to portfolio stress testing

CRE Portfolio Stress Testing Tool

- Description
  - o Utilizes bottom-up approach
  - o Estimates risk arising from changes in key economic variables
  - o Quantifies risk in terms of impact on earnings and capital
  - o Examiner and banker versions
    - Main difference - proprietary economic data and links to internal OCC data sources removed from banker version

QUESTIONS

Questions and Answers

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Evaluation Form

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April 12, 2012

If you prefer to submit your evaluation online, please go to: http://eval.krm.com/eval.asp?id=19003

SCALE:	1 - Excellent	2 - Good	3 - Fair	4 - Poor

	1	2	3	4
1. Overall rating	☐	☐	☐	☐
2. Audio quality of seminar	☐	☐	☐	☐

Presenter: Overall Effectiveness

	1	2	3	4
3. Darrin Benhart	☐	☐	☐	☐
4. Francis Plonkey	☐	☐	☐	☐
5. Brent Spencer	☐	☐	☐	☐
6. Timothy Ward	☐	☐	☐	☐
7. Matt White	☐	☐	☐	☐

8. How many people listened at your site?

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