July 6, 2016

Weekly Post: Important New Features Released

Dear Clients-

Beginning with the current June cycle, three important new features have been added to Risk Officer: credit risk analysis, budgeting and projecting risk-weight capital. In my previous Post, I have discussed the importance of Current Estimated Credit Loss (CECL) and the THC budgeting approach. Starting with the June cycle, the credit risk analysis and budgeting features will now be available to you at no additional cost.

Your Risk Officer site has already been upgraded to include the credit risk analysis and budgeting features. You just need to provide THC the required additional data to begin using these new features and reports.

Challenges

- How do I use these features and receive these reports?
- What are the data requirements and what is the process for submitting the data?
- How will the results be explained to me?

Solution

Credit Risk

The THC approach to credit risk is consistent with CECL guidelines and is fully integrated with your Interest Rate Risk reports. Your ALM reports will provide you with a holistic analysis of risk and return tradeoff. This approach enables you to meet regulatory requirements and is essential to the internal management of your institution. The new credit risk reports are:

- Contingency Funding Plan Quantitative Assessment
- Credit Stress Tests: transactional and portfolio reports (CECL)

Budgeting

Under current Interest Rate Risk regulation pertaining to your EaR and EVE reports, the requirements assume "flat growth" and as we know, this assumption is often inconsistent with your budgeting numbers, rendering your EaR and projected EVE reports inappropriate for internal management purposes.

Market Wisdom - Art Hilliard*

Less than lustrous

Attached is a Scratch and dent pool that has a few more warts than usual:

- WAC – 3.97%
- WAFICO – 706
- WALTV – 89.73%
- WADebt To Income – 40.379

Nothing stellar here. The WAC is a little low, the WAFICO is a little low, the WALTV is a little high as well as the WADTI.

Note also that these loans :

- Are all govies – not a bad thing
- Most have no insurance/guarantee or it has been removed
- Others have eligibility issues
- None have regulatory compliance issues – good thing

Some feel it isn't worth trying to get loans like these off their balance sheet. Yet this pool sold to multiple bidders in the low 80s. This isn't the best pool, but as long as we can give investors something they can work with, we can get a bid.

TFO can help you determine if bids like the one above will fit your income and capital needs.

Art Hilliard has been in the mortgage industry for 29 years. He has originated, managed secondary marketing, securitizations and settlements, provided mortgage financial advisory and performed multiple mortgage portfolio sales and acquisitions.He was past president of the Illinois Mortgage Bankers Association.

In Risk Officer/Financial Simulation, you can easily input your growth plan and non-interest income/expenses. You can then generate the following reports:

- Financial Simulation Reports- create and compares multiple scenarios to determine the most profitable strategic direction
- Earnings at Risk Report (Budgeting) version which incorporates your growth plan
- Variance Analysis Report-compares Budgetted vs Actual performance
- Pro-forma EVE Report
- Management Summary report

Numerical Example

The additional data required for these new features are outlined in the THC June PATH file, available in Risk Officer/Public Resource and attached with this Post. In particular, the data should be entered in the Growth Plan, Non-interest Income, Re-investment Rate and Credit Loss tabs. The example provided below is a screen shot of the excel input tab from the PATH file

- *Credit Risk* Estimate your net loss rate (= charge off rate – recovery rate from the charge off) based on your internal rating. CECL requires the data to be institutional specific, similar to the ALLL requirements. The THC model actually calculates the loss rate over the life of the loan taking into consideration the impact of interest rate risk on the credit .

Loss Rate Table											
Internal credit rating	A1	A2	A3	A4	A5	A6	B	C	D	E	F
credit score	**840**	**810**	**780**	**750**	**720**	**690**	**660**	**630**	**600**	**570**	**540**
1-4 family first mortgage*	0.33	0.34	0.35	0.36	0.37	0.40	0.50	0.64	0.84	1.13	1.52
Construction	0.73	0.75	0.77	0.79	0.81	0.90	1.31	1.86	2.68	3.84	5.38
CRE	0.53	0.55	0.57	0.59	0.61	0.70	1.11	1.66	2.48	3.64	5.18
commerical loan	0.79	0.81	0.82	0.84	0.86	0.96	1.37	1.91	2.74	3.89	5.44
commerical LOC	2.19	2.20	2.34	2.48	3.34	2.53	8.37	11.59	16.28	23.44	25.62
Farm land	0.33	0.35	0.37	0.39	0.41	0.50	0.91	1.46	2.28	3.44	4.98
Agricultural	0.23	0.24	0.24	0.25	0.26	0.36	0.77	1.31	2.14	3.29	4.84

- *Budgeting* The THC budgeting approach is very user friendly. You can first download Fin Sim Excel work book with THC models embedded. There, you can set your target projected balance sheet and income statements and the THC model will determine the balance sheet strategies to best fit your project. In the PATH book or Fin Sim, you just need to use the Excel functions to estimate your financial projections. The THC approach will provide you the results and save your assumptions in Risk Officer to generate all the related reports. See the example provided below

Growth Plan

Apply | Show Help

Input assumptions of growth, and click 'Apply', go back sheet 'output Financial Simulation' to check results, see the 'Instructions' sheet for the details about the growth plan input

Pattern: Monthly (varying amount)

Category	Sector	Group	Sub-group	P002	P003	growth type	Balance	201604	201605	201606
Total assets	Cash & Short Term	Interest-bearing balances				flat	65325000			
Total assets	Cash & Short Term	Noninterest-bearing balances and currency and coin				flat	2312000			
Total assets	Loans and lease financin	Loans sec	Construction, lan	1-4 family residential cons		target to ($)	4481000	4,514,607	4,548,467	4,582,581
Total assets	Loans and lease financin	Loans sec	Construction, lan	Other construction loans a		target to ($)	2624000	2,643,680	2,663,508	2,683,484
Total assets	Loans and lease financin	Loans sec	Secured by 1-4 fa	Closed-end l	Secured by f	target to ($)	217455000	219,085,912	220,729,057	222,384,525
Total assets	Loans and lease financin	Loans sec	Secured by 1-4 fa	Closed-end l	Secured by j	target to ($)	7377000	7,432,328	7,488,070	7,544,230
Total assets	Loans and lease financin	Loans sec	Secured by 1-4 fa	Revolving, open-end loan:		target to ($)	6028000	6,073,210	6,118,759	6,164,650
Total assets	Loans and lease financin	Loans sec	Secured by multifamily (5 or more) residenti			target to ($)	19127000	19,270,453	19,414,981	19,560,593
Total assets	Loans and lease financin	Loans sec	Secured by nonfa	Loans secured by other n		target to ($)	6952000	7,004,140	7,056,671	7,109,596
Total assets	Loans and lease financin	Loans to i	Automobile loans			target to ($)	54000	54,405	54,813	55,224
Total assets	Loans and lease financin	Loans to i	Other consumer loans (includes single pay			target to ($)	311000	313,333	315,682	318,050

Conclusions

For the current June cycle, by simply providing the additional data referenced above, you will now be able to satisfy the life-of-loan regulatory requirements on CECL credit reporting, thus ensuring internal management reports are consistent with regulatory reporting.

If you have any questions regarding your June data requirements, please do not hesitate to contact THC.

Regards,

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