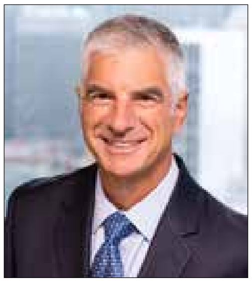
Issues & Answers

December 2022

In This Issue

A Look Back And A Look Ahead



By Glen Simecek, President and CEO, Washington Bankers Association

December is, as one traditional holiday carol declares, "the most wonderful time of the year." One of the things that makes the season wonderful is gathering together with family and friends, celebrating and reflecting on the past year.

From a business standpoint, we tend to do something similar. As 2022 comes to an end, we will reflect on the year that was and make plans for the year to come.

After two years of pandemic interruptions, it was good to see a return to a more normal operating environment this year. For WBA, that meant hosting our first in-person Convention in several years in conjunction with our partners at the Idaho, Nevada, and Oregon Bankers Associations. It meant returning to nearly our full slate of professional development and continuing education opportunities rather than being limited to what we could offer remotely. And it meant stepping up our advocacy programs with a full slate of state legislator lunches and a visit to our congressional delegation in Washington, D.C.

WBA staff and our bank members can take pride in the innovative work that was done over the last few years to maintain services and provide value to our members despite COVID-related restrictions. We can even apply some of the lessons we learned during that time to enhance the flexibility of our program offerings going forward. But having emerged from the worst of the pandemic and now enjoying much greater flexibility in delivering our service to our members, I can't help but be optimistic about that future.

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The official publication of the Washington Bankers Association is sponsored by Vericast and WBA Professional Services.

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On the Cover

Glacier Peak shines in the distance to the south as seen from a glacier on Mt. Baker.

Photo by U.S. Forest Service PNW Region via Flckr

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Bank executives across the state share that sense of optimism from my conversations. The interest rate environment, the economy's general health, and a challenging employment climate are legitimate sources of concern. But our industry has weathered those challenges repeatedly, and we are prepared to do so in the coming year. Compared to the complete disruption of a global pandemic, these are manageable issues.

Looking ahead to 2023, I'm planning to take advantage of the fact that we once again can get together face-to-face and hold more meetings with individual banks and bankers around the state. Visiting a bank executive team in their headquarters is a great way to get a better feel for their organization and the market they serve.

We'd also like to organize more small group sessions for bankers who share similar roles in their organizations. For instance, late last summer, we hosted a lunch for new bank CEOs to get together and get to know one another, ask questions, and discuss the issues they face. The participants found the conversation and networking very helpful, and, again, it's another way for us to get to know our members even better. So, if you have a suggestion for a group that would make for a lively and productive conversation, please let me know.

Finally, we would like to build on our 2022 Convention experience to expand our partnership activities and offerings with other state banking associations. These relationships present significant opportunities to develop professional education for our members and increase our advocacy's effectiveness through collaboration on public policy.

As rewarding as 2022 has been, 2023 will be even better. Until then, at this "most wonderful time of the year," I want to wish all WBA members and their families a peaceful and joyous holiday season and a happy and healthy new year.

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28 Bankers Graduate from WBA's 2022 Executive Development Program

In mid-November, the WBA celebrated 28 students who completed the 2022 Executive Development Program.

This year-long program began in January, bringing together students from across the state and throughout the different departments of their banks.

The students learned how to successfully manage and run an organization, including sessions on credit risk, financial analysis and performance, ethics, legislation and politics, and much more.

"Having worked in banking for 14 years, I thought I knew all there was to know about banking - boy was I mistaken," said Todd Laush from Washington Trust Bank. "Between learning how to read a balance sheet, how legislation can directly affect bank activities, and how the threat of nuclear annihilation of mankind can make me a better negotiator, the EDP experience has been one that I have thoroughly enjoyed. Most importantly, however, the connections made with my fellow participants are what I am most thankful for, and I'm looking forward to keeping in touch with you all."

Congratulation to Anthony Aceto, 1st Security Bank of Washington; Aalesa Barker, Columbia Bank; Norm Calhoun, 1st Security Bank of Washington; Shannon Carmody, Mountain Pacific Bank; Paul Crawford, Heritage Bank; Shawna Davis, Kitsap Bank; Keith Demaline, Bank of Idaho; Amy Encinas Yount, Columbia Bank; Ryan Eskelson, U.S. Bank; Kim Gabica, Columbia Bank; Robert Golden, Peoples Bank; Andy Hastings, Washington Trust Bank; Todd Laush, Washington Trust Bank; Jessica Lembo, Peoples Bank; Rob Mat, First Financial Northwest Bank; Blake Mittelstaedt, 1st Security Bank of Washington; Leza Moyer, First Interstate Bank; Karlee Munger, Mountain Pacific Bank; Renee Naidu, Peoples Bank; Kelley Nieffenegger, Washington Trust Bank; April Onofre, Kitsap Bank; Austin Panger, U.S. Bank; Sonya Pare, Kitsap Bank; Kim Peterson, Kitsap Bank; Jennifer Puckett, North Cascades Bank; Stan Reed, Washington Trust Bank; Allyson Roberts, Washington Trust Bank; Elaine Wolfe, Heritage Bank.

The 2023 Executive Development Program will begin in mid-January. As of graduation, the next program was over half full, and prices increase on December 23, so register your emerging leaders today!

Industry News

New Hires

Curtis Arnesen
Senior Vice President, Director of Commercial Banking at First Fed Bank

Peter Cutbill
Senior Vice President, Market Executive at Heritage Bank

Kris Hollingshead
Senior Vice President, Commercial Real Estate Team Leader, Washington Trust Bank

Have Industry News to share with WBA? Email megan@wabankers.com or call (206) 344-3472.

Secure Your Place at 2023 WBA Events

As we say goodbye to 2022, a year full of transition and changes, and welcome January, WBA encourages you to prepare for continued professional development with one of our upcoming events.

In mid-March, WBA will host the **2023 Northwest Compliance Conference** at the DoubleTree Hotel, Seattle Airport. This two-day event focuses on all that compliance professionals need to know about changes in the industry.

On May 4-5, WBA will host the newly revamped **Engage: Retail Banking, Training, and Engagement Conference** at the Washington Athletic Club in Seattle. This conference will include tracks focused on each bank area. The combined conference will also bring together bankers who often work closely together daily.

Also, in May, WBA is co-sponsoring the Idaho and Oregon Bankers Association **Annual Agriculture Conference**. The 2023 event features Dr. David Kohl, a nationally-regarded speaker on agriculture banking topics, and Mike Pearson, the host of Agriculture of America!, a weekly show about all things agriculture.

Moving into autumn, WBA will also host the **Credit and Lending Conference** on September 7-8 at the Washington Athletic Club. Previously the Senior Credit Conference, this event has been expanded to include lenders and will cover topics relating to the economy, current credit, lending regulations, and more.

In honor of October being Cybersecurity Awareness Month, we will host the **Virtual Financial Technology and Security Conference**, co-sponsored by the New Jersey and North Carolina Bankers Association. This event brings IT, operations, and security professionals from across the industry to discuss innovation and learn about the latest in the industry.

Outside these conferences next year, WBA will continue to provide our Development Programs to help bankers expand and advance their careers.

The **2023 Executive Development Program** begins in January and features a rigorous 12-session program designed for future leaders in the industry. Registration prices increase in late December, and the program regularly sells out, so early registration is recommended.

The **Management Development Program** is also scheduled to begin in mid-April, while the Credit Analyst Development Program and Retail Branch Manager Development Program will be held in the autumn.

On January 25, WBA is launching its newest program, a **virtual cybersecurity tabletop exercise** run by NUARI, a nationally recognized leader in cybersecurity. The event is open to any financial institution doing business in Washington state and includes unlimited virtual registration.

Attendees will be given a scenario and guided through the exercise while testing their procedure and protocols in real-time. The training is designed to help institutions gain valuable insight into their processes and test planned responses.

Please visit the WBA website at www.wabankers.com for more information about registration for our upcoming programs.

Events Calendar

January 18 – Executive Development Program
January 25 – NUARI Virtual Cyber Tabletop Exercise
March 16-17 – 2023 NW Compliance Conference, DoubleTree Hotel, Seattle Airport
May 4-5 – Engage: Retail Banking, Training & Engagement Conference, Washington Athletic Club
April – Management Development Program
June 26-28 – 2023 Annual Convention, Sunriver Resort
Sept. 7-8 – Credit & Lending Conference, Washington Athletic Club
October – Retail Branch Manager Development Program
October – Virtual Financial Technology & Security Conference

To register or to learn more about any of the listed events, please visit www.wabankers.com/calendar.

20 Students Complete 2022 Virtual Credit Analyst Development Program

In early November, 20 students graduated from the 2022 Virtual Credit Analyst Development Program.

The students began the program in September, which covered the basics bankers need to understand to be successful in the credit department. Sessions focused on how a credit analyst fits into the bank as a whole, a refresher in accounting, financial analysis, tax returns for both business and personal clients, loan structure, and commercial real estate lending.

Congratulations to Holly Baxter, Washington Trust Bank; Riley Boomhower, Washington Trust Bank; Kolby Currin, Bank of Eastern Oregon; Ricky Dua, Heritage Bank; Joe Erwin, Baker Boyer Bank; Carlos Flores, SaviBank; Justin Folz, Baker Boyer Bank; Adrian Green, Farmington State Bank; Danielle Hampton, Liberty Bank; Brady Henderson, 1st Security Bank of Washington; Rhyan Kyle, 1st Security Bank of Washington; Mai Thanh Le, First Financial Northwest Bank; Matthew Leffel, Wheatland Bank; Stacia McRae, Washington Trust Bank; Amanda Moloney, Columbia Bank; Lupe Rodriguez, Columbia Bank; Morgan Strain, 1st Security Bank of Washington; Linnea Sturges, Wheatland Bank; Mary-ann Theang, Heritage Bank and Erik Titterness, Heritage Bank.

The 2023 Credit Analyst Development Program will be held in the autumn.

Bankers Care

WBA Member News

KeyBank Announces $300,000 Grant to Treehouse

In mid-October, KeyBank Seattle announced it made a grant of $300,000 to Treehouse to support the organization's programs of working with youth in foster care.

Treehouse helps children in foster care as they begin to transition into adulthood and provides basic material needs, access to extracurricular and school activities, and individualized coaching and mentorship.

The grant funds will support the Young Adult Services program, helping to coach and mentor youth. Over the next three years, Treehouse will update the program to meet participants' needs better. It will also add an increased focus on financial literacy.

"For many years, KeyBank has been an avid champion of Treehouse's proven model, and we are delighted to accelerate our support with this new grant dramatically," said Matt Hill, President and Commercial Banking Sales Leader, Seattle Cascades for KeyBank. "This gift combines our core values – a commitment to philanthropy and financial wellness. Helping underserved youth realize their full potential is critical to their success and instrumental in building and maintaining a vibrant economy."

"We are thankful for KeyBank's strong support of Treehouse and our growing Young Adult Services program," said Lisa Chin, CEO of Treehouse. "The model we are creating will demonstrate what's possible when youth transitioning from foster care receive the resources, mentorship, and interventions they need, co-designed with their input. KeyBank's investment is invaluable to the evolution of this program and our ability to serve even more young people."

Olympia Federal Savings Names Employee of the Quarter

Olympia Federal Savings announced that Justin Jacobs was named the OlyFed employee of the quarter.

Jacobs, an assistant branch manager at the Yelm Highway location, was selected by his peers because of his leadership during the bank's recent core conversion and his ability to take the initiative and lend a helping hand.

Jacobs has gone from teller to his current position in just three years. At the beginning of the quarter, he saw a need to rebuild the retail branches' knowledge of essential technology for digital customers. He visited every branch monthly to conduct DocuSign training to ensure employees were up-to-date and make it smoother for clients.

"Justin is a great example of what being an OlyFedder is all about," said Josh Deck, President & CEO. "He is knowledgeable with an incredible work ethic, which means he can be relied upon in any situation and makes him an invaluable team member."

U.S. Bank Celebrates Chinese Flagship Branch Program in Factoria

In early November, U.S. Bank celebrated its Factoria branch as the newest U.S. Bank Chinese flagship branch program. It is a special designation reserved for a small subset of branches in the bank's footprint.

The event also included a $3,000 donation to Bellevue LifeSpring.

Baker Boyer Bank Announces Owl of the Quarter

This fall, Baker Boyer Bank announced that Alanna Jacob had earned the bank's Owl of the Quarter award.

Jacob, a senior program manager, designs and develops technology solutions to improve the bank's existing

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tools and processes.

She was nominated for her core competencies embodying the Baker Boyer spirit. She also developed a new business process to provide clarity and transparency to inflight deals, increasing accuracy.

Olympia Federal Savings Hosts Pet Food Drive

Throughout the fall months, branches in the Olympia Federal Savings footprint hosted a pet food drive for Concern for Animals.

The Yelm branch had a local customer and his daughter who donated a large pile of dog and cat food to help with the drive. They donated because their pet had recently died, and they wanted to ensure the food went to a good cause.

Washington Trust Bank Hosts Veterans Card Drive

In Spokane, Washington Trust Bank provided cards and encouraged residents to send a quick note to local veterans in honor of Veteran's Day.

The cards were sent to veterans throughout the area with special notes from bankers, residents, and customers expressing their thanks for their service.

Kitsap Bank Celebrates Successful "From Shred to Fed" Events

Kitsap Bank hosted annual "From Shred to Fed" events at Puget Sound branches this fall. Customers and residents could get documents shredded for free with a donation to a local food bank.

The bank supported 10 local food banks and donated just over $18,000, which will help local families this holiday season.

Olympia Federal Savings Supports Turning Pointe Survivor Advocacy Center

Olympia Federal Savings announced that its October Two Cent partner Turning Point Survivor Advocacy Center, received $2,825 in donations from the bank's program.

The organization provides safety and support for sexual and domestic abuse survivors through advocacy, prevention education, and action for social change.

The bank's Two Cent Program donates two cents monthly from each debit card transaction to a local organization.

Washington Trust Raises $5,900 at Benton-Franklin Fair & Rodeo for Cancer Foundation.

Washington Trust Bank sponsored the Benton-Franklin Fair & Rodeo's Tough Enough to Wear Pink Night this summer, which raised money for the Tri-Cities Cancer Center Foundation.

The efforts raised $5,938 in donations this year, and the Tough Enough to Wear Pink program at the fair has brought in over $200,000 for area hospitals for preventative care and treatment.

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First Fed Bank Add Another Name to Club 100 Roster

First Fed Bank announced this autumn that another banker joined the bank's Club 100, featuring employees who have volunteered over 100 hours in their communities.

Allison Mahaney is a Port Angeles Youth Basketball Association coach, volunteering her time and expertise.

U.S. Bank Celebrates Branch Reopening with Car Giveaway

Shortly before Veteran's Day, U.S. Bank celebrated the grand re-opening of its Lakewood branch in Tacoma.

The branch had undergone an extensive remodel and was designated the first U.S. Bank military flagship branch, which features a new look and feel with enhancements to improve the banking experience for customers.

In support of the local military and veteran community, the bank donated $5,000 to Support the Enlisted Project, which builds financial self-sufficiency among

junior active duty enlisted members and recently discharged veterans and their families.

The bank also partnered with Operation Homefront to provide a vehicle to Army veteran Elliott Wager from Auburn. The donated vehicle will allow Wager to get to and from medical appointments.

"We are incredibly proud to bring our latest branch concept and first military flagship designation to the Lakewood community," said Chris Befumo, Washington market leader for U.S. Bank. "Not only did we invest in the physical branch and our military community, but we invested in our staff to ensure we can better serve our military customers and their families."

First Financial Northwest Bank Collect Items for Renton Salvation Army

Members of the First Financial Northwest Bank residential lending team recently hosted a collection drive to gather food items to donate to the Renton Salvation Army food drive.

WaFd Bank Announces Acquisition of Luther Burbank Savings

Washington Federal, Inc. announced in November that it had signed a merger agreement with Luther

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Burbank Corporation, the parent company of Luther Burbank Savings.

The transaction is expected to close in the second quarter of 2023 and expand the WaFd Bank franchise into California.

"One thing I have learned is that you do not find the right deal - the right deal finds you. That is the case here," said Brent Beardall, President, and CEO of Washington Federal. "It checks all the boxes. It creates scale. It creates a contiguous footprint from Seattle to Austin. We want everyone at our respective banks to know how excited we are to grow our team and serve our customers and communities together."

Once the merger is finalized, WaFd Bank will be approximately $29 billion in total assets with branches in Washington, California, Oregon, Idaho, Utah, Nevada, Arizona, Texas, and New Mexico, with approximately 2,400 full-time employees.

Washington Trust Bank Rings Kettle Bell for Salvation Army

Once again, this holiday season, the Washington Trust Bank team members volunteered their time outside to ring the kettlebell asking for donations to the Salvation Army.

Throughout December, residents can find the team outside their office on W. First Avenue.

Bank of America Sends Handmade Cards to Local Organizations

The Seattle Bank of America team kicked off the holiday season for the third year by hand-making over 150 cards for seniors in the local community.

The project was part of Hearts for the Holidays, which benefits the Fieldstone Memory Care Center and Life Care Center of Puyallup. Along with special treats, the cards will be given to residents are each location.

Banner Bank Employee Named Burlington Chamber of Commerce Volunteer of the Year

This fall, Banner Bank announced that Cody Ellison, a bank's mortgage team member, was recognized by the Burlington Chamber of Commerce as the Volunteer of the Year.

Ellison was recognized for her commitment to financial literacy education and work supporting first-time homebuyers and veterans.

YWCA BankWork$ Program Celebrates Graduation

On November 10, the YWCA BankWork$ program finished its 69th cohort by celebrating the graduation of 12 students.

These students completed an 8-week training program to help them find lasting careers in the banking industry.

Glen Simecek, WBA President and CEO, congratulated the graduates on their success and willingness to tackle a new challenge to grow their careers.

If you have news to share with WBA regarding Bankers Care, please send it to Megan Managan at megan@wabankers.com. Tag us on social media by using #BankersCare.

WBA Endorsed Vendor: Vericast

5 Marketing Strategies to Put on Your Radar for Next Year

By Lisa Nicholas, Vice President, Strategy, Financial Services, Vericast

Q4 is upon us. ‘Tis the season when marketing budgets and strategies are evaluated and fine-tuned for the next year. In light of current market trends, consider these five strategies that could have a big impact on your 2023 marketing results.

Re-evaluate your digital approach

The digital advertising landscape has changed over the past two years. Increased consumer privacy, the shift to cookie-less browsing and limits on targeting parameters all have affected how we identify customers and prospects.

Make sure you have a plan to use your first-party data or other methods for matching. According to the Vericast 2022 Financial TrendWatch report, fewer than 1/3 of financial institutions surveyed are ready for a cookie-less targeting strategy, with only 28% reporting they have a plan to address it.

Take a fresh look at your behavioral targeting. Reevaluate not only your digital strategy but also your partnerships. Be sure you’re working with a company that is well-versed in the dynamic landscape of display ads and Google® keywords, email, short-form video, social media and connected TV (CTV).

Build customer connections by engaging social media

The adage, “People don’t care how much you know until they know how much you care,” still holds true. Show you understand this by producing social media content that is not just informative but demonstrates empathy.

How to make it happen

Incorporate engagement opportunities into your stories. There is a trend toward inviting more brand interaction across digital touchpoints. The easier you make it to connect with your brand, the more likely people are to feel you know or want to get to know them.

Be wise about the type and tone of content you produce for each social media channel. It’s not a one-size-fits-all experience. TikTok viewers are very different from those on LinkedIn, for example. Sharing the wrong messages to the wrong audience can damage your reputation.

Your customers expect personalized financial advice and guidance on how to grow their money. Help them reach their savings goals and give them a reason to choose your financial institution.

Consider offering incentives for deposit promotions. According to Vericast’s Financial Health Survey, sixty-six percent of respondents said “yes” to incentives for opening an account like a cash reward for switching financial institutions.

Now is the time to reevaluate your credit card offers, rewards and rates. It’s also an ideal time to help your customers leverage their higher home values by informing them about fixed rate or low introductory-rate home equity loans.

Leverage your data for personalization

According to the Vericast 2022 Financial TrendWatch, 72% of consumers only engage with personalized messaging. Banks should take advantage of their wealth of customer insight to enhance marketing efforts, including delivering personalized messages, offers and contact.

Merge customer data and transactional data with demographics and other consumer insights to create smarter segmentation and targeted campaigns to serve customers and grow revenue.

Remember, what’s old can be new again

New technology and innovation have their place. For example, AI and robot assistance are great at helping behind the scenes ... not so much for building meaningful relationships with customers. Sometimes tried and true methods hold the best solution.

Offer live chat agents with 24/7 availability or extended hours. People want to talk to live support when they need help. Use outsourced support that lets you scale up or down as needed.

Don’t discount direct mail. Direct mail is gaining favor by consumers for discounts and coupons, especially when combined with QR codes and personalized URLs

Lisa Nicholas specializes in marketing and digital transformation for the financial services industry. Nicholas has more than 30 years of experience in the banking and tech industries.

Assuring Your Financial Customers as Interest Rates Increase

By OnCourse Learning

Customers are bracing themselves for an interest rate increase. They are anxious, nervous, and worried for what this means for them. And with talks of another increase happening soon, and more to come, customers are rightly worried. What are you doing to re-assure your customers you are in this together?

How inflation affects interest rates

Let's first take a look at why this is happening. The cost of living has increased so much, so fast, the Federal Reserve is stepping in to assist. Consumer prices rose in May at the fastest pace in 40+ years. This will likely force the Fed to raise interest rates several more times in the coming months. Fed officials may even resort to additional large rate increases in a bid to cool off inflation.

The Consumer Price Index (CPI) notes this both directly and indirectly affects the interest rate. The CPI is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The CPI reported that from May 2021 to May 2022, the Consumer Price Index for All Urban Consumers increased 8.6 percent, the largest 12-month increase since the period ending December 1981.

Higher Interest Rates change the way people borrow money

Every time the Fed raises rates, it becomes more expensive for consumers to borrow. That means higher interest costs for mortgages, home equity lines of credit, credit cards, student debt and car loans. This is one way the Fed speeds up or slows down the economy by moving interest rates higher or lower; hopefully lessening the cost of inflation. But this also puts a larger strain on those who have borrowed money.

As CBS news reported, Americans will initially experience this policy shift through higher borrowing costs. It is no longer incredibly cheap to take out a mortgage or car loan. The most tangible way this is playing out is with mortgages, where rate hikes have already driven up rates and slowed down sales activity. The rate for a 30-year fixed-rate mortgage averaged 5.23% in the week ending June 9. That's a drastic change from being under 3% this time last year. Potential borrowers are feeling the stress of increased payments as they look to purchase a home.

As PocketSense states "a slowdown in consumer spending slows down inflation because sellers have to lower the prices of goods in order to make sales in an environment where consumers have less disposable income due to more of their money going to borrowing costs."

Good news on the horizon

There are a few advantages to the increased rates. One small upside is the cash sitting in their savings accounts will finally earn something. It may not be that significant, but it is a start. That savings should increase as the interest rate increases, and so will consumers hope.

Also, the rapid rise of inflation should slow. The cost of goods will hopefully slow their steep incline. As Investopedia puts it "A stronger economy means more consumers seek loans, helping banks as they benefit from the difference between the interest they charge investors for the loan and the amount they earn by investing that money."

With interest rates increasing, so does the profit banks make on loans. There is a larger difference between the federal funds rate that banks pay and the rate the bank charges its customers. The spread between long-term and short-term rates also increases because long-term rates tend to rise faster than short-term rates. This is good news for the financial services industry, but they must keep in mind that there will be a decrease in customers applying for loans.

Borrowers will look to financial institutions for assurance they will get through this, and that things will be OK. Be open with your consumers. Explain to them the benefits they should see from the higher interest rate. And be sympathetic to those that may start struggling with the increased rates on the mortgages and loans.

Best Practices for Credit Risk Management in Uncertain Times

By Kate Stoneburner, Content Marketing Manager, Abrigo

Coming out of a global pandemic, financial institutions are navigating how to remain profitable amid government interventions, record inflation numbers, and rising rates. In a recent Abrigo webinar on credit risk management, four experts weighed in to pinpoint the following areas for focus and improvement in 2023.

Ensure training for lenders who don't have loan modifications experience

Loan modifications, loan workouts, charge-offs, and special assets are a priority for financial institutions striving to prepare for unknowns as they observe macroeconomic trends like inflation impacting their customer base.

"Considering the uptick in the cost of living and interest rates, on top of the labor shortage, our customers are concerned," said Steven Matzus, Senior Vice President and Managed Asset Division Manager at S&T Bank. "They are having to outsource a lot and increase their operating expenses without any offsetting revenue and while dealing with supply chain issues."

Matzus says his bank's most successful customers are proactive with their approach to staying in supply by hedging on materials they need. This is a good solution for many customers, but one that has the potential to put a strain on their liquidity.

So how can banks help customers keep up in uncertain markets? By getting their own credit risk management operations ready for potentially tougher times for borrowers, lenders can be more proactive in reaching out to assist those headed for trouble — helping both the borrower and the financial institution.

With government stimulus money to help get customers through the pandemic dwindling, Paula King, Senior Advisor for Abrigo, anticipates lenders will be dealing with more loan workouts toward the beginning of 2024 and continuing to increase from there.

Updating policies and procedures for the new environment is a good place to start tightening up credit risk management.

"If you haven't updated your policies and procedures or dusted them off in 5 or 7 years, the time is now," she said.

Most banks' policies and procedures around loan modifications are outdated because they were not written in a rising rate and inflationary environment. Updating these for the current economic conditions can help banks prepare for the future. And by involving junior lenders in the revision process, banks can cultivate and retain talent that is prepared to handle the new environment.

King recommends more staff training on loan modifications and workouts, particularly for banking staff that came on board after 2015 and may not have any experience with loan modifications.

"You have time to make changes before we see an increase in loan modifications," she said.

Automate loan modifications, workouts, and special assets processes to ensure efficiency and consistent loan terms

King also recommends automating loan modification procedures, including processes tied to special assets management. Loan modification software can save time and increase efficiency related to the highly manual steps many institutions follow to complete and document loan modifications and workouts.

"Historically, special assets are one of the more manual procedures to track within the institution. Think about ways that you can automate that, whether you just need something basic or you need to look to a third party to help."

Examine stress testing techniques to understand potential pitfalls better

Stress testing on a loan level or a portfolio level can help financial institutions understand their threshold for any future upheaval. Zach Englert, Consultant with the Abrigo Advisory team, recommends that banks perform a "what-if scenario" stress test to see what would happen if charge-offs increase as expected. That's especially important for variable-rate loans, where banks have seen more than a 3% increase in prime over the past six months.

"It's important for financial institutions to know their limits," said Englert. "For example, what is considered an impairment or charge-off? How will the situation be handled if a bank must repossess a building and the building is now worth 20% less collateral value than it was when the loan originated 18 months ago?"

Financial institutions wondering at what percent to stress test their real estate portfolios can use the Fed's DFAST scenario document as a guide for creating boundaries based on where the different agencies think the market is headed. The document provides a baseline and severely adverse scenario that banks can use as a defensible starting point for stress testing worst-case scenarios.

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Get to know regulator expectations and priorities.

Regulators' risk management perspective is evolving, and financial institutions should expect to be held accountable for consistent stress testing. It is essential to have a process for stress testing that includes the steps your institution is taking, how often testing is performed, and what numbers are used as a guide. Having a playbook will help institutions avoid regulatory scrutiny.

Having a playbook for loan modifications will also help come exam time. King says regulators and banks are on the same team when it comes to loan modifications—they want to see loans repaid.

"Regulators are not going to criticize you for these short-term loan accommodations or these workouts. They would prefer that scenario over a bank ending up with a charge-off."

King cited a new interagency policy proposal and other pieces of FASB guidance that financial institutions should keep in mind when preparing to speak with regulators.

The proposed policy document includes an appendix with loan modification examples broken out by loan types. The examples define regulator expectations for what designates a loan workout arrangement, risk rating categorization, interest accrual categorization, and other controls that help risk mitigation.

Another new rule for financial institutions to be aware of is the Consumer Financial Protection Bureau's 1071 rule, which has a March 2023 implementation date and is essentially an extension of the Equal Credit Opportunity Act.

This rule requires all organizations that originated 25 or more small business loans in the last two years to record and maintain about 25 data points for loans to women-owned and minority-owned small businesses. Financial institutions should have a LOS system or other means to cover this new reporting task before the compliance date arrives.

Finally, when it comes to CECL preparations, King says many clients are getting negative feedback from regulators and validators on the documentation component of the new standard.

"In their hurry to get compliant with CECL, it seems like maybe banks have forgotten the documentation piece. I would go back through the decisions made on your segmentations and methodology and ensure that your documentation is firmed up."

Analyze loan pricing techniques and adjust to the current rate environment

According to Rob Newberry, Senior Advisor at Abrigo, pricing will play an important role in credit risk management in the current environment. Banks are constantly making a trade-off by accepting credit risk to eliminate interest rate risk.

"In today's up-rate environment, the low-interest rates from several years ago are now much higher," Newberry said. "Financial institutions need to know how likely it is that their customers will qualify again and be able to make the payment structures they are willing to offer."

Stress testing to understand how much margin for error banks have in their credit analysis will be critical, especially since loan demand has not been high after stimulus money. Financial institutions hungry for loans may be willing to price lower than they usually would but should be cautious about doing as much volume as possible considering the rising rate environment.

"I would look for opportunities in your product offerings to help not only increase your net interest margin but help with the credit risk of your borrowers," he said. "For example, if you offer a term sheet, are you charging a potential lock fee? Create opportunities to regain some non-interest income. Be sure to include language that allows you to price to the current rate or potentially charge your rate lock fee. That will give your institutions some protection in uncertain times."

Kate Stoneburner is a Content Marketing Manager at Abrigo, where she works with industry thought leaders to create digital content that helps financial institutions better serve their customers. Before joining Abrigo, Kate managed social media and produced articles for Campbell University's quarterly magazine and other university content initiatives.

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