RISK MANAGEMENT

Economic Downturn Impacts

bakerhill NextGen®

WHERE TO START.

As we face these new economic challenges, it is important to have solutions in place that can assist with understanding your potential risks. No one knows exactly how the economic forces will play out, but what we do know is that it will impact all parts of your loan portfolio.

Rather than gathering and analyzing information from a multitude of disparate systems, the right solution will help assess risks, monitor events in your portfolio, and allow for various reporting.

KEY FOCUSES FOR SUCCESSFUL RISK MANAGEMENT.

Determining the right solution for your institution can be overwhelming. There are four key focuses for successful risk management during an economic downturn.

1

Understand what you are willing to negotiate.

Your financial institution needs to determine its new risk tolerances. Identify which clients are you willing to "stretch" for and what standard credit underwriting items are you willing to forego.

2

Be prepared now for tomorrow's discussions and decisions.

Now more than ever, it's important to plan ahead. Analyze your portfolio to understand where you have room to negotiate and where you do not.

3

Monitor your portfolio-proactive and reactive measures.

You don't have to focus on origination at the cost of portfolio monitoring and management. Stay focused on good, sound portfolio management practices and be willing to expand into proactive, behavioral analysis as well.

4

Watch for government guarantees.

SBA and other government guarantee programs can allow your financial institution to lend a bit outside the box. Even as the new programs and guidelines are still being developed, it is crucial to ensure you are following the guidelines to make guarantees valid and enforceable.

IN AN ECONOMIC DOWNTURN, IT IS EASY TO GET OVERWHELMED. FINDING THE RIGHT SOLUTION PARTNER, ALONG WITH SOUND POLICY AND PRACTICES, CAN AID IN ADDRESSING THE CHALLENGES.

01 UNDERSTAND WHAT YOU ARE WILLING TO NEGOTIATE.

As clients begin to reach out for assistance during the economic slowdown, it is important to have a strategic understanding of how your financial institution will respond to these requests.

- **Decide your financial institutions tolerance for additional risk.** Identify which industries or business types you are comfortable stretching your standard requirements for so you can have a quick and consistent response.
- **Determine how to account for the additional risk quickly.** It is important to respond quickly to the businesses needing assistance. Choose if you are willing to forego full underwriting, financial statements, etc. and how will this impact your risk ratings and loan loss reserve.
- **Establish your non-negotiables.** During times of economic uncertainty, are you standing firm on your amortization for certain types of collateral? Or are you unwilling to accept the waiver of personal guarantees? It is very important to understand and communicate where lines will be drawn.

First, we discussed the strategic side of understanding how your financial institution will respond to events and what can and cannot be negotiated. Next, we will focus on understanding of the tactical side. In order to get ahead, create a plan around the following items. There are no right or wrong answers to these questions but it is important to consider them now and not wait.

- **Create a plan for communicating with clients.** Do you proactively reach out to clients in certain areas or industries to discuss options? Or do you wait for them to reach out to you?
- **Determine who will lead the conversation.** Will each lender answer the questions on topics of restructure, payment deferments, and interest rate adjustments, or should you centralize those conversations? Who has the skills and authority to manage those interactions and benefit the customer and protect your financial institution?
- **Make an authorization plan.** What will the credit authorization look like for these loan changes? Will you need to document “one up” authority? Should these go to a streamlined committee? How should credit risk be involved?

02 BE PREPARED NOW FOR TOMORROW’S DISCUSSIONS AND DECISIONS.

03 MONITOR YOUR PORTFOLIO- REACTIVE AND PROACTIVE MEASURES.

As clients begin to reach out for assistance during an economic slowdown, it is important to have a strategic understanding of how your financial institution will respond to these requests.

- Monitor your portfolio daily. Proactive portfolio management is not new, but it may be to your institution. As you move into streamlining requirements for loan requests using credit scoring, approving, and rewriting requests with stale tax returns, it is important to monitor the portfolio daily.
- Focus on behaviors to understand your portfolio. It is important to use this information to get ahead of any future delinquencies. Changes in deposits, credit rescores, and high line utilization will show the financial stress faced by your client long before your first delinquency. The goal of proactive portfolio management is to watch for trends and other indicators. This information should then feed back into your origination process. Loan types, industries, and collateral that are performing well should be the focus of origination. Evaluate items like:
    - NAICS to credit score and historical delinquency
    - OD or NSF to high line utilization
    - Time in business to score
- Reactive portfolio management does not lose its value. Stay with the tried and true as well. Ask yourself:
    - Are UCC's being renewed in a timely manner?
    - Do you have proof of hazard insurance? How many are past due? Focus on the larger dollar loan relationships or the riskier industries and collateral types.
    - How do concentrations look? Are they in line with the financial institutions strategic vision?
    - Are there concentrations of government guarantee loans?

04 WATCH FOR GOVERNMENT GUARANTEES.

SBA and other governmental agencies are working hard to make capital available for businesses, and financial institutions across the U.S. are ready to help. Unfortunately, a guarantee does not fix all things and they come with strings attached.

- Stay up to date with new information. New programs and new requirements are coming on-line daily. Be sure you understand and implement the SOP for the government program you are using. Don't assume you know. Double check!
- Listen to your SBA specialist. They are your best advocate to navigate these waters.
- Get help when needed. If you have not done SBA lending in the past, you will need help. Hire a specialist or use a third-party vendor for assistance.
- Understand all the requirements to maintain the guarantee. These include how the loan is underwritten, eligibility requirements, documentation requirements, Colson reporting (for SBA), etc. An issue in any of these areas could invalidate your guarantee.
- Use available programs. Whenever possible, use the programs available to enable your financial institution to do loans that are outside your normal parameters. These programs are not meant to shore up loan requests you would never otherwise consider.

CONCLUSION

No one has all the answers. When we're in the middle of an economic downturn, it feels like the world changes minute by minute. That is why it is crucial to understand your financial institution's risk tolerance and partner with a solution that understand your needs.

ABOUT BAKER HILL

Baker Hill empowers financial institutions to work smarter, reduce risk and drive more profitable relationships. The company delivers a single unified platform with modern solutions to streamline loan origination and portfolio risk management for commercial, small business and consumer lending. The Baker Hill NextGen® platform also delivers sophisticated analytics and marketing solutions that support sound business decisions to mitigate risk, generate growth and maximize profitability. Baker Hill is the expert solution for loan origination, portfolio risk and relationship management, CECL and analytics for financial institutions in the United States. For more information, visit www.bakerhill.com.

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