Credit Risk Benchmarks 1Q2020

June 2020

Can the Commercial Loan Market Weather COVID-19?

The first quarter of 2020 was unlike anything we've ever seen for the banking industry. Banks were challenged on numerous fronts – a global pandemic, a faltering economy, rising unemployment, turmoil in energy markets, and the implementation of the new CECL accounting standard. In a quarter that began much differently than it ended, commercial loan balances surged in March as corporate borrowers drew down on lines of credit in order to stockpile cash and brace for disruptions in cash flow. By quarter-end, short-term C&I delinquencies had risen to the highest level seen since the end of the last recession. Energy nonaccruals ticked up in the first quarter, although many commercial banks have limited their exposure to the riskiest borrowers within this industry.

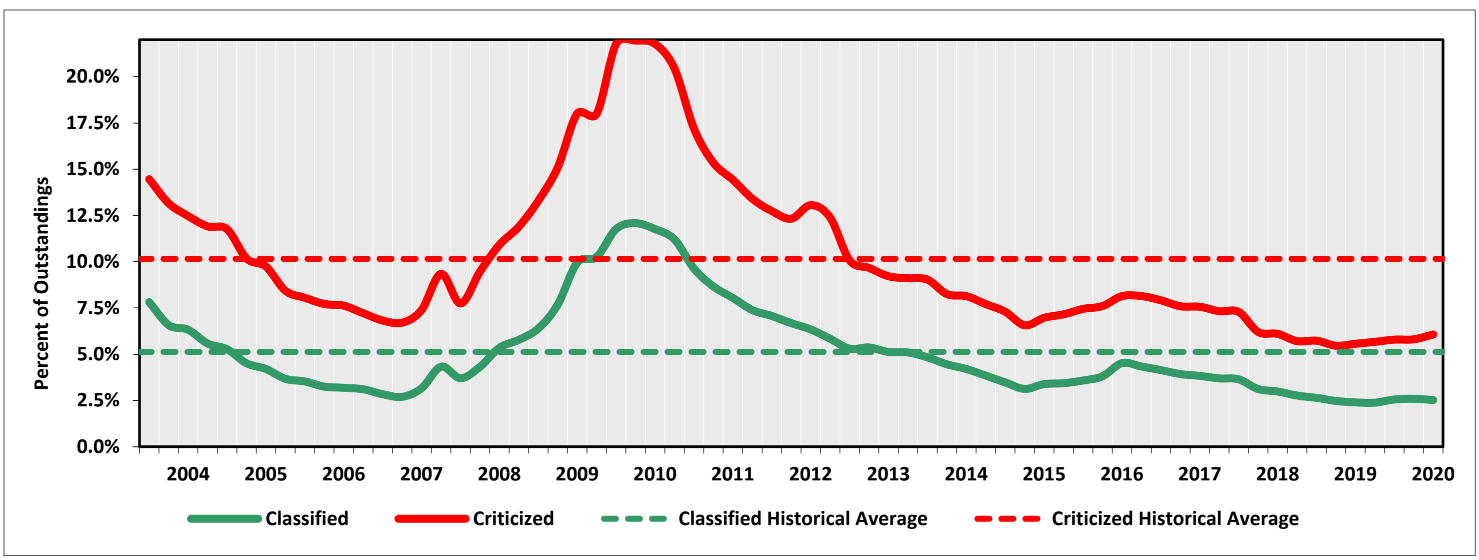
Credit Quality Comparison 1Q2020: By Market Segment

Percent indicates percent of outstanding balances unless otherwise indicated

Key Risk Indicators	Commercial & Industrial Loans			Commercial Real Estate
	Business Banking	Middle Market	Large Corporate	
Percent 30–89 Days Past Due	0.52%	1.01%	0.73%	0.63%
Percent on Nonaccrual	1.04%	0.82%	0.24%	0.28%
Percent Noncurrent (90 Days Past Due + Nonaccrual)	1.10%	0.96%	0.28%	0.32%
Weighted Average Risk Rating (10-pt. RMA Scale)	4.98	4.44	4.28	4.84
Weighted Average PD	3.13%	2.07%	1.88%	3.05%
Weighted Average PD: Non-Defaulted Portfolio	2.22%	1.56%	1.62%	2.99%
Percent Classified	3.83%	2.46%	1.24%	1.27%
Percent Criticized	7.76%	5.54%	5.43%	3.79%
LOC Utilization Rate	50.78%	39.32%	40.60%	67.47%

Within the RMA/AFS credit risk database, the business banking segment represents loans to companies with annual sales of less than $20 million, the middle market segment represents companies with annual sales of between $20 million and $200 million, and the large corporate segment represents companies with annual sales greater than $200 million. Commercial Real Estate (CRE) loans represent investor CRE, including land acquisition, development, and construction, multifamily, nonfarm nonresidential, etc.

C&I Loan Quality



From 4Q2019 to 1Q2020, the percentage of C&I loans risk rated criticized increased while the percentage of C&I loans risk rated classified fell slightly.

Notes: "Classified" represents loan outstanding balances risk rated Substandard, Doubtful, or Loss. "Criticized" represents Classified loans as well as loans risk rated Special Mention.

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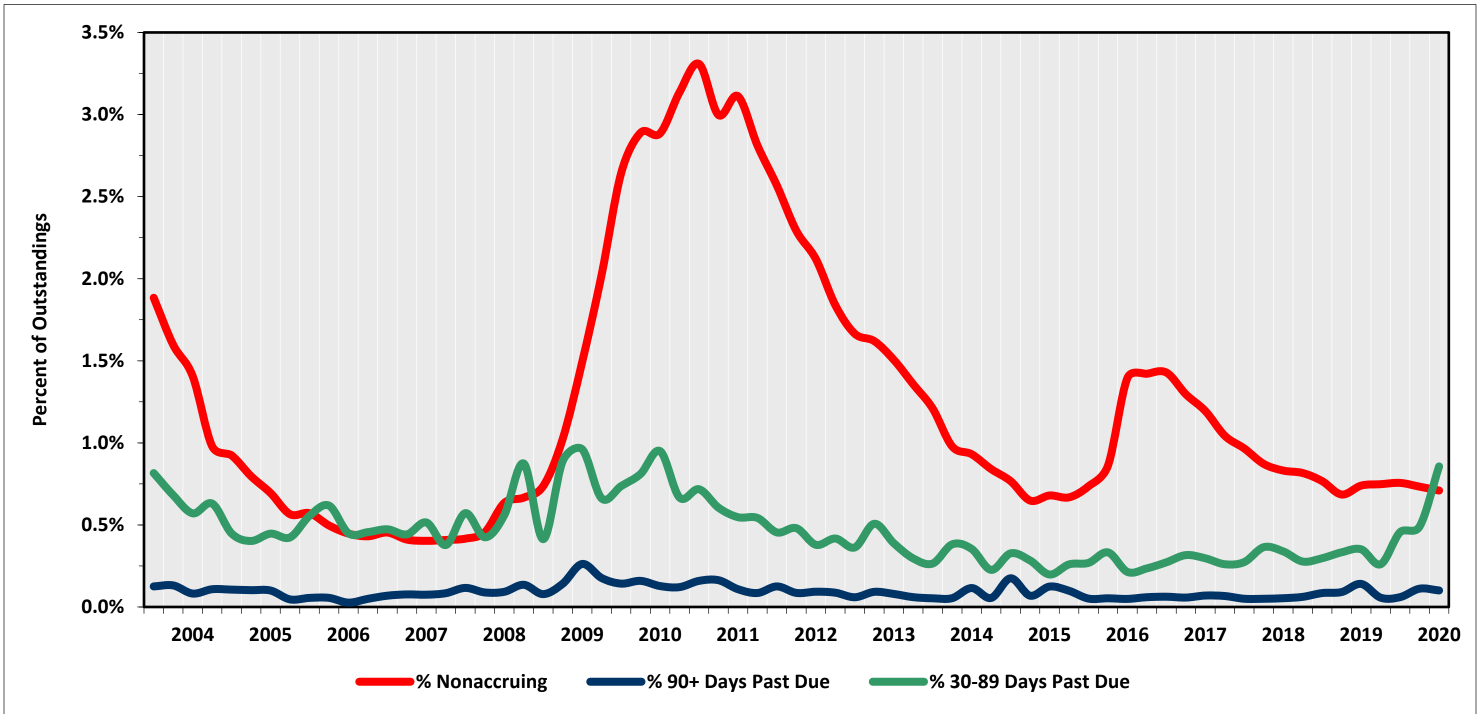
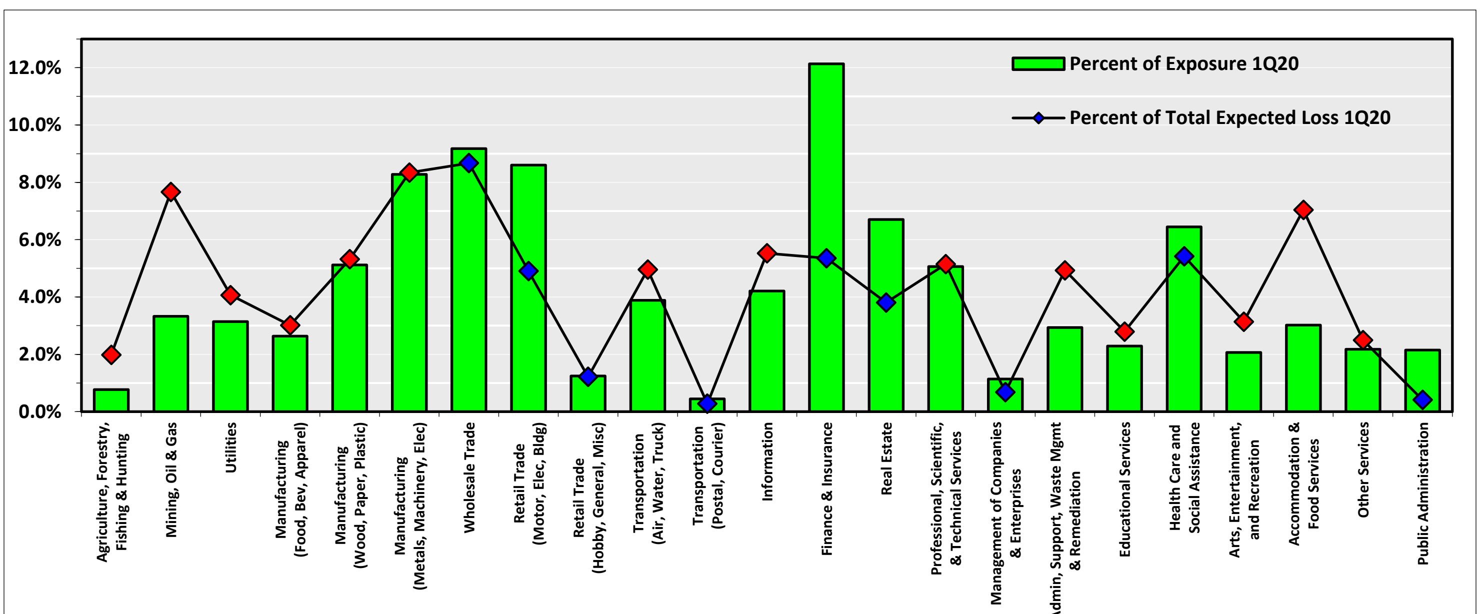
Delinquency and Nonaccrual Trend



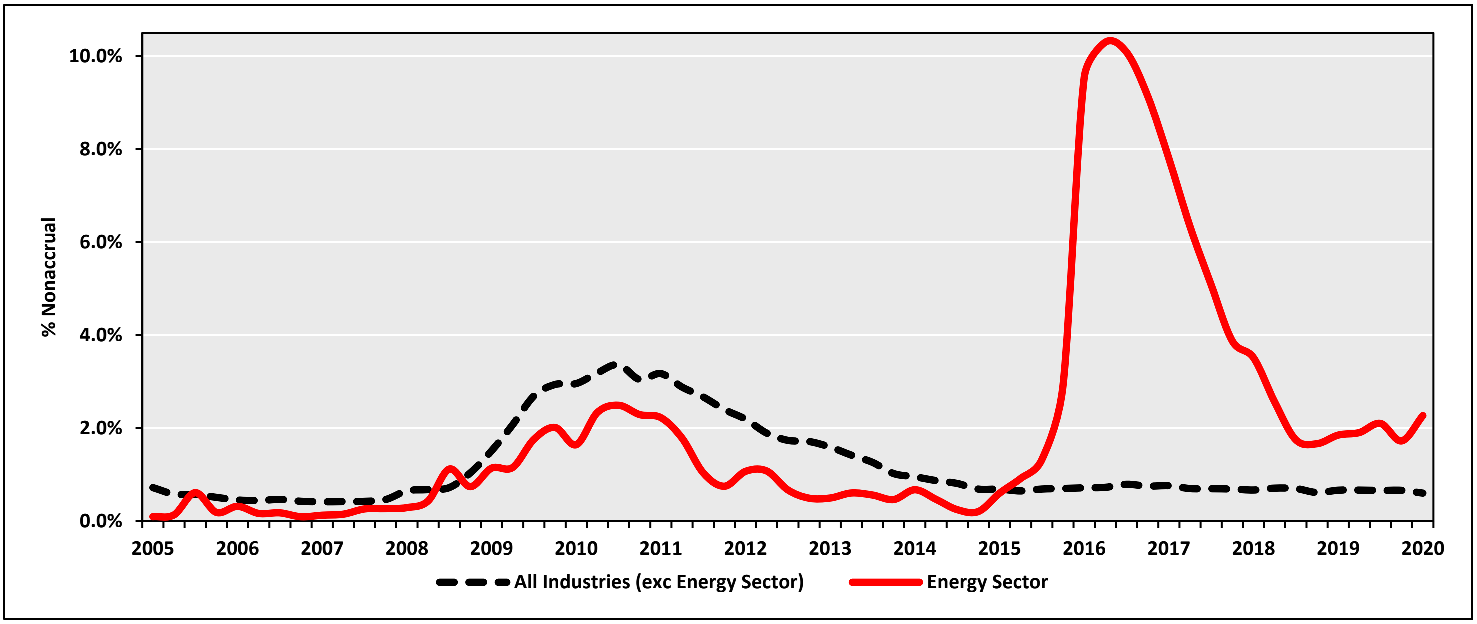
Short-term delinquencies (30–89 days past due) spiked in 1Q2020, rising to the highest level seen since the end of the last recession.

Expected Loss by Industries



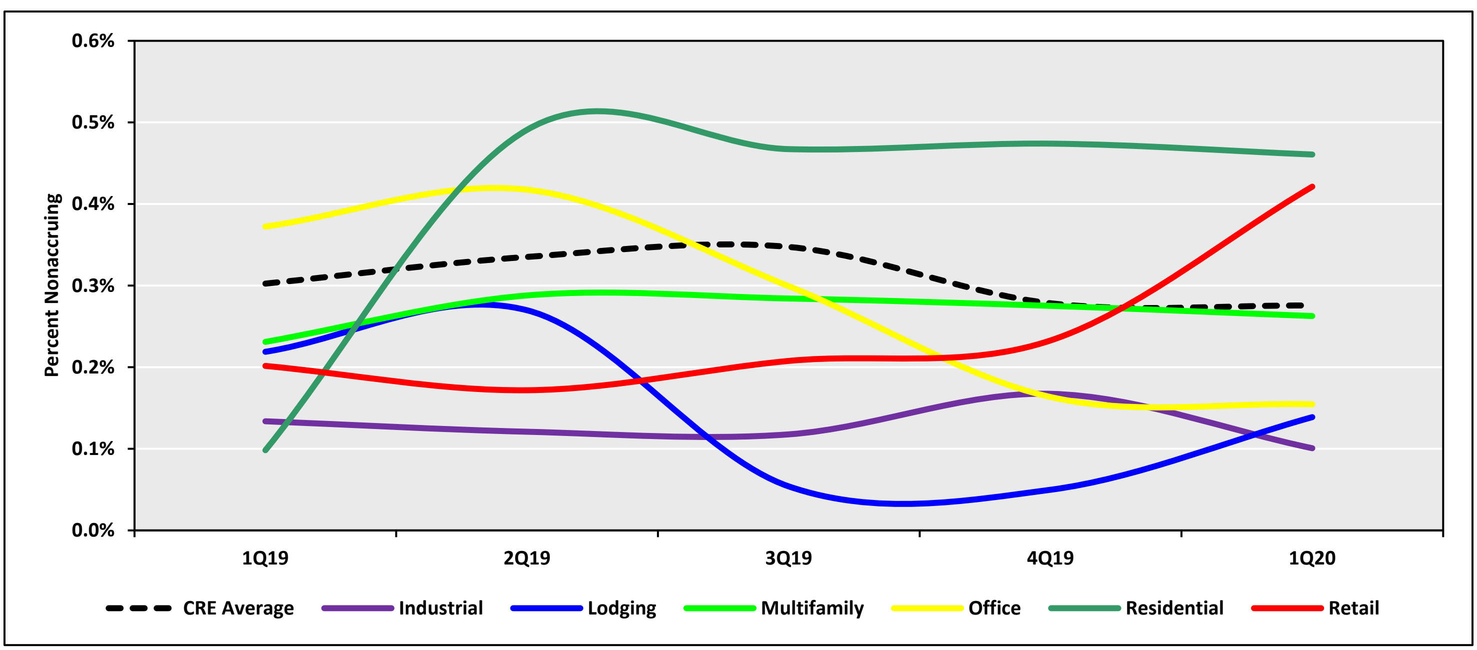
The industry make-up of the RMA/AFS credit risk database is represented by the green bars. The horizontal line graph represents the expected loss estimates. For the industries where the line graph is greater than the green bars, the expected loss for that sector is greater than the relative contribution of the sector in terms of exposure. The industries depicted by the red markers are currently bearing a disproportionate amount of expected losses.

Stress in the Energy Sector



The Energy sector faces a precarious supply and demand imbalance that has driven oil prices to historic lows. On the supply side, an oil price war between Russia and Saudi Arabia in March flooded the market with cheap oil, leading to one of the sharpest declines on record in oil prices. On the demand side, government imposed shutdowns to combat the spread of COVID-19 have sharply reduced demand for crude, resulting in additional downward pressure on oil prices and raising the prospect for defaults in the sector. Already the Energy sector is showing signs of stress: nonaccruing Energy loans increased in the first quarter. If the previous collapse in oil prices is any precedent, then the 1Q2020 increase in nonaccruing Energy loans could be the start of a significant and prolonged deterioration in credit quality for the sector.

CRE: Percent Nonaccrual by Property Type



CRE nonaccrual levels increased significantly quarter over quarter in March for the Retail and Lodging property types.

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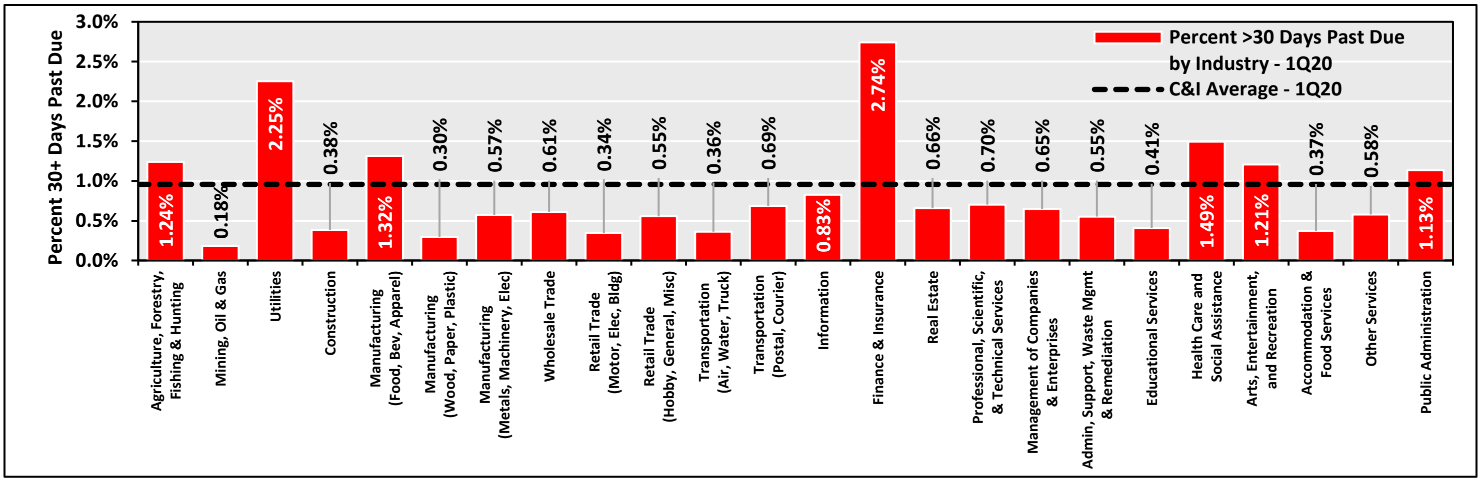
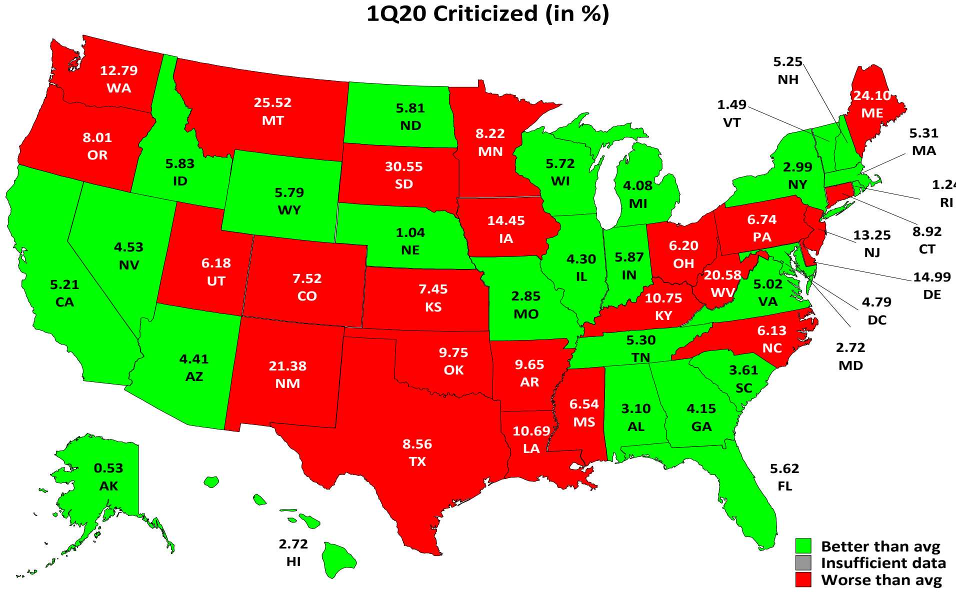
Problem C&I Loans by Industry: 30+ Days Past Due



Here, we examine 30+ day past due loan ratios by industry (red bars) relative to the C&I market average (dotted-black line). NAICS 52 Finance & Insurance – one of the fastest growing C&I industry segments in recent years – displayed the highest past due ratio seen across the industry spectrum in 1Q2020.

Problem C&I Loans by State: Criticized Loans

1Q20 Criticized (in %)



All geography-based data in the RMA/AFS credit risk database is based on the ZIP Code of the borrower (for C&I loans) or the property (for Commercial Real Estate). This map illustrates the percentage of C&I loans risk rated criticized as of the most recent quarter. In 1Q2020, criticized loan levels remained high in the Southwest region of the country, a region heavily exposed to the volatility and distress in the Oil & Gas sector.

About the Credit Risk Benchmarks

The information in this newsletter is derived from the RMA/AFS Risk Analysis Service, a comprehensive credit risk benchmarking program for U.S. commercial banks. The Risk Analysis Service is an industry led, credit risk data consortium providing peer benchmarks for risk ratings (PD, LGD, and EL), delinquencies, nonaccruals, charge-offs, and line utilization rates.

For more information and how to become part of the Risk Analysis Service, contact Doug Skinner at 484-875-1562 or dskinner@afsvision.com.

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