Credit Risk Benchmarks 3Q19

November 2019

Commercial Loan Credit Quality: Is the Cycle About to Turn?

The third quarter was a tough one for the U.S. banking sector. According to FDIC data, net income for the industry as a whole fell 8.3 percent quarter over quarter. The primary driver was margin compression; in fact, the FDIC reported that 71 of the 100 largest companies by total assets reported lower net interest margins quarter over quarter. Fortunately, commercial loan credit quality is holding steady. Several key RMA/AFS credit performance metrics and asset quality measures remain at or near their historical lows. A few outliers worth noting: Agriculture, Oil & Gas, and Restaurants continued to underperform C&I averages for nonaccruals and criticized loans; and, in the Commercial Real Estate space, the percentage of loans on nonaccrual continued to edge higher this quarter, led by a sharp deterioration for the Retail property type.

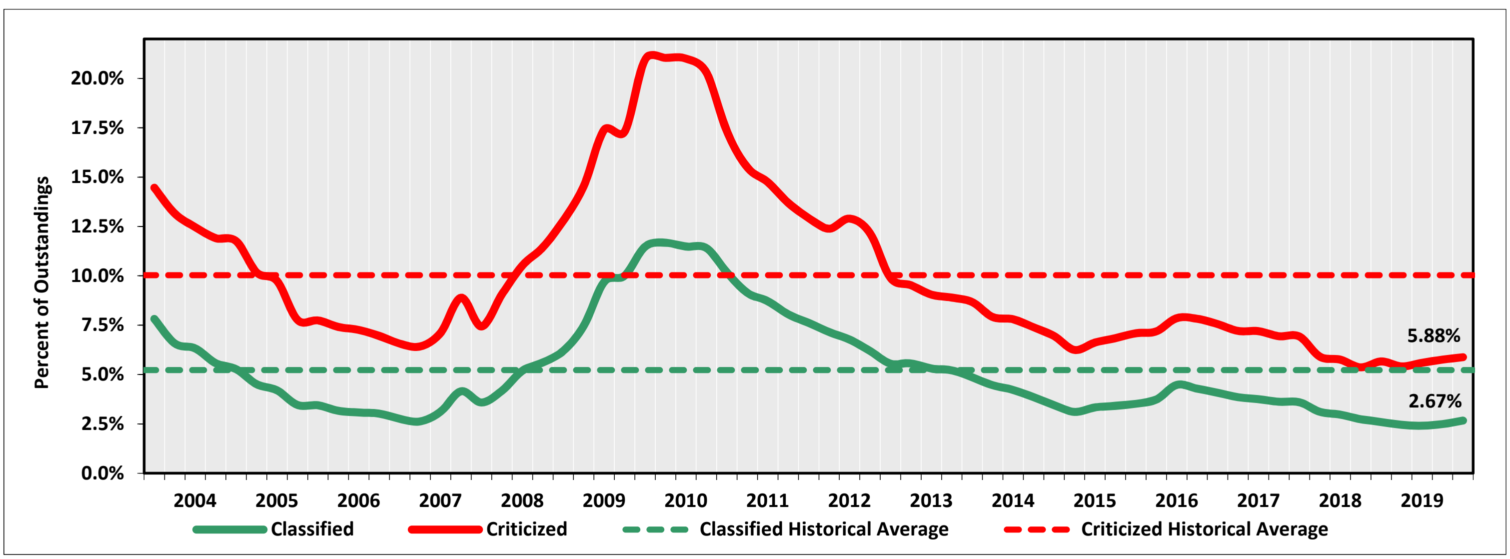
Credit Quality Comparison 3Q19: By Market Segment

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	0.39%	0.36%	0.74%	0.32%
Percent on Nonaccrual	1.10%	0.82%	0.34%	0.35%
Percent Noncurrent (>90 Days Past Due + Nonaccrual)	1.19%	0.88%	0.38%	0.36%
Weighted Average Risk Rating (10 pt RMA Scale)	4.98	4.27	4.20	4.71
Weighted Average PD	3.20%	2.21%	1.86%	2.95%
Weighted Average PD: Non-Defaulted Portfolio	2.28%	1.77%	1.54%	2.80%
Percent Classified	3.20%	2.43%	0.97%	0.80%
Percent Criticized	5.56%	5.10%	4.59%	2.77%
LOC Utilization Rate	50.44%	39.80%	36.60%	65.08%

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



The percentage of C&I loans risk rated criticized continued to edge higher in 3Q19. Among the industries with large increases in criticized balances this quarter were Chemical Manufacturing, Waste Management, and Animal Production.

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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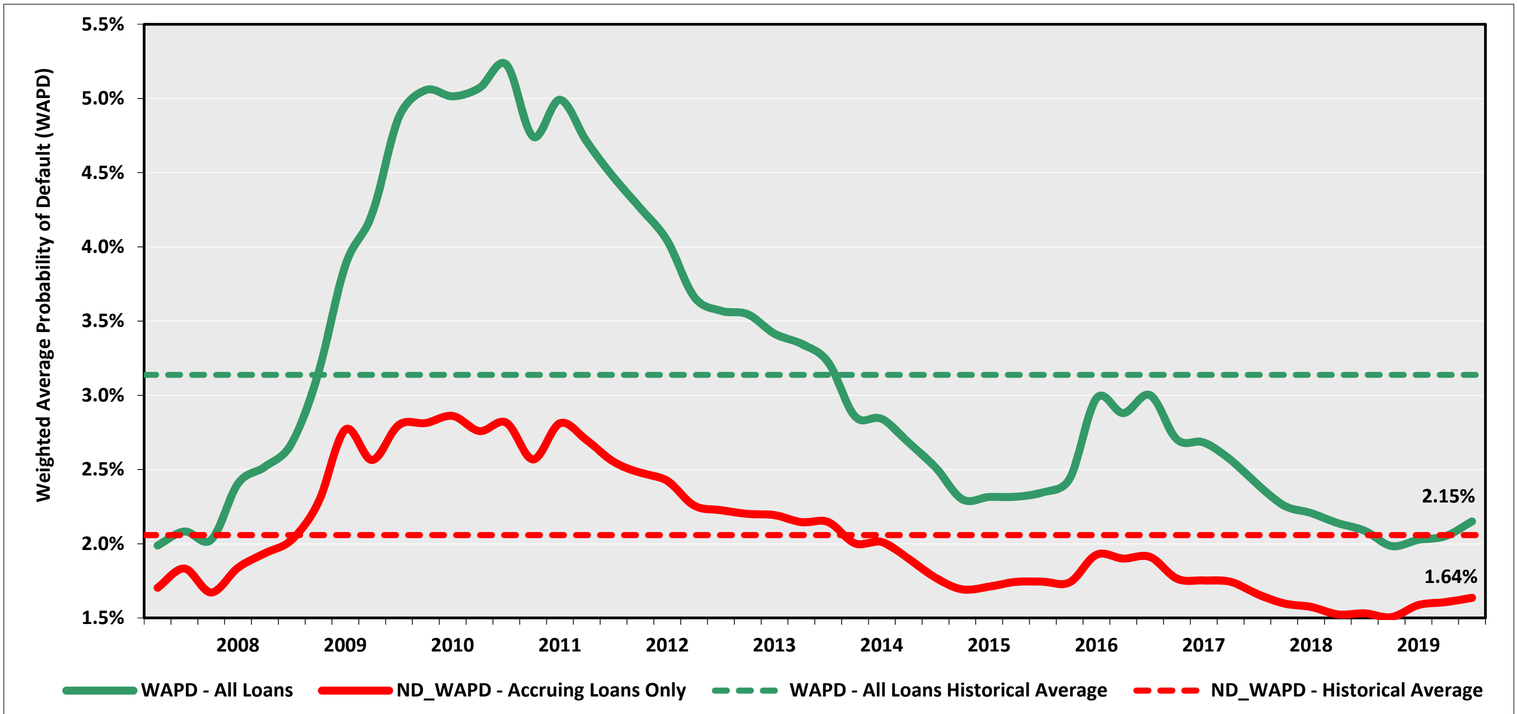
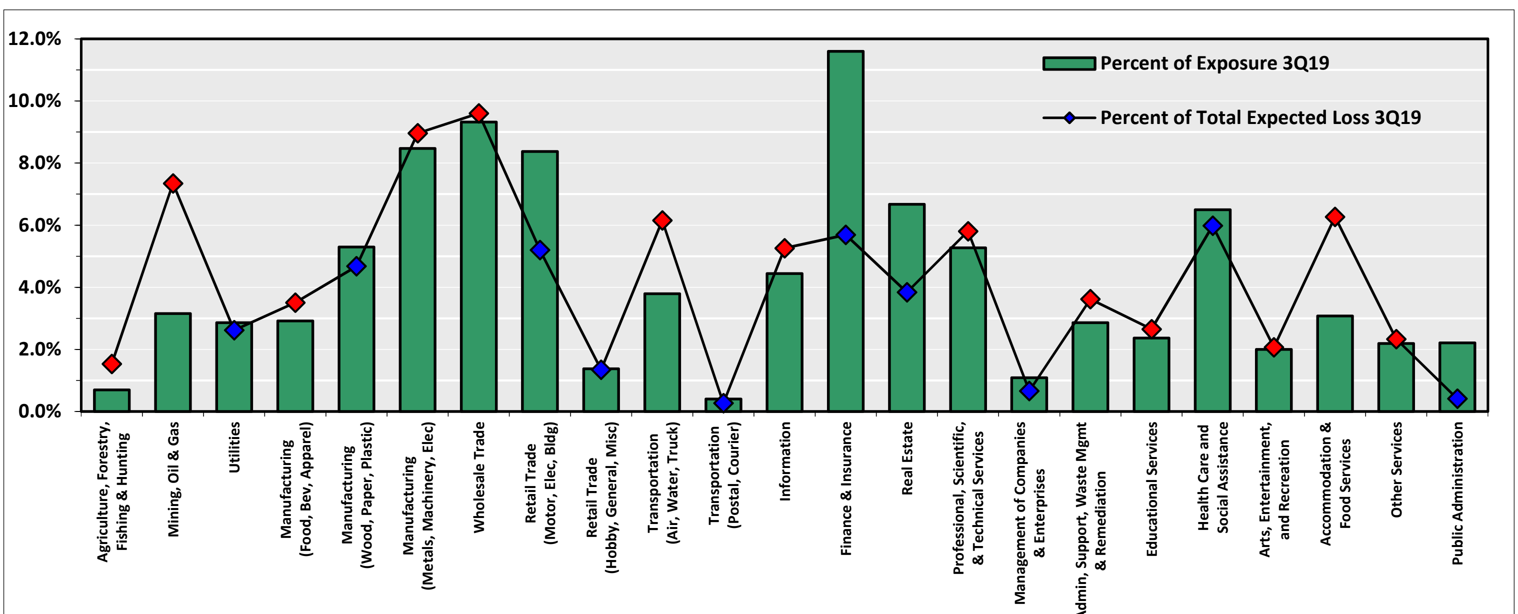
Weighted Average Probability of Default Trend



Default projections continued to elevate this quarter, with the non-defaulted weighted average probability of default (ND_WAPD) climbing to the highest level seen over the last two years.

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.

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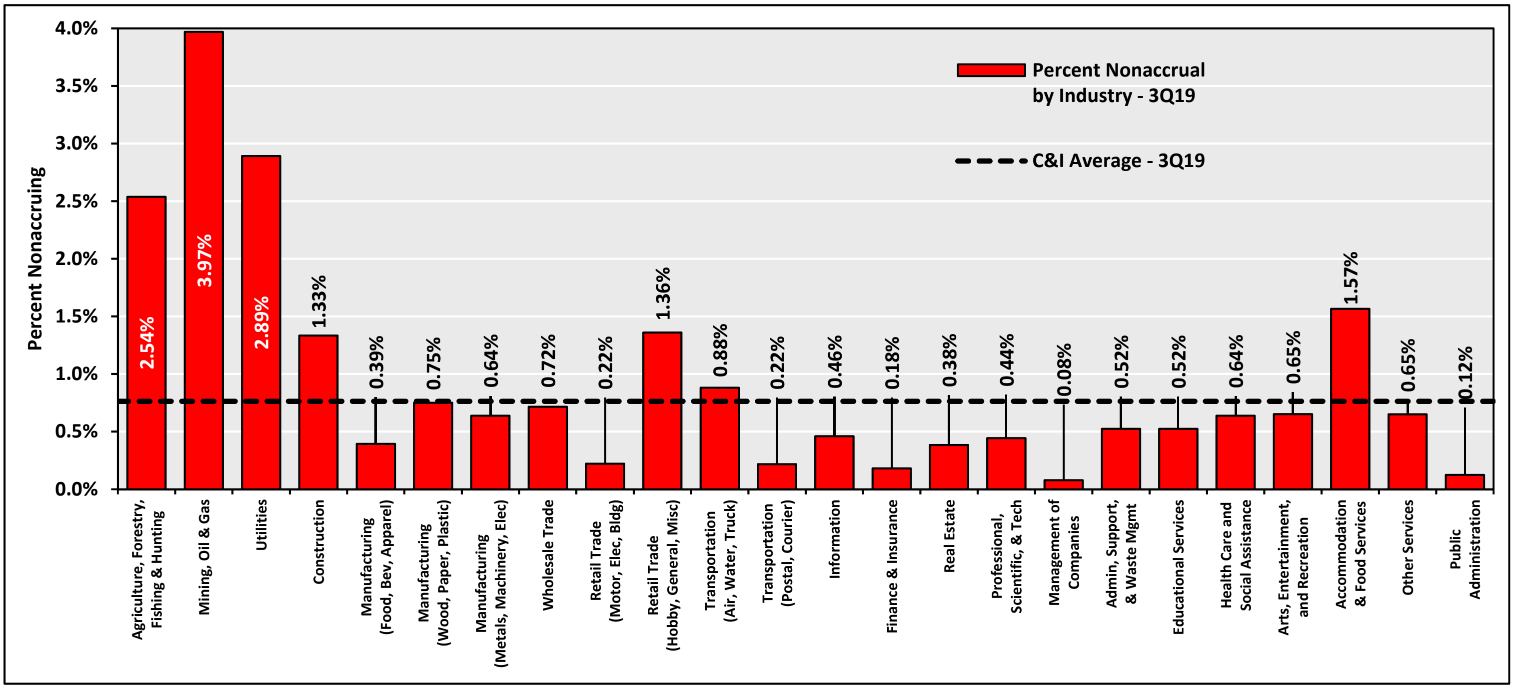
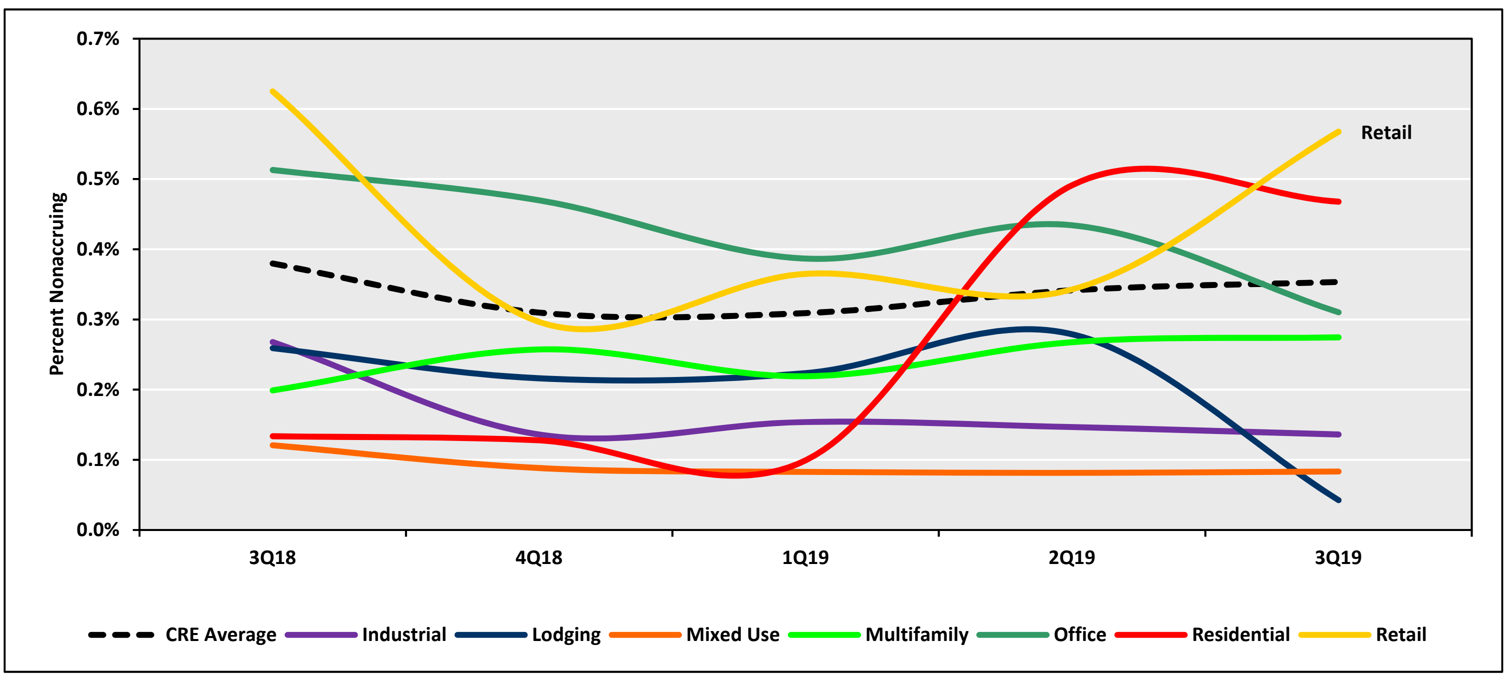
Problem C&I Loans by Industry: Nonaccruing Loans



Here, we examine nonaccruing loan ratios by industry (red bars) relative to the C&I market average (dotted-black line). Nonaccrual rates for Agriculture; Mining, Oil & Gas; and Utilities remained well above the C&I average in 3Q19. Additionally, Retail Trade and Accommodation & Food Services have recently exhibited signs of credit distress.

CRE: Percent Nonaccrual by Property Type



The percentage of Retail CRE loans on nonaccrual increased sharply in 3Q19 from the prior quarter. Currently, Retail is the worst performing property type in terms of nonaccruing CRE loans.

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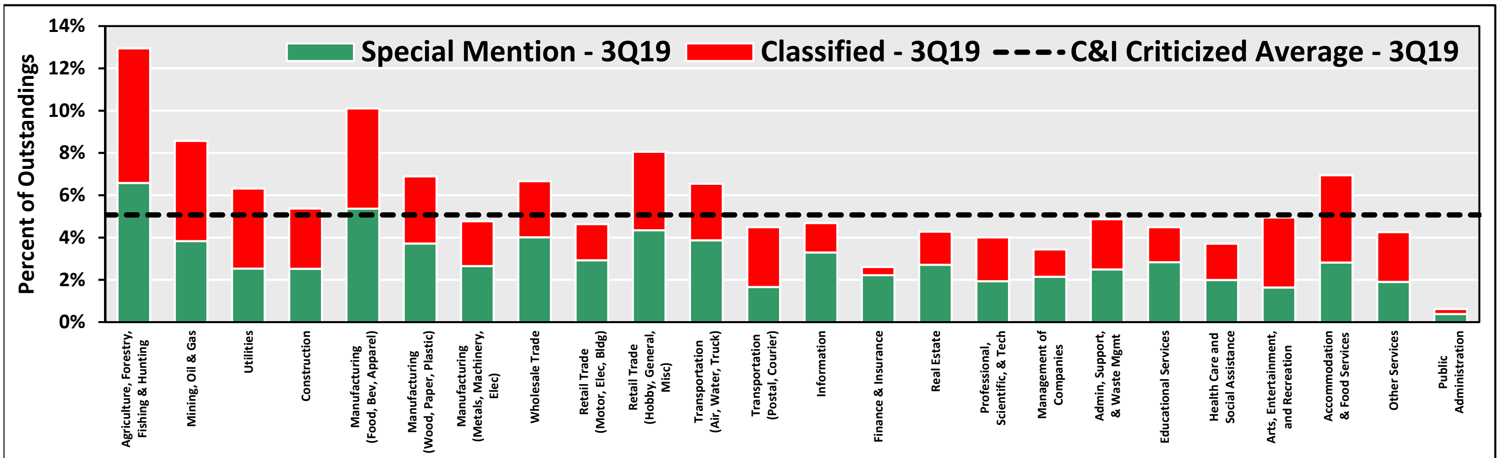
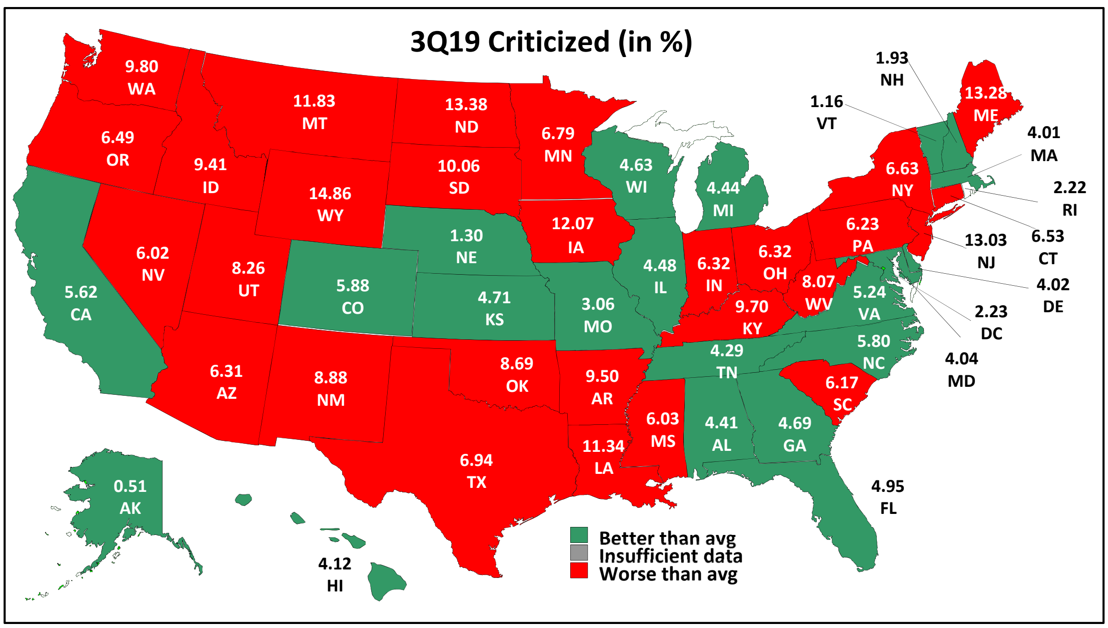
Problem C&I Loans by Industry: Criticized Loans



In 3Q19, food-related industries—namely, Agriculture, Manufacturing (Food, Bev, Apparel), and Accommodation & Food Services—displayed high levels of criticized loan balances. In the Accommodation & Food Services sector, loans risk-rated classified made up the majority of the sector's total criticized balances.

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

Problem C&I Loans by State: Criticized Loans



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. Several states dependent on the Energy sector – including Texas, Oklahoma, and North Dakota – exhibited criticized loan ratios worse than the national average in 3Q19.

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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