Quarterly Client Survey-3rd Q15

New York, December 10, 2015-CEIS Review Inc., a financial services consulting firm serving the needs of commercial and savings banks, has released its survey of loan quality trends as observed from reviews of its client base.

Executive Summary-Industry Wide Trends

Based on the **FDIC Quarterly Banking Profile for the 3rd Quarter 2015,** Community Banks, which represent approximately 93% of all insured institutions, reported a 7.5% increase in net income from one year earlier, the result of improved net interest income and noninterest income, coupled with lower loan-loss provisions. These results show a higher profitability growth rate versus the aggregate FDIC insured institutions which reported a 5.1% increase in earnings on a comparative basis. The proportion of banks on an industry wide basis that were unprofitable fell to 5.0% compared to 6.6% in the third quarter of 2014. The percent of unprofitable community banks in the third quarter was at 5.2%, the lowest level since the third quarter of 1998. Total results for all insured institutions also reflected continued asset quality improvement with net losses declining for the 21st consecutive quarter while noncurrent loan balances declined for the 22nd consecutive quarter.

The FDIC also reports that all insured institutions reduced their loan-loss reserves in the third quarter of 2015, which represents the 21st consecutive quarter that the industry reserves have declined. However, the "coverage ratio" of reserves to non-current loans improved for the 12th consecutive quarter, from 82.7% at the end of June to 85.2% at the end of September, the result of an overall decline in noncurrent loan balances. Loan losses continue to decline as NCOs declined for the 21st consecutive quarter to the lowest industry rate since the third quarter of 2006. Offsetting all of this positive news is a cautionary note from the FDIC that margins remain near historic low levels as higher yielding assets continue to be replaced by lower yielding investments within a low interest rate environment. The Quarterly Report also references on the Community Bank side a continued increase in the holding of long-term assets while long term funding has not grown at the same pace. "This imbalance may lead to an increase in interest rate risk"

American Banker (AB) Articles (December 2015) The American Banker reports that the FDIC has highlighted a definite warning sign it sees in bank portfolios; riskier loans. It observes signs of institutions becoming bolder in their risk profiles and officials also pointed to loosened credit standards in some categories. FDIC Chairman Martin Gruenberg is quoted as follows: "As loan growth has picked up, supervisory surveys have noted a relaxation in underwriting standards in some loan portfolios, including auto and multifamily housing portfolios. We have also seen growth in riskier loan categories, such as loans to leveraged commercial borrowers." Mr. Gruenberg flagged credit risk as well as interest rate risk “as the two key issues from a risk management perspective from our institutions.” …”We are very focused on having the institutions address these issues.” The articles in AB also point out the continuing positive trends in the banking industry with respect to credit quality and earnings and place an emphasis on continued vigilance with respect to stringent ongoing loan reviews.

CEIS Client Survey Results

The following comments are based on quarterly testing results from loan review activities CEIS undertakes with its client base. CEIS compiles data from all of its completed reviews with the goal of identifying trends related to various activities including loan quality, delinquencies, variances, exceptions, LLR for Classified loans and Grade outlook. This particular report will focus on statistics compiled for the 3rd Quarter 2015.

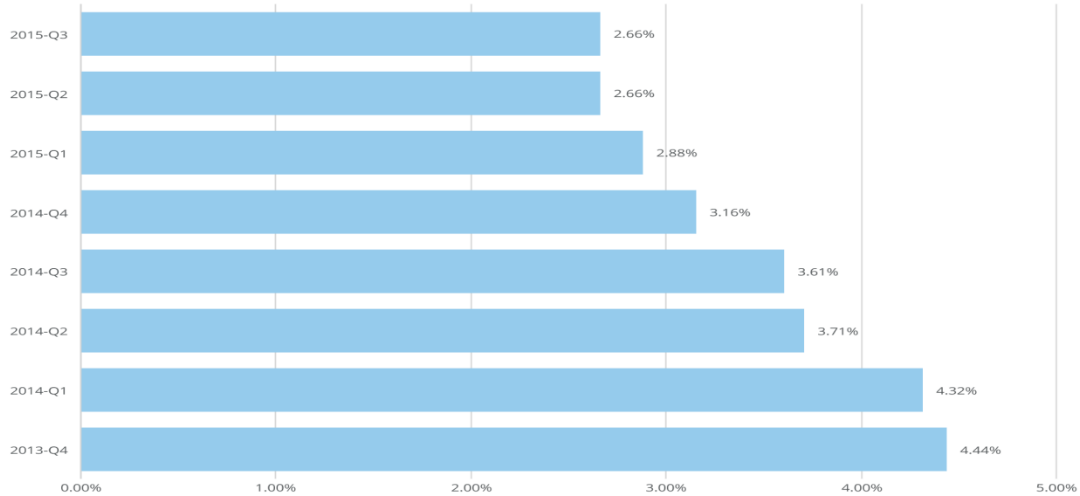
The data used herein is for the most part on a “rolling four quarters” basis as data from any particular quarter can be misleading due to extraordinary events that can skew or distort the direction of any trends. The “rolling four quarters” method is considered to be more reflective of trends developed as it eliminates the impact of any outliers or chance events that may occur in any particular period.

The CEIS client base includes domestic and international bank portfolios, branches, agencies and specialty finance portfolios. The data referenced herein excludes portfolios that are managed outside the US and those that are defined as specialty finance. The bank portfolios include those of commercial and savings banks primarily in the states of New York, New Jersey, Connecticut and Florida and to a lesser extent banks on Pennsylvania, Massachusetts, Vermont, Illinois, California and Maryland.

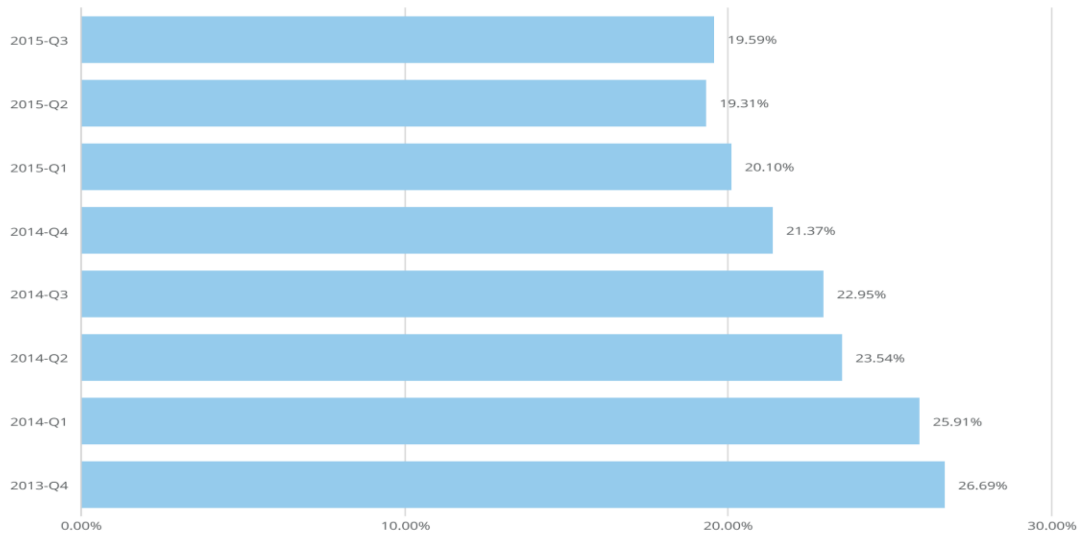
Loan Quality (LQ)

The number of banks reviewed by CEIS for the four Quarters ended 9/30/15 was 84 of which 41 were over $500mm portfolio size and 43 were below $500mm portfolio size. Regional breakdown was 65 in the NY, NJ, CT areas, 10 in Florida and 9 in other areas. Asset quality ratios as evidenced by average criticized and average classified loans vs. total outstanding portfolios have remained steady and on a downward trend over the past two rolling 4Q periods and as against Q4 2013 and subsequent rolling periods. Banks with portfolio size lower than $500mm and Florida banks showed the greatest improvement in these areas since Q4 2013. The ratios of average criticized and average classified loans to Capital + LLR reflect a similar steady pattern over the past two rolling 4Q periods and as against Q4 2013 and subsequent rolling periods. The Florida banking sector and banks with portfolio size lower than$500mm were the leaders in these categories over this extended period of time. All of these results reflect ongoing management attention to portfolio monitoring.

Rolling 4Q Average Classified / Portfolio

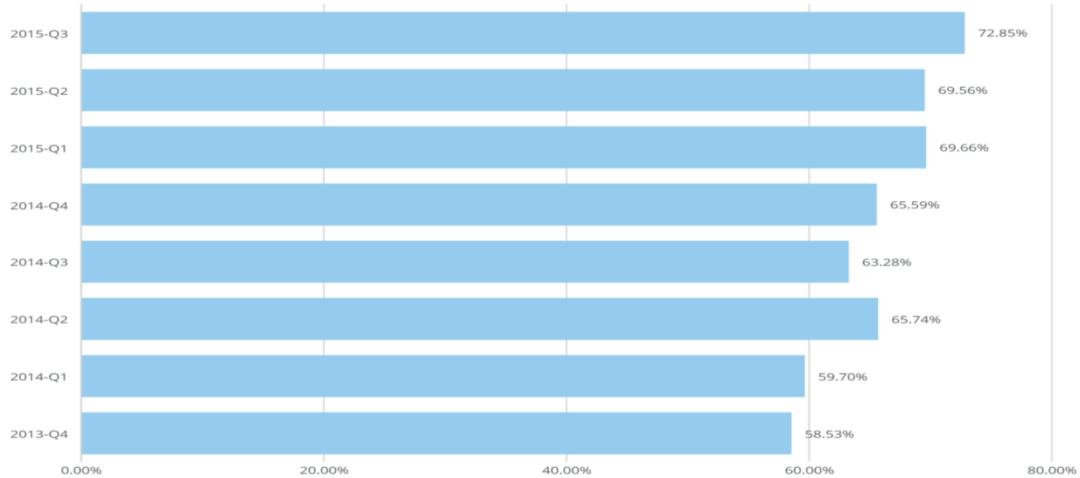


Rolling 4Q Average Classified / (Capital + LLR)



LLR/Classified Ratio for the composite group continues to increase from 63.3% at 9/30/14 to 72.9% at 9/30/15 demonstrating a continued cautious approach to this segment of the portfolio. The results here somewhat mirror the industry wide coverage for non-current loans.

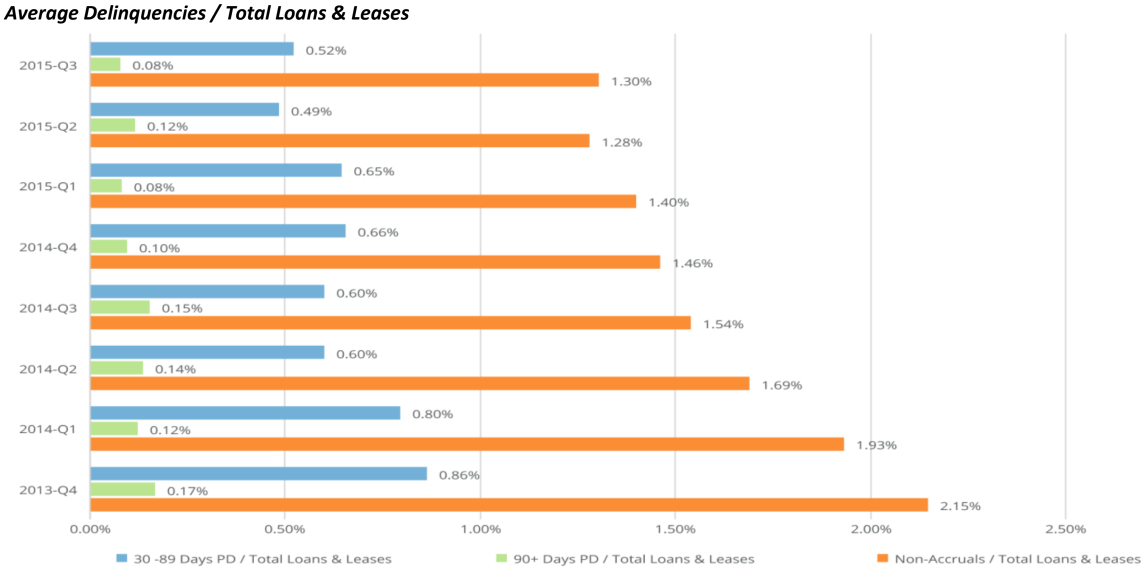
Rolling 4Q Average LLR / Classified



Delinquencies

Average Delinquencies/Total Loans and Leases Ratio for all clients is showing improvement over the past two years in all categories and especially in the non-accrual sector. These results demonstrate continued adherence to tighter monitoring controls and stricter credit parameters.

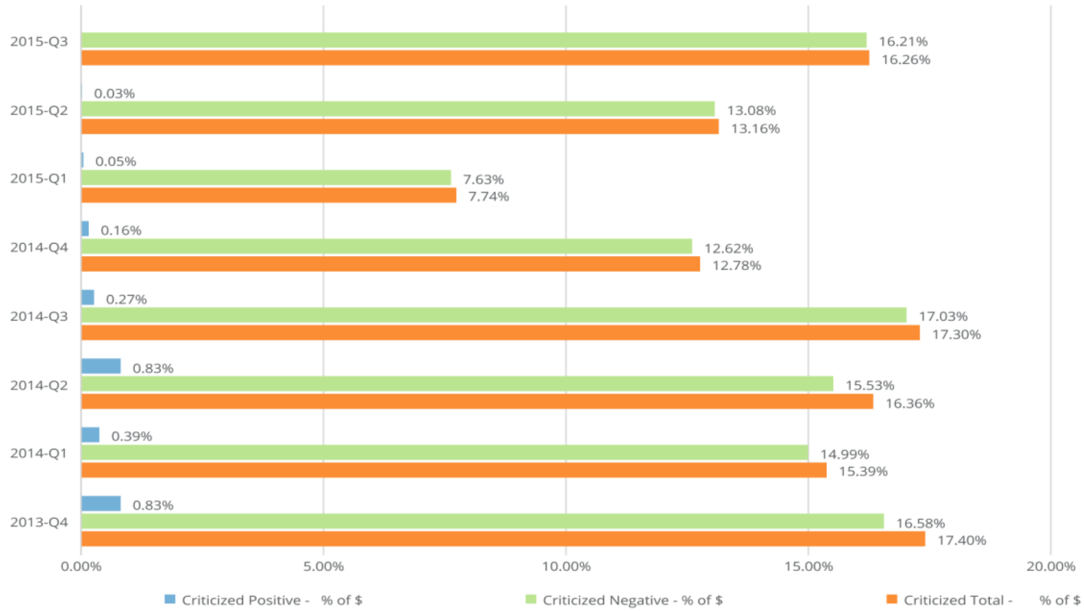
Average Delinquencies / Total Loans & Leases



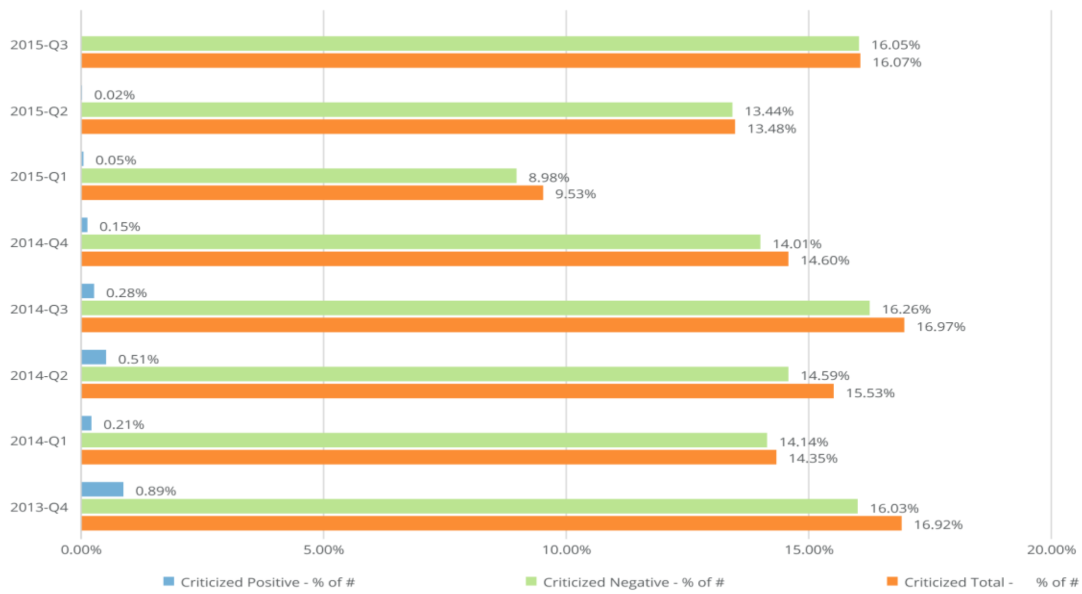
Grade Variances

On a rolling 4Q basis Grade variances on Criticized loans as a percent of dollars outstanding and as a percent of number of loans have remained consistent over the past 4 such periods. It is noted here that negative grade variances on Criticized loans using the aforementioned ratios are showing some noticeable increases since Q1 results.

Rolling 4Q Grade Variance – Average % of dollars – All Banks – Criticized Loans

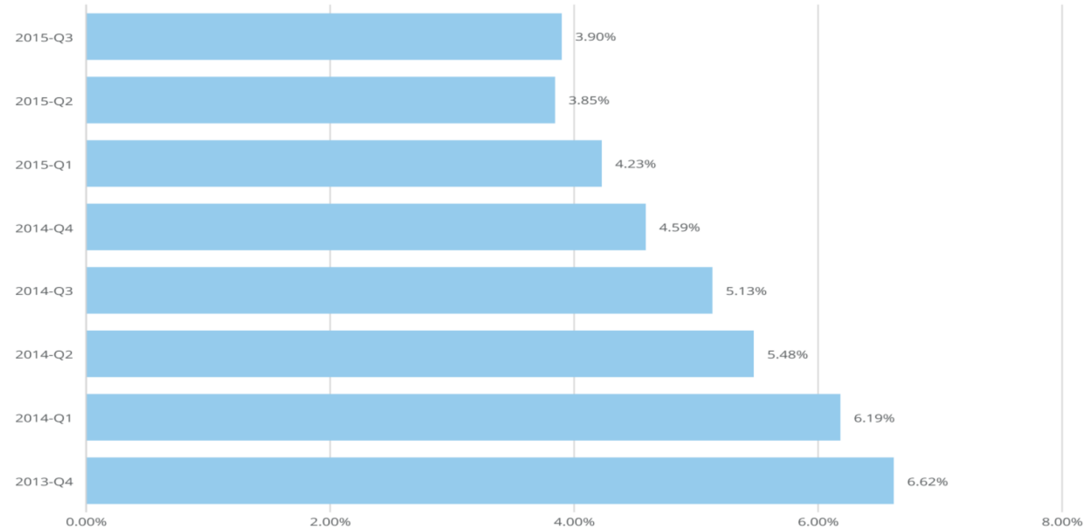


Rolling 4Q Grade Variance – Average % of Number of Loans – All Banks – Criticized Loans

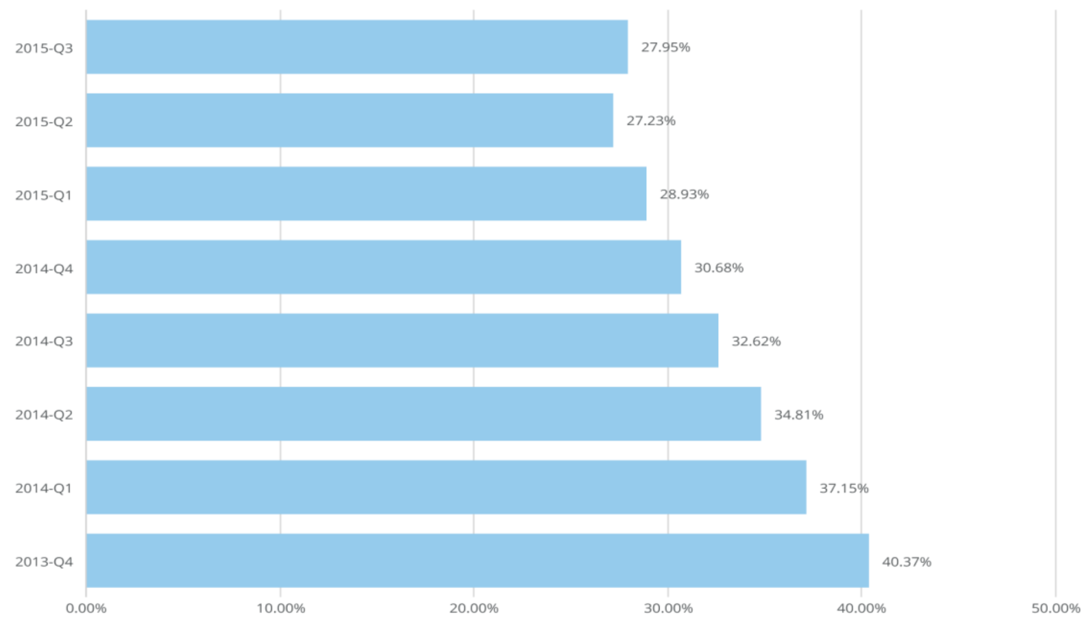


It is also noteworthy that the average criticized ratio to total portfolio and as a percent of Capital +LLR continues to track a downward trend from Q4 2013 but remaining flat over the past 2 rolling 4Qs**.**

Rolling 4Q Average Criticized / Portfolio

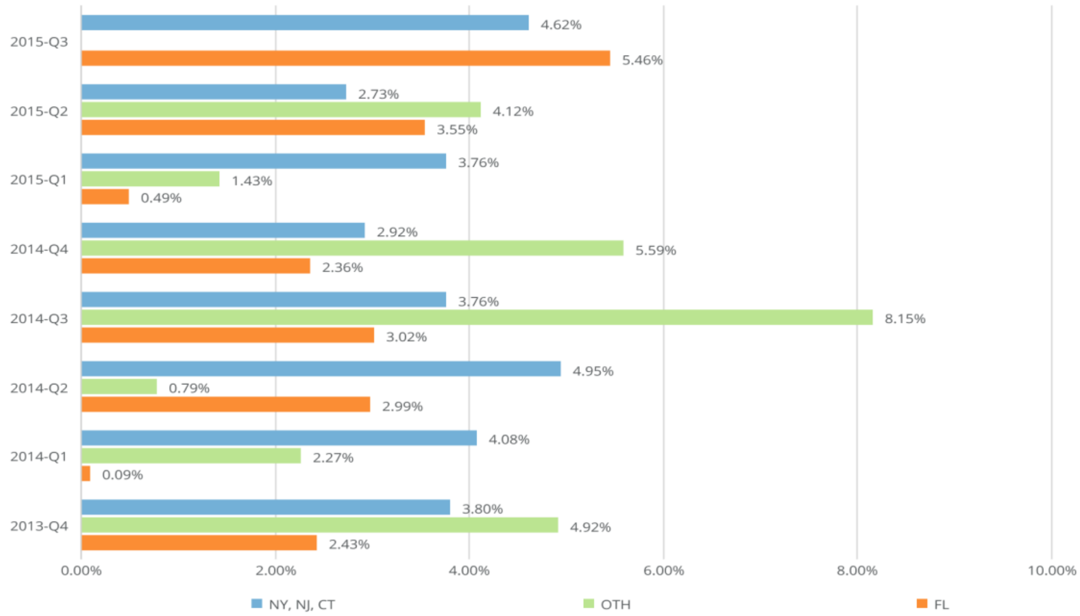


Rolling 4Q Average Criticized / (Capital + LLR)



On a regional basis Florida is showing an increasing trend in negative variances as a percent of outstanding dollars, moving from 3.02% at 9/30/14 to 5.46% at 9/30/15. NY area has also moved from 3.8% to 4.6% over this same period.

Grade Variance – Average % of Dollars by Region – Negative Variances

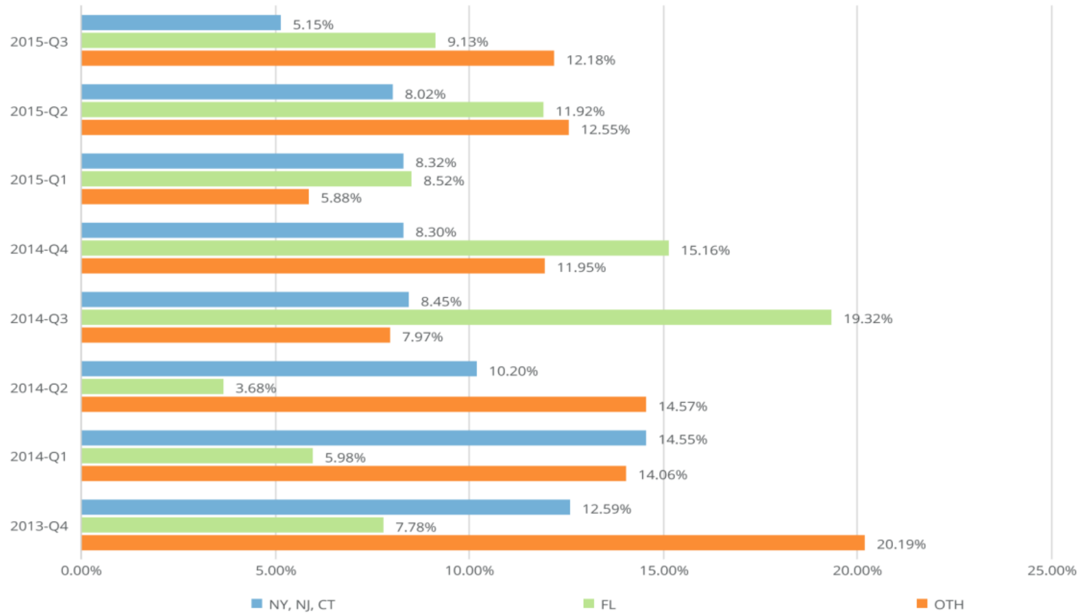


Overall, most loan variances continue to be within the criticized loan sector of which negative grade variances show substantially higher levels vs. the pass category.

Grade Outlook

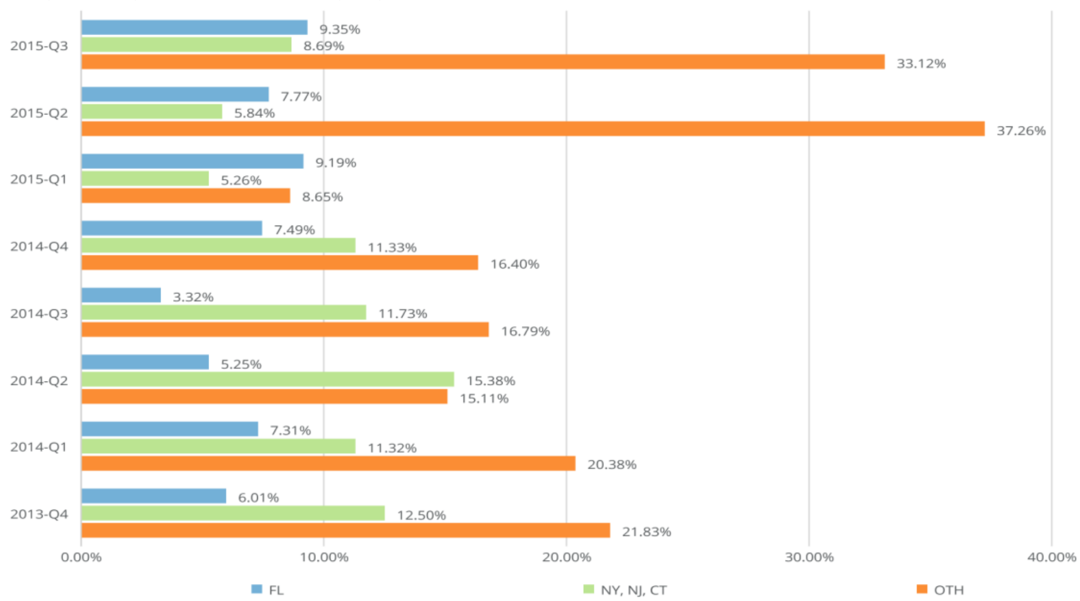
Based on available file information from the most recent credit review CEIS will assign a grade outlook which represents a forward looking assessment for the individual account over the next six months. As the grade outlook in the Pass category for the most recent rolling 4 quarters was predominantly Positive/Stable, we will focus here on the Criticized loan category. The grade outlook for this most recent rolling 4 Quarter period on the Criticized sector showed an average of 76% in the Stable category. This has been consistent over the past 4 rolling 4Q periods. On a regional basis the Florida banks and "Other Area Banks" consistently show a higher percentage of Insufficient Data Category for grade outlook. (There may be some issues here with file maintenance that needs to be addressed).

Rolling 4Q – ISD Grade Outlook by Region – Criticized Loans



The Positive Grade outlook for Criticized loans in Florida and New York areas has remained fairly consistent over the past 4 rolling 4 Q periods at averages of 8.3% and 6.3% respectively. Negative Grade Outlook on the Criticized loans has shown consistent increases in the Florida portfolio and steady declines in the NY portfolio except for the most recent 4 Quarter period.

Rolling 4Q – Negative Grade Outlook by Region – Criticized Loans



Exceptions

Exceptions will exist against existing credit policies for a multitude of reasons some of which can be justifiable and explained in the credit proposal. The materiality of individual exceptions must be assessed in making a final judgment on the credit risk rating. The average percentage of Borrowers with exceptions for all banks has remained stable stable at around 27% over the past rolling 4 Quarter periods. Banks with portfolio size less than $500mm have been consistently higher versus the larger banks for these same periods averaging 30% exception level.

Summary

The credit quality metrics for the CEIS Client Base remain consistent with industry results as evidenced by lower levels of average criticized and average classified loans vs. total outstanding loans. These ratios have stabilized over the past two rolling 4 Quarter periods but continue on a favorable trend since the 4th Q 2013. Loan Loss Reserve coverage vs. Classified Loans for all banks in the CEIS Client Base has been consistently increasing over the past two years which somewhat mirrors the industry wide coverage for non-current loans. Average delinquencies vs. total loans and leases ratio is also trending favorably, especially in the non-accrual category. This is in tandem with industry wide results. Negative grade variances for the Criticized Loan Sector for the last two rolling 4 Quarter periods are showing noticeable increases both as a percent of dollars outstanding and as a percent number of loans compared to Q1 2015. A more focused management attention is recommended here to strengthen this portfolio segment to prevent further deterioration

There continues to be a plethora of continued positive news for all insured institutions and for the community banking sector out of the FDIC quarterly survey. However, FDIC Chairman Martin Gruenberg has expressed some concern that there has been some relaxation of underwriting standards in some loan portfolios and that… "We also have seen growth in riskier loan categories such as loans to leveraged commercial borrowers." Mr. Gruenberg has stated that banks can generally expect examiners to focus on balance sheet exposure to interest rate risk and credit risk.

CEIS continues to stress the critical importance of maintaining a high level of underwriting and loan monitoring standards at all times so as to maintain a sound credit portfolio on a going forward basis.

Additional Resources

http://www.ceisreview.com/category/ceis-quarterly/

http://www.ceisreview.com/emerging-trends-in-community-bank-cre-underwriting/

http://www.ceisreview.com/services/