

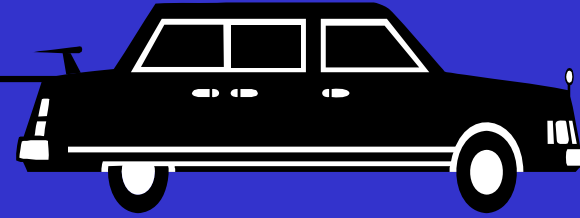
CREDIT COMMITTEE

ASSET QUALITY TRENDS & BOARD OVERSIGHT



Presented to
National Association of Corporate
Directors
April 8, 2008

Discussion Issues



- **Recent Asset Quality Trends**
 - Loan Problems
 - Commercial Real Estate
- **Regulatory Expectations**
 - Asset Quality
 - Credit Underwriting
 - Appraisals
 - Loan Review
 - Portfolio Analysis
- **Board Oversight**
 - Powers, Duties, and Responsibilities
 - Why be a Bank Director?
 - Management Information Systems



Recent Asset Quality Trends



- Increasing delinquencies and foreclosures
- Shrinking collateral values
- Very high asset concentrations in real-estate related loans, particularly commercial real estate
- Problems with acquisition, development, and construction (ADC) loans
- Increased use of interest reserves

Recent Asset Quality Trends

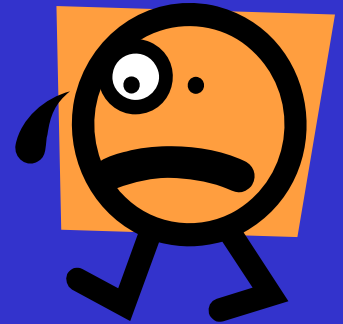


- Rising level and severity of adverse asset classifications
- Other Real Estate Owned (OREO)
- Additional provisions required for adequate ALLL
- Impaired earnings
- Use of brokered deposits and other volatile sources to fund loans
- Liquidity and market rate sensitivity issues

Loan Problems

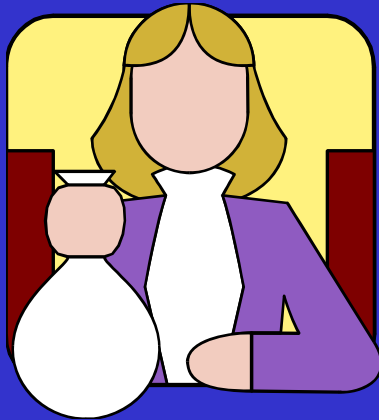
Some Notable Causes:

- Poor Risk Selection
- Overlending
- Failure to Establish/Enforce Repayment Agreements
- Lack of Attention to Changing Economic Conditions
- Competition

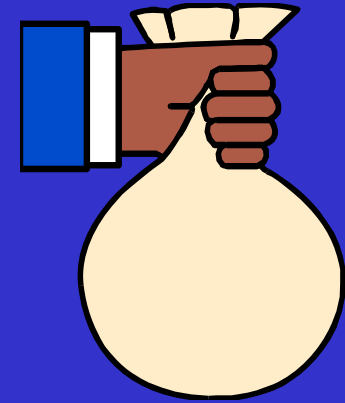


Commercial Real Estate

- **Comprises a major portion of many South Florida banks' loan portfolios**
- **Warning signs of troubled real estate markets/projects:**
 - **Rent concessions or sales discounts resulting in lower cash flow**
 - **Changes in plans/concepts (e.g. condo project converting to apartment project)**
 - **Construction delays resulting in cost overruns**
 - **Slow leasing or lack of sustained sales**
 - **Lack of sound feasibility study**
 - **Excessive construction draws beyond those needed to cover costs and expenses**
 - **Identified problem credits, past due and nonaccrual loans**



Regulatory Expectations



- **Cautious, thorough underwriting**
- **Improved credit administration**
- **Awareness of changing collateral values**
- **Planning and updating of strategies, as necessary**
- **Good information flow between management and the Board**
- **Better documentation of discussions and decisions in meeting minutes**
- **Director participation on examinations**

Appendix A to Part 364 of the FDIC Rules and Regulations Interagency Guidelines Establishing Standards for Safety and Soundness

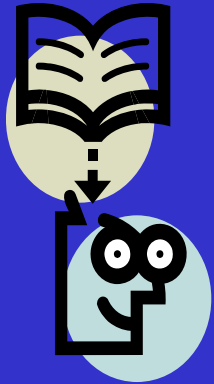
- **Asset quality – the institution should:**
 - **conduct periodic asset quality reviews to identify problem assets**
 - **estimate the inherent losses in those assets and establish sufficient reserves to absorb losses**
 - **compare problem asset totals to capital levels**
 - **take appropriate corrective action to resolve problem assets**
 - **consider the size and potential risks of material asset concentrations**
 - **provide periodic asset reports with adequate information for management and the Board of Directors to assess the level of risk**

Appendix A to Part 364 of the FDIC Rules and Regulations Interagency Guidelines Establishing Standards for Safety and Soundness

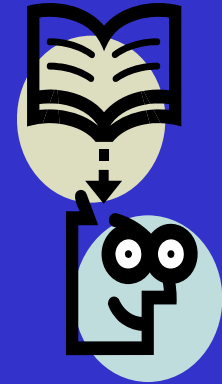
- **Credit underwriting practices should:**
 - **be commensurate with institution loan types, terms & conditions, and markets**
 - **consider:**
 - **The borrower's overall financial condition and resources**
 - **The financial responsibility of guarantors**
 - **The nature and value of underlying collateral**
 - **The character and willingness of borrower to repay as agreed**
 - **establish a system of independent, ongoing credit review with appropriate communication to management and the Board of Directors**
 - **take adequate account of concentration of credit risk**
 - **be appropriate to the size of the institution and the nature & scope of activities**

Appraisals and Appraisal Evaluation Program

- Importance heightened in current financial environment
- Know when a new appraisal or evaluation is required:
 - Obvious and material change in property or market conditions
 - Advancement of new money
- The Board of Directors is responsible for reviewing and adopting policies and procedures that establish an effective real estate appraisal and evaluation program
- The appraisal evaluation program should:
 - Establish selection criteria and procedures to evaluate and monitor ongoing performance of appraisers.
 - Provide for appraiser independence
 - Identify the appropriate appraisal for various lending transactions
 - Assess the validity of existing appraisals or evaluations to support subsequent transactions



Loan Review Systems



- Provide the Board of Directors and Senior Management with an objective assessment of the overall loan portfolio quality.
- Help the Directorate fulfill its responsibility to maintain the ALLL at an adequate level
- All review systems should include a mechanism for reporting identified loans, and any corrective action taken, to Senior Management and the Board

Portfolio Analysis

- Higher risk credits require more frequent monitoring.
- Management and the Board should receive comprehensive reports on such exposures at least quarterly
- Such reports should include:
 - Total exposure and segment exposures compared to established limits
 - Risk rating distribution and migration data
 - Portfolio performance, including delinquencies, restructured loans, and impaired loans
 - Exceptions to policy, procedures, and underwriting standards
 - Collateral composition of the portfolio
 - Unsecured exposures

Powers, Duties and Responsibilities of Bank Directors

- Regulating the Manner in Which All Business of the Bank is Conducted
- Corporate Planning
- Appointing, Dismissing, and Defining the Duties of Officers
- Personnel Administration
- Honestly and Diligently Administering the Affairs of the Bank
- Observance of Applicable Laws
- Establishing an Appropriate Internal Control System and Adequate Auditing Program
- Ensuring Effective Management Information Systems (MIS)

FDIC Statement of Policy Concerning the Responsibilities of Bank Directors and Officers

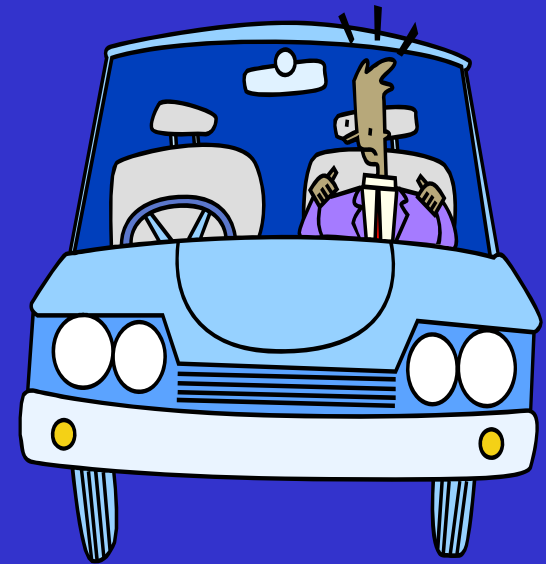
- Concerns regarding civil damage litigation risks
- Duties of loyalty and care
 - Loyalty – candor, honesty, and integrity
 - Care – prudence and diligence
- fulfill responsibilities and make reasonable, fully-informed judgments
- Timely and ample information
 - Directors must require
 - Management must provide



WHY??

It Ain't Easy!!

- Directors can be held personally liable
- Qualified Management
 - Can you find them?
 - Can you keep them?
- Over-regulation??
- Not enough time in the day...



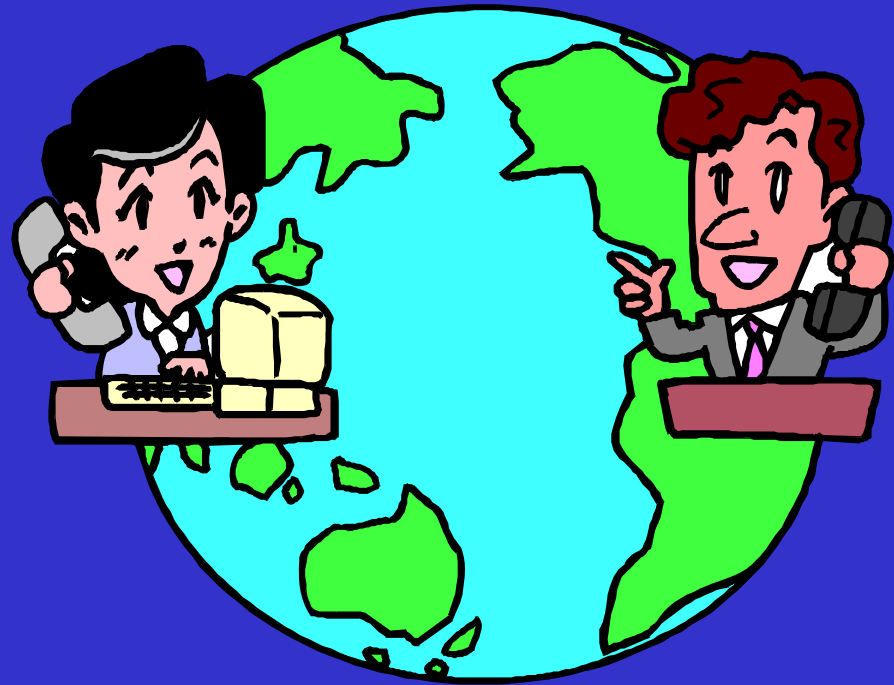
Management Information Systems (MIS)

- A system or process that provides the information necessary to successfully manage an organization
- The usefulness and effectiveness of MIS is determined by:
 - Quality (accuracy) of data
 - Quantity of data
 - Timeliness of data
 - Consistency of data
 - Completeness of data
 - Relevance of data

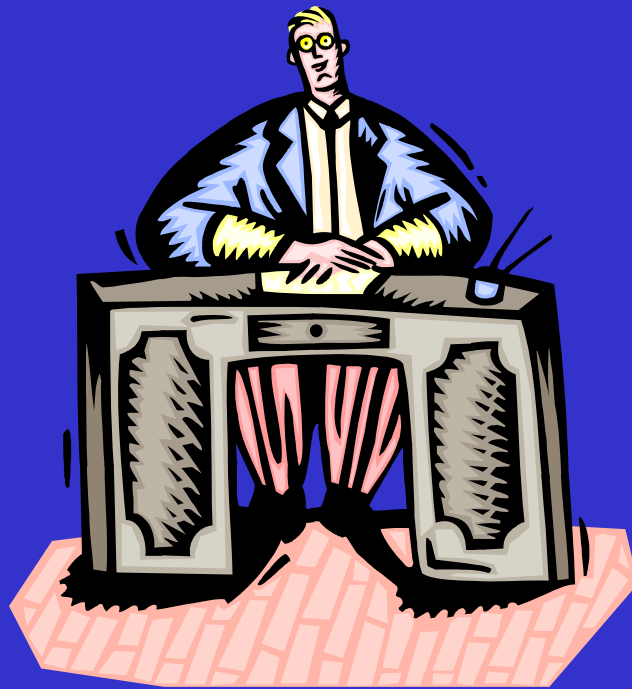


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Questions?



Thank You

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