The Evolution of Risk Ratings: Lessons Learned and Where We Go From Here

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November 5, 2019
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Risk management in financial institutions has changed substantially over the past decade, due in large part to regulations that emerged from the global financial crisis.

The practice of measuring credit risk is at the forefront of these changes.

» A decade ago, there were only a handful of FIs outside the top 30 or so who were using a quantitatively-driven approach for commercial risk ratings (e.g., statistically-driven measures of credit risk)

» Today, the practice exists at most of the top 100 institutions, and even within firms whose commercial loan portfolios are less than $5 billion
The Amount of Problem Loans Remains at Historically Low Levels

% of Loans Noncurrent

- SFR Construction: 0.47%
- CRE Construction: 0.44%
- Single-Family Residential: 1.84%
- Multifamily: 0.13%
- CRE - Owner Occupied: 0.83%
- CRE - Non-Owner Occupied: 0.40%
- Commercial & Industrial: 0.79%

Source: FDIC
Loan Loss Rates Remain Near Zero

Only $60 billion in total non-consumer loan losses since 2013

Source: FDIC | 2014-2019: Avg Non-Consumer Loans (incl SFR) ~$9T. Non-Consumer Loans (incl SFR) accounted for 25% of NCO and 85% of loans
Loss-Absorbing Capital Increased Significantly This Decade

Source: FDIC
Nearly 4,000 Institutions Have Twice the “Well Capitalized” Minimum for CET1 RBC

Source: FDIC

Number of FDIC-Insured Institutions

Common Equity Tier 1 RBC Ratio

- > 13.00
- 12.00-13.00
- 11.00-12.00
- 10.00-11.00
- 9.00-10.00
- 8.00-9.00
- 7.00-8.00
- 6.50-7.00
- 6.00-6.50
- 5.00-6.00
- 4.50-5.00
- 4.00-4.50
- 3.00-4.00
- 2.00-3.00
- < 2.00

- “Well Capitalized” (5,294)
- “Adequately Capitalized” (5)
- “Undercapitalized” (3)
- “Significantly Undercapitalized” (1)
Banking Industry Growth and Consolidation

Over the last decade...

» The number of institutions declined by 33.8%

» Industry assets grew $5.2 trillion, or 39.6%

» The number of FTEs is unchanged (0.30% increase)

» More than 2,250 bank mergers and acquisitions

» 84% of industry assets now held by banks > $10B (141)
Which have been the leading drivers for change? (your top 3)

1. Direct feedback from supervisors
2. Industry growth and consolidation
3. Additional capital to spend on risk management
4. Preparing for the next recession (whenever that will be)
5. Seeking a competitive advantage
6. Ability to demonstrate a stronger risk culture to external stakeholders
Our Panelists’ Institutions

» Bank OZK | Little Rock, AR
   » $23B Assets | $17B Loans | $18B Deposits
   » 264 offices in Southeastern U.S. | Listed OZK (NASDAQ)

» BMO Financial Group | Montreal, QC
   » [CAD] $839B Assets | $418B Loans | $553B Deposits
   » 588 U.S. offices | Listed BMO (NYSE & TSX)

» Western Alliance Bancorporation | Phoenix, AZ
   » $26B Assets | $20B Loans | $22B Deposits
   » 39 offices in AZ, CA, NV | Listed WAL (NYSE)