Agenda

1. Regional Economic Performance at a Glance
2. Near Term Risks
3. What to Expect from CECL?
REGIONAL ECONOMIC HEALTH
Regional Joblessness at All Time Lows

Unemployment rate, %

Sources: BLS, Moody’s Analytics
Recessions Are Almost Nonexistent

Status as of April 2019 data

Source: Moody's Analytics
Only four metro areas are in RECESSION

Which unlucky ones?
Which metro area has the LOWEST unemployment rate?
Which metro area has the HIGHEST unemployment rate?
Supply Constraints Boosting House Prices

Housing Supply Now Exceedingly Tight

House Price Growth the Best in the West

Sources: NAR, Census Bureau, Moody’s Analytics
Dlq Patterns Match Credit Qual. Patterns

Delinquency Rate, Auto
% of outstanding, NSA

…As of 19Q1

Delinquency Rate, Bankcard
% of outstanding, NSA

Delinquency Rate, Home Equity
% of outstanding, NSA

Sources: Equifax, Moody’s Analytics
2 | THINGS TO WATCH
TRADE WAR

Which Regions are at Greatest Risk?
The China Effect

% of GDP in industries hit by Chinese retaliatory tariffs

Sources: BEA, Moody's Analytics

U.S. = 13%
Trade War Hurts Northwest, South Most

Peak % difference in real GDP, trade conflagration vs. no tariff

Sources: BEA, Moody’s Analytics
Border Towns and Auto Hubs at Risk From Trade War…

North American exports as share of GDP, 5-yr avg, 2013-2017, %

<table>
<thead>
<tr>
<th>Metro Area</th>
<th>North American Exports as Share of GDP, 5-yr avg, 2013-2017, %</th>
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<tbody>
<tr>
<td>Laredo, TX</td>
<td>85</td>
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<tr>
<td>El Paso, TX</td>
<td>75</td>
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<td>Brownsville, TX</td>
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<td>McAllen, TX</td>
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<td>Corpus Christi, TX</td>
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<td>Toledo, OH</td>
<td>25</td>
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<tr>
<td>San Antonio, TX</td>
<td>20</td>
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</tbody>
</table>

Metro areas with at least 250,000 residents that export most heavily to Mexico and Canada.

Sources: International Trade Administration, BEA, Moody’s Analytics
INTEREST RATE UNCERTAINTY

Is a rate cut coming?

What does it mean for the different regions?
Wealth Effect Most Pronounced in Northeast

A rate cut will juice equity prices and equity wealth in Northeast

Share of income tax returns with qualified dividends, %, 2018Q3

Connecticut
New Jersey
Massachusetts
Vermont
Washington DC
Alaska
Wisconsin
New Hampshire
Minnesota
Pennsylvania
Iowa
Virginia
Illinois
Colorado
Washington
Nebraska
New York

States with highest share of returns that include qualified dividends

Sources: IRS, Moody’s Analytics
Where are Energy Prices Headed?

WTI Crude (Dec'18) (@CL1: New York Mercantile Exchange)
USD

Last: 1:51:11 PM EST
56.19 -3.74 (-6.24%)
YTD

Which Regions are at Greatest Risk?
Outlook for Oil Prices in 2019 is Stable

If oil prices decline and stay low…

Prices will **↓** if
- Global demand softens
- Production increases

Prices will **↑** if
- Geopolitical risks increase
...Jobs in Oil Patch Will Hurt

Energy-related as % of total employment, Oct 2014

Sources: BLS, Moody’s Analytics
Manufacturers in South and Midwest will Gain

Petroleum used by manufacturing sector per dollar of output, 2013

Sources: BLS, Moody’s Analytics
Overall Northeast and Midwest Output Will Benefit

% Increase in gross state product under a low oil price scenario

Sources: BEA, Moody’s Analytics
CURRENT EXPECTED CREDIT LOSS (CECL)
CECL 101

What is it?
New accounting standard replacing today’s ‘incurred loss’ approach
Requires reserving for life of loan losses, at origination.

Why this change?
Current allowance approach considered ‘too little, too late’

Who does it apply to?
Any institution issuing credit and filing under US GAAP

When does it go into effect?
2020 for SEC filers. Dec 2021 for credit unions
What is Changing?

FAS 5: “Losses in the Portfolio”
- Estimate of “Incurred loss”

CECL: “Risk in the Portfolio”
- Estimate of “Expected loss”

Source: ABA
Historical loss experience + Adjustments for Current Economic Conditions + Adjustments for Reasonable & Supportable FORECAST + Qualitative Adjustments

* Adjustment for Current Conditions and Reasonable and Supportable Forecast can be quantitative or qualitative
Implementation Challenges

More focus on data, models, governance
More granular data (loan terms, vintage, credit risk, prepayment,..)
More sophisticated models (segmentation, prepayments,..)
Forward looking view (economic forecasts)
Detailed documentation to satisfy auditors

Aligning CECL with ALM, budgeting, planning capital management
Coordination between risk, finance and credit teams

**Pro Tip** – Start Now! So you have time to run parallel next year
CECL Implementation Timeline

Source: ABA
How Much Higher will LLR be Under CECL?

Depends on a number of factors. Some are:

- Portfolio composition
- Contractual term of loan
- Age of loan
- Credit quality
- Stage of economic cycle and forward-looking assumptions (benign vs adverse)
- Reasonable and supportable period
- Current incurred loss method (forward, backward/look-back period)
But….Let’s take a break from CECL-bashing
CECL as an Opportunity

Use the life of loan loss estimates to make better pricing and credit decisions

- Improve profitability while providing lower rates to members
- Improve efficiency in cost of capital

In short……

BE A BETTER LENDER !!
For More Information

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