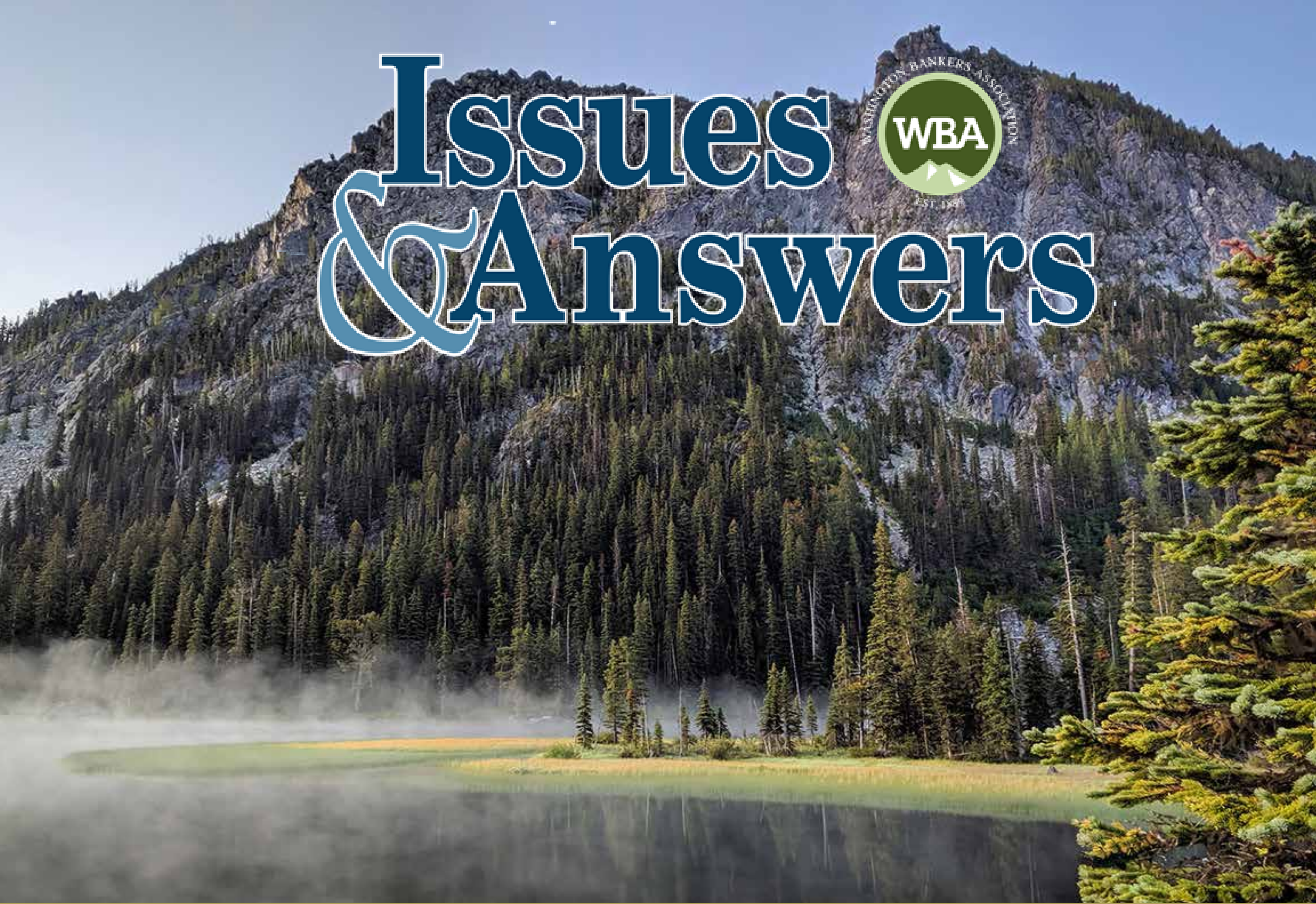
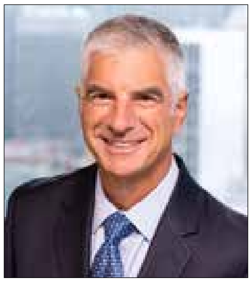
Issues & Answers

Washington Bankers Association

September 2021



Political Winds Change, But Need for Strong Advocacy is Constant



By Glen Simecek
President and CEO
Washington Bankers Association

Politics is like a pendulum. By its very nature, it tends to swing back and forth. The only real question is how far and how fast the swings will occur.

While state politics have been on a leftward course for more than a decade, the climate in "the other Washington" has whipsawed back and forth over at least the last four presidential administrations. With the arrival of the Biden Administration, it appears that the regulatory climate for financial services is about to become less business friendly with more emphasis on the stick, rather than the carrot.

This new posture can be seen in several areas that should be of concern to WBA members. For instance, leaders of the Consumer Financial Protection Bureau are responding to Congressional advocates urging the agency to become much more aggressive in regulatory enforcement. Some of the issues most frequently mentioned include mitigating the impact of the pandemic on consumer finances; reviewing overdraft fees; curbing predatory or misleading advertising in auto lending; and addressing real or perceived racial inequities in all lending.

While some of these actions are more likely to benefit WBA members by focusing attention on the practices of irresponsible competitors, history has demonstrated an unfortunate and uncomfortable tendency for aggressive regulation practices to be adopted by virtually all Federal regulators and cast a wider net than market conditions may warrant.

Meanwhile, President Biden's proposed American Families Plan could impose new requirements on banks across the country. The plan proposes a wide range of new benefits, ranging

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On the Cover

Fog hovers over a lake in the Enchantments, one of Washington's popular hiking destinations.
Photo courtesy Ian Hubert, WGS/DNR

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from direct payments to families with children to free or reduced-price higher education. The costs for these programs are intended to be covered in large part by closing tax loopholes and increasing collections from the current tax code.

To facilitate increased tax enforcement, it has been proposed that banks have increased reporting responsibilities to the IRS. Instead of simply reporting interest earned and capital gains or losses, banks under the plan would also be required to report bank balances and "aggregate account outflows and inflows." This new requirement would impose a new, massively expensive compliance burden on the nation's financial institutions and dramatically reduce consumers' privacy regarding their financial affairs. Furthermore it would likely ensnare innocent consumers as the bad actors would seek to avoid regulated entities in favor unregulated financial intermediaries.

Fortunately, the most recent version of the American Families Plan has dropped this provision, but it's safer to assume that ideas in DC never really die.

These are just two examples of how a sincere desire to help some segment of the population can lead elected and appointed government officials to take actions that may not be grounded in market realities or that pose unintended consequences.

As such, they clearly illustrate the importance of building solid working relationships with our elected and appointed representatives so that we can effectively advocate for our industry, our employees, and our customers. We need to be able to have candid conversations with state legislators and with our Congressional delegation. And we need to identify content experts like yourselves and your team that can credibly discuss the implications of proposed legislation.

That's why it's so important that WBA members take advantage of the opportunity to participate in our legislative briefings and our DC outreach this month. Given the surge in Delta variant cases and changing healthcare directives, we have decide all of these sessions will take place remotely; meeting details and sign-up information can be found https://wabankers.com/userfiles/uploads/2021_Virtual_Leg_Roundtables.pdf..

These sessions are great opportunities to talk with key lawmakers and staff about your bank and how you serve your community. We can highlight programs like Bank On (https://bankonwashington.org/), a collaborative initiative to reach the unbanked and underbanked in our state. Estimates are that 3% of Washington's 7.5 million residents are unbanked, meaning that don't have a checking or savings account. While that's significantly better than the 7% national average, it's still 225,000 people. With studies showing that being unbanked can cost $40,000 over a lifetime due to reliance on costly alternative financial services for routine transactions, being unbanked is a major drain on a family's finances and a drag on the state economy.

You can learn more about the program at the 2021 Bank on Washington Forum, another virtual event scheduled for October 19-20.

Bank On is exactly the type of program lawmakers like to hear about. It shows that our industry is taking the initiative to be as inclusive as possible in helping Washingtonians meet their financial goals.

No matter which way the wind is blowing.

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U.S. House Financial Services Committee Update

By Congressman Blaine Luetkemeyer (R-MO)

Recently, the House Financial Services Committee held a hearing entitled "A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity." Committee Chairwoman Maxine Waters called for this creatively named hearing to gain support for legislation to create a government-run credit bureau within the Consumer Financial Protection Bureau.

Bankers in Washington understand the value of accurate credit reporting. It is how risk is assessed and interest rates are determined. Incomplete or inaccurate credit reports force banks to either deny loans or raise the cost of credit. As one of the few members of Congress with a banking background, I started my career as a bank examiner then spent over 30 years in the banking and insurance industries. I often find myself explaining these very basic facts to some of my colleagues on the Financial Services Committee, particularly those who believe government control over credit reporting is a good idea.

The bills discussed at the hearing would quite literally give the CFPB the power to determine who is creditworthy in the U.S. by giving the Bureau the authority to decide which portions and how much of a person's credit history is made available to banks when considering a loan application. Proponents of these bills believe this new, centralized credit bureau would benefit disadvantaged communities that struggle with access to credit. They believe the current system unfairly punishes certain people based on factors out of their control. While we all likely have ideas on how to improve the current credit reporting system, this solution would only exacerbate the problem. Misreporting credit history or limiting available information raises the cost of credit across the board, but particularly for low-income communities. The people reading this know how to assess and price risk. It takes information, and when that information is limited or altered you have no choice but to assume additional risk. Not only will that raise costs for low-income borrowers, but it will also eliminate access for some altogether which is bad for consumers, the banks, and the surrounding communities.

Eighteen months ago, the American economy was ground to a halt. Businesses were shuttered, people were forced to stay at home, and everyone was left to wonder what's next. When the American people looked to the government for a solution, the government turned to the banks. Through PPP and other rescue programs, banks facilitated the movement of trillions of dollars and were the key factor in their survival for many businesses. Even though we continue to grapple with loan forgiveness and workforce participation remains low (also thanks to the government) the economy is improving. That wouldn't be possible without the banks.

While there are plenty of bad ideas floating around in Congress, looking no further than the proposed CFPB credit bureau, there are also efforts to work with the private sector to keep the momentum going. As the Ranking Member of the House Small Business Committee, I'm pushing the Small Business Administration to improve the forgiveness process and get their other programs in order. I also just recently introduced a bill to replace the single director position at the CFPB with a five-person bipartisan commission. The Bureau is constantly being used as a political football and its director wields so much power that the Supreme Court grappled with whether the position was even constitutional. Allowing one person to hold such unchecked power over our economy is irresponsible and verges on negligence. My bill would provide increased accountability and transparency so the American people can trust the CFPB to do its job without political motivation.

If you take one thing away from this column, I hope it is this: banks' participation in our economy and our government is critical. As you can likely tell, my beliefs differ wildly from some of my colleagues, which illustrates the need for private sector input. Banks are often the first to see economic winds changing. You likely know what programs work and don't work before lawmakers. So, whether it's to elected representatives or even your regulator, please speak up. You know your business better than anyone else and will be your customers' and community's best advocate. Our economy and our government depend on a strong financial system.

Republican Blaine Luetkemeyer represents Missouri's 3rd District in the U.S. House of Representatives. He serves on the House Financial Services Committee as Ranking Member of the Subcommittee on Consumer Protection and Financial Institutions as well as the Ranking Member of the House Small Business Committee.

Events Calendar

September 30 – 2021 Virtual Credit Analyst Development Program
October 6 – 2021 Hybrid Retail Branch Manager Development Program
November 4-5 – Virtual Women in Banking Conference
December 2-3 – Virtual Bank Executive Conference
January 26, 2022 – Executive Development Program
February 10-11, 2022 – NW Compliance Conference, DoubleTree Suites, Seattle Airport Southcenter
March 29, 2022 – Retail Sales & Leadership Conference, Washington Athletic Club, Seattle

To register or to learn more about any of the listed events, please visit www.wabankers.com/calendar.

Advance Your Career with Autumn Conferences, Development Programs

This autumn, the WBA is offering a variety of opportunities for bankers to expand their careers and knowledge through our Development Programs and conferences.

These programs have been designed specifically with bankers in mind, helping you build skills to further your career and provide the latest updates in the industry.

Beginning in September, the virtual **Credit Analyst Development Program** will provide students with the skills needed to become strong credit analysts. Sessions include a refresher on accounting, understanding and employing financial analysis tools, personal business tax return analysis, loan structure, documentation, and compliance, as well as the basics of commercial real estate lending.

WBA's virtual program gives students a strong connection to each instructor and provides time for questions and networking with fellow students. Classes are purposely kept small to maximize the learning opportunities for students virtually.

At the beginning of October, the hybrid **Retail Branch Manager Development Program** will kick off. This program was redesigned in 2019 to fit the current retail banking environment. Sessions, which run through March, will be virtual except for the final class, which will be held at the WBA office in Seattle.

Students will gain a broader understanding of the retail branch market, build interpersonal communication skills, and ways to strengthen client relationships.

The **2022 Executive Development Program** is also now accepting registrations. Classes begin January 26, 2022, and run through November. The 2022 EDP will be held largely in-person, with classes at the Washington Athletic Club in downtown Seattle, with some sessions held virtually. This popular program regularly sells out, so WBA highly recommends any interested student registers early to ensure their participation next year.

The **2021 Virtual Women in Banking Conference** will be held on November 4-5. The conference runs from 8:30 a.m. to noon each day and will feature a session with Elizabeth McCormick, a decorated U.S. Army Black Hawk helicopter pilot who will share leadership lessons she learned not only as a member of the armed forces but in business as a contract negotiator and commodity manager.

On December 2-3, WBA will host the **2021 Virtual Bank Executive Conference**. The conference will run from 8:30 a.m. to 4 p.m. on December 2, followed by a half-day from 8:30 a.m. to noon on December 3. The agenda will feature sessions on the economy, regulatory and legislative trends to watch, and more. This year, banks can send an unlimited number of attendees because registration was included in WBA membership dues.

In 2022, mark your calendars for the **Retail Sales and Leadership Conference**, to be held on March 29. This conference will be hybrid, with in-person attendees congregating at the Washington Athletic Club; and banks can choose a virtual option to best fit their needs based on the number of attendees.

Please visit the WBA website at www.wabankers.com for more information about registration for any of our upcoming programs.

Legislative Roundtables Move to All Virtual

Due to the ongoing pandemic and new mask mandate, the WBA made the decision to shift the Legislative Roundtables to all virtual. The health and well-being of our attendees is always a top priority for WBA.

The previously published dates and times for each Roundtable will remain the same, and Zoom information will be provided the week before the Roundtable.

Each event is a chance for local bankers to learn about the latest legislative issues, including what happened during the 2021 Legislative Session, what we expect in 2022, and other policies impacting the industry.

Following the briefing with WBA lobbyists, local lawmakers will join us, giving bankers the chance to visit with elected officials.

This event is open to WBA member bankers only and is free to attend.

Please contact Megan Managan at megan@wabankers.com if you would like to learn more or register for any of these events.

2021 Virtual Legislative Roundtables

September 9	9:00 – 11:00 a.m.	Wenatchee	Virtual
September 9	1:00 – 3:00 p.m.	Peninsula	Virtual
September 10	9:00 – 11:00 a.m.	Vancouver	Virtual
September 14	11:00 a.m. – 1:00 p.m.	Spokane	Virtual
September 15	11:00 a.m. – 1:00 p.m.	Tri-Cities	Virtual
September 21	11:00 a.m. – 1:00 p.m.	Seattle	Virtual
September 22	11:00 a.m. – 1:00 p.m.	Tacoma	Virtual
September 23	11:00 a.m. – 1:00 p.m.	Bellevue	Virtual
September 24	11:00 a.m. – 1:00 p.m.	Mt. Vernon	Virtual

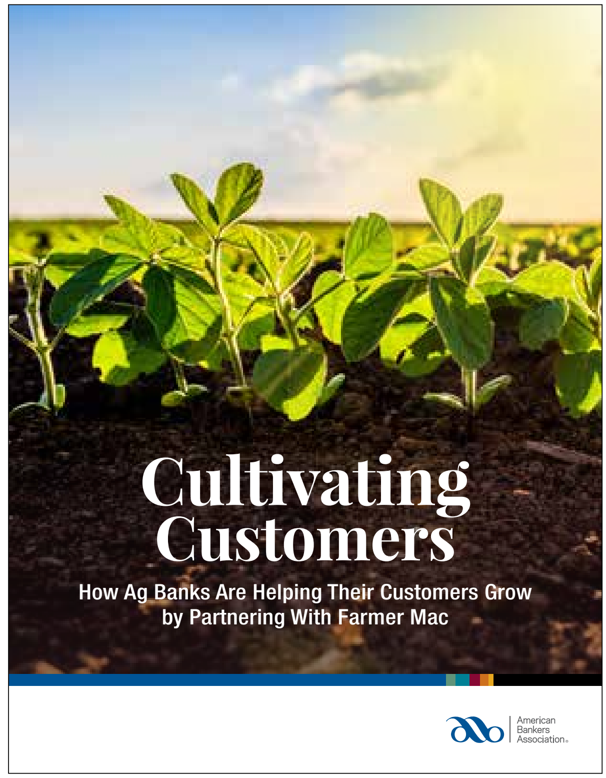
ABA Releases Report on Farmer Mac, Bank Partnerships

A new report released by ABA explores the influence of Farmer Mac as the secondary market provider of agricultural credit—including first-person accounts from bankers who are using the resources it provides.

The report provides information on the history of the organization, how Farmer Mac meets demand while maintaining loan limits and how it can help manage and mitigate the unique risks in agricultural lending.

The report also includes information on how Farmer Mac was able to respond to market disruptions stemming from the COVID-19 pandemic and examines how Farmer Mac's presence as the secondary market provider of agricultural credit is reshaping the landscape. Interviews with lenders, economists and Farmer Mac leaders, provide a glimpse into how banks are delivering benefits to their customers by strategically harnessing what Farmer Mac has to offer.

Download and read the report online at the ABA's website at: https://www.aba.com/member-tools/industry-solutions/insights/cultivating-customers?utm_campaign=NEWSBYTES-20210715&utm_medium=email&utm_source=Eloqua.



Industry News

New Hires

Marcella Lang
Client Service Specialist at Kitsap Bank

Ambrose Ng
Assistant Branch Manager at First Federal

Patrick Kennedy
Commercial Relationship Manager at First Interstate Bank

Collin Parker
Credit Analyst at First Sound Bank

Kimberly Tucker
Branch Manager at First Federal

Tina Naasz
Assistant Secretary and Branch Manager at Yakima Federal Savings

Laurel Bishop
Assistant Secretary and Branch Manager at Yakima Federal Savings

Dave Hansen
Executive Vice President and Director Of Retail Banking at Columbia Bank

Promotions

Kasi O'Leary
Director of Commercial Banking West at First Federal

Sherrey Luetjen
Executive Vice President and General Counsel at Banner Bank

Board of Directors

Villette Nolon
First Sound Bank

Cindy Runger
First Financial Northwest Bank

Gabriela Valencia
Yakima Federal Savings

Retirements

Douglas Wolford
Washington Trust Bank

Craig Miller
Banner Bank

Have Industry News to share with WBA? Email megan@wabankers.com or call (206) 344-3472.

2021 VIRTUAL BANK EXECUTIVE CONFERENCE

DECEMBER 2-3, 2021

Learn more online at www.wabankers.com/bec

WBA Member News

1st Security Sponsors Kitsap Medical Society Memorial Golf Classic

Earlier this summer, members of the 1st Security Bank of Washington team sponsored a hole at the Kitsap Medical Society Memorial Golf Classic.

The bank sponsored an Italy-themed hole and gave away prizes to golfers.

Washington Trust Bank Participates in Superheroes 4 Kids Mediathon

In July, Washington Trust Bank in Spokane participated in the annual Superheroes 4 Kids Mediathon, benefiting the Children's Miracle Network Hospitals.

The community raised over $21,000 during the event, and the bank made a $5,000 donation. Funds raised locally will benefit Sacred Heart Children's Hospital, which is one of the 170 Children's Miracle Network Hospitals in the country.

Banner Bank Participates in Habitat for Humanity Spokane's Blitz Build

In early June, members of the Banner Bank team participated in the 20th annual Habitat for Humanity-Spokane blitz build.

Over 1,000 volunteers come together for the event which accelerates the normal Habitat for Humanity home building timeline, to help get a family into the home faster.

First Federal Sponsors 2021 Builders Classic Golf Tournament

First Federal sponsored this summer's 2021 Builders Classic Golf Tournament, put on by the Kitsap Building Association.

This year's theme was Margaritaville and volunteers and golfers were encouraged to dress in the theme.

U.S. Bank Volunteers Help Clean Green Lake Park

Earlier this summer, members of the Seattle U.S. Bank team helped clean Green Lake Park by picking up litter.

Working with the Green Lake Litter Patrol, volunteers collected garbage around the popular park.

Heritage Bank Team Volunteers with United Way of Pierce County

Throughout the summer, United Way of Pierce County hosted a Summer of Action, encouraging volunteers to help in a variety of ways.

Members of the Heritage Bank team volunteered with the organization by assembling snack packs for kids in need.

The snack packs are given to kids who are out of school and in need, as well as anyone experiencing homelessness in need of a meal.

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Mountain Pacific Bank Sponsors Golf Tournament

Mountain Pacific Bank sponsored the annual IRG Physical & Hand Therapy charity golf tournament this summer.

The volunteers staffed hole 9, offering complimentary snacks and goodies to the golfers as they came through the course.

Baker Boyer Banker Completes Graduate School of Banking at Colorado

In August, the Graduate School of Banking at Colorado announced that Dana Evans, with Baker Boyer Bank, completed the program.

Graduates receive their diplomas after completing three annual two-week sessions of classroom training at the University of Colorado Boulder. This year's class included 141 graduates during the school's 70th annual session.

Sound Community Bank Hosts Community Shred Event

During the second weekend in August, branches throughout the Sound Community Bank footprint hosted a community shred event.

Residents of the surrounding area were able to bring documents that needed to be shredded safely at one of several locations.

Commencement Bank Celebrates Rainiers Kids Day

Members of the Commencement Bank team participated in the annual Tacoma Rainiers Kids Day event in Tacoma in mid-August.

Volunteered helped build boats with children at the park and offered sail decoration at their booth.

The bank sponsors the team's Summit Club.

KeyBank Washington Team Hosts School Supply Drive

Members of the KeyBank WA Hispanic-Latinx KBING partnered with El Centro de la Raza for the second annual school supply drive in August.

The donations will help local students in need as they head back to the classroom, some for the first time since the beginning of the COVID-19 pandemic.

The group also donated supplies to Big Brother Big Sister Puget Sound.

1st Security Bank of Washington Hosts Shred Events

In mid-August, 1st Security Bank of Washington hosted several events providing free shredding for residents with documents that needed to be safely disposed of.

Anyone with items to shred was asked to bring a donation for the local Relay for Life team.

During the event at the bank's Hadlock branch, volunteered helped over 160 cars through the line and raised $421.67 in donations.

U.S. Bank Provides Market Impact Fund Grant to Renton Organization

This summer, U.S. Bank announced that a Market Impact Fund Grant would be made to Renton-based Renton Innovation Zone Partnership.

The grant to the Partnership will help support entrepreneurs and small business owners, workforce development programs, and financial inclusion efforts for both individuals and families.

The funding will also allow them to create a new immersion program for Title 1 elementary and middle school students in the Skyway and West-Hill neighborhoods.

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WBA Endorsed Vendor: Harland Clarke

Trends and Opportunities in Mortgage and Home Equity Lending

Unprecedented housing demand. Record-low supply. All-time low interest rates. Rising home equity. Paradigm shifts in consumer values, careers and lifestyles.

All have combined to create a mortgage lending environment that is intensely competitive, exciting — and full of possibilities.

The dust hasn't settled just yet. Rates will remain low, meaning it's still a great time to buy, refinance and borrow. Analyzing these factors has revealed a reshaping of the market and led to some really important trends affecting mortgage and home equity lending.

Home improvement loans are surging

As lockdowns went into effect and social distancing orders dragged on, homebound Americans took a hard look at their living spaces and decided their current conditions just weren't quite up to snuff.

Homeowners quickly realized there's never been a better time to tap into their increased home equity, driven up by higher home values, low inventory and increased demand. Accessing that equity spike was a no-brainer for those looking to finance the reimagination of their homes.

U.S. homeowners with mortgages saw their equity increase by a total of nearly $1.5 trillion since the fourth quarter of 2019, an increase of 16.2 percent, year over year.

Homeowners desperately sought to add functionality, comfort and fullness to pandemic life by making their living spaces larger and more luxurious. Online home remodeling platform Houzz reported a 58 percent increase in project leads. Home extensions and additions jumped 52 percent and fence installation and repairs rose 166 percent.

An even deeper dive revealed how low rates have worked out rather swimmingly for homeowners looking to explore the depths of their outdoor renovation dreams. Online searches for pools and spas have tripled since the start of the pandemic.3 Many swimming pool manufacturers are struggling to meet the tidal wave of demand.

- Zillow expects home values to increase 10.3% through Nov 2021
- Home equity loan debt outstanding and borrower utilization declined in 2019 and 2020, but originators expect modest increases in 2021
- Lenders of HELOCs expected annual originations to decrease 2.9 percent in 2020 but grow 10.8 percent in 2021
- HELOC borrowers are well-qualified, having an average FICO score of 774

Although rates will likely go up over time, they will remain historically low.

Just because mortgage rates dropped overnight during 2020's wild ride, with rates hitting record lows multiple times, doesn't mean they will rise to more traditional levels overnight. Experts agree mortgage rates will inch back up in 2021-2022, but remain favorable, which means the opportunity is still there for folks wanting to purchase or refinance a home.

The economic forecast is still fragile and uncertain. The Fed will surely proceed with caution, as any future optimism-driven rate hikes would be reversed from a sudden and unexpected setback.

Purchase originations could reach an all-time high

For many others, the pandemic magnified the need for more space and change that couldn't be satisfied through home renovation. City dwellers went searching for larger living spaces, a lower cost of living, less clutter, and more serenity.

Undeterred by the low-supply/high-demand market, well-healed urbanites are ready, willing and able to engage in bidding wars for larger homes located in more spacious suburban surroundings.

Purchase originations predicted to reach an all-time high in 2021 at 1.67 trillion

The pandemic sped up an already-emerging trend to flock to the suburbs, particularly among Millennials and Gen Z.

"As conditions improve in 2021, housing supply is expected to increase," said Stephenie S. Williams, Vice President of Financial Institution Marketing Product and Strategy for Vericast. "People hesitant to sell their homes during the pandemic, will soon be ready to get back to their original plans."

- H5-year record new housing starts 1.67MM in December 2020
- Fannie Mae forecasts single-family housing starts will increase 12.5% in 2021
- 923K new home sales in January 2021, 19% year-over-year increase
- Home inventory remains low
- Nationwide: homes are typically under contract within 24 hours of listing at or above asking price

The refi boom may me over (for now), but...

Nearly everyone who was eligible to refinance to a lower rate has done so. With rates predicted to inch back up in 2021-2022, the well of rate-based refinance prospects has mostly run dry. But, despite an expected 10 percent decline in total refinance originations from last year, there's another potential high ceiling yet to explore.

Cash out refinance loans offer homeowners the opportunity to convert the high equity in their home into a substantial

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ISSUES & ANSWERS

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amount of cash to use for whatever they choose, without incurring the cost of higher rates of other loan types. For example, cash out refinance loans are a popular way for homeowners to pay for previously mentioned renovations, after paying off their mortgage early.

Refinance originations are expected to be $2.2 trillion, down from all-time highs of $2.8 trillion in 2020 — more than 10% decline in total originations compared with 2020.

Opportunities in Mortgage Lending

The current state of mortgage financing demonstrates an ongoing opportunity for financial institutions to serv customers and grow their loan portfolio. Here are five best practices for building an effective loan acquisition strategy that works for what's now and what's next.

1. Utilize digital channels with video and Connected TV.

Connected TVs (CTV) are televisions that are connected to the internet and can stream digital content through preloaded apps or over-the-top (OTT) devices, like Roku®, Hulu®, Amazon Fire TV®, Tubi®, Chromecast® and more.

CTV is among the fast-growing channels for advertisers. Smart marketers are cashing in on the above-average interest and engagement of a growing video consumption culture by integrating CTV into their multichannel marketing campaigns.

By 2023, CTV households are expected to increase to 82%.

This is a major trend, as marketers are spending more on CTV ads than ever before. Brands are projected to spend $11B on CTV ads in 2021. CTV captures the attention of larger audiences, targets key generational demographics, and engages audience that are ready to act.

2. Build relationships by closing the knowledge gap.

Communication is the key to building trust and great long-term relationships. Consumers' knowledge of the mortgage process and what it takes to purchase a home is regressing. Many consumers are admittedly mortgage illiterate, creating apprehension and anxiety for the mortgage process.

Consumers' knowledge of the mortgage process and what it takes to purchase a home has not improved, and in some instances regressed, compared with a 2015 study, according to Fannie Mae.

Consistently communicate and educate your audience with messages that reflect your core values, dedication to community, and commitment to customer service.

Understanding Millennials' current borrowing needs and behaviors is essential for building long-term relationships with them.

3. Send pre-qualified, personalized offers.

The real estate market is moving fast right now, so reaching someone before they decide to buy a home is a highly effective strategy. Adopting a data-driven approach that uses superior analytics to help pinpoint promising targets, send them customized communications, follow up with timely emails, or phone calls, provides a home buyer with the reassurance of a lending opportunity.

4. Drive loans with trigger-based, pre-approved offers.

Reach prospects and customers within 24 hours of a mortgage inquiry with a pre-approved loan offer via direct mail, email and phone. The timeliness and relevance of this approach generally results in high response rates and customer satisfaction.

5. Do your homework.

Knowledge is power in a competitive market. Do you know your competition? Have you studied the data? Are you following the trends? Are your most important loan processes, like average time to close, competitive? Learn all the important details of the mortgage lending landscape to gain the edge needed to dominate the market.

The outlook for mortgage lending remains strong.

Consumer interest is high. Interest rates are low. The economy is in recovery and analysts are optimistic. Barring any unexpected bad news, if you consider how these trends affect you, and act on the opportunities created by continued consumer desire to return to pre-pandemic life, you can crush your mortgage and lending goals.

Q Factors under CECL and How They Will Compare

Article Submitted by Abrigo

Want to know how to develop qualitative factors, or Q factors, under CECL, the current expected credit loss standard? You're not alone.

Q factors – more specifically, "What'll happen to my Q factors under CECL?" is a popular topic among bankers, especially those with a 2023 CECL implementation date, according to Zach Englert, a CECL Consultant with Abrigo's Advisory Services.

Many financial institutions in recent years have relied on qualitative factors for a larger percentage of their reserve when calculating the allowance for loan and lease losses (ALLL) under the incurred loss method as good credit quality put downward pressure on the quantitative portion of the estimate. Understandably, banks and credit unions transitioning to CECL in 2023 want to know how usage of Q factors under the new standard will compare with their current practices. Another common question from institutions, Englert says, is "What should the percentage of quantitative to qualitative be in the allowance under CECL?"

First Step: Understand the quantitative analysis

While there's no universal answer to either question because banks and credit unions and their loan portfolios and loss experiences can differ so much from each other, CECL experts agree that the first step to applying Q factors under CECL is a solid understanding of the quantitative side of your financial institution's CECL calculation. After all, said Garver Moore, Abrigo Managing Director, "The purpose of the qualitative factors is to address what's not in the losses expected from the quantitative baseline analysis."

"When we talk about Q factors with our clients, I think about three questions that they've got to answer" in using them, said Graham Dyer, Partner at Grant Thornton, LLPthe adjustment quantitatively appropriate?, during Abrigo's recent ThinkBIG Conference. He outlined these questions as follows:

1. What is not captured by the model that requires you to make this adjustment?
2. Is the adjustment directionally consistent?
3. Is he adjustment quantitatively appropriate?

"Tell me what is not in that model -- why you need an adjustment in the first place," Dyer said.

Some methodologies necessitate the use of more Q factors than others, said Regan Camp, Managing Director at Abrigo. "It really depends on the type of methodology you're leveraging." The COVID-19 pandemic illustrates this. Quantitative models incorporating loss-rate forecasts based on unemployment estimates were complicated by the impact of government stimulus payments and other factors.

Documenting the reasoning behind adjustments tied to qualitative factors is important. "We continue to see clients making adjustments for things that we say, 'Can you show me why that's not captured by your model?' And it's not something they've considered," Dyer said. "So building that logic into the process is going to be important."

Whether the adjustment is up or down also needs to make sense, as does the amount of the adjustment. This last issue can sometimes be difficult for financial institutions to address, Dyer said. "Sometimes it's helpful to have quantitative methods to try to put boundaries around those things as much as possible," he said. "You at least have to tell me not just why I adjusted but why I made it this much."

Experts also suggest scratching the existing numerical Q factor adjustments an institution is using in the incurred loss model.

Some financial institutions might say, "'Here are my Q factor adjustments. Do I keep that and start from there?'" said Gordon Dobner, Partner in BKD's National Financial Services Group, during the recent ThinkBIG Conference. "I think you completely scratch it. It should be a brand new consideration. You can't really say, 'In incurred, I had 75 basis points, so that's my starting point.'"

Dyer agreed. CECL is a "wholly different approach" than the incurred loss methodology, he said. "I can't see why you wouldn't start from a pretty blank sheet of paper."

A framework for Q factor adjustments

A qualitative scorecard for the allowance provides a framework that enables the financial institution's management team to determine reasonable and supportable Q factor adjustments to the quantitative baseline estimate. The scorecard is a reliable and consistent mechanism that can be backtested against subsequent performance, too.

Here's how scorecard development works:

1. Review the quantitative model(s)/methodology that will be used to calculate the baseline loss estimate.
2. Identify quantitative metrics that assist in framing various risk scenarios, from minor to major.
3. Leverage peer analysis against historical loss experience to determine a high- and low-mark estimation framework.
4. Identify appropriate scorecard frameworks to specific circumstances and institution preferences.
5. Create a qualitative scorecard for each allowance pool based on the broadly or uniquely identified selections (or a combination of both).

Currently, many institutions use the same Q factor for the entire portfolio, but under CECL, qualitative adjustments may differ on a pool-by-pool basis. "Depending on the nature of the asset, not all of the factors may be relevant and other factors also may be relevant and should be considered," according to a 2019 Frequently Asked Questions (FAQs) on CECL by regulators.

A qualitative adjustment scorecard can simplify the quarterly process of developing and documenting Q factors, especially if the scorecard can be interconnected with the financial institution's CECL model.

"To assess a Q factor, you have to know what's in the quantitative model and the limitations of it," said Moore. "A qualitative scorecard, therefore, should ensure that the qualitative aspects are not ignorant of the quantitative aspects. They should 'talk' to each other."

This is also an advantage of the scorecard when it comes to financial reporting from period to period. As credit losses associated with Q factors are recognized and the quantitative portion of the allowance is updated, the concomitant qualitative factor adjustments drop off the scorecard.

Conclusion

Q factors aren't going away under CECL. And while it's impossible to provide a blanket assessment of how every institution's Q factor adjustments will compare to those under the incurred-loss method, it's a certainty that auditors and regulators will be focused on understanding the reasoning behind adjustments, as well as how the adjustments were determined. Using a qualitative scorecard can make this process easier and more consistent for financial institutions.

HAVE NEWS TO SHARE?

Email it to megan@wabankers.com to be included in an upcoming *Issues & Answers*

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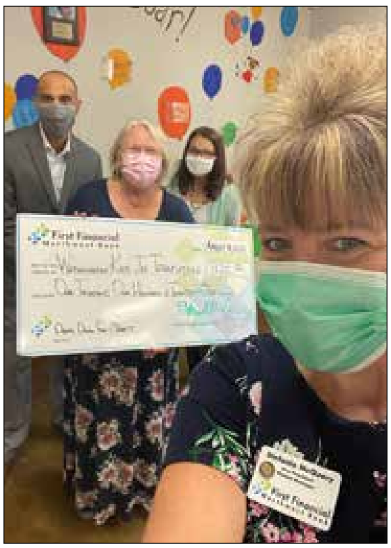
WaFd Team Supports Obliteride with Weekend Event

Every summer, Washington residents come together to raise money for Fred Hutchinson Cancer Research through the Obliteride event, to obliterate cancer.

This year, members of the WaFd Bank team participated in a weekend of cycling, walking, and running to help raise money for the cause.

First Financial Northwest Bank Supports Washington Kids in Transition



In August, First Financial Northwest Bank announced a donation to Washington Kids in Transition (WAKIT).

WAKIT provided a tour to the bankers of their expanded facility, and First Financial Northwest donated over $1,000 to help WAKIT continue its work of helping and supporting kids in the community.

1st Security Hosts Stuff the Bus Drive for Local Students

Branches throughout the 1st Security Bank of Washington footprint hosted donation drives as part of the annual Stuff the Bus, encouraging customers and residents to donate school supplies ahead of the new school year.

Members of the Disabled American Veterans in Poulsbo dropped off donations to help prepare students for the classroom.

Career Path Services and YWCA Celebrate BankWork$ Graduations

In late August, Career Path Services (CPS) and YWCA Seattle | King | Snohomish celebrated the graduation of BankWork$ classes.

CPS celebrated two classes, as Cohort Nine completed the program earlier this summer, with two students going on to jobs in the industry, including one at Olympia Federal Savings.

Cohort 10 celebrated their graduation on August 19, with 10 students completing the program.

"How wonderful it has been to meet and work with the BankWork$ program," said Julie Ponder, corporate recruiter for Heritage Bank, the spotlighted bank partner at graduation. "We've been so impressed with how the students and staff have persevered over the last two years. Continue to work toward your goals."

The YWCA class finished on August 27 with 10 students graduating from the program, also the 10th anniversary of the program opening in Seattle. Since beginning in 2012, the YWCA program has had over 1,000 students complete the program.

Since the BankWork$ program began in 2006, it has expanded to 13 cities and has over 4,000 graduates.

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Sound Community Bank Celebrates Another Successful Food Frenzy

Over several weeks in August, Sound Community Bank participated in the annual Food Frenzy benefiting Food Lifeline.

The event encourages local businesses to raise awareness and donations for the organization which helps provide food for those in need throughout the greater Puget Sound area.

This year, Sound Community raised $86,026 in donations, which generates about 500,000 meals for families.

HomeStreet Foundation Golf Tournament Raises $50,000 for Seattle University RAMP-Up Program

Earlier this summer, the HomeStreet Foundation hosted its annual Golf Charity Tournament, this year benefiting the Seattle University Resource Amplification & Management (RAMP-Up) Program. The tournament raised $50,000.

The RAMP-Up program provides business coaching, planning, and technical support, along with other assistance, to underserved local businesses in Seattle. Qualified clients are assigned a Seattle U client account manager and a student consulting team for a renewable one-year engagement. Students are in the Seattle U Albers School of Business. Since it launched in 2016, 150 businesses have been served.

In 2020, 1,200 student hours were spent helping RAMP-Up businesses, and $1.5 million in funding was accessed by those businesses.

Vicki Foege, director of community relations and DEI at HomeStreet Bank and the chair of the HomeStreet Foundation, said the program has helped businesses learn about the opportunities they have with banking partners, as well as other funding sources such as CDFIs and grants. Plus, the business gets hands-on help and students get on-the-job training and experience.

The 2021 golf tournament was the Foundation's ninth, which grew out of the bank's commitment to make the community a better place to live and do business. Since the tournament began in 2013, the Foundation has donated over $525,000 to partner non-profits, like Habitat for Humanity, YWCA, Kent Youth & Family Services, Plymouth Housing, Seattle Goodwill, and more.

Washington Trust Bank Volunteers Surprise Attendees at Benton Franklin Fair

At the end of August, the Benton Franklin Fair took place in Kennewick, and members of the Washington Trust Bank Crew in Blue surprised attendees with random acts of kindness.

The employees spent the day throughout the fair surprising local attendees and making their day better.

North Cascades Bank Distribute Backpacks of School Supplies in Chelan

Members of the North Cascade Bank Chelan team volunteered in late August with Thrive, a local organization.

The groups distributed backpacked stuffed with school supplies for local kids in need throughout the Chelan and Manson K-12 schools.

In total, they gave out 518 backpacks just in time for the new school year to begin.

If you have WBA member news to share, please email Megan Managan at megan@wabankers.com. Submissions are run on a space available basis.

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