Risk Management Association
Long Island Chapter

Summer 2022 | Volume 1.15

A Message From Our President

Summer is quickly racing to a close and that means your LI RMA Chapter Board will soon be back at work organizing the 2022-2023 event schedule. I speak for the entire Board when I say our humblest thanks for your continued support as we transitioned back to in-person events in the spring. The strong attendance at all three of our in-person events provides tremendous enthusiasm and momentum for this upcoming year.

And speaking of the upcoming year, our first event will be on Friday, October 21, 2022. Watch this space for details. Our October event is our opportunity to bring new content to our chapter, along with our signature Economic Update (February), Panel Discussion (April) and Networking (June) events.

Thanks again to all of our sponsors. Their support allows us to 1) put on these events for our members and 2) award a significant amount of scholarship funds annually to deserving local students preparing for a degree in banking and finance.

Congratulations to our James T. McCarthy Award winner: Robert Perez. Robert is a Finance major at Long Island University. Wishing Robert continued success as he pursues his Finance degree.

Sincerely,

Michael Heller

In Memory:

In recognition of the contributions of our former LI Chapter Board Member, William "Bill" Cimbol. We lost Bill far too early; in June 2022. He was a steadfast contributor to the LI RMA Chapter; continuing to support the Chapter into his retirement. Most of all, he was a friend. Our deepest sympathies to the Cimbol family.

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Please join the RMA in recognizing our 2022 Scholarship Winner:

James T. McCarthy Scholarship: ($2,500)
Robert Perez – Long Island University

Save the Date

Information Security's Growing Impact on the Financial Industry
October 21, 2022, 8am – 10am
Venue: Radisson Hotel Hauppauge

Join us and our panel of information security experts for a discussion covering the growing threat of cyber security, current vulnerabilities and how these will impact you and your customers.
REGISTER HERE

Young Professionals Nine and Dine
Date: October 27, 2022, golf: 230pm – 5pm; cocktails: 5pm – 8pm
Venue: Smithtown, NY

Golf & Restaurant: Young Professional's Fall Nine & Dine | **Register**
Golf only: Young Professional's Fall Nine & Dine | **Register**
Restaurant only: Young Professional's Fall Nine & Dine | **Register**

Annual Sponsorships Still Available

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RMA Scholarships

James T. McCarthy Scholarship - $2,500
Dr. Pearl Kamer Scholarship - $2,500
Patrick M. Demery Bankers' Lifetime Achievement Award - $1,500

Application deadline: May 1, 2023

Eligibility:

Bankers and students interested in pursuing their education and career in the area of banking, commercial lending or credit risk management. You must be enrolled at an accredited college, pursuing a pertinent degree program.

Application package must include the following:

- College transcript and evidence of current enrollment at an accredited college
- Essay from applicant stating:
  - Why you have chosen or are interested in a career in banking
  - Your career goals and how this scholarship will help you meet your goals
- Employment history and current job description, if applicable
- Extracurricular activities, community service
- List of leadership positions, honors and awards
- Letter of recommendation from your current employer or professor

Note: Incomplete application packages will be disqualified.

Applications will be reviewed by the
Scholarship Committee of the
Long Island Chapter of Risk Management Association.

Forward questions or your completed application package to:
Bonnie Dougherty, Senior Vice President
Valley National Bank
BDougherty@valley.com

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The Benefits of CECL Model Validation Beyond Regulatory Compliance

Ivan Cilik, Sean Statz
Baker Tilly US, LLP

The current expected credit loss (CECL) adoption deadline of Jan. 1, 2023 has many financial institutions evaluating various models and assumptions. Many financial institutions haven't had sufficient time to evaluate CECL model performance under various stress scenarios that could provide a more forward-looking view beyond just checking the compliance box.

One critical element of CECL adoption is model validation. The process of validating a model is not only an expectation of bank regulators as part of the CECL process, but also can yield advantages for institutions by providing them with crucial insights into how their credit risk profile would be impacted by uncertain conditions.

In the current economic environment, financial institutions need to thoroughly understand what an economic downturn, no matter how mild or severe, could do to their organization. While it really depends on what assumptions they are using, modeling out different scenarios using more severe assumptions will help these institutions see how prepared they may or may not be.

Often vendors have hundreds of clients and use general economic assumptions on them. A validation will give you a deeper dive into assumptions specific to your institution and offer you the opportunity to assess their relevance to your facts and circumstances.

When doing a validation, there are three main pillars: data and assumptions, modeling, and stress testing.

Data and assumptions: Using your own clean and correct data is a fundamental part of CECL. Bank-specific data is key as opposed to using industry data that might not be applicable to your bank. A validation allows for back-testing of what assumptions the banks are using for their specific data in order to confirm those assumptions are accurate or identify other data fields or sources that may be better applied.

Modeling (black box): When you put data into a model, it does some evaluating and gives you an answer. That evaluation period is often referred to as the "black box." Data and assumptions go into the model and a CECL estimate is returned as the output. These models are becoming more sophisticated and complex, requiring many years of historical data and future economic projections to determine the CECL estimate. As a result of these complexities, we believe that financial institutions should perform a full replication of their CECL model. This best practice when conducting a validation will assure the management team that the model the bank has chosen is estimating its CECL estimate accurately and also providing further insight into its credit risk profile. By stripping the model and its assumptions down and rebuilding them, we can uncover potential risks and model limitations that may otherwise be unknown to the user.

Validations: should give financial institutions confidence in how their model works and what is happening. By being familiar with the annual validation process for CECL compliance, an institution will be better prepared to answer all types of questions from regulators, auditors and other parties. Furthermore, it's a valuable tool for management to be able to predict future information that will help them plan for how their institution will react to stressful situations while also aiding them in future capital and budgeting discussions.

Stress testing: In the current climate of huge capital market swings, dislocations and interest rate increases, stress testing is vital because no one knows exactly where the economy is going. Once the model has been validated, we believe the next step is for banks to understand how the model will behave in a worst-case scenario. It is important to run a severe stress test to uncover where they will be affected by those assumptions most. The information gained can help management to see that if these two or three things occur, this is what that could mean to us. From here, management can gain a clearer picture of how changes in the major assumptions impact its CECL estimate so there are no surprises in the future.

CO-BORROWER OR GUARANTOR

Kenneth A. Hoffmann
Certilman Balin Adler & Hyman, LLP

Lenders often structure a transaction with multiple borrowers rather than utilize a borrower and guarantor structure; the rationale being that the multiple borrower structure will provide greater protection for the lender. However, lenders should be aware that multiple borrower transactions require the use of specific drafting techniques to prevent the inadvertent discharge of a co-borrower's obligations. A co-borrower who provides credit support for the principal obligation but does not benefit from the proceeds thereof may have suretyship defenses which should be dealt with in the loan documents.

In order to properly structure a multiple-obligor credit, a lender must consider the legal classification of each party, its related rights and obligations and the use of the transaction's proceeds. The proper structural choice hinges on the intended use of the loan proceeds and who will benefit from such use.

Guarantors or sureties have several defenses that can be raised to avoid liability, which are based on the underlying premise that an obligation cannot be unilaterally modified by lender after execution. Sureties may also be discharged from their obligations in situations where the lender and primary obligor take actions that would alter the risks to the surety. Examples of situations that might result in the discharge of a surety include an increase in the amount of the loan, extension of maturity of the loan or release of collateral. Each of these changes could make it more difficult for the surety to seek reimbursement from the primary obligor if the surety is called upon to perform under its guaranty; therefore, the taking of any of these actions could result in the surety's full or partial discharge.

Fortunately, the law recognizes the freedom of parties to contract with one another and thereby provide for a waiver of suretyship defenses in advance. The general practice of lenders is to require guarantors to sign lengthy and detailed waivers that deal with various issues such as post-execution modifications, joint and several liability and dealing with multiple obligors. Any well-crafted guaranty contains such waivers.

On the other hand, multi-party notes, even long-form notes, are often drafted without suretyship law in mind. Consequently, many notes do not contain language necessary to waive a co-borrower's suretyship defenses. Since it is clear that properly drafted waivers are effective to prevent discharge, it is of paramount importance for a lender to ensure that its documents have the appropriate language when co-borrowers are actually in a surety relationship.

In order to avoid the unintended discharge of a co-borrower which is, actually, a surety, multi-party notes should contain suretyship defense waivers. Since it may not be clear whether a co-borrower is, in fact, a surety, it would be prudent to draft all notes executed by co-borrowers to include such waivers. While there is no foolproof method that can ensure enforcement under all circumstances, the inclusion of suretyship waivers in multi-party notes should be considered to minimize the risk of inadvertent discharge of a co-borrower.

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