

“An investment in knowledge always pays the best interest.”
- Benjamin Franklin

A Message from the President



Dear Long Island Chapter Members,

Welcome to our (end of) Summer 2025 Newsletter. Thanks again to the Emerging Leaders for a fantastic Nine and Dine event on August 13th at Stonebridge Country Club. This always proves to be a popular event, and we appreciate the continued support of our members.

Watch this space for an exciting announcement regarding our October 31st event, to be held at the Heritage Club at Bethpage State Park. We have secured a dynamic speaker who is joining us for the first time, bringing a new dimension to this annual event.

As always, I urge our faithful sponsors to take advantage of placing a short journal article in our newsletter. It's a great way for our members to learn a bit more about your firm's capabilities and strengths.

I also encourage our members to spread the word about our annual scholarship program. The scholarships, which typically award up to \$2,500, are instrumental for the LI Chapter to develop future risk management professionals and fulfill the organization's not-for-profit charter. Help us by submitting some worthy candidates.

As always, I encourage your feedback at rmalongisland@gmail.com. If I don't hear from you in the interim, I'll see you in October!

Sincerely,
Michael Heller

RMA-LI Chapter

Save the Date

Special presentation: The Power of Playing Big
Featuring Liz Bentley

Friday, October 31, 8am – 10am
Venue: The Heritage Club at Bethpage State Park

Register:

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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, 2026

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 (or schedule for incoming freshman) 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
- ONE 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

Identifying and Managing Volatility in Your CECL Model



**Authored by Sean Statz, Sam Hoffman
Baker Tilly Advisory Group LLP**

The adoption of current expected credit losses (CECL) requires institutions to estimate lifetime losses of their current portfolio. While an institution can estimate lifetime losses in many ways, the CECL standard requires considering three main components: historical experience, current conditions and reasonable and supportable forecasts. In other words, the institution must start by analyzing historical data and adjusting it based on current conditions and forecasts. Regardless of how institutions run models or calculations to estimate their allowance for credit losses (ACL) under CECL, volatility is inevitable and may originate from various sources. This article aims to help institutions identify sources of volatility so they can better understand CECL risk management.

Inputs and assumptions

Assumptions are typically the main driver of volatility in CECL models. CECL models may use different assumptions depending on the selected model methodology. Common methods involve projecting cash flows and estimating future losses using a cash flow model. This

normally involves developing a prepayment assumption, or a payment made beyond what is contractually obligated. To run an accurate cash flow projection, the model requires an assumption regarding expected prepayments. For institutions using the WARM (weighted average remaining maturity) method, prepayments are also commonly used to calculate the weighted average remaining life. Regardless, including prepayments in the calculation will shorten the effective life of the portfolio and thus decrease the exposure for future losses. Higher prepayment rates reduce projected losses, while lower rates increase them. In cash flow calculations, the expected loss calculation can be extremely sensitive to changes in prepayment rates, especially long-term loans such as mortgages.

It's crucial to understand and document how prepayment rates in your model are calculated. Many models use a constant prepayment rate (CPR) that remains the same throughout the entire life of the portfolio.

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In these cases, more recent look-back periods are recommended because they better align with the expectations of prepayment activity over the near term. Other models use regression analysis to predict prepayment rates over a forecast period (typically one or two years) and then revert to a long-term historical average. This is often recommended because the long-term average will remain more consistent and thus will reduce volatility related to prepayment rates.

Another source of volatility, regardless of methodology, is the loss rate assumption. This can either take the form of probability of default (PD) / loss given default (LGD), net charge-off rates, or gross charge-off rates with a recovery rate assumption. Changes to the loss rates will affect the outcome of the projected loss model regardless of the loss rate methodology. Generally, these changes have less effect on cash flow compared to similar prepayment rate changes, unless the portfolio is short-term. Like prepayment rates, reverting to a longer-term historical loss rate after a forecast period will help reduce volatility.

Forecasting

CECL now requires the consideration of reasonable and supportable forecasts. Depending on your forecasting methodology, they may also be a significant source of volatility. Models often use economic factors to predict future assumptions over a forecast period. If the forecast period is only one to two years before reverting to

a historical calculation, it may not result in high volatility. The initial years of cash flow calculations have the highest exposure since the cash flows have not yet amortized for the payments and prepayments. Therefore, changes to a year one or two loss rate will significantly affect any changes compared to changes in subsequent years. Assuming the economic forecast utilizes regression analysis to predict assumptions, these forecasted assumptions may be sensitive to variations in the forecasted economic metrics, particularly if the slope of the regression line is high.

Qualitative Factors

Another source of potential volatility is qualitative adjustments. A significant qualitative adjustment indicates a major change in current conditions that is not captured within the actual modeling using historical data, which management could document and understand why a change to the allowance was made. With the introduction of CECL, there has been a shift towards quantifying qualitative factors and establishing a more supportable and measurable qualitative factor framework.

This involves creating a framework that is consistently applied, reducing the subjectivity of making adjustments and ensuring consistency in the future. Depending on how the framework is set up, small changes to current conditions may lead to large swings in the applied qualitative adjustment. It's important to understand how your qualitative framework operates so you can identify any areas of potential volatility.

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For example, factor scales are a common way for institutions to quantify the application of risk ratings within the framework. For changes in delinquency, institutions may develop a sliding scale to determine which risk rating to apply to which levels. It's important to develop scales that are not overly restrictive, ensuring that minor variations in delinquency trends do not result in significant risk designations when no risk was apparent in the last period. To avoid this unnecessary volatility, it's important to keep the sensitivity of the framework in mind when developing it.

Black Box Models

Many CECL models use complex methodologies, including discounted cash flow models that integrate industry data, economic factors and contractual data and model loans on an individual basis. This means assumptions are applied on an individual loan level and not at a segment level. These models are often seen as “black box” as the calculation of the assumptions is done behind the scenes using proprietary formulas and calculations. It can be difficult for users of these models to understand how the model calculates assumptions; therefore, it can be difficult to understand where volatility in the model originates from.

For example, does volatility originate from changes to economic forecasts? Which underlying assumptions are driving the volatility; did the economic forecasts change the predicted prepayment rates or was the volatility related to changes in predicted loss rates, default rates, loss given defaults or recovery rates?

All these questions can be difficult to answer if the users do not understand how their model works. Another solution is to have a model validation completed on your CECL models.

Model validations will ensure the model is working properly and can provide valuable insight into how the calculations “behind the scenes” are working together to produce your institution's CECL estimate. These value-added insights tend to provide further insight to management and users of the model to help better understand where the volatility is originating from.

Sensitivity testing

The best way to understand potential sources of volatility in your CECL model is with sensitivity testing. Sensitivity testing is meant to quantify, (1) which inputs and assumptions the model is most sensitive to and (2) how sensitive the model is to changes in these inputs and assumptions. It is important to isolate assumptions so users can understand how each assumption impacts the calculation. For example, how do changes in prepayment rates affect the model compared to similar changes in loss rates? By performing the sensitivity tests, users can create scenarios with varying changes to key assumptions. Comparing the results of the different scenarios will help the user understand the overall sensitivity of the model.

Our CECL specialists are here to help your organization understand and navigate the complex modeling environment. Connect with our professionals for more information on this topic or read our relevant insights.

Committed/Uncommitted Lines of Credit by Kenneth A. Hoffmann

A working capital revolving line of credit (“LOC”) is fundamental to the success of most businesses. The ability of a company to quickly and easily draw on a LOC to cover short term company expenses is vital for day-to-day operations. Banks and other lenders routinely make LOCs available to companies on fairly standard terms; the available amount, interest rate, collateral and other loan terms vary depending on the needs of the company and the policies of the lender. One important issue that is sometimes overlooked when lenders extend LOCs, is whether the LOC is intended to be uncommitted or committed.



Uncommitted LOCs are advanced at the lender’s discretion, and repayment may be due on demand by the lender. Advances can be denied by lender for any reason or no reason. Compliance with covenants and other loan terms does not change the discretionary nature of the uncommitted LOC. Uncommitted LOCs are utilized for short-term borrowing needs. If a fee is charged for an uncommitted facility, it is usually characterized as a “review fee” and not a commitment or origination fee. Any such review fee should not be based on credit usage or maximum availability. Uncommitted LOCs are usually available for approximately one year (subject to potential demand).

Below is a sample of an uncommitted LOC provision:

“Any Advance made by the Bank hereunder shall at all times be within the sole and absolute discretion of the Bank. This [Name of Document] does not constitute and should not be construed as constituting a commitment and in no way obligates the Bank to lend to the Borrower at any time or from time to time. The making of an Advance or loan by the Bank to the Borrower at any time or from time to time hereunder shall not be deemed a waiver of the foregoing, or a consent, agreement or commitment by the Bank to the making of any future Advance or loan to the Borrower. This [Name of Document] and the Bank’s willingness to receive and consider requests from the Borrower for Advances hereunder are subject to cancellation by the Bank in its sole discretion at any time without prior notice to the Borrower.”

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While lender’s discretionary rights might give companies concern, uncommitted LOCs are popular, as they typically do not require fees and are subject to an easier approval process.

Conversely, a committed LOC is one that is available to the company for a set term, subject to specific conditions unless an event of default exists. As long as the company complies with the terms and provisions of the LOC documents, the company may borrow.

Committed LOCs usually require a commitment or origination fee, and sometimes have requirements such as a borrowing base availability limitation, or a one-month clean up period (i.e., zero outstandings for 30 days). If an event of default occurs, the LOC is no longer available and amounts outstanding may be required to be repaid.

Lenders under committed LOCs may sometimes include events of default in their loan documents such as “the existence of a material adverse change in the opinion of the Lender” or “the failure of the Borrower to maintain the usual credit factors as required by the Lender from time to time”, in order for the lender to obtain a level of control and discretion that is similar to an uncommitted LOC.



The distinctions between committed/uncommitted LOCs are substantial. It is important for Lenders to be clear so as to set proper expectations. If the intent is to provide an uncommitted LOC, great care should be taken to avoid inclusion of any language that might conflict with its demand, discretionary nature. If you have any questions, reach out to your counsel to ensure the lender is protected.

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