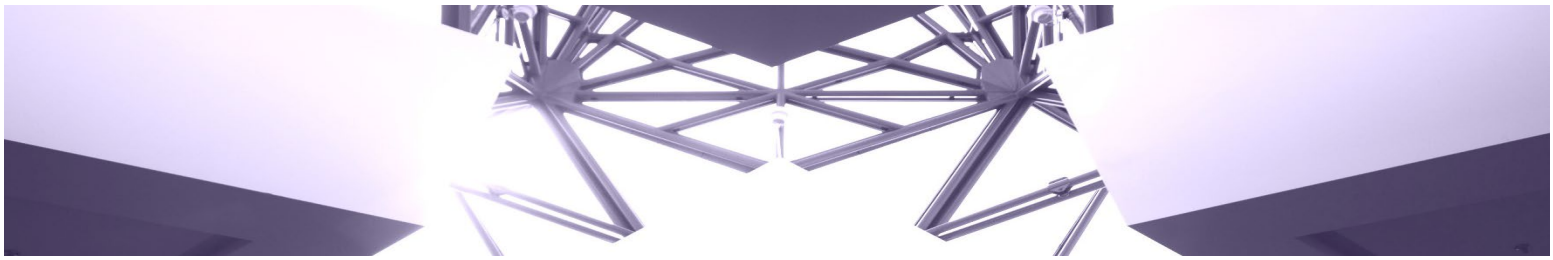
Risk Management Association

Advance Your World.

Winter 2022 Newsletter



MEMBER SPOTLIGHT



Sometime in 2012, I was speaking with an individual in the commercial finance industry here in Buffalo, who I had garnered a significant amount of respect for, and they mentioned the Buffalo Chapter Risk Management Association (RMA) as an organization that would be of interest of me. They elaborated that the Buffalo Chapter RMA was very active locally and maintained a robust membership. Being that in 2012, my role at LaBella Associates, D.P.C. (LaBella) included managing a significant quantity of financial industry clients, I followed up on the suggestion and attended my first Buffalo Chapter RMA event shortly thereafter. The RMA Buffalo Chapter immediately struck me as having significant value by providing industry relevant content and also access to my client base through RMA hosted networking events. What was initially something that I participated in as a curiosity in 2012 grew into participation as an RMA member, and subsequently accepting nomination to the Buffalo Chapter RMA board. In fact, the incredible experience I have had with the RMA Buffalo Chapter resulted in me participating in several RMA chapters located within the geographies LaBella serves, and also me encouraging other professionals, whether it be in Buffalo, New York or else ware, to participate with the RMA. Participation in the RMA has been a significant influence on my ability to understand the issues important to my clients and the landscape under which we collectively do business, while building financial industry relationships within the geographers I serve. Thanks to all those who have made RMA the great organization that it is!

Board Member – Adam Zebrowski
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CREDIT RISK RATINGS AND NOISE

BY MICHEL ARATEN, PH.D. NOVEMBER 2021 - *RMA Journal*

Behavioral economics has long been an important area of study as to how people make judgmental decisions. The latest contribution to this field comes from the Nobel Prizewinning Daniel Kahneman and his co-authors in *Noise: A Flaw in Human Judgment.* They examine the degree to which judgments in areas as diverse as medicine, law, economic forecasting, police behavior, food safety, bail, security checks at airports, strategy, and performance evaluations are affected by both bias and noise. While effects from bias can often be corrected, it is more difficult to identify and correct for the presence of what might be described as noise. They find time of day, outdoor temperature, personal moods, desire to over-correct, and simple randomness to be behind much of how people arrive at judgmental forecasts and evaluations. They have a number of suggestions for conducting a noise audit, ensuring noise hygiene, and subsequent reduction of noise.

The validity of credit risk ratings can improve from the perspective of these findings. All areas of credit risk management including credit underwriting, loan review, and credit audit would benefit. Since so many applications, such as approval levels, pricing, loan loss reserves, economic and regulatory capital, and stress testing are dependent on these ratings it is critical that stakeholders have confidence in them.

Read the entire article in the November 2021 edition of the RMA Journal.
https://www.rmahq.org/the-rma-journal/current-issue/

UPCOMING EVENTS

January 26, 2022 8:30am – 10:00 am – Update on the LIBOR Transition with Doug Sheline and Craig Hallgren. M&T Bank. Virtual event - https://mtb.webex.com/mtb/j.php?MTID=m1f08b04231f5fde6cabab7d840a5ccea

January 27, 2022 5:00pm – UNY TMA Event – Panel on the state of the Post-COVID Commercial Real Estate Market. Virtual event - https://online.turnaround.org/tmassa/evtssareg.custid?p_event_id=7575

February 10, 2022 5:00pm - 7:00pm, DIY Charcuterie Board Night with A Board Above. Market Arcade, 639 Main Street, Buffalo NY 14203

Stay tuned for other exciting events throughout this year. We are always willing to take suggestions and help, so please reach out with any ideas!

THANK YOU TO OUR SPONSORS!

AMERISOURCE Business Capital
https://www.amerisource.us.com/

Pursuit
https://pursuitlending.com/

LaBella Powered by partnership
https://www.labellapc.com/

Community Bank N.A.
https://cbna.com/

Update on the Leasing Standard

The Financial Accounting Standards Board ("FASB") has endured a multi-year process to formally adopt the new lease standard under Accounting Standards Codification ("ASC") 842: Leases. This new standard includes leases of all property, plant and equipment. It excludes leases of intangible assets, exploration of nonregenerative resources, biological assets, inventory and assets under construction.

The new lease standard became effective for public companies for periods beginning after December 15, 2018. Public companies have already implemented this standard and started to disclose the impact on financial statements with further disclosures that are required to be made in the year-end financial statements.

The FASB delayed the effective date of the new lease standard for non-public companies that became effective for the periods beginning after December 15, 2021 (calendar year 2022). The FASB delay was based on feedback it received from various constituents on the challenges that non-public companies were facing implementing the standard.

The FASB's main goal of this standard was to eliminate the use of "off-balance sheet" financing. Under the previous lease standard, entities with operating leases were able to lease assets without needing to record an asset or lease liability on its balance sheets. With the exception of short-term leases (generally 12 months or less in nature), all leases will now be required to be recorded as a right-of-use asset and a corresponding lease liability on the balance sheet. Under the old lease standard (ASC 840), companies were not required to record operating lease liabilities on the balance sheet, while the associated lease commitments were merely disclosed in the notes to the financial statements. The new standard also significantly increases the required disclosures in the notes to the financial statements which will provide the users more ability to assess the amount, timing and uncertainty of cash flows arising from leases.

Jeremy D. Blecha, CPA, Partner – Tronconi Segarra & Associates LLP

STUDENT RESOURCE CENTER

RMA provides free student memberships and a student resource center!

https://www.rmahq.org/studentresources

The student resource center provides tools and resources for students to:

- Build their network
- Get practical experience through internships
- Strengthen resumes
- Apply for scholarships
- Gain insight beyond the textbook
- Get latest industry trends and research information
- Supplement university education

STUDENT SCHOLARSHIPS

Students in an undergraduate program who are interested in working in the banking industry may apply for an RMA Foundation Scholarship!

The RMA Foundation awards over $200,000 annually in scholarships ranging from $1,500 to $8,000!

The 2021-2022 scholarship window is open through March 31, 2022. For more information:

https://www.rmahq.org/studentresources/scholarships/

As Pandemic Cash is Spent Down, Look Out for the Merchant Cash Advance (MCA) Market

By Andy Allaire, Amerisource Business Capital

We have all seen the impact of the various government programs to prop up the economy during the pandemic. Whether it was PPP, EIDL or the Main Street lending program, companies have been flush with cash. Most banks would say deposits are at historic highs, companies have a tremendous amount of liquidity and borrowing on operating lines of credit is down.

As this excess cash is spent down, companies will have to rely on more conventional sources of working capital to fund operations. As a result, bank customers may start returning to their bank lines to finance daily working capital needs. Those who do not qualify for a bank line of credit may then turn to alternative lending sources, many of which are perfectly sound and make sense.

However, we are seeing the growth of one alternative lending source that does not make long-term sense. Be on the lookout for the Merchant Cash Advance (MCA) market.

What are MCAs?

Originally, MCAs were offered to companies that had credit card sales. The MCA lender would advance a percentage of historical credit card sales, with the advance being repaid from a certain percentage of future credit card receipts. Over the past 10 to 15 years, this source of cash has become available to just about any business that can produce a few months of bank statements.

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One negative issue often cited with this credit product is that the lender debits the company's bank account every day for a daily repayment. But this is not the real issue. If you take out a 48-month car loan at 3% APR, it does not cost you any more than if the payments are made monthly or daily.

The Real Issue

The real issue with MCAs is the hidden cost. Many MCA lenders go to great lengths in their agreements to indicate the advance they make is *not* a loan but an advance against future sales. This is how they avoid disclosure and usury laws. A "buy rate" or some similar term is used instead of quoting an interest rate. But this rate is not comparable to an interest rate.

A typical "buy rate" ranges from 1.2 to 1.5. It is not a percentage – it is a multiplier. To know the true cost of money, you need to convert this "buy rate" to an approximate APR. You also need to know the amount advanced and the repayment period, typically 3 to 9 months.

One Example

Consider this example: a $50,000 advance with a buy rate of 1.3 payable over three months. The amount the company pays back is the advance ($50,000) times the rate (1.3) to equal $65,000.

Notice the buy rate is not 1.3%. The 1.3 is a multiple of the advance that is to be repaid. The company is paying a fee of $15,000. The fee is the repayment amount ($65,000) less the advance amount ($50,000) over 90 days.

An equivalent APR is not disclosed by the lender and is not always easy for a company to calculate. To approximate an APR, divide the fee ($15,000) by the advance ($50,000), and you are at 30%. But now you need to annualize this, so multiply by four (the 90-day repayment period against a 360-day year), and you are at 120%.

Furthermore, consider that the initial advance was $50,000, and it fully amortizes evenly. The average advance is only $25,000, so you can double APR from 120% to 240%. In addition to the stated fee, there is often an origination fee, documentation fee or some other costs to be paid. Often these costs are taken out of the initial advance, so the company receives a lower net amount than the $50,000. What is disclosed to the company is typically the advance, the total amount repaid and the daily repayment amount.

Long-Term Consequences

While a single advance may not be catastrophic, few businesses can survive long-term when they continually pay over 100% for the cost of money. Many companies obtain the first advance to hold them over for a short time. The problem begins when they realize the need for more cash and get add-on loans. The industry term for adding loans is "stacking," either by the original lender or another MCA lender. Some companies have so many stacked MCAs that the daily repayments eat up all their cash flow.

A further problem is MCA lenders will generally record all-asset UCC filings. We have had almost no success in convincing MCA lenders to subordinate their liens for new transactions, even though they may have been in junior positions at the outset. They are more than happy to have their advances paid off early because the fees have already been paid, increasing their yields.

What Bankers Can Do

As a banker, how do you tell if one of your customers has taken an MCA? One tell-tale sign is when you notice that a depository customer's bank account has daily debits of an equal amount. It may be an MCA.

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If it's an MCA, what do you do? At Amerisource, we monitor UCC filings that have been recorded after our transactions close. We always investigate the identities of the lenders and the terms of the loans. If we identify MCA lenders, we advise the customers of the dangers of this type of financing. We also remind them that it is a violation of our financing agreement to have junior liens filed behind us without our authorization.

It is possible that a company goes for an MCA as a one-off solution because they have an emergency cash need without the time or resources to explore a more conventional credit facility. But the repeated use of this type of financing is often a symptom of a problem, not the problem itself. The root problem is likely a cash flow shortfall the bank should investigate with its borrower. It might be time to consult your special assets area or recommend an outside consultant to the company – before it is too late.

About the Author

Andy Allaire has served in Commercial Lending and Asset-Based Finance since 1985. He graduated from State University of New York at Fredonia with a bachelor's degree in dual majors Accounting and Computer Science. His career began at Marine Midland Bank, where Andy worked in various Commercial Lending roles, including nine years in Asset Based Lending – Structured ABL transactions from $5 to $25 million. He worked for two years at GE Capital with small- to medium-sized businesses that needed Asset Based loans and Factoring. Andy has been with Amerisource since February 2001.

RMA UPDATES

RMA TAKES ACTION ON TOP RISKS

RMA provides numerous resources to keep members informed of the latest thinking on the top risks facing the industry. Members are encouraged to discuss the particular ways these risks will affect their institutions, and to get the latest perspectives on them through RMA's various communication channels, which include award-winning RMA Journal articles, the Industry Insider e-newsletter, our new Risk Readiness Webinar Series, LinkedIn posts, blog posts, podcasts, round tables, forums, conferences, and website resources.

https://www.rmahq.org/rma-takes-action-on-top-risks/

RMA'S WHARTON PROGRAM

The RMA/Wharton Advanced Risk Management Program Application window is Now Open!

RMA, in partnership with The Wharton School, offers the only advanced risk management program aimed at developing C-suite risk professionals at financial institutions. The program meets a critical need in the industry to integrate risk management with financial management and strategy. In fact, many former participants are now CROs.

Enroll today: https://lnkd.in/eWJg2kD
Learn more about the program: https://lnkd.in/eYbwZ8T

ABOUT OUR CHAPTER

We are over 350 members strong in representing banks, financial institutions and professional organizations dedicated to risk management in Upstate New York. As one of over 120 active RMA Chapters, the Buffalo RMA Chapter plays an active role in fulfilling the mission. Through our area general meetings and educational events we enrich financial services professionals and our region's banking community. It's an important undertaking that is led and implemented by loyal volunteers from area institutions -- bringing RMA to you in your local market area.

SPONSORSHIP OPPORTUNITIES

RMA sponsorship and involvement in our local Buffalo Chapter will be of great benefit to your organization. In a time when many are very focused internally, RMA provides a "window to the world" keeping you on the leading edge with timely knowledge and access to contacts in the financial industry. Sponsorship offers you the opportunity of introducing your colleagues to Western New York commercial lenders and other credit professionals in a favorable setting for a fraction of the cost. Sponsorship offers an unparalleled opportunity to meet lenders and credit professionals who are in a position to recommend your firm's services either to their own institution or to their customers.

General meetings and events center on luncheon programs with featured speakers, panels, educational forums and social events.

Sponsorship is the perfect solution for firms looking to target market lending professionals who are not only a source of business themselves but may also provide secondary referrals to their customers.

CONTACT: Charlie Brooks - cbrooks2@mtb.com

KEEP IN TOUCH

https://www.linkedin.com/company/rma-the-risk-management-association-buffalo-chapter/

https://community.rmahq.org/buffalo/home?ssopc=1