

In this month's installment of Community Bank Views, we are pleased to provide you with insight from our Bank's Chief Credit and Risk Officer, Dan Callahan. Mr Callahan and his team are responsible for all Credit Risk including C&I and Consumer loans within Commerce Bank

If you are familiar with Commerce Bank's 150+ year history, you know it is one based on sound, longstanding lending principles. I trust you will enjoy what follows....

What are Commerce Bank's core principles with regards to lending?

Simply put, stay the course and do not stretch. Our appetite for Credit Risk is geared toward maintaining credit metrics that place Commerce in the top quartile of industry comparisons. Our Credit Culture has a long-term, conservative, risk-averse view, while supporting the shared values with each line of business and their customers.

Our credit culture and policy are very consistent over the economic cycle. Lending practices are consistent. Fundamentally, we don't lend or provide credit products when we don't understand a company's business model. We ask our Lenders very basic questions such as, "how does the company operate?" and "how does the company make money?" and "how does this company pay back the loan?". If answering this is difficult, we move on.

Commerce Bank was one of the largest publicly traded banks to not participate in the Troubled Asset Relief Program (TARP) during the Great Recession that began in 2008. Non-Performing Assets (as % of Total) currently stand at 5 basis points and peaked at only 64 basis points in 2009 during the depths of the Great Recession. This was a materially better result than the industry and our competitors. Why do you think Commerce was able to fare so well?

Again, this is the result of our longstanding credit culture. Specifically, we seek to maintain a diverse portfolio. We stick to our hold limits and manage industry concentrations. We lend to customers who we know and understand how their loan will perform throughout a cycle. You do all that, and you will minimize your problems.

One thing we do particularly well is identifying and addressing potential problem loans. Given our strong relationship and associated ongoing communication with our borrowers, we can quickly partner with them to implement corrective action plans which address these problems.

Continuing with credit management, we have seen competitors suffer material losses on large exposures. What mitigants do we employ to avoid this same fate? Any early warning signs or tactics for managing this type of unfortunate situation?

We continually measure & monitor concentrations across obligor, geography, and industry. Of most importance, we hold the line when it comes to our hold limits. Stretching your hold limits on an exception basis will almost always lead you into trouble. Our hold limits are risk adjusted in that we may be willing to expand our exposure if the credit is particularly strong. Conversely, for marginal credits our hold limit is much smaller. Every bank will get caught with some unforeseen problem credits, but our hold limits have kept us out of trouble.

Furthermore, we seek to understand the borrower's comprehensive credit need in both the near term and long term so we can create a structure that works for both parties. If required, we will bring in other banks to partner with us to fulfill the borrower need.



The market has experienced its longest economic recovery on record. Despite the many near term challenges such as tariffs, it seems the numbers (GDP, employment) are still coming in relatively strong. Some economists, however, believe we are due for a recession. Against that backdrop, what sectors do you like or dislike?

We operate and lend in all sectors of the economy. We think the agricultural sector is still suffering and may continue to suffer. We see some softness in trucking, consumer loans, senior living projects and in high end commercial real estate, particularly the multifamily segment. We've also paired back our automobile exposure in certain geographies. Our loan losses are still fairly benign. I would characterize these as yellow lights, not necessarily red lights.

A lot has been mentioned in the press recently about the Institutional Leveraged Loan market. In particular, there is a concern about covenant lite deals with higher leverage and weaker structures. How do you think this market impacts our bank lending market?

I really don't like how this market has impacted banking given aggressive underwriting. It is extremely aggressive, and I am concerned some holders of this debt (individuals by way of ETFs & institutional funds) don't really know what they have purchased. Deal structures are much weaker than traditional bank financing and the use of proceeds is typically for financial purposes like buyouts or dividends. Leverage and deal valuations are much higher and, as you point out, covenants are very weak.

With regards to the holders, many of these deals are in CLOs, Private Equity, family office, pension plan, or hedge fund hands. Hence, much of these transactions are no longer within the traditional banking system. I have concerns some of these institutions don't have the infrastructure to monitor, service and potentially work out these deals.

That said, we do, on occasion, participate in these types of loans and partner with sophisticated partners where we can help enhance the economic value of the transactions. However, while doing so, we still abide by our core lending principles.

What career achievement are you most proud of and why?

Becoming the Chief Credit Officer of Commerce. I am especially proud given our bank's strong, historical track record of being a conservative, high performing institution. I am also proud to work alongside our bankers to help them structure and underwrite both simple and complicated deals to help their customers achieve their goals.

What are some of the most interesting developments or innovative trends you are seeing in underwriting loans, booking and servicing loans?

Automated Loan Operating Systems. These systems provide quicker decisions for customers. This took some time for us to embrace but once you trust the system, it really simplifies the approval process. Speeding up the decision-making process has helped us win quality deals. In addition, this process is electronic, so we cut down on a lot of our paper usage.

Thank you for your time today, Dan.

If you would like to further discuss any of the topics covered, please reach out to your CMG representative.

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