FHN FINANCIAL
CAPITAL ASSETS CORP.

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WEEKLY COMMENTS

Many COVID-19 Forbearance Initial Accommodations are Nearing their End — Are you Ready?

An August 3, 2020, interagency advisory issued guidelines for prudent risk management and consumer protection principals when managing additional accommodations for COVID-19 forbearance loans nearing the end of their initial loan accommodation periods.[(1)] In order to effectively administer these guidelines, most regulated institutions will need to have in place extensive information technology capabilities as well as forbearance mortgage analytics previously unavailable to many lenders. Do you have the forbearance information technology and mortgage analytics in place to assess additional loan accommodations while meeting prudent risk and consumer protection principals? How do you know your current process accurately assesses exposure? The answer to both of these questions is FHN Financial Capital Assets Corp.'s ("Capital Assets'") complimentary Forbearance Risk Assessment ("FRA"), tailor-made to assist your institution in meeting these interagency advisory guidelines.

Overview

With many COVID-19 forbearance loans nearing the end of their initial loan accommodation periods, the Regulators recently issued interagency guidance on prudent risk management and consumer protection principals when dealing with COVID-19 forbearance loans (August 3, 2020, "*Joint Statement on Additional Loan Accommodations Related to COVID-19*" [(1)]). Many of the home mortgages currently in their initial stage of accommodation are nearing an end, and lenders will have to assess the borrower's financial wherewithal at that point to determine the appropriate action to be taken. In addition, many fear that if Congress does not come to terms on additional funding for the Payroll Protection Program ("PPP") [(2)], there will be a second wave of layoffs and COVID-19 forbearance applications. Many institutional lenders simply do not have the information technology and mortgage analytics needed on a large scale to assess which loans are able to resume amortization at the end of an accommodation, which loans continue to not have the financial wherewithal to resume their obligations, and which loans need more time to determine the borrower's financial capabilities.

Capital Assets Forbearance Risk Assessment ("FRA")

Capital Assets has developed a proprietary Forbearance Risk Assessment ("FRA") to give our customers the horsepower necessary to deal with this impending wave of forbearance credit decisions. The development of the FRA assessment was such a significant event that ACUMA, the credit union industry's trade magazine,

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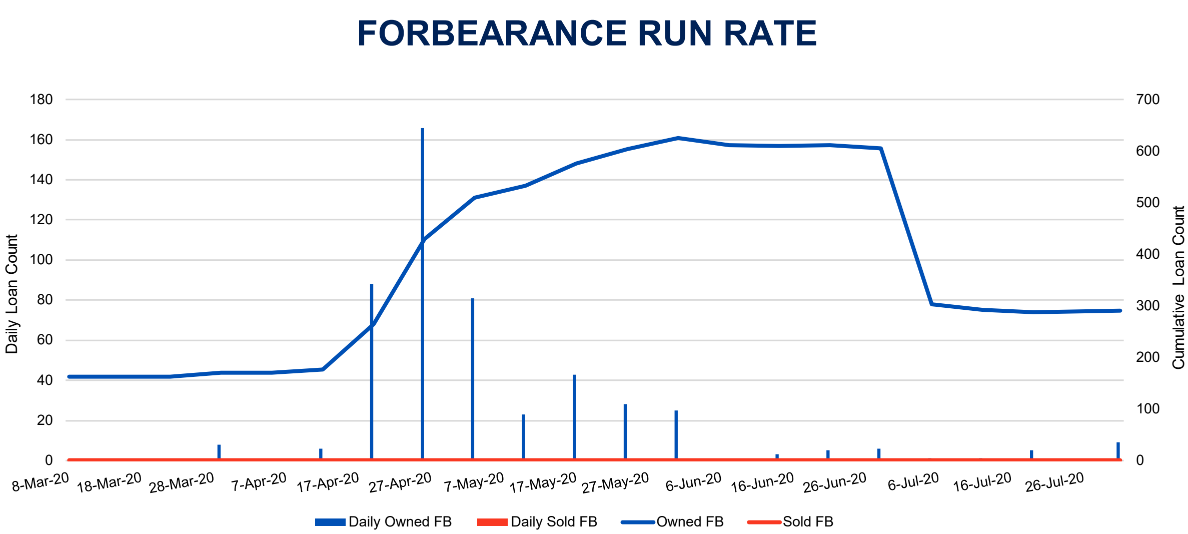
published a detailed article on the FRA written by Jerry Hubbard, the President of Capital Assets, in their Summer Edition of 2020.[3] The FRA provides extensive analytics that specifically meet individual interagency guidelines when dealing with COVID-19 forbearance loans. Below is a list of the more significant guidelines in the advisory and which sections of the FRA that address those guidelines.

A) ***Pg. 3, "Effective management information systems and reporting helps to ensure that management understands the scope of loans that received an accommodation,...when the accommodation period ends, and the credit risk of potential higher-risk segments..."***

The Capital Assets FRA begins with a reconciliation of non-forbearance versus forbearance loans across both the owned and sold loan sectors to quantify the impact of forbearance loans. This is followed by a forbearance run rate analysis to determine trends in the forbearance rate, the forbearance extension rate, and which loan accommodations are coming to an end. Next, the FRA presents a series of risk stratifications of the portfolio covering numerous variables including DTI, LTV, current delinquency, historical delinquency, and geographical distribution of the forbearance sector of the portfolio.



Source: FHN Financial Capital Assets Corp.

B) ***Pg. 4, "When a financial institution considers whether to offer additional accommodation options to a borrower,...assess each loan based on the fundamental risk characteristics of that particular credit."***

The FRA assessment offers a proprietary loan level credit risk assessment called the Credit Risk Layering Analysis. Capital Assets created a list of loan credit risks and defined measurements of each risk that make it a low risk, moderate risk, or high risk. If an individual loan ranks as high on a particular loan risk, the loan is given one high risk "hit." The number of high risk hits for each loan are accumulated, and the loans are then ranked from the most to the least high risk hits. The loans with multiple high risk hits are determined to contain multiple layers of risk, making those loans exponentially more at risk of default.

FORBEARANCE PORTFOLIO CREDIT RISK LAYERING ANALYSIS

Average Number of Risks Per Loan :	0.79
Percent of Loans Without Layering :	77.1%

Number Of High Risk Categories	0	1	2	3	4	TOTAL
Number of Loans	18	6	4	2	1	31
Total Balance ($)	2,883,453	806,229	516,219	355,215	225,116	4,786,232
Percent of 1-4 Portfolio Balance	60%	17%	11%	7%	5%	100%

Source: FHN Financial Capital Assets Corp.

C) ***Pg. 3, "Sound credit risk management includes applying appropriate loan risk ratings or grades and making appropriate accrual status decisions…"***

The FRA includes a liquidity and credit waterfall which places individual loans into one of six risk categories:

CAPITAL ASSETS WATERFALL RISK CATEGORIES

- Prime Credit Grade
- Moderate Credit Risk
- High Credit Risk
- Negative Equity Risk
- Problem Credit Risk
- Extremely Distressed Risk

Source: FHN Financial Capital Assets Corp.

Loans are individually filtered through the highest risk category, with loans fitting that category of risk removed from the analysis. Loans that pass that risk category are successively filtered in each of the lower risk categories and removed if the loan meets that individual risk, and so on.

D) ***Pg. 5, "According to GAAP, loans are to be segmented into a separate portfolio when they share similar risk characteristics for the purposes of estimating credit losses… "***

The risk categories from the above discussed Waterfall Liquidity Analysis are used to apply the appropriate default rate and loss given default rates to each individual loan for the purpose of assessing potential future losses. Each loan is then cash flowed to maturity incorporating the prepayment potential as well as the default rate and loss given default rate. The resulting absolute level of projected losses and the present value of those losses are then summarized across each of the six risk categories. These projected losses via cash flow analysis can be used as a confirmation of losses expected by management in setting ALLL levels using other methodologies.

Estimated Forbearance Losses

Liquidity Grade	A	B	C	D	E	F	Total
Owned							
Current Balance	0	0	830,474	0	0	0	830,474
Default Assumption	0.00%	0.00%	5.00%	0.00%	0.00%	0.00%	5.00%
Owned FB Loss Severity	0.00%	0.00%	-4.13%	0.00%	0.00%	0.00%	-4.13%
Owned FB Lifetime Net Losses	**0.00%**	**0.00%**	**-0.21%**	**0.00%**	**0.00%**	**0.00%**	**-0.21%**
Sold							
Current Balance	0	1,627,681	2,450,823	0	0	0	4,078,504
Default Assumption	0.00%	2.00%	5.00%	0.00%	0.00%	0.00%	3.80%
Sold FB Loss Severity	0.00%	-29.17%	-24.43%	0.00%	0.00%	0.00%	-26.32%
Sold FB Lifetime Net Losses	**0.00%**	**-0.58%**	**-1.22%**	**0.00%**	**0.00%**	**0.00%**	**-0.97%**
Total							
Current Balance	0	1,627,681	3,281,297	0	0	0	4,786,232
Default Assumption	0.00%	2.00%	5.00%	0.00%	0.00%	0.00%	4.01%
Total FB Loss Severity	0.00%	-29.17%	-19.29%	0.00%	0.00%	0.00%	-22.47%
Total FB Lifetime Net Losses	**0.00%**	**-0.58%**	**-0.96%**	**0.00%**	**0.00%**	**0.00%**	**-0.86%**

Source: FHN Financial Capital Assets Corp.

Capital Assets understands that loans with differing underwriting standards, loans with differing servicing and collection programs, and loans with collateral located in differing real estate markets can cause management to wish to adjust either the default rate, the loss given default, or both for their individual portfolios. The last section of the FRA provides a stress test of these two variables in the form of a matrix. Management can slide up and down the scale of each of these two variables and assess the resulting loss rate on their portfolios.

Default Rate and Loss Severity Stress Test

$4,786,232

RESULTING CUMULATIVE LOSSES

YEAR ONE DEFAULT RATE		YEAR ONE LOSS SEVERITY										
	Change	-100%	-40.0%	-30.0%	-20.0%	-10.0%	0%	34%	113%	106%	144%	179%
		0.0%	-13.5%	-15.7%	-18.0%	-20.2%	-22.5%	-30.3%	-50.1%	-47.0%	-55.9%	-64.2%
-100.00%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
-80.00%	0.80%	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	-0.5%	-0.8%	-0.8%	-0.9%	-1.0%
-60.00%	1.60%	0.0%	0.0%	-0.1%	-0.1%	-0.2%	-0.3%	-0.9%	-1.5%	-1.6%	-1.8%	-1.9%
-40.00%	2.41%	0.0%	-0.1%	-0.1%	-0.1%	-0.3%	-0.4%	-1.3%	-2.2%	-2.4%	-2.6%	-2.8%
-20.00%	3.21%	0.0%	-0.1%	-0.1%	-0.2%	-0.3%	-0.5%	-1.7%	-2.9%	-3.1%	-3.4%	-3.7%
0.00%	4.01%	0.0%	-0.1%	-0.2%	-0.3%	-0.5%	-0.9%	-2.6%	-4.4%	-4.9%	-5.3%	-5.7%
31.74%	5.30%	0.0%	-0.1%	-0.2%	-0.3%	-0.7%	-1.0%	-3.2%	-5.3%	-5.8%	-6.3%	-6.8%
63.47%	6.59%	0.0%	-0.1%	-0.3%	-0.4%	-0.7%	-1.1%	-3.6%	-6.1%	-6.7%	-7.3%	-7.8%
95.21%	7.88%	0.0%	-0.2%	-0.3%	-0.4%	-0.8%	-1.2%	-4.1%	-6.9%	-7.6%	-8.2%	-8.8%
126.94%	9.17%	0.0%	-0.2%	-0.3%	-0.5%	-0.9%	-1.4%	-4.6%	-7.7%	-8.4%	-9.2%	-9.9%
158.68%	10.87%	0.0%	-0.2%	-0.3%	-0.6%	-1.0%	-1.4%	-4.8%	-8.1%	-8.9%	-9.5%	-10.3%

Source: FHN Financial Capital Assets Corp.

Conclusion

Many existing forbearance loans are nearing the end of their initial accommodation periods. In addition, many fear an additional wave of layoffs and forbearance applications if Congress does not come to agreement on additional PPP funds. The Regulators have issued guidance on how to make all of these impending credit decisions while taking into consideration prudent risk and consumer protection standards. If you do not have the information technology and forbearance analytics to make these credit decisions in bulk, Capital Assets has created a complimentary Forbearance Risk Assessment directly tailored to assist in making these credit decisions while meeting the regulatory guidelines. Contact your account representative or Capital Assets at 800.456.5460 to start your own FRA.

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[1] August 3, 2020, "Joint Statement on Additional Loan Accommodations Related to COVID-19" (Click Here)

[2] U.S. Department of the Treasury guidance on the small business Paycheck Protection Program ("PPP") (Click Here)

[3] "The Risk of People Helping People", Jerry Hubbard, ACUMA Summer edition, pg. 12 (Click Here)