Decision of the

Supervision Appeals Review Committee

In the Matter of * * *

Case No. 2025-02

I. Summary

* * * (Bank) requested that the Supervision Appeals Review Committee (Committee) review the Asset Quality rating assigned at the February 3, 2025, joint examination conducted by the FDIC and the [State regulator]. For the reasons discussed below, the Committee finds in favor of the FDIC Division of Risk Management Supervision (RMS).

II. Background and Procedural History

The Bank operates * * * in * * * and specializes in commercial real estate (CRE) lending to * * *. The 2025 joint examination of the Bank resulted in CAMELS/composite ratings[1] of 2-3-2-2-2-2/2. In discussing the Bank's Asset Quality rating, the 2025 Report of Examination (2025 Report) focused on the Bank's CRE concentration risk management and elevated and increasing adverse classifications.

The Bank filed a request for review with the RMS Director on August 25, 2025, contesting the assigned Asset Quality rating. On October 2, 2025, the RMS Director concluded the Asset Quality rating was appropriate and consistent with regulatory guidance.

The Bank timely filed an appeal with the Committee on October 30, 2025. In accordance with the *Guidelines for Appeals of Material Supervisory Determinations* (Guidelines),[2] the Committee has reviewed the Bank's appeal for consistency with the policies, practices, and mission of the FDIC, and the reasonableness of support for the positions of the parties. The Committee met to consider the appeal and hear oral presentations from the parties on December 19, 2025.

III. Parties' Positions

<u>2025 Report</u>

The Bank was assigned a "3" Asset Quality rating due to continued weaknesses in CRE concentration risk management and elevated and increasing adverse classifications. The Report

---

[1] The Federal Financial Institutions Examination Council (FFIEC) Uniform Financial Institutions Rating System (UFIRS) is used by the federal banking agencies to assign a composite rating based on an evaluation and rating of six components of an institution's financial condition and operations. These component factors address the adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity, and the sensitivity to market risk (CAMELS ratings). Evaluations of the components take into consideration the institution's size and sophistication, the nature and complexity of its activities, and its risk profile.

[2] FDIC Guidelines for Appeals of Material Supervisory Determinations.

also cited issues with the Bank's frameworks for credit risk grading and the allowance for credit losses (ACL) methodology, as well as management's failure to periodically provide reporting on large borrowing relationships to their Board.

Bank's Position

Credit Quality

The Bank argues that RMS's focus on metrics, such as the adversely classified item (ACI) ratio and level of past due and nonaccrual loans, when evaluating its credit quality, do not account for the Bank's unique business model and risk management approach. The Bank believes that a collateral risk-based methodology is a more accurate model for assessing risk for its business model. Under this methodology, the Bank models the net liquidation value of individual loans to measure and manage risk.

The Bank states that it protects its loans with collateral that has a liquidation value in excess of the loan principal, which mitigates the Bank's risk. The Bank also utilizes Small Business Administration and U.S. Department of Agriculture loan guarantees for a significant portion of its loans. The Bank asserts that reliance on the FDIC's metrics does not accurately assess risk for its business model and would negatively affect the Bank's customers.

The Bank also points to its historical success of liquidating assets without increased charge-offs as evidence that the gross dollar amount of adversely classified, past due, and nonaccrual loan balances are not accurate indicators of stress or predictors of credit losses. The Bank argues that loan classifications will not affect its ACL or earnings so long as sufficient collateral is present. Moreover, the Bank asserts that vagueness in the Generally Accepted Accounting Principles (GAAP) definition of nonaccrual loans resulted in the Bank placing all of its loans that are 90 days or more past due on nonaccrual status.[3]

CRE Concentration Risk

The Bank argues that the issues related to its CRE concentration risk management framework and the ACL methodology should not adversely impact the Asset Quality rating. The Bank acknowledges that its existing collateral valuation system, based on data from an external data source, has "caused some unreasonable valuation volatility adjustments."[4] The Bank argues, however, that these calculations would not have altered any decisions given its business model

[3] The Bank's appeal also requests that the FDIC modify rules and related interpretations for placing loans on nonaccrual status. Banks are required to prepare and file the Consolidated Report of Condition and Income (Call Report) in accordance with the instructions. The regulatory reporting requirements applicable to the Call Report conform to GAAP as set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification. Regulatory reporting forms and instructions are determined by the FFIEC. Therefore, the Committee's decision does not address this issue, as under the Guidelines the SARC cannot change or modify existing FDIC rules and policies in the manner requested by the Bank.

[4] Appeal to the SARC, page 8 (October 30, 2025).

because management is primarily concerned with assets that may have depreciated in value and may present risk of loss if liquidated.

The Bank argues that expanding stress testing, as requested by the examiners, would be duplicative of existing tests. It also contends that expanded stress testing is unnecessary because the Bank sets capital parameters to trigger corrective action before earnings become an issue. The Bank provided data suggesting that its nonaccrual portfolio would have to grow beyond * * * percent of the total loan portfolio before it ceased to make a profit.

ACL Methodology

The Bank claims its ACL framework does not need to provide for reevaluation of pools on a quarterly basis, where the loan characteristics will not change as loans mature.

For these reasons, the Bank requests that the Committee upgrade the Asset Quality rating to "2."

RMS's Position

Credit Quality

RMS contends that the Bank's increased level, and negative trends, of adversely classified, past due, and nonaccrual loans support the view that the Bank's credit quality has deteriorated since the last examination. Examiners identified an elevated and increasing level of adverse classifications totaling $* * * million, resulting in an ACI coverage ratio of * * * percent, an increase from total adverse classifications of $* * * million and an ACI ratio of * * * percent at the 2023 examination. Further, the volume of other real estate owned increased from $* * * million to $* * * million since the previous examination. Additionally, the ratio of past due and nonaccrual loans increased to * * * percent of gross loans and leases compared to the peer group average of 1.09 percent and 3.23 percent at the previous examination.

CRE Concentration Risk

RMS notes that the Bank's CRE concentration remained significant, with non-owner occupied and total CRE concentrations representing * * * percent and * * * percent of Tier 1 capital and reserves, respectively, compared with * * * percent and * * * percent at the 2023 examination. RMS asserts that weaknesses in the Bank's CRE concentration risk framework must be addressed, though it acknowledges that the Bank has taken various steps to improve its framework since the last examination.

Additional weaknesses in the Bank's CRE concentration risk management framework included the collateral valuation process, stress testing practices (including quantifying the impact to Asset Quality and earnings), and controls. RMS asserts that the Bank's collateral valuation process needs improvement to attain more reliable and realistic valuations. Once the collateral valuation process is updated, calculation errors are remediated, and controls are improved, RMS agrees that stress testing, including the impact on Asset Quality and earnings and the magnitude of

stress, should be revisited to ensure that stress tests are appropriate for the Bank's portfolios and risk.

ACL Methodology

RMS disagrees with the Bank's position that pool migration logic does not apply to its collateral-based loans and asserts that quarterly analyses for the ACL are warranted and consistent with regulatory reporting instructions and accounting standards. RMS points to FASB Accounting Standard Codification Topic 326, Financial Instruments—Credit Losses, which requires that entities measure expected credit losses of financial assets on a collective (pool) basis when similar risk characteristics exist and evaluate whether a financial asset in a pool continues to exhibit similar risk characteristics with other financial assets in the pool to support its conclusion.

For the reasons above, RMS asserts that the "3" Asset Quality rating is appropriately supported by the record.

IV. Committee Findings

Asset Quality Rating Standards

The Asset Quality rating of a bank "reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned, and other assets, as well as off-balance sheet transactions."[5] The Asset Quality of a bank is rated based upon, but not limited to, an assessment of evaluation factors listed in the FDIC Examination Manual.[6]

An Asset Quality rating of "2" indicates "satisfactory asset quality ***and*** credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities."[7]

---

[5] Risk Management Manual of Examination Policies section 1.1-24.

[6] These factors include the adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices; the level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance sheet transactions; the adequacy of the allowance for loan and lease losses and other asset valuation reserves; the credit risk arising from or reduced by off-balance sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit; the diversification and quality of the loan and investment portfolios; the extent of securities underwriting activities and exposure to counter-parties in trading activities; the existence of asset concentrations; the adequacy of loan and investment policies, procedures, and practices; the ability of management to properly administer its assets, including the timely identification and collection of problem assets; the adequacy of internal controls and management information systems; and the volume and nature of credit-documentation exceptions. *Id.* at section 1.1-25.

[7] *Id*. (emphasis added).

An Asset Quality rating of "3" is "assigned when asset quality ***or*** credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level of severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices."[8]

Analysis

The Committee recognizes the improvements the Bank has made since the previous examination to its CRE risk management framework and notes the modest reduction in CRE exposure relative to capital. Notwithstanding these improvements, the Committee finds the Bank's increasing ACI ratio (* * * percent), continued high total CRE exposure (* * * percent), and increasing ratio of past due and nonaccrual loans to gross loans and leases (* * * percent) require an elevated level of supervisory concern. Moreover, the examination identified new weaknesses in the collateral valuation methodology, stress testing, accuracy and execution exceptions, the credit grading system, and board reporting that impede management's ability to effectively manage the Bank's loan portfolio and CRE concentration.

Based on the identified weaknesses in the Bank's asset quality and credit administration practices in a highly concentrated business plan, the Committee finds the "3" Asset Quality rating is appropriate and supported by the record.

V. Conclusion

The Committee is encouraged by the Bank's efforts to address the issues cited in prior Reports of Examination and acknowledges the Bank's progress to improve its CRE risk management. The Committee also reaffirms its view that the FDIC's supervisory approach should be sufficiently flexible to allow banks with unique business models and demonstrated effective risk management practices to serve their customers and communities. However, for the reasons described above, the Committee does not find sufficient evidence to overturn the Asset Quality rating of "3."

By direction of the Supervision Appeals Review Committee of the FDIC, dated February 2, 2026.

---

[8] *Id*. (emphasis added).