

Credit Risk I

Sample Loan Policy Outline

- I. Statement of Mission and Objectives
 - A. Policy Goals
 - 1. External: Serve community needs
 - 2. Internal
 - a. Safe and sound operations
 - b. Earnings performance, liquidity, asset/liability management
 - c. Risk Management
 - d. Desirable Loans
 - e. Undesirable Loans
 - B. Complying with laws and regulations
- II. Geographic Limitations
 - A. Primary trade area
 - B. Secondary trade area
 - C. External or internal restrictions
- III. Confidentiality
- IV. Consumer and Equal Credit Opportunity Laws
- V. Determination of Lending Policy
 - A. Originators
 - 1. Board of directors
 - 2. Chief executive officer
 - 3. Loan committee
 - B. Responsible parties
 - 1. Chief executive officer
 - 2. Senior loan officer
 - 3. Loan committee
 - 4. Loan officers
 - C. Regulatory requirements
 - D. FASB standards
- VI. Administration of Loan Policy
 - A. Director responsibility
 - B. Daily operation by designated parties
 - C. Periodic review and modification, determined by:
 - 1. General economic conditions
 - 2. Money market conditions
 - 3. Bank asset and liability position

- 4. Bank capital structure
 - 5. Variable nature of loan applicants
 - 6. Problem loan reporting system
 - 7. Competition
 - D. Credit Grading System
 - E. Funding procedures
 - F. Monitoring technical exceptions
 - G. Guidelines for maximum maturities
 - H. Outline of loan-to-collateral values
 - I. Problem loan identification
 - J. Acceptable types of loans and purposes
 - K. Exceptions to policy
- VII. Lending Authorities
- A. Delegation of authority by the Board of directors
 - B. Specific dollar amounts delegated to lending personnel by:
 - 1. Title and level of experience
 - 2. Area of responsibility
 - 3. Combination authority by group, such as committee, for larger limits
 - C. Secured and unsecured loans, and overdrafts
 - D. Authorities for branches and other offices
 - E. Maximum loan permissible
 - 1. Relationship to the bank's lending limit
 - 2. Experience of lending staff
 - 3. Corporate objectives
 - 4. Economic conditions and trends
 - F. Minimum loan permissible
- VIII. Loan Committee Organization
- A. Composition
 - B. Frequency of meeting
 - C. Responsibilities
 - D. Loan review procedures
 - E. Relationship to officer support groups
- IX. Lending Staff Capabilities
- A. Relationship to effective operations
 - B. Need for effective communications
 - C. Training program
- X. Credit Analysis Requirements
- A. Customer history vs. noncustomer
 - B. Financial statement evaluation
 - C. Character and management ability

- D. Historical performance with emphasis on established, profitable businesses with proven track records
 - E. Loan-to-collateral value ratios and valuation methods
 - F. Outline of maximum maturities and repayment programs
 - G. Rules on special types of loans
- XI. Credit file maintenance
- A. Importance of records
 - B. Loan applications
 - 1. Nature and history of borrower
 - 2. Purpose of loan
 - 3. Repayment programs
 - 4. Sources of repayment
 - 5. Collateral description and value
 - 6. Loan and deposit summary
 - C. Memoranda by loan officers on individual loans
 - D. Correspondence
 - E. Credit reports
 - F. Appraisals
 - G. Financial statements and analysis
 - H. Note and documents to perfect security interest
 - I. Documentation checklist
 - J. Inspection reports
- XII. Types of High Risk Lending
- A. Capital loans including venture capital
 - B. Newly established businesses
 - C. Loans originating outside the bank's defined trade area
 - D. Loans secured by stocks or bonds in closely-held companies or by non-marketable or restricted stocks
 - E. Low-priced stocks as collateral
 - F. Highly leveraged transactions
 - G. Speculative real estate loans
 - H. Credit lines for new business solicitation
 - I. Bridge loans (in anticipation of a public issue or certain event)
 - J. Loans to enable borrower to speculate on futures in the commodities market
 - K. Loans to undercapitalized businesses
 - L. Loans secured by furniture, fixtures, and leasehold improvements
 - M. Loans secured by household goods such as jewelry, art, guns, or furs
 - N. Non-amortizing term loans
 - O. Loans to individuals of questionable character
 - P. Loans to provide debt service for other credits or taxes
- XIII. Financial Statement Requirements and Evaluations

- XIV. Interest Rates and Pricing
 - A. Interest rate schedule that is influenced by:
 - 1. Cost of funds
 - 2. Loan administration factor
 - 3. Loan loss factor
 - 4. Desired profit margin
 - 5. Market rate risk
 - 6. Bank capitalization
 - 7. Compensating balances
 - B. Minimum and maximum rate limits
 - C. Differentials determined by:
 - 1. Risk
 - 2. Deposit balances
 - 3. Liquidity of collateral
 - 4. Repayment program
 - 5. Labor-intensive monitoring
 - 6. Other considerations

- XV. Collateral margins

- XVI. Appraisal Policy
 - A. Qualifications and independence
 - B. Types or methods used
 - C. Criteria to determine which loans require appraisals
 - D. Requirements of FIRREA and other regulatory guidelines
 - E. Minimum standards
 - F. Review procedures after receipt of the appraisal
 - G. Instruction letters to appraisers

- XVII. Repayment Program and Maximum Terms
 - A. Loan repayment schedules
 - B. Maximum maturity
 - C. Clean-up periods

- XVIII. Credit Line Policy
 - A. Credit lines and “guidance” lines
 - 1. Bank’s policy
 - 2. Method of establishing
 - 3. Duration (maturity)
 - 4. Records and controls over funding
 - 5. Reports for monitoring
 - 6. Loan agreement
 - B. Consumer lines of credit
 - 1. Home equity
 - 2. Personal lines of credit

- XIX. Purchasing Loans
 - A. Loans from other institutions
 - B. Dealer paper
 - C. Underwriting standards and documentation

- XX. Concentrations of Loans
 - A. By type of classification
 - B. By field of business
 - C. By geographical area
 - D. By common source of repayment
 - E. Loan demand and liquidity
 - F. Future outlook

- XXI. Portfolio Mix and Aggregate Percentages
 - A. Guidelines, with aggregate percentages
 - B. Relationship to deposits, capital, and assets

- XXII. Loan Review and Problem Loan Identification
 - A. Loan officers
 - B. Loan committee
 - C. Loan review team or department
 - D. Outside, independent reviews
 - E. Scope, including penetration

- XXIII. Problem Loan Administration and Collection
 - A. Internal system to identify problem loans independently
 - B. Formulate action plans
 - C. Establish responsibility for the workout plan
 - D. Monitoring system
 - E. Risk assessment with appropriate reserves
 - F. Collection procedures
 - G. Charge-off guidelines and recovery procedure
 - H. Early warning signs of a problem loan

- XXIV. Restructured and Renegotiated Loans
 - A. Definitions in concert with federal guidelines
 - B. Monitoring Systems

- XXV. Charge-off and Nonaccrual Policies
 - A. Guidelines for definitions and criteria
 - B. Establish procedures and responsibility
 - C. Follow-up criteria
 - D. Criteria for placing a loan on nonaccrual status
 - E. Guidelines to return a loan to accrual status

XXVI. Reserve for Loan and Lease Losses

- A. Systematic problem loan identification program
- B. Methodology for allocated reserves for classified and problem loans
- C. Methodology for unallocated reserves based on various criteria

XXVII. Capitalization of Interest

XXVIII. Financing Other Real Estate

XXIX. Conflicts of Interest

- A. Maintain objectivity and integrity
- B. Define types of interests
- C. Limitations on gifts or services

XXX. Loans to Employees, Officers, Directors, and Their Related Interests

- A. Define insiders and related interests
- B. Outline permissible loans

XXXI. Miscellaneous

- A. Demand loans
 - 1. Amortization
 - 2. Periodic reviews
- B. Deposit Balance Requirements
 - 1. Method of assessment (gross, collected, net of costs of other services, etc.)
 - 2. Weight given collateral business from borrower
- C. Loans from other institutions
- D. Dealer paper
- E. Underwriting standards and documentation
- F. Other considerations

XXXII. Exceptions to Policy

- A. Tracking system
- B. Reporting program

XXXIII. Monitoring Compliance with Policy

- A. Responsibility of directors
- B. Training program
- C. Audits and reviews

XXXIV. Conclusion