"Double, double toil and trouble; Fire burn, and caldron bubble…"

Will *'Eye of newt, and toe of frog, wool of bat, and tongue of dog,'* be enough to protect today's bankers from the scrutiny of regulators beyond even what William Shakespeare could envision?

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Macbeth never had to face scrutiny like today's beleaguered community banker, but had he toiled under an ever watchful eye like we do today, I am not certain he would have found a way to persist without the aid of the three witches!

Perusals of Regulatory cease and desist orders issued over the previous 12 months shows a wide variety of issues confronting the industry. But none carry so much weight as the effectiveness of the bank's risk assessment program and their ability to apply those risk assessments to their ALLL methodology.

Many banks use outside loan review companies to perform risk assessments of credits on a periodic basis. While this does a good job of identifying the inherent credit and administration risk, in many cases this assessment is too late; the loan has already been made! How do we institute an effective initial risk assessment without adding expensive staff and investing in new software packages?

Once the risk assessment is complete, what do we do with them? Many banks simply file them in the credit file, report the result to the Board, and expect the examiners to be satisfied with our process. In fact, there are many important proactive and defensive uses to which we must put these assessments.

An evaluation of your risk assessment process. Does your credit policy require your line lenders and credit underwriters to accurately assess the risk of a credit before approval? Because the lending officer knows the customer better than anyone else inside or outside of the bank, the initial risk assessment must be performed by the line lender in consultation with the credit underwriter. By using their knowledge and using an objective, simple tool to evaluate the inherent risk in the credit, the bank will be able to assign a consistent risk assessment at origination, while satisfying the Board that loans meeting their credit policy criteria are being booked.

An evaluation of your loan review process. Does your loan review team, whether in-house or outsourced, provide you with the tools needed to measure risk on an ongoing basis? Your loan review team is in place to validate what your line lenders and credit underwriters have already done. The results of their reviews, reported periodically to the Board, should be used to assist management in preparing their analysis of loan and lease losses and ensure your bank is adequately protected against future credit losses.

Much like an internal audit function, the loan review team should act in a proactive, consultative manner, ensuring that policy standards are being applied correctly by the line lenders and credit underwriters and are being communicated effectively through the ALLL process.

An evaluation of your portfolio management. How do your credit managers make use of the information provided to line lenders and credit underwriters each year? Your portfolio analysis must take into consideration the current market conditions, portfolio concentrations, and changes in the performance of the underlying businesses and collateral supporting the loans. Most core processing systems provide ample user fields to track this information allowing management to see changes in the portfolio that may not be uncovered simply through delinquency analysis. This type of analysis allows the bank to take a proactive approach, identifying weakening credits and devising exit strategies that may allow the bank to get out whole.

An evaluation of your ALLL methodology. Many of the current enforcement actions criticize the methodology used by community bank for establishing an adequate allowance for loan and lease losses. Will yours stand up to increased scrutiny? ALLL methodology requires three different sets of analysis: allocation analysis for performing loans, allocation analysis for special identified concentrations, and specific allocations for criticized and classified assets. Each type of analysis is different and must be supported by data ideally from your own portfolio.

CAMELSolutions can help you evaluate your credit administration processes to ensure that the bank is well positioned for its next exam. Our solutions can let your Board rest easy that the risks inherent in the loan portfolio have been identified and properly reserved.

Let us show you that proper loan administration isn't magic…

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