

How to Use This Manual

Your bank's loan review department is uniquely placed to add value to a banking organization in a way that is too rarely utilized. Loan review is a very important source of information. Turning that information into both immediate and long-term value to the bank can be a real challenge. Credit decisions that are sound at the time of origination can be undermined over time by both internal factors within the bank's control and by external factors such as national or local economic or environmental conditions. The *Commercial Loan Review and Audit Manual* is designed to help you identify, monitor, and control risks to reduce commercial loan losses and will enable you to take prompt corrective action before the safety and soundness of the loan portfolio becomes a serious issue. *Commercial Loan Review and Audit Manual* is a comprehensive resource providing effective loan review and credit review processes, complete with checklists, forms, and useful exhibits, to help your loan review department realize its full potential.

This manual and CD help you develop and maintain a comprehensive loan review process — the most effective and reliable tool available for the early identification of risk. This streamlined process will help you to provide candid feedback on the loan portfolio and enables senior management and the board to act on corrective plans before the regulators examine the portfolio and point out exceptions, violations, and other potential problems. This manual will serve as the primary reference for loan officers, internal auditors, compliance officers, management, board members, and particularly members of the audit committee.

BETWEEN THE BANK AND THE REGULATORS

Loan review is also one of the most important interfaces between the bank and the regulatory authorities. If no one is charged with the responsibility of making the regulators understand how the bank's propensity to take on risk is related to the strategic planning process, the allocation of resources, control measures, policies, procedures, staffing, etc., then the bank is taking an unnecessary compliance risk. The risk is one of perception. It does not matter if the bank has strongly upgraded its controls (for regulatory review purposes) unless it is not perceived as having done so. By assigning this function to loan review, the board and other management can hold loan review accountable for the regulators' conclusions about the adequacy of the bank's controls given its level of assumed risk. This also firmly aligns the incentives of loan review in the right direction. If it is accountable to the board for the regulators' conclusions about the loan portion of the risk management system, then there is no influence within the bank (i.e., senior management and line management) that can subvert loan review's goals.

HOW THE MANUAL IS ORGANIZED

Commercial Loan Review and Audit Manual consists of three areas of focus, corporate structure, loan review process, and maximizing the benefits of loan review, divided into 13 chapters.

Corporate Structure

Chapters 1 and 2 deal with the corporate structure that governs approval of policies and procedures and oversees the origination and continued management of loans in the bank's portfolio — in other words, what is supposed to happen and who is responsible. These chapters cover the systems that banks have developed to monitor loans and identify existing or potential risks. The focus is on the role that internal controls, especially loan reviews, play in the risk management process — a process relied upon to ensure the safety and soundness of the bank's commercial loan function. Included are a review of the corporate structures that support this function, and a survey of the laws and regulations that apply to commercial lending and establish the parameters within which commercial lending activities must take place.

Loan Review Process

Chapters 3 through 8A deal with the loan review process. They explain the process of what to do and what to look for and detail a professional's experience with some of the less obvious (but most significant) aspects of the process. The goal is to help you prepare an audit report that provides an independent analysis of a bank's commercial loan portfolio and, at the same time, an objective evaluation of credit administration's performance with respect to the implementation of the bank's internal controls.

Maximizing the Benefits

Chapters 9 through 13 deal with maximizing the benefits of a loan review — the array of potential benefits that arise when the bank closes the gap between its policies and procedures and actual practices. Closing this gap might entail improving internal controls, including MIS reports and other monitoring systems, or realigning policies and procedures with the bank's business strategies, including new products and services. If exceptions or violations are noted in the findings, action plans designed to address them must be developed and implemented within a reasonable timeframe. Changes in the yearly training schedule for loan staff are likely to be indicated. The payoff is that the resulting improvements in policies, procedures, and loan quality will narrow the scope of the bank's next safety and soundness examination. Chapter 12 describes and explains the logic behind Basel IA and II.

If you have questions, would like information on another Sheshunoff product, or would like to share a comment about this manual, please call client services at 1-800-456-2340 or customercare.sis@sheshunoff.com. You may also visit our Web site at www.sheshunoff.com.