

Other Commercial Lending Program

EXAMINATION OBJECTIVES

To determine if policies, practices, procedures, and internal controls regarding commercial loans are adequate.

To determine if lending personnel are operating in conformance with the established guidelines.

To evaluate the commercial loan portfolio for credit quality, collectibility, and sufficiency of collateral.

To determine the adequacy of the audit function(s) in this area.

To determine compliance with applicable laws and regulations.

To initiate corrective action when policies, practices, procedures, or internal controls are deficient or when violations of laws or regulations have been noted.

EXAMINATION PROCEDURES

LEVEL I

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1. Review the commercial lending policies and procedures for adequacy, given the volume and type of lending activity.

2. In conjunction with the regulator(s) performing the review of the audit programs (Sections 350 and 355), review the scope and depth of the work performed by internal and external auditors in the commercial lending area. Obtain a list of any deficiencies noted in the latest review.

3. Review adequacy of management reports to the board of directors to assure that policies and procedures are consistently followed.

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4. Obtain from the examiner assigned Section 201 examination program, Lending Operations and Portfolio Risk Management, the following reports and schedules, if applicable to the commercial loan area:
- Lending and collection policies and procedures.
 - Past due loans.
 - Loans in a nonaccrual status.
 - Loans on which interest is not being collected in accordance with terms of the loan.
 - Loans whose terms have been modified by reduction of interest rate or principal payment, by a deferral of interest or principal, or by other restructuring of repayment terms.
 - Participations purchased and sold.
 - Loans sold in full since the preceding examination.
 - Loan commitments and other contingent liabilities.
 - Loans secured by stock of other depository institutions.
 - Extensions of credit to employees, officers, directors, principal shareholders, and their interests.
 - Extensions of credit to officers, directors, and principal shareholders of other institutions.
 - Miscellaneous loan debit and credit suspense accounts.
 - Loans considered problem loans by management.
 - The current interest-rate structure/loan pricing.
 - Officers' current lending authority.
 - Useful information resulting from the review of minutes of the loan committee.
 - Reports furnished to the loan committee.
 - Reports furnished to the board of directors.

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- Loans classified at the previous examination.
- List of rebooked charged-off loans.
- Nature and extent of loans serviced.

5. Review the preceding report of examination and all commercial lending exceptions noted and determine if the association made the appropriate corrections.

6. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

LEVEL II

1. Reconcile or review the reconciliation of the commercial loan trial balance to the general ledger and review reconciling items for reasonableness.

2. Perform the following using the loan commitment and contingent liability schedule:

- Reconcile appropriate contingency totals to memorandum ledger controls.
 - Review reconciling items for reasonableness.
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3. Using an appropriate sampling technique, select loans for review and transcribe appropriate information to the line sheets, where appropriate, including indication of any past-due, nonaccrual, or problem status. (See [Section 209, Sampling.](#))

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4. Prepare line sheets for any loans not in the sample that, based on information contained in the above schedules, require in-depth review.
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5. Obtain the institution's credit or loan files for all borrowers for whom line sheets were prepared and analyze for credit quality, adequacy of loan and collateral documentation, and compliance with established policies, procedures, and controls. In analyzing the loans, determine and consider the following:

- Analyze the loan for credit quality by determining the adequacy of primary and secondary sources of repayment, including the value, quality, and liquidity of any collateral support. Financial statements from previous and current periods, as well as loan officer memoranda and correspondence, should be analyzed to determine the existence of any unfavorable or adverse trends.
 - The adequacy of any secondary support afforded by guarantors and endorsers.
 - Compliance with established policy and procedures.
 - Compliance with applicable laws and regulations.
 - Loans not supported by current and complete credit information.
 - Loans in which collateral documentation is deficient, including collateral verification and inspection by loan officers.
 - Compliance with provisions of any loan agreements.
 - Whether the original amount of the loan was within the lending officer's authority.
 - Whether the interest rate charged and terms are within the established parameters of the interest-rate schedule and whether loans to affiliated persons of this or other institutions represent preferential treatment or actual or potential conflicts of interest.
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6. For participation loans purchased and sold and loans sold in full since the preceding examination:

- Test participation certificates and records and determine that the parties share in risks and contractual payments on a pro rata basis.
 - Determine that the books and records properly reflect the institution's liability.
 - Determine that the institution exercises controls and procedures over loans sold and loans serviced for others similar to those it exercises for loans in its own portfolio
 - Investigate any loans or participations sold immediately prior to the examination to determine whether any were sold to avoid criticism during the examination.
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7. For loans in the sample, check the central liability file on borrower(s) indebted above the cutoff or borrower(s) displaying credit weaknesses or suspected of having additional liability in other loan areas.

8. Perform the following steps for past-due loans:

- Compare the following and determine any material inconsistencies:
 - The past-due loans provided to the examiners.
 - Delinquency reports submitted to the board.
 - List of loans considered problem loans by management.
 - Delinquency levels provided on reports to the Office of Thrift Supervision.
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9. Determine projected loan growth.

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10. Determine general distributional characteristics of the commercial loan portfolio by:

- Determining percentage of total loans in specific classes.
 - Comparing loan category distributions with policy guidelines.
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11. Compare management's list of problem loans with classified loans to determine management's knowledge of its future problems.

12. Determine the causes of existing problems or weaknesses within the system that present potential for future problems.

13. Determine compliance with laws, rulings, and regulations pertaining to commercial lending.

- Review loans to affiliates with respect to adherence to regulatory requirements, institution procedures, and regional office policy statements.
 - Review loans to affiliated persons with respect to the regulatory limitation of \$100,000 per person (pursuant to 12 USC § 563.43).
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14. Ensure that the Objectives of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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