LOAN REVIEW—GREAT EXPECTATIONS[i]

BY DEV STRISCHEK – PRINCIPAL, DEVON RISK ADVISORY GROUP, LLC

SPONSORED BY DICOM SOFTWARE

INTRODUCTION

Mark Twain observed, "A thing long expected takes the form of the unexpected when at last it comes." For example, the FDIC's regulatory expectations for loan review seem quite expansive and encompassing, especially for an industry concerned about its non-interest expense ratio and the cost of its non-revenue-producing staff. Nevertheless, bankers must figure out how to adhere to the FDIC's guidance on loan review systems, credit risk rating systems, loan review system elements, qualifications of loan review personnel, loan review personnel independence, frequency of reviews, scope of reviews, review of findings and follow-up, and work paper distribution and reporting.

So let's get a sense of what regulators specifically expect loan review to do, and let's start with loan review systems.

LOAN REVIEW SYSTEMS DEFINED

The terms loan review system or credit risk review system refer to the responsibilities assigned to various areas such as credit underwriting, loan administration, problem loan workout, or other areas. Responsibilities may include assigning initial credit grades, ensuring grade changes are made when needed, or compiling information necessary to assess the appropriateness of the ALLL. The complexity and scope of a loan review system will vary based upon an institution's size, type of operations, and management practices. Systems may include components that are independent of the lending function, or may place some reliance on loan officers. Although smaller institutions are not expected to maintain separate loan review departments, it is essential that every institution have an effective loan review system. Regardless of its complexity, an effective loan review system is generally designed to address the following objectives:

- To promptly identify loans with well-defined credit weaknesses so that timely action can be taken to minimize credit loss;
- To provide essential information for determining the relevant trends affecting the collectability of the loan portfolio and isolate potential problem areas;
- To evaluate the activities of lending personnel;
- To assess the adequacy of, and adherence to, loan policies and procedures, and to monitor compliance with relevant laws and regulations;

- To provide the board of directors and senior management with an objective assessment of the overall portfolio quality; and
- To provide management with information related to credit quality that can be used for financial and regulatory reporting purposes.

CHECK OUT YOUR LOAN REVIEW SYSTEM

So does your own loan review system meets these objectives? Here's a handy checklist grid to diagnose your current state, identify objectives that need to be addressed, and set action plans to implement any missing or underperforming objectives:

Objective	Yes/No	If no/who to fix?	Deadline	Update
1-identify weak loans for remediation				
2-provide essential information on trends affecting collectability				
3-evaluation of lending personnel activities				
4-adherence & compliance with policy & regs				
5-assessment of overall portfolio quality to board & management				
6-credit quality info for financial & regulatory purposes				

In future sessions, we will examine more closely these objectives and options for remediating them. Meanwhile, start thinking about what is expected of your loan review system—internal or external—to see if all systems are go. But be careful, as Henry David Thoreau warned, "Lo! Men have become the tools of their tools." Use the checklist grid, but don't get tooled again.

[i] Section 3.2 Loans-FDIC, **https://www.fdic.gov/regulations/safety/manual/section3-2.pdf** (01/11/2020)