Introduction to Loans and Credit Administration

Financial Institution Analysis School

Loan Document
Objectives

• Explain the general lending and repayment process.
• Describe elements of credit administration.
• Highlight the role of management, the Board of Directors and auditors.
• Discuss the role of bank examiners.
Overview

• Credit analysis and Underwriting
• Credit administration
  – Loan documentation
  – On-going monitoring of a borrower
  – Portfolio administration
• Independent credit review and audit
Basic Loan Analysis Questions

• What is the purpose of the loan?
• What has caused the need to borrow?
• Is there sufficient cash flow to service the loan?
• Is collateral value equal to or greater than the loan amount?
• What is known about the customer’s character?
• How will the loan be repaid?
• How should the loan be structured?
The Lending Process

• Preliminary Analysis
  – Customer analysis
  – Borrowing cause

• Repayment Source
  – Risk
  – Financial Statement Analysis
  – Prospects for repayment

• Packaging the Loan
  – Structuring
  – Terms
  – Recommendation to loan committee
Appropriate Loan Structure

- Structure of loan should match use of funds
- Management should assess the financing need
- Common structure weaknesses
  - evergreen loans - WC lines or ST loan which don’t revolve and a renewed anyway
  - WC lines used to finance LT assets
  - Interest only loans which should amortize
Various Loan Types

- Secured/Unsecured
- Fixed/Variable
- Demand
- Time
- Term
- Revolving Line

- Bullet
- Balloon
- Installment

- Mortgage
- Commercial
- SNC
Loan Documentation

• Credit Documents
  – Provide the bank with the information regarding the borrower’s ability to repay the loan and collateral

• Legal Documents
  – Evidence rights and obligations of all parties as well as the borrower’s assignment of collateral
Some Common Documentation Problems in the U.S.

- Poor credit analysis
- Stale or missing financials
- Appraisals lacking
- Unperfected liens
- Expired insurance
- Disorderly files
- Underwriting weaknesses
On-going Monitoring

- Updating financial analysis, loan grades, and reserve requirements
- Monitoring delinquencies & collections
- System to track receipt of financial statements
- Ensure compliance with covenants
- Documentation of phone calls, visits, and correspondence with borrower
Portfolio Administration

• Concentrations of credit
• Trends in overall portfolio quality
  – loan grades
  – delinquencies
• Implementation of loan loss reserve methodology
• Monitoring compliance with loan policy
Roles and Responsibilities of Management and Audit

- The Board of Directors and senior management
  - establish policies and procedures
  - ensure on-going monitoring of individual loans and aggregate portfolio

- Internal and external auditors
  - assess the system of controls and verify controls are followed
Loan Policy Components

- Underwriting Standards
- Lending Authorities
- Credit Terms
- Compliance/Limitations
- Collection Procedures
- Trade Area
- Loan Review
- Allowance Adequacy
- Acceptable Portfolio Mix
Examination Procedures

• Assess the adequacy of the credit administration process and audit thereof
• Select a sampling of credits to test:
  – loan documentation
  – credit monitoring
• Evaluate management’s understanding of the risks inherent in the loan portfolio
Summary

• Loan documentation is a critical aspect of credit risk management
• Loan officers must document on-going monitoring efforts
• Management must understand the risk inherent in the loan portfolio
• Audit should test the system of controls
• Examiners assess the overall credit administration process
Questions???