



TEXAS DEPARTMENT OF BANKING

Bank Name/City

Charter #

Exam Date

Performed By

#15 – Loan Review

Assignment Overview

Every bank, no matter what its size, should have some system of evaluating the quality of its loan portfolio between examinations. The system may range from an internal grading of loans by disinterested loan officers to a full external loan review performed by an outside party. Both may be effective if they have sufficient independence, reliability, and scope. The objective of these procedures is to determine the competence and independence of the loan review function, and to evaluate its effectiveness in providing timely identification of problem loans.

Refer to the FDIC Risk Management Manual of Examination Policies, [Section 3.2 - Loans](#) and the [Interagency Guidance on Credit Risk Review Systems](#) issued May 8, 2020 for additional guidance.

Instructions

IMPORTANT! These procedures are designed to promote critical thinking. Your comments should include what you looked at, what you found, and your conclusions. It is your narrative that should tell the story for a reader who may not be familiar with this bank. The reader/reviewer should have a thorough understanding of what was performed and conclusions made.

Examiners must follow the instructions below and the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations. If there is a conflict between these Instructions and the Examiner Bulletin, the Instructions prevail. Documentation should support weaknesses and criticisms. All examiners performing these procedures must be listed above in the "Prepared By" section.

Examiners are responsible for exercising sound judgment and utilizing reasonable investigative and analytical skills to arrive at an accurate assessment of the risk profile of this segment of the institution's operations.

Evaluation Factors, Risk Guidance, and Comments

The focus of this procedure is to evaluate and address each of the Evaluation Factors. The Risk Guidance is provided to guide the examiner in developing a full and complete analysis for the Evaluation Factor. Documenting responses in the Risk Guidance section is not required. All conclusions should be documented in the Conclusion box for the Evaluation Factor. **Examiners will use their discretion to determine when to comment on a risk guidance item, considering what data or findings merit emphasis and which are secondary or of little importance.** The examiner is expected to write a comment in the Conclusions box that is complete and supportive of findings, recommendations, and ratings. Do not write a comment to refer to the Risk Guidance.

The examiner may also address areas not included in the Risk Guidance section as it is not intended to be all inclusive.

▶ Risk Guidance

*To view the Risk Guidance, click on the arrow to the left of the “Risk Guidance” text.
To Hide the Factors, click on the “arrow” again.*

Documentation

Supporting documentation should include the standard required documents identified in the Reference Documents section for each Evaluation Factor.

- Embedded documents should be named such that the reviewer will know the contents.
- If a required document will not be included for any reason, DO NOT DELETE the document title, instead, check either “Not Included” and add a reason why OR if a document is not applicable, check “N/A”.
- Any other relevant documents may be added to fully support the examiner’s findings. These documents may be embedded in the Reference Documents section.
- If a document needs to be reference in more than one Evaluation Factor comment, include a reference in the comment indicating the Evaluation Factor where the document can be found.

Documentation is to be sufficient to allow an audit trail of the examiner’s thought process and all significant findings.

Violations of Regulations

Violations of regulations should be addressed under the appropriate Evaluation Factor. Indicate compliance using the drop-down box next to the regulation in the Compliance section. Address non-compliance in the Comment section.

Yes = In compliance

No = Not in compliance

Not Applicable = Requirements in the regulation do not apply. For example, if there were no dividends paid, then the regulation related to approval of dividends would reflect “Not Applicable”.

Nonconformance with Policy

Adherence with best practices identified in Department and federal financial regulatory policy/guidance should be addressed under the Comments for the appropriate Evaluation Factor. Indicate if the bank adheres to the best practices using the drop-down box next to the appropriate policy in the Adherence to Policy section. Comments regarding best practices should be summarized in the Summary Comments.

Summary Comments and Conclusions

The Summary Comments and Conclusions should be a high-level summary that highlights the examiner’s material findings and conclusions. A description of what to include in the Summary Comments and Conclusions is provided. These comments are not intended to be a report ready comment and will contain comments that may not be report worthy. Summary comments must support the Summary Rating.

The EIC will determine if the use of bullet points is appropriate for completing the Summary Comments and Conclusions. *The SEIC/EIC will have discretion in determining what is included in the Report of Examination.*

Navigating this Procedure

This procedure can be easily navigated by clicking on View from the Word menu bar then selecting Navigation Pane found in the Show section. All headings in this document will appear on the left side of the screen, for easy navigation through the document.

Performing alternate or expanded procedures not listed with these guidelines may be necessary to complete this risk analysis.

Summary of Findings

Loan Review Summary Comment and Conclusions

Document conclusions regarding the adequacy of the bank's loan review function relative to the size and complexity of the institution. Include recommendations for implementing best practices from policies and management responses to weaknesses. *The SEIC/EIC will determine what to include in the report of examination.*

Summary Rating: [Click Here to Select Rating](#)

Violations

Prepare a comment for any violation cited. Include management's response.

Preliminary Review

Review the following items:

- Examination Scope Memo
- Prior examination Loan Review and ALLL/ ACL/CECL comments
- External/Internal audit findings
- Audit and loan review scope
- Last State examination Loan Review workpapers
- Loan Review Policy
- Board / Loan Committee Reports
 - Problem Loan and Watch List
 - Delinquency and Nonperforming Asset Reports
 - Concentration Reports
 - Modified or Restructured Loan Reports
- Internal/External Loan Review reports
- Significant charge-offs or concentration of charge-offs (by industry or types of borrowers) since the last examination
- Portfolio stress test reports and documentation, if applicable

Loan Review Analysis

EVALUATION FACTOR 1

Review the last examination, internal/external audit, and correspondence for recommendations, violations, Matters Requiring Attention, or regulatory enforcement actions related to the loan review function or the identification or management of problem credits. Determine Board and Management’s efforts and corrective actions to comply with or correct noted deficiencies or concerns

Reference Documents	Conclusions – Evaluation Factor 1
<p>Prior Examination Criticisms, and/or Audit Exceptions</p> <p><input type="checkbox"/> N/A <input type="checkbox"/> Not Included</p> <p>Copy of management response/corrective action</p> <p><input type="checkbox"/> N/A <input type="checkbox"/> Not Included</p> <p>Other Supporting Documents:</p>	

EVALUATION FACTOR 2:**Evaluate the effectiveness of the Loan Review system including the loan review policy, scope, and depth of review.****Risk Guidance**

- 1. Evaluate the loan review policy for appropriateness given the size and complexity of the institution.**
- 2. Determine if the loan review is outsourced or internal, and if it is appropriate for the size and complexity of the institution.**
- 3. Evaluate the adequacy of the loan review scope and frequency. Consider the following:**
 - a. Is the loan review scope appropriate and adjusted as needed for changes in the economy, new business activities, etc.?
 - b. Is the overall loan penetration and sampling method appropriate?
 - c. Who sets and approves the loan review scope?
 - d. Does the frequency of the overall loan review function allow for timely recognition of problem credits?
- 4. Assess if the loan review is adequate to identify material weaknesses in a particular credit. Including but not limited to:**
 - a. Credit quality.
 - b. Adherence to loan covenants.
 - c. Strength provided by guarantors.
 - d. Lien perfection.
 - e. Sufficient credit and collateral documentation
 - f. Loan Committee or Board approval.
 - g. Policy exceptions.
 - h. Appropriateness of credit loss estimation.

Refer to [*Interagency Guidance on Credit Risk Review Systems, May 2020*](#) (FIL-55-2020; SR 20-13)

- 5. Assess if the loan review reports are adequate to convey the conclusions of the work performed.**

Compliance with Regulation	
Interagency Guidelines establishing Standards for Safety and Soundness (12 CFR 364 for state nonmembers; 12 CFR 208 - Regulation H, Appendix-D-1 for member banks).	<i>Select Response</i>
Adherence to Best Practices in Regulatory Guidance/Policies	
Interagency Guidance on Credit Risk Review Systems, May 2020 (FIL-55-2020 ; SR 20-13)	<i>Select Response</i>

Reference Documents	Conclusions – Evaluation Factor 2
<p>Internal Watch List</p> <p><input type="checkbox"/> N/A <input type="checkbox"/> Not Included</p> <p>Loan Review Reports</p> <p><input type="checkbox"/> N/A <input type="checkbox"/> Not Included</p> <p>Other Supporting Documents:</p>	

EVALUATION FACTOR 3

Evaluate the effectiveness of the process for identifying, reporting and managing problem credits.

Risk Guidance

- 1. Assess whether the identification of problem credits is timely.**
- 2. Evaluate if the watch list and/or loan review reports accurately reflect overall loan quality.**
 - a. Were all problem credits properly identified on internal watch lists?
 - b. Consider the number and dollar volume of examiner loan downgrades as compared to the bank watch list or a recent external loan review.
- 3. Evaluate whether problem credits are managed appropriately.**
 - a. Identify the staff responsible for managing the credits. This could be the loan/servicing officer or a different department.
 - b. How effective are collections and problem loan workout procedures?
 - c. How often does the Board or Loan Committee discuss or review problem credits and their workout progress?

Reference Documents	Conclusions – Evaluation Factor 3

EVALUATION FACTOR 4

Evaluate the effectiveness of Board and Loan Committee oversight of the loan review function to ensure that the Board and management appropriately monitors, provides guidance, and follows-up on loan review findings.

Risk Guidance

- 1. Evaluate if Board and/or Loan Committee oversight, monitoring, and follow-up is adequate, considering:**

- a. Who is designated and accountable for changing loan risk ratings based on loan review findings?
- b. Who has the authority to change loan risk ratings and who are these changes reported to?
- c. How are changes reported?
- d. Are management responses to loan review findings appropriate and timely?
- e. Does follow-up on significant findings occur in a timely manner to assess the effectiveness of management's responses?

2. Determine if the Board receives regular and timely loan review reports.

3. Determine if the Board approves changes to the watch list.

4. Determine if it is apparent that the board or designated committee sets plans to address and manage the following:

- a. Problem Assets
- b. Technical exceptions
- c. Loan policy exceptions.

5. Determine if there is an adequate process to approve policy exceptions at the time of origination or renewal.

Reference Documents	Conclusions – Evaluation Factor 4

EVALUATION FACTOR 5

Evaluate the effectiveness of the system of internal controls and the independence of the loan review function.

Risk Guidance

1. Determine if the loan review function is adequately independent from the lending function.

- a. Are loan review staff separate from the lending function?

b. Do loan review personnel report to management that is independent of the lending function or directly to the board?

2. Evaluate the competence and independence of the loan review function in relation to the size and complexity of the institution. Consider the following:

- a. Review staff experience and training.
- b. Duties performed by staff, if internal.

3. Determine if any portion of loan review is outsourced, and if so, consider the following:

- a. Is the outsourced firm independent of the financial statement auditing firm?
- b. If a new firm is engaged, assess their credentials to determine if they possess sufficient experience.
- c. Are linesheets/workpapers available to management?

4. Determine whether loan review reports are submitted to the Board through proper lines.

Reference Documents	Conclusions - Evaluation Factor 5