

Breakout 2: How to Value the Performance of Your Loan Review Department

#BDAudit23

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Assessing the Value of your Loan Review Departments – Best Practices Guide

06/2023



Ardmore Banking Advisors



Background

Ardmore Banking Advisors – Deep Loan Review Expertise

- Ardmore Banking Advisors has performed outsourced and co-sourced loan review services across the US for more than 30 years
- As a full-service credit risk consulting firm, Ardmore assists banks of all sizes in improving their credit risk management processes and practices, including their internal loan or credit review practices
- Ardmore also provides automation tools to the financial market to help create efficiencies and leverage technology to do much of the heavy lifting in the loan review process.
- In the past 30 years Ardmore have worked with more than 150 different banks, and has created an effective and efficient loan review process that meets or exceeds the expectations of regulators and auditors nationwide “The Ardmore Way”.
- Ardmore’s combination of being a provider of high quality outsourced services as well as an industry leading loan review software platform; uniquely positions Ardmore as an expert in the best practices of efficient and effective loan review services





Challenges for Bank Loan Review Departments Today

- Bank boards are concerned about future economic conditions and the impact on loan portfolios, can Loan Review be an effective “early warning system”?
- It is getting harder to find and retain credit risk professionals, particularly Loan Review analysts (few banks have internal track for this)
- A bank’s Loan Review department should be a true third line of defense to protect the bank from credit risk. How can you determine if it is bringing the bank the value it should?
- Remote work lifestyle minimized collaboration, peer exchange interpersonal impact
- Emerging technology support now available for Loan Review Departments
- Growing Regulatory expectations for risk management and Loan Review as banks grow





Bank Loan Review Department Quality Objectives

- Relationship & Communication with other two lines of defense (Credit, the Line)
- Perception of Department Value
- Scope of Commercial Responsibilities/Duties (Internal methodology)
- Department Structure and Leadership (Internal Practices)
- Reporting by Constituency (Findings and Risk Assessment)
- Technology (Loan Review Automation, Credit Administration Tools, File management)
- Consumer Review (Consumer business lines - Fintechs)
- Delivery Models (Internal/3rd Party)



Loan Review Functional (“Loose”) Definition:

OCC Bulletin 2020-50|May 8, 2020, Credit Risk: Interagency Guidance on Credit Risk Review Systems

- May include **qualified** members of the staff, ... who are **independent of the credits being assessed**. ...a credit risk review system may include a dedicated credit risk review function that are **independent of the institution’s lending function**
- ...Some or all of the credit risk review function **may be performed by a qualified third party**
- ...these groups may:
 - administer the internal problem loan reporting process
 - maintain the integrity of the credit risk rating process
 - confirm that timely and appropriate changes are made to risk ratings
 - support the quality of information used to estimate the ACL



Loan Review Functional (“Loose”)Definition:

OCC Bulletin 2020-50|May 8, 2020 Credit Risk: Interagency Guidance on Credit Risk Review Systems

- Promptly **identifies loans with actual and potential credit weaknesses**
- Appropriately **validates and, if necessary, adjusts risk ratings**
- **Identifies relevant trends** that affect the quality of the loan portfolio ...that are potential problem areas
- **Assesses the adequacy of and adherence to internal credit policies** and loan administration
- **Evaluates** the activities of lending...including compliance with lending policies and **the quality of their loan approval, monitoring, and risk assessment.**
- Provides management and the board of directors with **an objective, independent, and timely assessment of the overall quality** of the loan portfolio.
- Provides management with ...**credit quality information for financial and regulatory reporting purposes...as applicable**





Overall Bank Specific Considerations



Bank Loan Review Department Assessment Considerations

- Bank Size
- Loan Review Department Functional Scope
- Penetration Objectives
- Staffing/Outsourcing Model
- Level of Authority
- Bank Credit Culture



Scope of Commercial Responsibilities/Duties (Internal methodology)

- Re-underwriting/Re-Spreading
- Document Review
- Documentation Compliance
- Credit Admin Review
- Level of Analysis/Text
- Policy Exceptions
- Admin/Technical Exceptions
- Covenant Compliance
- Risk Rating Changes



Penetration Goals/Thresholds

- Planned/Targeted Exams by Category
- Risk Based Exams - Concentrations
- Continuous Monitoring – New Loans, Modifications
- Emerging Risk Trends

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- 60% Penetration Goal based on portfolio wide criteria
 - 35 – 40% Penetration Goals – based on risk targeting



Models (Internal/3rd Party)

- All Internal
- All Outsourced
- Hybrid
- Transition
- Cost Considerations





Key Techniques & Issues For Assessment



Typical Value Assessment Techniques (Gathering the data, rating results)

- **Surveys** – Gather data on the perceptions staff have and external stakeholders of performance and value. Identify systemic issues, commonly held beliefs
 - Anonymous Internal Department Staff
 - External Stakeholders (Line of Businesses, other lines of defense)
- **Interviews** – Personal observations, validate conclusions from the survey results
 - Internal Department Staff
 - External Stakeholders (Line of Businesses, other lines of defense)
- **Review of Credit Analysis Quality** – Observe quality and value of borrower/relationship credit review results. Clear, meaningful, substantiated?
- **Review of External Reporting** – Quality, Meaningfulness, Constructive Challenge



Relationship with other two lines of defense (Credit, the Line) and Perception of Value

As determined via interviews and surveys of all stake holders in the process (1st, second lines, loan review staff, business line managers)

- Collaborative
- Challenging
- Conflicts and Surprises
- Constructive Challenges
- Formal/informal – Documentation
- Findings and Follow up
- Importance to the Bank's risk appetite
- Importance to the banks Enterprise Risk Management program



Department Structure and Leadership (Internal Practices)

As determined via interviews and surveys of all stake holders in the process (1st, second lines, loan review staff, business line managers) with particular focus on line of business management and loan review staff

- Proper Skills, Expertise
- Proper Tools, Technology
- Formal Training, Standards
- Department Leadership Roles, opportunities
- Effective Mentoring and Support, Communication



Reporting (Findings and Risk Assessment)

As determined via interviews and surveys with particular focus on line of business management (who receive the findings) credit and risk management and the board. Also critical review of write up contents and exam summary reporting.

- Internal Reporting standards/Line sheets
- External Findings with Business Lines
- Board Reporting, Summaries
- Tracking of Findings
- Leading and lagging Risk Indicators
- Identifying Emerging Risks



Technology (Loan Review Automation, Credit Administration Tools, File management)

As determined via interviews and surveys with particular focus on loan review staff (who perform the analysis and summarize results) and review of available technology, tools and their utilization.

- RM/Lender Use of Tools, Data Ownership
- Loan File automation, standards and practices
- Department accessibility of information and systems
- Workflow Automation/Standardization/QC
- Scoping and Sampling tools
- Summary Reporting



Extra – High Level Consumer Loan Review (Consumer business lines) considerations

- Using similar assessment methodologies as commercial, but with the understanding that Consumer is typically more standardized, more of a validation of polices – less borrower analysis. Management by exception.
 - Validation of Established Practices
 - Validation of Established Policies
 - Specific Skill sets for specific disciplines (Small Business, Credit Card, Risk Based lending)
 - Fintech Challenges and Evolving standards
 - Coverage
 - Reporting





Summary and Wrap Up



Loan Review Needs to be Responsive to Bank's Credit Management's Needs for 2023 and Beyond



- Get real value from your credit review department
- Empower the department to perform true independent risk management
 - Establish staff trained on best practices and processes to perform a meaningful and efficient risk-based Loan Review Exam
 - Enable loan review analysts to create concise and risk-based analysis as opposed to “re-underwriting” the credit in redundant and superfluous detail
 - Generate meaningful statistics and trends from Loan Review exam results that show potential impact on bank and product profitability, bank risk and strategies
 - Provide data from loan reviews that can be used for peer comparisons of performance as well as portfolio budgets and targets
 - Consider using an automated Loan Review toolset that can increase production and consistency of results
- Strengthen the relationship between all three lines of credit defense



Loan Review Needs to be Responsive to Bank's Credit Management's Needs for 2023 and Beyond



- Plan and budget for a loan review effectiveness assessment using either independent internal or 3rd part expert resources
- Conduct a thorough inventory of baseline capabilities, areas working well and opportunities for improvement
- Establish short and long term road maps to reach the goal of raising the value of your Loan Review Department
- Communicate and synchronize the new department goals within the enterprise risk management fabric and risk appetite of your institution



Thank You

For more information or to discuss an assessment, please feel free to contact:

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