

# Other Commercial Lending Program

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## EXAMINATION OBJECTIVES

- To determine if policies, practices, procedures, and internal controls for commercial loans are adequate.
- To determine if lending personnel are operating within 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 there are violations of laws or regulations.

## EXAMINATION PROCEDURES

### LEVEL I

WKP.REF.

1. Review the preceding report of examination and all commercial lending exceptions noted. Determine if management has taken appropriate corrective actions.  

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2. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.  

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3. Coordinate with the examiner performing the procedures in [Section 201, Lending Overview](#), to review the commercial lending policies and procedures for adequacy, given the volume and type of lending activity.  

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4. In conjunction with the examiner(s) performing the review of the audit programs (Sections [350](#) and [355](#)), review the scope and depth of work performed by internal and external auditors in commercial lending. Obtain a list of any deficiencies noted and determine if corrective action was taken.
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5. Review adequacy of management reports to the board of directors applicable to the commercial loan area to assure that association personnel consistently follow policies and procedures.
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6. Obtain from the examiner assigned [Section 201, Lending Overview](#), 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 according to terms of the loan.
  - Loans where the savings association modified the terms by reducing the interest rate or principal payment, by a deferring 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.

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- Extensions of credit to officers, directors, and principal shareholders of other institutions.
- Miscellaneous loan debit and credit suspense accounts.
- Classified and watch list loans and those considered problem loans by management.
- The current interest rate structure and 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.
- Pass loans classified at the previous examination.
- List of previously charged-off loans that have been rebooked.
- Nature and extent of loans serviced.
- Internal credit concentration risk memoranda and analyses.

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

8. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.
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9. Reconcile or review the reconciliation of the commercial loan trial balance to the general ledger, and review reconciling items for reasonableness.
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10. 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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11. Using an appropriate sampling technique, select loans for review.
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12. Obtain the institution's credit or loan files for loans in the sample 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:
- The credit quality. Determine the adequacy of primary and secondary sources of repayment, including the value, quality, and liquidity of any collateral support. Determine the existence of any unfavorable or adverse trends. Analyze financial statements from previous and current periods, as well as loan officer memoranda and correspondence.
  - The adequacy of any secondary support afforded by guarantors and endorsers.
  - Compliance with established policy and procedures.
  - Compliance with applicable laws and regulations.
  - Whether loans are supported by current and complete credit information.
  - Note any loans in which collateral documentation is deficient, including collateral verification and inspection by loan officers.

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- Compliance with provisions of any loan agreements.
  - Whether the original amount of the loan was within the lending officer's authority, internal lending limits, and the association's legal lending limit.
  - Whether the interest rate charged and terms are within the established limits of the interest rate schedule.
  - Whether loans to insiders represent preferential treatment or actual or potential conflicts of interest.
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13. Review participation loans purchased and sold and loans sold in full since the preceding examination:

- Test participation certificates and records to determine if the parties share in risks and contractual payments on a pro rata basis or whether credit support exists which may be deemed recourse.
  - Determine that the association's financial statements and records properly reflect the sales and any related liabilities.
  - 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.
  - Determine that the institution monitors the performance and credit quality of loan participations purchased and risk rates (classifies) them pursuant to OTS and interagency classification policy.
  - Investigate any loans or participations sold immediately before the examination.
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14. Determine if the association sold (or traded) any of the loans to avoid criticism during the examination.

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15. 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.

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16. For past-due loans, compare the following to 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 OTS.
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17. Determine projected loan growth.

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18. Assess the general distribution characteristics of the commercial loan portfolio by performing the following steps:

- Determine the percentage of total loans in specific classes.
  - Compare loan category distributions with policy guidelines.
  - Determine whether the association identifies, monitors, and controls concentration risk.
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19. Compare management's list of problem loans with classified loans to determine management's knowledge of its future problems.

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

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

- Review loans to affiliates and determine if they comply with regulatory requirements and association procedures.
  - Review loans to insiders. Determine if they comply with 12 CFR § 563.43.
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22. Ensure that your review meets the Objectives of this Handbook section. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

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## **EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS**

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