CREDIT RISK
Financial exposure resulting from a bank’s dependence upon another party to keep it whole. It is acquired when bank funds are extended or committed to another party. Must be recognized and evaluated when acquired and priced appropriately.
IMPACT OF CREDIT

• Impacts capital through diminished earnings from increased loan losses
• Increases personnel and legal costs
• Impacts bank’s ability to market new equity or debt issues
• Increases the level of other risks, liquidity, legal, and reputational risk
**MEASUREMENT NEEDS**

- System to measure risk at onset and throughout duration of the loan

- Ability to aggregate customer’s credit risk
CONTROL ELEMENTS

- Policy
- Credit risk evaluated at the outset of the borrower’s ability to repay
- Credit structured so that the purpose of the loan will match the source of repayment
- Secondary sources of repayment are identified
BANK LENDING POLICIES
BANK LENDING POLICIES

• Provides the foundation for sound loan portfolio management

• Basic objectives:
  – Made on a sound and collectible basis
  – Profitable for shareholders and provide protection for depositors
  – Serve the need of the community
LENDING POLICY

- Should contain general outline of scope and allocation of credit
- Broad and not overly restrictive
- Flexible rules
- Provide for presentation of loans staff believes are worthy of consideration which may or may not be in scope of the policy
DEVELOPING THE LENDING POLICY
DEVELOPING THE LENDING POLICY

- Bank’s financial resources
- Personnel
- Facilities
- Future growth potential
COMPONENTS OF A LENDING POLICY
COMPONENTS OF A LENDING POLICY

- Geographic Limits
- Distribution by loan category
- Types of loans
- Maturities
COMPONENTS OF A LENDING POLICY

- Loan Pricing
- Loan-to-Value Ratios
- Financial Information
COMPONENTS OF A LENDING POLICY

- Concentrations
- Loan Authority
- Collections
- Exceptions to the Policy
LOAN PROCESSING
SEQUENCE

• A written application is made
• A credit file is maintained
• Internal risk rating assigned
• Pricing
• Appropriate approval process
• Conforms to established policy and underwriting standards
LOAN ADMINISTRATION PROCESS
LOAN ADMINISTRATION PROCESS

- Policy development, revision and implementation
- Underwriting standards
- Management Information Systems
- Loan approval process
- Credit file requirements
LOAN ADMINISTRATION PROCESS

- Collateral documentation requirements
- Monitoring reports
- Collection guidelines
- Provision for bad loans
INTERNAL LOAN REVIEW
INTERNAL LOAN REVIEW

- Systematic analysis of Portfolio
- Independence
- Qualified personnel
- Depth of reviews
- Review and follow-up