

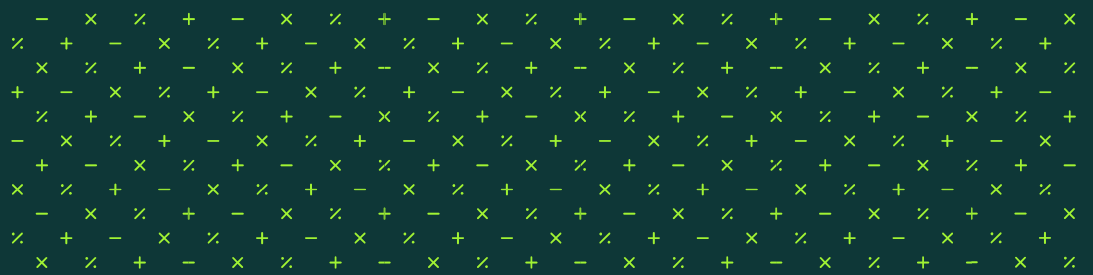
BankDirector

Breakout 2: Strategies for Performing Loan Portfolio Due Diligence

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Strategies for Performing Loan Portfolio Due Diligence

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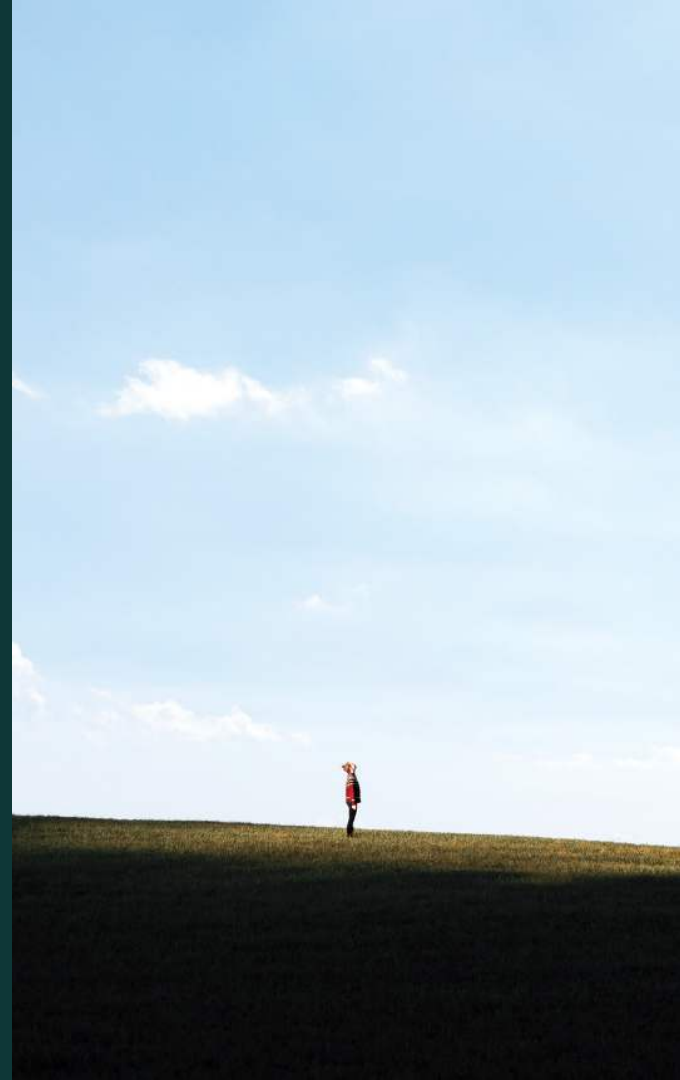
It's critical in today's environment to understand the underlying credit quality and the emerging credit risks related to these transactions.

This session will discuss various factors and strategies to consider to assist in reducing overall credit risk and avoiding the integration pitfalls when acquiring a commercial loan portfolio.



Topics of Discussion

- Preparing for the due diligence engagement
- Asset quality
- Inherent and residual risks
 - Credit policies and procedures
 - Portfolio management
 - Other factors to consider
- Proforma post acquisition



Preparing for the Due Diligence Engagement

READY, SET, GO!

Consider the following areas:

- Experience of staff
- Number of staff involved
- Establish timelines, roles, and responsibilities
- System constraints and availability



Preparing for the Due Diligence Engagement (Cont.)

READY, SET, GO!

- Define scope
 - Asset quality, other nonfinancial impact, and profitability (pricing)
- Be flexible
 - Timelines, scope, sampling methodology, staffing
 - Have a back up plan



Asset Quality

- Pass rated loans versus problem loans
- Past due loans
- Losses, nonaccruals, and other real estate owned
- Collateral and loan types
- Relationship and guarantor-based loans



Asset Quality (Cont.)

- Unique loans and/or industries in the portfolio
 - Do you have the expertise to manage these loans
 - Are there concentration risks within these loan types and industries?
 - Will you divest these loans or grow?
 - How does this impact your regulatory limits?



Inherent and Residual Risks: Credit Policies and Procedures

DO THE POLICIES AND PROCEDURES ALIGN TO YOUR LENDING PRACTICES?

- Review the two financial institutions lending policies and procedures
 - This should include reviewing lending authorities
 - Are there material differences?



Inherent and Residual Risks: Credit Policies and Procedures (Cont.)

DO THE POLICIES AND PROCEDURES ALIGN TO YOUR LENDING PRACTICES?

- What are the impacts?
 - Financial impact
 - Customer impact
 - Reputational impact
 - Regulatory impact



Inherent and Residual Risks: Credit Policies and Procedures (Cont.)

DO THE POLICIES AND PROCEDURES ALIGN TO YOUR LENDING PRACTICES?

- Can it be mitigated or resolved?
 - Update to policies and procedures
 - Controls implemented
 - Financial/cost analysis
 - Legal advice/opinions



Inherent and Residual Risks: Portfolio Management

WHAT ARE THEY DOING TO EFFECTIVELY MANAGE THEIR LOAN PORTFOLIO AND ENSURE ASSET QUALITY IS PRESERVED?

- Obtain and review various reports used to actively monitor their loan portfolio, including board minutes and management meeting minutes
 - Frequency of published reports, contents, who receives these
 - Frequency of meetings and who attends
 - Look for systemic issues and trends
 - Are the tools being used to monitor the loan portfolio accurate?



Inherent and Residual Risks: Portfolio Management (Cont.)

WHAT ARE THEY DOING TO EFFECTIVELY MANAGE THEIR LOAN PORTFOLIO AND ENSURE ASSET QUALITY IS PRESERVED?

- Review tickler reports for past due annual reviews, financial covenants, non-financial reporting requirements (i.e. insurance, property site inspections)
- Review exception reports
 - What types of exceptions are these? Are they excessively aged?



Inherent and Residual Risks: Other Factors to Consider

IS THE RISK WORTH THE VALUE OF THE LOAN PORTFOLIO?

- Asset quality
 - Collateral
 - Loan documentation
- Policy exceptions
 - Look for trends, concentration of policy exceptions



Inherent and Residual Risks – Other Factors to Consider (Cont.)

IS THE RISK WORTH THE VALUE OF THE LOAN PORTFOLIO?

- Conduct stress testing (cash flow, collateral value, and interest rates)
- Analyze interest rates (repricing frequency, fixed vs. variable, what are the variable rates tied to?)
- Assess loan maturity (will there be loan runoffs)



Inherent and Residual Risks: Other Factors to Consider (Cont.)

IS THE RISK WORTH THE VALUE OF THE LOAN PORTFOLIO?

- Assess the collateral type and LTV
- Review current and historical internal/external audits and regulatory issues



Proforma Post Acquisition

THE GOOD, THE BAD, THE UGLY

What do the two financial institutions look like when consolidated?

- Industry concentration
- Single relationship concentration
- Risk rating downgrades and the impact to asset quality



Proforma Post Acquisition (Cont.)

THE GOOD, THE BAD, THE UGLY

- Regulatory challenges
- Balance sheet and income earnings impact
- Are the identified risks within your financial institution's risk tolerance?
 - Can these be mitigated or fixed?
 - Do you have the resources and expertise to make improvements?



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