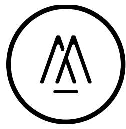

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Manage Your Credit Risk Without Overburdening Your Resources

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Increased labor costs and related challenges such as talent acquisition have affected all industries, including banks. Additionally, banks are facing:

- Potential deteriorating credit quality
- Growth challenges amidst tightening credit standards
- Increased scrutiny from regulators and auditors

Loan origination, portfolio management, and credit quality reviews are key areas to successfully managing an apparently inevitable increase to credit risk.

Prior to any changes in these areas, understanding your bank's risk appetite and credit risk profile is critical. You should also discuss any material changes you plan to implement with your regulatory agencies and board to ensure it doesn't create undue risks.

Loan Origination

Originating new loans doesn't have to be cumbersome and complex for both the bank and the client. The risk and rewards are a delicate balancing act. Not all loans require the same level of due diligence or documentation.

Documentation Requirements and Underwriting Parameters

Banks might want to consider establishing minimum loan documentation requirements and underwriting parameters based on loan amounts. This can put banks at a competitive advantage compared to financial institutions requiring more documentation which can increase the loan processing time.

Centralize the Loan Processing

For less complex and smaller loan amounts, centralizing the loan origination process can create a streamline workflow, potentially helping with consistency and efficiency, allowing less-experienced staff to process loans.

Automation

If your bank has a high volume of loan origination requests, automation may be useful. Consider conducting, or hiring a consultant to complete, a cost-benefit analysis. You may find automation is not only cost-effective but might reduce human errors and improve consistency in credit decisions.

Portfolio Management

Ongoing management of your loan portfolio doesn't have to be time consuming. Not all loans are created equal or create equal risk and ongoing management should correspond to the risk of the loan portfolio. Consider evaluating the frequency of the internal loan reviews based on various risk attributes, including risk ratings, loan amounts, and other financial and non-financial factors.

Annual Internal Credit Review

An annual internal credit review might be all that's necessary for loans that have lower risk attributes, such as:

- Small dollar loan amounts
- Loans secured by readily liquid collateral
- Loans that have strong risk ratings

Conduct Frequent Internal Reviews for Some Loans

A more frequent internal review should be conducted on:

- Larger loan amounts
- Loans in higher risk industries
- Highly leveraged loans
- Marginal performing loans
- Adversely risk rated loans

When completing frequent reviews, focus on key ratios relevant to the borrower, and monitor and identify financial trends. An internal review doesn't necessarily require the same level of analysis as an annual review or effort performed at loan origination.

Payment Performance or Bulk Risk Rating

Payment performance or bulk risk rating could be an alternative for banks who have a high volume of small dollar loans. These types of loans are:

- Low risk

- Monitored through payment performance
- Requiring minimal oversight
- Monitored through frequent reporting

Centralization

Centralization of portfolio management might be appropriate and can create efficiencies, consistencies in evaluation, and can reduce overhead expenses.

Credit Quality Reviews

From small borrowers to national corporate clients, there are many creative ways to achieve loan coverage while having the ability to identify systemic risks. Banks can accomplish this through a risk-based sampling methodology. Rather than reviewing 100 individual loan files, you can come to the same conclusions with the following process.

Multiple Risk Attributes

Focus on selecting credits that have multiple risk attributes, such as*:*

- Borrowers with large loan commitments, high line usage, unsecured or high loan-to-value, adversely risk rated, and high-risk industries
- Select credits with a mix of newly originated and existing loans, new underwriters and relationship managers, various loan commitment sizes, and property types and collateral

Consider credits within the Pass range, but may have marginal debt service coverage ratios—typically the most common multiple risk attributes for identifying risk rating discrepancies—or are highly leveraged, unsecured, or lack guarantor support.

Targeted Review

More targeted reviews can offer additional portfolio coverage. These types of reviews require less time to complete, giving you the ability to also identify systemic trends. Below are some things to consider when selecting a targeted review.

- Select a sample of loans with multiple risk attributes and confirm the risk ratings by reviewing the credit write-up for supporting evidence and analysis
- Complete a targeted review of issues identified in the previous review

For banks that have recently acquired a loan portfolio, review the two banks’ credit policies and procedures and determine where the differences are. Select loans that are outliers from the acquiring banks loan risk appetite—loans that don’t meet the acquiring bank’s risk appetite.

We’re Here to Help

To learn more strategies to manage your credit risk, contact your Moss Adams professional. You can also visit our Banking Services (/industries/financial-services/banks) page.

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