



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS

Loan Scoping Best Practices

A job aid developed by the CSBS State Examiner Review Team

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Introduction

Asset review is a cornerstone of determining an institution's safety and soundness and forms the basis of many conclusions drawn during an examination. Perhaps more than any other component, an institution's asset quality affects nearly all other markers of that institution's performance, both in the long term and short term. Determining an institution's asset quality begins with the development of a reasonable and thoughtful scope for loan review. In 2016, the FDIC, in cooperation with the state banking departments and Federal Reserve released ETS. This job aid was created to encourage state banking department examiners to make the most of ETS when developing a loan review scope and to consider factors which, historically, may not have been considered or possible to consider given the previous software's limitations. Further, this document discourages examiners' sole reliance on traditional scoping criteria such as past due status, size, internally-identified weaknesses, or other similar traditional risk factors. Instead, it encourages the development of a more surgical and creative scope by considering factors specific to the institution in question.

Appropriate uses

This job aid was developed by state examiners to be used by state examiners. It is not meant to replace or circumvent any processes required by a state banking department. Its sole purpose is to improve the loan scoping process by providing a set of considerations and action steps to assist the examiner in forming a comprehensive and thoughtful loan review scope by taking advantage of the enhanced scoping power of ETS. The information within this document should be used at the discretion of each examiner after considering facts and circumstances relevant to the examination.

By using these tools, examiners may be able to create a more thoughtful loan scope that is less focused on meeting a pre-determined penetration ratio and more focused on finding risk. Rather than waiting for problems to emerge to build a scope, the considerations in this job aid aim to help examiners uncover risk sooner. Not only will this lead to a more effective examination, but also a more valuable loan review experience from the institution's perspective.

Tailoring the Loan Scope to Your Institution

Frequently, the standard approach to developing a loan scope involves focusing on the following criteria or some derivation thereof:

- Past due loans greater than \$xxx.xx and xx days
- Nonaccrual loans greater than \$xxx.xx and xx days
- Internal watch list loans greater than \$xxx.xx
- Previously-classified loans greater than \$xxx.xx
- Loans exceeding \$xxx.xx

What frequently happens in this scenario is that examiners spend a majority of their time working loans with known



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problems that have likely been worked many times in past exams. While this approach may generate an acceptable penetration ratio, it may not allow examiners to find risk in other areas of the portfolio.

For example, what if a bank is exhibiting rapid growth in a particular branch, loan type, or by loan officer? Would it not be wise to sample those loans before they become problems? In the past, creating such a sample would involve significant manual effort inside and outside of legacy ALERT. Examiners had tools such as the LPAT reports and the query function, but these tools only generated reports. Examiners then had to take those reports and manually identify loans to include in any specialized sample. With ETS, many of these tools are now fully integrated into the Grid Tools tab:

LPAT and other queries. ETS allows an examiner to generate a LPAT query, standard query, or custom query and view the results in the loan scoping tab. From the Grid Tools tab, the examiner can select the icon labeled **Queries**, the examiner has complete flexibility to add all loans or selected loans to the loan scope. Printing out the report and manually tagging individual loans for scope inclusion is no longer required. What was once a multi-step process, is now much more straightforward.

Generate Sample. In the Grid Tools tab, there is a feature labeled **Generate Sample**. This feature allows an examiner to randomly choose loans from those in the current grid. The examiner can choose (a) number of assets, (b) percentage of assets, or (c) percentage of the adjusted scoping balance. Further, the generate sample process can be applied directly to any existing playlist, allowing for quick, but precise, samples.

Top x% by Loan Type. This feature was built into the Scoping Criteria function in Legacy ALERT. In ETS, it has been moved to the **Queries** icon under the Grid Tools tab. The examiner can access it by selecting: **Queries – Run Query—Other Built-in Queries – Top x% by Loan Type**. This query, like all queries, can be run against any existing playlist.

Search options:

- To find a particular data element (e.g. borrower name, note number, etc.), examiners can type in relevant data column in the first row of the data grid.
- Examiners can also use the built-in filtering capability by hovering on the right-side of any data column and clicking on the pull-down arrow.
- By clicking directly on the column heading, examiners can sort the entire grid by any column in an ascending or descending order.

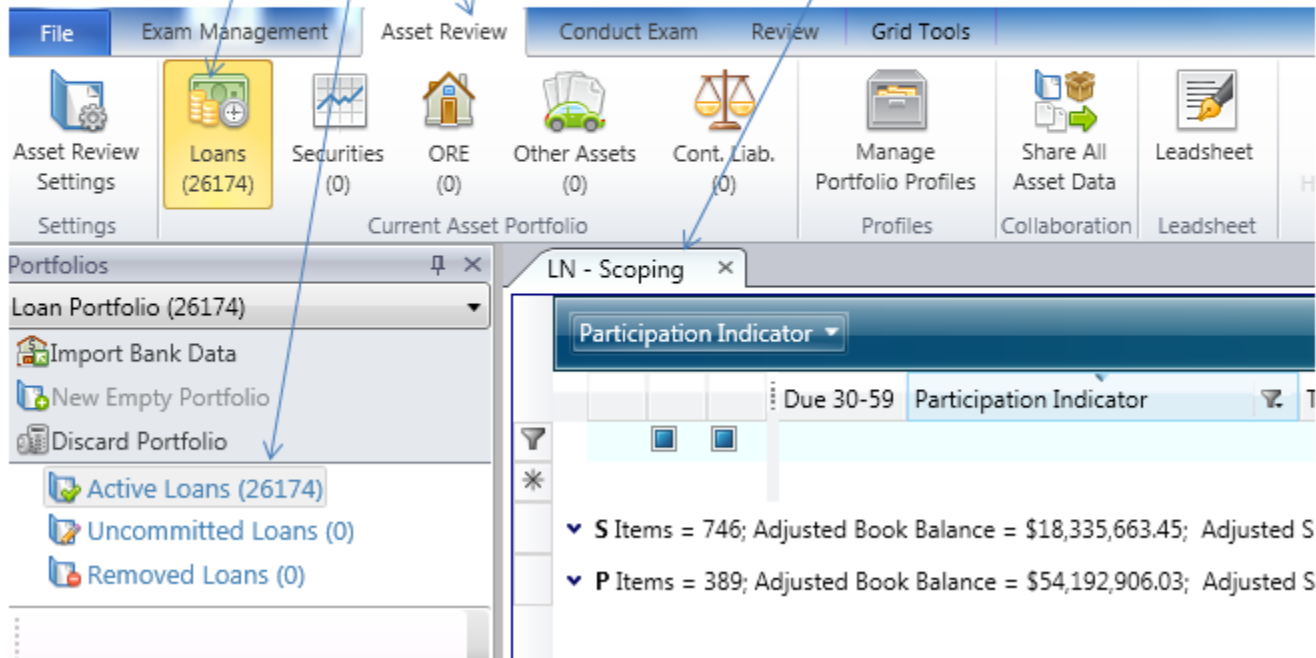
Group by:

Any column in the data grid can be dragged up to the dark blue *grouping bar*. This will group all loans in the data grid by that column's record. For example, by dragging the *Type* column name up to the *grouping bar*, the system will group loans by their loan type and provide a count of loans and total outstanding balance for each group.

The scenarios below are intended to illustrate the concepts needed to develop a targeted scope. Once the process is understood, the process within ETS becomes very straightforward. The scenarios below show potential steps to take in ETS to locate and scope loans relative to the preceding criteria.

The following are directions on how to navigate to the loan scoping area:

1. Click on the *Asset Review* tab
2. Click on the *Loans* icon
3. Double Click on the *“Active Loans”* line, which will open the *LN-Scoping* tab.



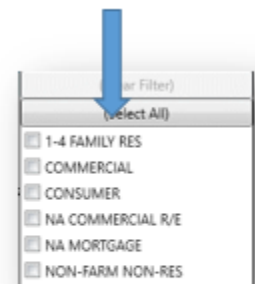
Note: if a column is hidden on the LN-Scoping tab, clicking “Active Loans” will make all columns on the LN-Scoping tab reappear.

Concerns with a particular loan type

- Certain loan types are exhibiting high growth rates on the most-recent UBPR.
- New or unusual lending products are found during a review of loan committee minutes or during discussions with management.
- Given the market area in which the bank operates, the examiner perceives risk in a certain loan type(s).

Find these loans by:

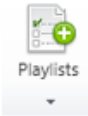
1. Navigate to the *LN-Scoping* tab.
2. Scroll to the *Type* column.
3. Search for the loan types using the filter function on the *Type* column. The filter function can be enabled by selecting the small dropdown arrow that appears when the pointer is on the *Type* column.
4. Use the checkboxes in the filter dropdown to show only selected loan types.
5. Once only the selected loan types are shown in the grid, add loans to a new playlist by selecting *Add to playlist*. The loans can then be added to In Scope or a new playlist as desired.



Concerns with individual loans or relationships

- You notice the borrowers on this exam’s watchlist are significantly different than previous watchlists.
- A review of the bank’s board of director or loan committee minutes reveals frequent mentions of a particular borrower or relationship.
- Loans that were subjected to an impairment analysis, but were deemed not impaired.
- Loan administration weaknesses and/or a high level of technical exceptions cited on certain loans during past examinations.
- Loans that are under consideration for an upgrade. These may be identified through a discussion with management or a review of the loan committee minutes.

Find these loans by:

1. Navigate to the *LN-Scoping* tab.
2. Scroll to the *Short Name* column.
3. Use the search feature in the *Short Name* column to isolate the borrowers in question. By separating names by semicolon, multiple names can be isolated simultaneously.
4. Once the desired borrowers are shown in the grid, select the loans to be added to In Scope or playlist.
5. Use the  button to add the loans to either In Scope or a new playlist.



Concerns with a particular collateral type

- You are aware that, given the institution’s operating market(s), certain types of collateral are common and the

Find these loans by:

1. Navigate to the *LN-Scoping* tab.
2. Scroll to a search field. There are a few fields in the standard data file that may help identify loans with certain collateral type(s). These fields are *FFIEC Code, Type, Collateral Code, and Collateral Description*.
3. Using the search feature in each field, enter search criteria to isolate loans with the collateral types of concern. Alternatively, the filter function may be used.




Concerns with the volume of participation and/or out-of-territory loans

- You would like to identify the volume of participation loans and/or loans made outside the bank's market area.

Find these loans, or the volume of these loans by:

- Navigate to the *LN-Scoping* tab.
- Filter the *Participation Indicator* column to show purchased loans, sold loans, or both. To quickly get the total for each category (sold or purchased) use the *group by* functionality. Select the column heading *Participation Indicator* and drag it to the dark blue grouping bar above the grid. This will group the loans in the grid by their respective indicator in the grouped column and provide a subtotal of the number and amount of loans in each group. Note the highlighted elements below.

Participation Indicator			
	Participation Indicator	Participation Sold	Participation Sold O...
▲ S Items = 6 . Adjusted Book Balance = \$7,848,704.02 . Adjusted Scoping Balance = \$7,848,704.02			
▶	I ✓	\$738,187.79	\$800,000.00
	S	\$478,245.43	\$500,000.00
	S	\$329,290.84	\$1,050,000.00
	S	\$747,254.47	\$800,000.00
	S	\$532,127.26	\$577,500.00
	S	\$636,592.28	\$1,600,000.00
▲ P Items = 5 . Adjusted Book Balance = \$3,176,230.38 . Adjusted Scoping Balance = \$3,176,230.38			
	P	\$401,511.55	
	P	\$967,503.45	\$1,000,000.00
	P	\$479,492.61	\$496,251.71
	P	\$358,392.85	\$372,376.17
	P	\$969,329.92	\$1,012,500.00

- If the volume of participation loans is high, relative to the loans portfolio's size, select specific loans and add them to the scope.
- Use the  button to add the loans to either In Scope or a new playlist.

Note: the same process applies to the Out-of-Territory column.

You would like to determine whether any loans are chronically past due but reported as current in the data.

- Loans that are frequently past due but reported as current may have been manipulated to avoid detection or reporting.
- A high number of such loans may indicate inappropriate use of extensions and/or inaccurate reporting of past due loans.

Find these loans by:

1. Choose a LPAT query by selecting



with all loans displayed in the data grid.

2. Open the LPAT section of the available queries and choose *Current but Chronically Past Due, Renewed, or Extended*. Upon selecting that query, a dialogue box with changeable fields appears.

Current but Chronically PD, Renewed, or Extended

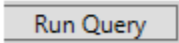
Enter Criteria:

Number of Extensions / Renewals times or more

Times Past Due 30-59 times or more

Times Past Due 60-89 times or more

Times Past Due 90+ times or more

The enter the criteria desired and then select  to run against the loans displayed in the grid.

3. If loans are captured by the query, select any potential loans and use the




button to

add the loans to either In Scope or a new playlist.

Concerns or risk factors relative to the originating officer have been identified

- A particular loan officer has a history of poorly performing loans or poor administration of loans.
- A loan officer unexpectedly left employment with the institution.
- Loan committee minutes frequently mention disagreements with a particular loan officer.
- A loan officer has a history of exceeding his/her lending limit established by the loan policy.

Find these loans by:

1. Navigate to the *LN-Scoping Loans* tab.
2. Scroll to the *Lending Officer* column.
3. Using the filter function, isolate the loans originated by the loan officer in question.
4. Use the  button to add the loans to either In Scope or a new playlist.

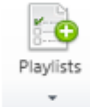
Concern about the level of interest-only loans

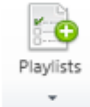
- Amortization schedules appear lengthy.

Find these loans by:

1. Navigate to the LN-*Scoping Loans* tab.
2. These loans may be identified in a number of ways.
 - a. The LPAT query *Lengthy or Negative Amortizations* may identify some loans of concern. Enter the parameters appropriate for the portfolio under review.

Payment Type	#Payments Per Year	Aggregate Book Balance	Number Of Loans	Include
MATURI	<input type="text"/>	\$27,338,472.00	64	<input type="checkbox"/>
MONTHL	<input type="text"/>	\$484,464,489.05	1110	<input type="checkbox"/>
TWICEM	<input type="text"/>	\$128,694.76	1	<input type="checkbox"/>
VARIABL	<input type="text"/>	\$36,497,372.89	59	<input type="checkbox"/>

- b. Alternatively, align the columns *Payment Amount* and *Balance Outstanding* next to one another and search for those with relatively small payment amounts.
3. If loans are captured by the query or otherwise identified, select any potential loans and use the  button to add the loans to either In Scope or a new playlist.



Methods for reducing scope or loan review hours

Because the above procedures will lead to an increase in scope, the ideas presented below are meant to provoke thought on ways to reduce scope and shift examiner resources toward loans with higher potential or unknown risk. While it may seem counterintuitive to remove loans with identified risk from a loan review scope, in many cases the risk has already been accounted for and reported. By limiting review of internally-identified loans by examiners, resources are able to be reallocated to where they are most needed; identifying risk, not validating risk. Limiting these loans from scope may be considered if:

- Management has a proven track record of proactive risk identification
- The examiner is familiar with the loan portfolio, market, and management team
- The level and trend of substandard loans remains stable

While it may be prudent to include loans with identified risk in scope, such loans may warrant only a cursory review.

Regardless of the reason, it is often desirable to limit the review of certain loans or exclude them from the scope altogether. The steps below explain a method of handling qualifying loans and any impact on the loan penetration ratio in ETS.

Consider limiting from scope or perform only a limited review

- Small/medium loans internally rated “Substandard.”
- Large, high-quality, loans reviewed at each examination.
- Severely past-due or nonaccrual loans, either previously identified or internally identified.
- Low-risk, current, but large loans.

Find these loans by:

1. Isolate the desired loans in the data grid using any of the search criteria discussed above.
2. Add the desired loans to In Scope but using the reason of “Do Not Work” or “Perform Collateral Review Only.” By adding these loans to the In Scope playlist, they will be able to be tracked and reviewed if needed. Enabling the lock/unlock functions are useful for ensuring the loans do not get accidentally added to scope during the scoping process.

Note: including these loans in the In Scope playlist will affect the loan penetration ratio. To avoid distorting the LPR, consider adding them to the Discuss Only list instead, which can be excluded from any LPR calculations.