

Business Lending and
Loan Administration
Best Practices

Training Materials Prepared by the :



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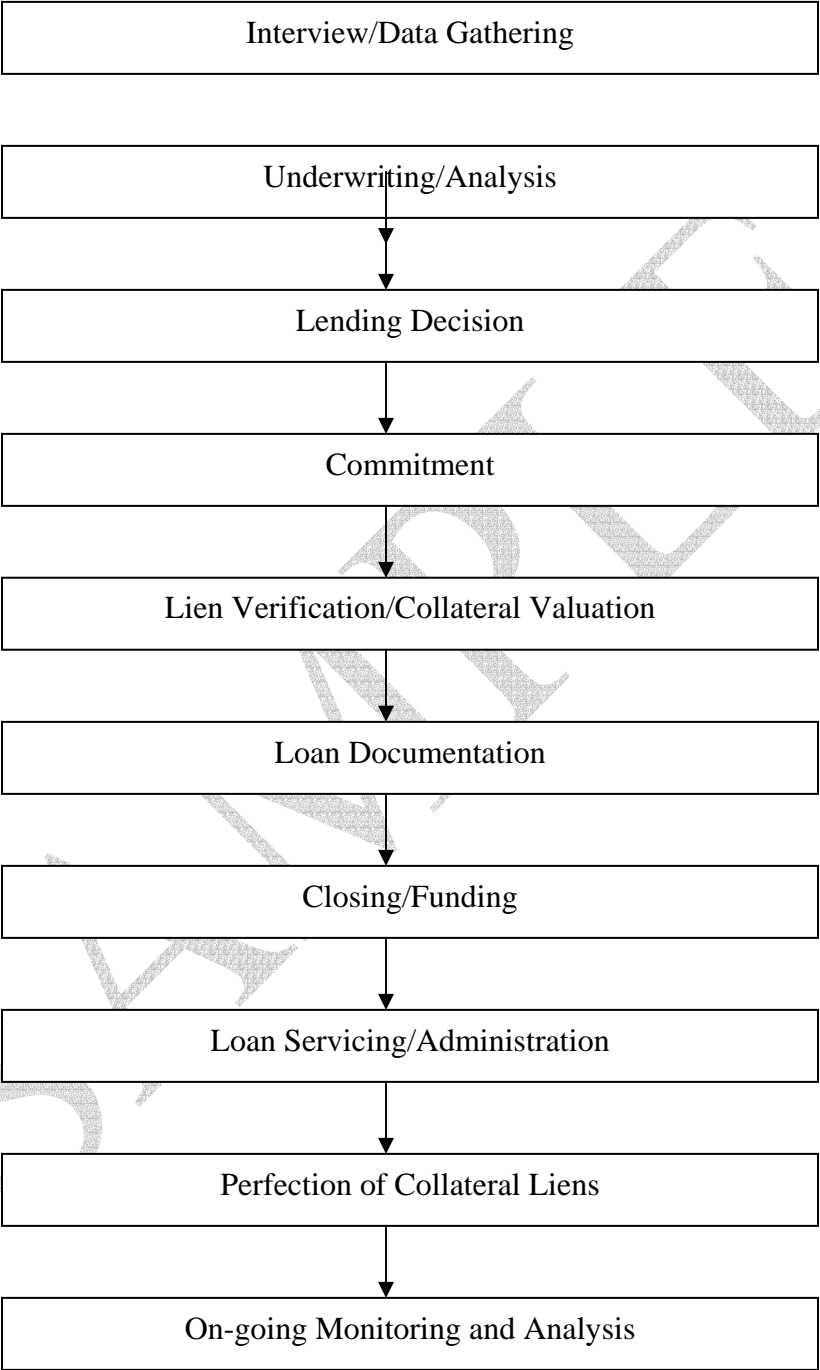
Business Advisory Services

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The following symbol has been placed throughout this manual indicating an area requiring specific monitoring mechanisms put into place.

The Small Business Lending Process



- √ Portfolio Monitoring
- Compliance with Regulations

Regulatory Requirements

NCUA Regulation 723- governs member business lending activities. The highlights of the regulation include:

- Board must adopt a MBL policy
- 2 years minimum MBL experience requirement
- Loans for business purposes less than \$50,000 individually or in the aggregate for business purposes to one individual, entity or related or affiliated individuals or entities are not business loans
- Loan portfolio monitoring requirements
- Evaluation of financial statement requirements

A copy of the regulation is contained in Addendum A.

NCUA Regulation 701-governs loan term or maturity limits.

Etc.....

SAMPLE

Signatures: The signature block on every document should clearly indicate three facts: (1) what individual or entity is responsible, (2) the correct name of individual(s) acting on behalf of the entity and (3) in what capacity, if any, the signer(s) is/are executing the document.

The use of the term “by” preceding the signature line normally denotes that the signer is executing the document in a representative capacity rather than an individual capacity. Therefore, the signer would not be personally liable, but rather the entity that the signer represents would be.

The following are examples of properly constructed signature blocks: (s/ = signature line)

In the case of a sole proprietor:

s/ Harry A. Hendricks

In the case of a sole proprietor using a trade name:

s/ Harry A. Hendricks

d/b/a Harry’s Auto Repair

In the case of a general partnership:

CAB Enterprises, A Partnership

By: s/ Harry A. Hendricks, General Partner

By: s/ Jim W. Miller, Partner

In the case of a limited partnership:

CAB Enterprises, LP

By: s/ Harry A. Hendricks, General Partner

By: s/ Jim W. Miller, Partner

In the case of a limited liability partnership:

CAB Enterprises, LLP

By: s/ Harry A. Hendricks, Partner

By: s/ Jim W. Miller, Partner

In the case of a corporation:

CAB Corporation

By: s/ Harry A. Hendricks, President

By: s/ Jim W. Miller, Treasurer

Etc.....

Origination or Application Documents

There are numerous documents required to support a business lending program. At a minimum, you'll need to create or obtain the following:

- Business Loan Application
- Personal Financial Statement
- Three years of Business Financial Statements and/or Tax Returns
- Three years of Personal Tax Returns
- Business Debt Schedule
- Environmental Assessment Form
- Rental Property Questionnaire
- Declination Letter

Depending on your product offerings and your target market, you may also need to obtain some of the following:

- Business Credit Card Application (If applicable)
- Questionnaire for Religious Organizations

√ Portfolio Monitoring

- Exceptions to Policy or Guidelines
- Pipeline Management-
 - Applications in Process

Assignments of Life Insurance Policies are used to place a lien against the cash value of a borrower's life insurance policy. The following things should be considered when dealing with assignments of life insurance.

√ Portfolio Monitoring

- Outstanding Document Monitoring and Reporting

1. The insurance carrier must acknowledge your lien. (The form must be sent to the carrier for signature and stamp and then returned to CU).

Etc....

SAMPLE

Loan Participations

Loan Participations result when the lead or originating credit union sells off a portion of a loan to one or more other credit unions. You could be the originating credit union, the seller, or the purchaser or buyer of a part of a loan. Unlike consumer loans that typically sold in bulk, MBL's are typically sold and marketed on a loan-by-loan basis.

- √ Portfolio Monitoring
 - Seller can perform:
 - Gross, Sold, Net Accounting
 - Complicated Loan Servicing
 - One monthly invoice to borrower
 - Automatic division of pro rata share of payment

Policy Requirements and Due Diligence:

NCUA requires that your lending policy address participation loan purchases and sales. Part of this documentation must include minimum due diligence requirements when considering acquisition of a participation loan interest. That is because purchasing a participation interest is not without risk. In fact, you may bear a larger risk of loss (in terms of dollars) than the originating credit union. It is suggested that you perform the same level of credit analysis and use the same processes as if the loan were originated by your credit union. This includes gathering (if you're the purchaser) or supplying (if you're the seller) copies of: the original complete credit memorandum and supporting statement spreads; copies of the original financial data, including the application, tax returns and/or financial statements, credit bureau reports and any other data used to complete the credit memorandum.

Etc....

Booking, Coding and Servicing

A greater number of individual items are tracked on a business loan than on a consumer loan. In order for detailed report generation and specific portfolio management, consistent and detailed booking and coding procedures are necessary. Once a loan is funded, they should be promptly encoded or booking into your (or an) accounting or servicing platform. Because of the level of detail, this is typically not an automated process.

At a minimum, the following items should be coded on an individual basis for better total portfolio management. In addition, to coding the items, processes will need to be put into place regarding those items that change annually or at some other frequency. These are some of the fields coded on business loans:

- NAICS Code (North American Industrial Classification System/ formerly SIC code) (See Page 36 for additional details)
 - May be as few as 3 digits or as many as 6 digits depending on the level of detail desired
- Financial Statement Expiration Date or Periodic or Annual Review Date
 - If possible this should also include the type of financial statements required annually
 - This encoded date will likely change annually

Etc.....

Consider your desired output when deciding on coding keys and sorting options for reporting purposes.

- | |
|--|
| <ul style="list-style-type: none">√ Portfolio Monitoring<ul style="list-style-type: none">• For best results consider one central repository to capture all data |
|--|

Business Loan File Organization

Loan documentation is an important contribution in the development of a quality loan portfolio. Loan documentation can generally be classified into two types; credit documentation which provides financial and other data which is utilized to support the credit decision and the credit quality; and collateral documentation which provides the negotiable instruments which substantiate the loan as well as the collateral behind the loan. Because these are two distinct types of documentation, two separate and distinct types of files for each commercial loan/relationship should be maintained; a credit file and a collateral file(s).

Credit File

It is the CU's full responsibility to support all loans with complete and well-organized credit files. The content of the credit file will vary depending upon varying factors such as size, complexity and nature of the loan but should always adhere to standards as set forth by NCUA Regulations 723. The CU should at all times maintain sufficient information to fully substantiate the loan.

Etc....

√ Portfolio Monitoring

- Tickler or process to track outstanding documents
- Tickler tracking expiration of insurance policies
- Expiration of UCC-1's

Collateral File

It is the CU's full responsibility to support all loans with complete and well-organized collateral files. The content of the collateral file will vary depending upon varying factors such as size, complexity and nature of the loan and should always support safe and sound practices. The collateral file may contain the following:

Use of a collateral file checklist similar to the one found below is recommended:

Another important aspect of loan file documentation is to track and report documentation and policy exceptions on a routine basis.

Etc....

√ Portfolio Monitoring

- Exception tracking
 - Per Loan
 - Per Loan Officer
- Exception reporting
 - Per Loan
 - Per Loan Officer

Managing the Pipeline

Effective management of business loan pipeline is essential to Asset and Liability Management (ALM) and loan officer productivity and accountability. It is essential that you develop some kind of process to manage and track loan requests through the various stages of the lending process. Additionally, consideration should be given to establishing an incentive program for your lenders to facilitate prompt customer service and loan volumes.

Stage of New Loan Requests on a Per Loan Officer Basis-

- Prospects
 - Number of
 - Frequency of contact with
- Applications in Process
 - Number of
 - Requested Loan Amount
 - New Money or Refinance

- √ Portfolio Monitoring
 - ALM Management
 - Loan Officer Productivity
 - Loan Officer Accountability

Etc.....

Early Warning Signs of Problem Loans

The reasons for the deterioration in a business borrower's ability to repay are numerous and widely varied. Common causes are poor or inappropriate financial management, change in management or loss of key employees, swift changes in local, regional or national economy, regulatory changes, rapid unmanaged growth, expansion in a new or unknown market and the loss of a key client.

The key to successful problem loan management and loss mitigation is early detection. Long before loans become delinquent, any number of the following are usually evident:

- Delinquency
- Declining deposit account balances
- NSF's or returned items occur on depository accounts

Etc.....

When one or more of the early warning signs are present take these additional steps toward loan loss mitigation:

- Pull Credit File
 - Review loan documentation
- Meet with Borrower

Etc.....

- √ Portfolio Monitoring
 - Policies and Procedures Manuals
 - Internal controls
 - Account Opening Procedures
 - On-going Transaction Based Procedures
 - Risk Mitigation-Quality Control

Commercial Credit Information Exchange

In the normal course of business, your member businesses seek credit from their suppliers and vendors as well as other financial institutions and credit providers. These other credit providers, suppliers and vendors often conduct commercial credit inquiries. Answering incorrectly or in a misleading manner can cause legal ramifications for your credit union. We recommend that you implement and follow the “Code of Ethics for the Exchange of Commercial Credit Information Between Banks” published by Risk Management Associates (RMA), formerly Robert Morris Associates.

Segregation of Duties

It is recommended that in all phases of providing business services, the duties be segregated or separated to prevent errors and internal misrepresentations and to provide the necessary checks and balances.

Recommendations:

- It is strongly suggested that those responsible for interviewing new members not be given the responsibility of placing or “boarding” the new account information on the core processing system.

Etc.....

- √ Portfolio Monitoring
 - Policies and Procedures Manuals
 - Internal controls
 - Account Opening Procedures
 - On-going Transaction Based Procedures
 - Risk Mitigation-Quality Control

FAQs

(As contained on CUNA's website)

Q: What information has to be reported to regulators about a credit union's business loans?

A: NCUA requires every federally insured credit union engaged in member business lending to maintain separate data on member business loans in its records and in the aggregate in its financial reports (Section 723.19 of NCUA's regulations).

NCUA has extensively revised the information that has to be provided in Schedule B of the quarterly call report for credit unions with more than \$10 million in total assets, because of changes to the member business loan (MBL) regulation made last year. Credit unions must report the number of MBLs outstanding at the credit union (and remember, some business loans aren't covered by the definition of "MBL"), and report aggregate amount of net member business loan balances (NMBLB). Credit unions must separately report the number and amount outstanding of all purchased nonmember business loans or participation interests. Credit unions must also report information on the number and amount of loans granted or purchased year-to-date.

NMBLB, a new concept in the MBL rules, means the outstanding loan balance plus any unfunded commitment, reduced by any portion of the loan that is: Secured by shares or deposits in the credit union or other financial institutions; secured by a lien on the member's primary residence; insured or guaranteed by any agency of the federal, state or local government; subject to an advance commitment to purchase by any government agency; or sold as a participation interest without recourse and qualifying for sales accounting under generally accepted accounting principles (GAAP).

NCUA also wants more detailed breakdown of information on certain types of business loans (whether made to members or nonmembers). Credit unions are required to report the total number and NMBLB amounts for the following:

Construction and development loans, excluding any loans made to finance the construction of a single-family residence if the prospective homeowner has contracted to purchase the property, as well as excluding one loan to finance the construction of a single-family residence per member-borrower (or group of associated member-borrowers) where there is no purchase contract.

Unsecured business loans, excluding credit card line of credit programs typically offered to businesses as well as unfunded commitments for unsecured business loans.

Purchased business loans or participation interests of loans made by other lenders to people who are members of the credit union. (Such loans count against the credit union's MBL lending cap, while purchased loans of nonmembers do not count.)

Agricultural related business loans.

Etc....