Abstract

The object of this project was to design and implement an automated system for managing a bank's commercial loan portfolio. The system creates and maintains a database to provide a framework for gathering and utilizing information. It provides analysis and comparison across and within the portfolio. The system is menu driven and provides on-line updating as well as inquiries and extensive report generation. This sensitive asset management system (SAMS) facilitates a bank's management of problem loans.
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Mr. Teafatiller's Original Document  
Banking Bulletin BB 93 - 60  
Installation Guide  
User's Guide  
Description of Linkage  
Description of Database Elements  
Test Data  
Source Code
Acknowledgments

I would like to thank Mr. Benny H. Teafatiller (Certified National Bank Examiner) - Field Manager of the Corpus Christi Duty Station of the Office of the Comptroller of the Currency. His concept of essential loan documentation prompted the development of SAMS. Mr. Teafatiller's original document which identified essential loan information can be found in appendix A.
June 29, 1995

Mr. Dave Swickheimer  
244 North San Patricio  
Goliad, Texas  77963

Dear Mr. Swickheimer:

The staff of the Loan Administration Department at the bank are pleased to inform you that the SAMS software installation went smoothly and the program is up and running. We were able to work through the program successfully by utilizing the User Guide instructions and were very pleased to note that the program contained a user computer interface.

We are planning to incorporate the use of this software into the Loan Administration Department at the bank. If possible we would like to request that you program in two enhancements which are as follows:

- Enhance software to operate in a Windows Environment.
- Expand and increase the number of files which can be utilized in the program. Current number is forty (40), minimum requirement would be eighty (80).

Thank you for allowing the First National Bank of Goliad to participate in the utilization and evaluation of the SAMS software.

Sincerely,

Clark W. Bierschwale, Sr.  
Executive Vice President/  
Senior Lending Officer

CWB/mh
Terminology
Description of Terminology

Within the banking industry are many technical words and phrases that have evolved special meaning:

**potential credit weakness** - a loan that may cause a loss to the bank.

**collectibility of the portfolio** - if the bank forecloses a loan, the assets sold by the bank may not be sufficient to cover the balance of the loan.

**evaluate the activities of the lending personnel** - determine the competency of the loan officers.

**formal credit grading system** - either the one to five scale used by examiners or the one to nine scale in which the first four classes used by bankers are consolidated into a 'pass' category. The five categories are:

- Pass
- Special Mention
- Substandard
- Doubtful
- Loss

**ALLL** - Allowance for Loan and Lease Losses - the amount of money set aside to cover the loan in case of default.
OAEM - Other assets especially mentioned - If a loan defaults the bank reserves the right to attach other assets of the borrower. These other assets are noted for special consideration.
Introduction
Within the banking industry, the administration, analysis, and servicing of commercial loans is a demanding and rewarding activity. Commercial lending can account for the lion's share of the profit generated by a bank. For example, an average commercial loan can generate more profit to the bank than 1000 consumer loans. Likewise, one bad commercial loan can negatively impact the bank's annual profit and, in some cases, affect profits for more than one year. Within the last six years the banking industry has been racked with scandal and charges of mismanagement. There have been over 400 bank failures in the last six years. The federal government has spent many millions and continues to spend millions to protect the assets of the depositors. While the exact reason of these bank failures may be hard to pinpoint, the causes range from incompetence, dishonesty and changes in government policy, to changes in the tax credit laws and emphasis on deregulation. It is generally felt that the overwhelming cause is overextension of credit to commercial borrowers, that is to say, the default of commercial loans. Bankers of today realize that one of the most sensitive areas of management and concern is the commercial loan portfolio.

The federal regulatory authorities have by necessity devoted more and more of their regulatory authority to a review of commercial lending. Recent changes in the law have strengthened the authority, discretion, and civil money penalties that the Office of the Comptroller of the Currency (OCC) can impose on banks. The Banking Bulletin (BB) 93-60 (Appendix B) issued by Chief National Bank Examiner Donald G. Coonley of the OCC dated December 21, 1993 and
issued to "all chief executive officers of all national banks and all examining personnel" starting on page 12 states:

"an effective loan review system should have the following objectives:

- to promptly identify loans having potential credit weaknesses

- to project relevant trends that affect the collectibility of the portfolio

- to provide essential information to determine the adequacy of the ALLL

- to evaluate the activities of lending personnel

each institution should ensure that its loan review system includes the following attributes:

- a formal credit grading system that can be reconciled with the framework used by the federal regulatory agencies

- an identification or grouping of loans that warrant the special attention of management
a mechanism for direct, periodic and timely reporting to senior management and the board of directors on the status of loans identified as merit[ing] special attention"

All national banks are expected to carry out the directives of BB 93-60. A commercial loan always has voluminous documentation. The documentation may include yearly profit and loss statements, tax receipts, tax returns, appraisals and environmental impact statements. A metropolitan bank may easily have 1000 commercial loans. The loan department manager according to BB 93-60 must "promptly identify ... credit weakness". The task mandated by BB 93-60 is overwhelming without an organizing framework and automated computer system.

Banks pay a fee to be examined. If the examination process can be shortened, banks save money.

National banks are examined by agents of the federal government under the direction of the Office of the Comptroller of the Currency. The local duty station in Corpus Christi reports to the Houston field office which in turn reports to the federal reserve bank in Dallas. There are eight federal reserve banks in the nation. The Corpus Christi duty station has responsibility for all South Texas national banks. The duty station in Austin governs all Central Texas national banks.

The local duty station determines the date of the examination and through correspondence informs the bank of the proposed examination date. They request numerous standard reports such as the Call report and audit report. They also call for special reporting requirements that they deem necessary at that time. The examination
process covers many wide-ranging aspects of the bank's operations from compliance to safety and soundness. Examiners have recently begun to focus in the areas of adequacy of load loss reserves, the commercial loan portfolio, and management of the bank.

A bank makes numerous kinds of loans such as consumer, automobile, real estate, agricultural, and commercial. Certain kinds of loans such as automobile, single family detached dwelling, and consumer loans are very standard. On the other hand commercial loans are very non-standard.

Commercial loans often have:

- specialized collateral for which it is difficult to determine market value
- variant cash flow requirements
- involved partnership arrangements with partners of varying financial strength
- high one-time capital improvement expenses
- varying accounts receivable/accounts payable plans

The thickness of a commercial loan documentation can vary from one inch to an entire file cabinet drawer. The examiner must laboriously review the loan documentation and determine a loan grade. When the examiners conclude the examination, they receive a cashiers check from the bank for the time spent examining the bank. Any effort or automated computer process which would speed up the examining process would save the bank considerable money.

For example: if the bank examiner spends six hours reviewing one loan, the bank is 'charged' for six hours of his/her time. If the pertinent information could be condensed to a single five page
document, the review process could be reduced from several hours to one hour and thus save the bank considerable money.