## STANDARDS OF SOUND BUSINESS AND FINANCIAL PRACTICES

DICO BY-LAW No. 5

Assessment Workbook Module: Commercial Lending

February 2005

## 3. Credit Risk Management: Commercial Lending

It is a sound business and financial practice for a member institution to have appropriate and prudent policies, procedures and controls to manage the onand off-balance sheet credit risk of the institution.

The fundamental elements of credit risk management include implementing a policy that addresses:

- authorized types and classes of credit instruments
- limits or prohibitions on credit exposures including concentration
- assessment criteria and security requirements for each authorized credit instrument
- an effective credit assessment and monitoring system
- defined and prudent levels of decision-making authority for approving credit exposures
- management of delinquent and impaired loans

Element	Assessment Criteria	Yes	C.U. Reference	DICO References
1. authorized types and	All the types and classes of authorized credit instruments are			
classes of credit instruments	included in the policy and procedures.			RM Sec.5202
	Commercial credit instruments typically include:			
	Commercial Mortgages			-
	Commercial Term Loans			-
	Operating Lines of Credit			_
	Construction Mortgages			
	Letters of Credit and Guarantees			-
	Mortgage Rental Properties in Excess of 4 units			-
	Policy and procedures appropriately address:			-
	<ul> <li>the terms and conditions of the facilities</li> </ul>			-
	eligible loan purposes			-
	amortization periods as appropriate			
Comments and/or exception	ons:			L

Element	Assessment Criteria	Yes	C.U. Reference	DICO References
2. limits or prohibitions on credit exposures including concentration	Appropriate and prudent limits or prohibitions on credit exposures should be established. These should include limits on:			RM Sec.5203, 5204,5205
	<ul> <li>loans in aggregate to any one borrower or group of associated borrowers (connected persons)</li> <li>the maximum size of a single loan by type</li> <li>loans in aggregate for each loan type</li> <li>loans, in aggregate, of large loans (as defined)</li> <li>aggregate loans by industry/sub industry</li> <li>loans concentrated within a particular region</li> <li>aggregate total commercial loans</li> <li>benchmarks for targeted high risk credit levels</li> </ul>			
Comments and/or exception	DS:			

Element	Assessment Criteria	Yes	C.U. Reference	DICO References
3. assessment criteria and	Appropriate and prudent assessment criteria and security			
security requirements for	requirements have been established, including:			RM
each authorized credit				Sec.5202,5504
instrument	<ul> <li>maximum debt coverage limits</li> </ul>			RM Sec.5505
	<ul> <li>minimum security margins for each type of security</li> </ul>			RM Sec.
	<ul> <li>minimum loan and security documentation required to</li> </ul>			5502,5503
	support the loan application			
	<ul> <li>the process for security valuation, registration,</li> </ul>		<u> </u>	
	insurance and renewal			
	appraisal and environment report for real estate loans			
	<ul> <li>loan agreement and/or loan commitment letter</li> </ul>			
Comments and/or exception	ns:			

Element	Assessment Criteria	Yes	C.U. Reference	DICO References
4 an effective credit assessment and monitoring system	<ul> <li>An effective credit assessment system has been established which includes:</li> <li>use of a commercial loan checklist outlining required steps in the application, approval, security and disbursement process</li> <li>standardized processes for each loan type</li> <li>investigation of borrower/guarantor information appropriate for the type, size and nature of the loan, including: <ul> <li>Financial statements (3 – 5 years)</li> <li>Business registration/incorporation documents</li> <li>Borrowing Resolutions and authorities</li> <li>Credit Bureau Reports</li> <li>Management Expertise</li> <li>Net worth of personal guarantors</li> <li>Business Insurance</li> <li>Capital protection or succession plan</li> </ul> </li> </ul>			RM Sec.5207, 5208 RM Sec. 5504 RM Sec.5506
	<ul> <li>which includes:</li> <li>a risk rating/risk rating trend of all commercial loans: <ul> <li>when approved</li> <li>annually when reviewed</li> <li>when risk materially declines</li> </ul> </li> <li>timely reviews of all commercial loans</li> <li>regular and timely confirmation of operating assets and liabilities (e.g. receivables, payables, inventory, etc.)</li> <li>interim financial results</li> <li>rent and tenant rolls</li> <li>tax and insurance payments</li> <li>project status/real estate sales</li> <li>regular exception reports</li> <li>identification of higher risk or "watch list" accounts for closer monitoring and follow-up action</li> </ul>			RM Sec.5402

Comments and/or exceptions:

Element	Assessment Criteria	Yes	C.U. Reference	DICO References
5. defined and prudent	Appropriate and prudent levels of decision-making authority			
levels of decision-making	have been established including:			
authority for approving				RM Sec.5206
credit exposures	<ul> <li>lender approval authorities</li> </ul>			RM Sec.5501
	<ul> <li>an acceptable combination of experience, expertise and training for lending staff for the types of credit</li> </ul>			<b>DM 0</b> 5000
	decision authority assigned	_		RM Sec. 5206
	escalating approval levels for large and complex loans			RM Sec. 5211
	<ul> <li>conditions for authorizing loan rewrites, loan postponements and formally restructured loans</li> </ul>			RM Sec.5205
	a process for board approval on restricted party loans			
	<ul> <li>a process for board approval in excess of lender (or</li> </ul>			RM Sec.5206
	credit committee) approval authorities, where			
	applicable			
	<ul> <li>approval for loan write-offs</li> </ul>			
Comments and/or exception	ns:			

Element	Assessment Criteria	Yes	C.U. Reference	DICO References
6. management of delinquent	Policy requires active management of delinquent and			
and impaired loans	impaired commercial loans in compliance with By-law #6			RM
	and requires that			Sec.5210,5507
	<ul> <li>delinquent and impaired loans are actively</li> </ul>			-
	managed including collection and legal activities			App. Guide
	<ul> <li>staff responsible for managing delinquent</li> </ul>			By-law #6
	commercial loans have the appropriate level of			RM Sec.5211
	knowledge and expertise			
	<ul> <li>valuation of the allowance for impaired loans in</li> </ul>			App. Guide
	accordance with DICO By-law #6			By-law #6
	<ul> <li>rewritten and restructured loans are appropriately</li> </ul>			
	recorded and monitored			
	<ul> <li>a process for determining the level of non-specific</li> </ul>			
	allowance is defined			
Comments and/or exceptions:				
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Element	Assessment Criteria	Yes	C.U. Reference	DICO References
Refer Standard 1 (B)	Management has implemented credit risk management policies that address the significant risks to which the institution is exposed			-
1. implementing appropriate and prudent risk management policies, procedures and controls	Management has established and implemented procedures for the credit risk management policies			-
for the Credit Risk Management standard	Management has established controls to maintain adherence to the credit risk management policies and procedures, including adequate segregation of responsibilities and duties			-
	Management has ensured that staff responsible for implementing the credit risk management policies, procedures and controls have an acceptable combination of skills, expertise and training			-
	Management has provided reports to the board on compliance with the institution's credit risk management policies, legislation and bylaws			-
	<ul> <li>The Credit Risk Management Reports:</li> <li>appropriately identifies the commercial credit risk position of the institution</li> <li>meets the requirements of the Act and Regulations</li> <li>provides the board with sufficient and accurate information to determine that the institution is adhering to its credit risk management policies</li> <li>identifies the status of all large loans</li> <li>provides details of aggregate risk in the commercial portfolio, including higher risk and "watch list" accounts</li> </ul>			RM Sec.5400 5404
	Management has identified, reported and initiated corrective action for material weaknesses or deficiencies			-
Comments and/or exception				