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Financial Services Report

Special Report

Ten Ways to Prepare for Your Next Bank Examination

In these troubled times, we are spending more time advising our clients on regulatory matters. From these ongoing conversations with our clients and the bank regulators, we have developed the following suggestions about how to prepare for your next bank examination.

1. Review your loan risk ratings. Make sure that your ratings reflect that you "get it," that is, that you recognize that the landscape has changed. Make sure that your independent loan review function is being realistic. Is independent loan review meeting with the Board of Directors at least once each quarter? Is a written analysis being provided to the Board of Directors? Is there appropriate follow-up on the deficiencies identified by loan review?

2. Review and update your real estate appraisal policy. Specific areas to enhance:

   - circumstances requiring an updated appraisal; and
   - documentation of appraisal reviews by bank personnel (narrative reviews, not just checklists, are necessary).

3. Review your ALLL process. Make sure that you are FAS 5 and 114 compliant. Specific areas to review:

   - adjustments to the historical loss experience (shorten the historical loss period); and
   - documentation enhancements, especially in regard to the allocations for the FAS 5 pools.

4. Review your Board of Directors monthly package. Make sure that the packages demonstrate that the Board of Directors is being fully advised of problem loans and workouts. Consider a separate monthly report on these subjects, not just statistics as usual. Board packages and Board minutes need to reflect increased Board involvement in those areas of the Bank under the most stress. Are there written action plans on all problem loans? Is the Board reviewing these action plans at least quarterly, if not more frequently?

5. Review your reliance on guarantees. If the Bank is relying on a guarantor, make sure not only that the financial information is current, but also that the Bank analysis is "robust"; that is, that the written analysis of the Bank takes into account current financial information of the guarantor, the global obligations of the guarantor and the willingness of the guarantor to assume the obligation.

6. Adopt or update as necessary a contingency funding plan. The plan should have detailed strategies to enhance liquidity under different stress scenarios. The contingency funding plan needs to identify specific sources of liquidity under these different stress scenarios. Include plans for testing liquidity lines. *See* OCC Bulletin 2009-21, July 6, 2009.

7. Review your policies and practices with respect to real estate lending. Make sure your policies are updated to address such matters as proper controls on construction lending, the use of interest reserves, guarantees, feasibility studies or new construction projects, troubled real estate development loans and concentrations. Do you have a specific plan to reduce your real estate concentration? Do you track it for the Board of Directors? Can you quickly and easily demonstrate to the examiners that you are reducing your commercial real estate concentration?

8. Review your capital plan. At a minimum, your capital plan should cover at least the next three years and contain realistic assumptions on growth and profitability. If the Bank is under any stress, consider restricting dividends voluntarily before being required to do so. Make sure the plan identifies specific sources of possible capital, types of capital available in the current economic environment and the triggers that will cause you to start raising capital. Have the plan reflect your current discussions with possible sources of capital and the Board of Directors.

9. Stay close to your regulator. The fewer surprises the better when the examiners come to the Bank. Maintain an ongoing dialogue with your examiner, and be honest about the issues you are confronting. It is not in your interest to surprise the examiners during the examination.

10. Remember that emotion will not win an argument with the examiners. However, you may alter the conclusions (especially the preliminary conclusions) of examiners with independent, thoughtful analysis that is based in facts.

If you have any questions, please contact **Daniel C. McKay II** (312-609-7762), **James M. Kane** (312-609-7533) or any other Vedder Price attorney with whom you have worked.

For more information about exam trends and potential issues, please see the transcript from the October 1 Bank Regulatory Teleconference at *www.vedderprice.com/2009_fig_trans*.

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