



# STATE OF WYOMING

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## DEPARTMENT OF AUDIT

### DIVISION OF BANKING

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## Supervisory Memorandum

**To:** Chief Executive Officer  
Wyoming State-Chartered Banks

**From:** Albert L. Forkner, Commissioner

**Sub:** Guidance on Credit Underwriting and Administration

**Date:** May 1, 2014

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### Applicability

This Supervisory Memorandum (Memorandum) applies to all Wyoming state-chartered banks effective immediately and supersedes the Division's guidance memorandum dated April 2, 2004. The Memorandum should be shared with all bank lending personnel.

### Loan Documentation Exceptions

Great importance is placed on a bank's written policies as the directorate-approved governance for bank management. Examiners will review a bank's loan policy to ensure that it is clear, concise and above all, prudent. Once loan policy effectiveness is determined, a bank will be examined for compliance with its policy. Historically, banks with high percentages of loan documentation exceptions (or technical exceptions (TEs)) have experienced significant problems in their loan portfolios.

Each bank should detail its loan documentation requirements in its loan policy. *In the absence of specific, acceptable loan policy documentation requirements, examiners will utilize the minimum standards detailed in this Memorandum for determining exceptions.* Examiners will discuss loan documentation exceptions with management prior to an examination's exit meeting. The final TE listing will generate the percentage used in the report of examination. The percentage is based on the dollar volume of exceptions divided by the dollar volume of loans reviewed.

### *Collateral valuation*

1. If the primary collateral is a real estate mortgage on commercial or residential property, an appraisal or evaluation should be completed within six months prior to the initial disbursement of loan proceeds. Appraisals or evaluations shall comply with Federal Reserve Board Regulation Y (for Federal Reserve member banks) or FDIC Rules and Regulations Part 323 (for nonmember banks), and the December 2, 2010, Interagency Appraisal and Evaluation Guidelines for all banks. Additionally, lien searches or title policies should be obtained to ensure and document the bank's lien position.

Section 1473 of the Dodd-Frank Wall Street Reform and Consumer protection Act (DFA), dated July 21, 2010, prohibits the use of broker price opinions for the purchase of a consumer's principal dwelling as the primary basis to determine the value of the property securing the loan.

2. If the primary collateral is accounts receivable or inventory, an aging schedule or valuation listing should be in the credit file. The schedule or listing should be obtained at origination or renewal and updated at least quarterly. Loans secured by other types of collateral (for example, machinery and equipment) should have a documented current listing and independent evaluation of the collateral at origination and renewal dates.

#### *Financial information*

3. Financial statements should:
  - Be dated as to the date of financial condition;
  - Total and balance;
  - Tie to the subsidiary schedules; and
  - Be signed and dated by all parties listed. Electronic financial statements are acceptable if the financial statement itself contains a valid digital signature.
4. Current financial statements are required except in the following instances:
  - Term consumer amortizing loans (only required at origination or renewal);
  - Residential real estate loans (only required at origination or renewal);
  - Borrowers in bankruptcy; and
  - Loans secured in total by deposits and/or U.S. Government Securities.
5. Personal and corporate financial statements should be obtained not more than fourteen months after the last statement date or upon renewal of the note.
6. A loan with guarantees should have current financial statements on each guarantor at origination and each renewal date.
7. All operating and unsecured loans should have a complete tax return in the credit file unless CPA-prepared financial statements are available. Management is encouraged to obtain tax returns for all types of loans. A tax return is considered stale if it is not in the file within sixty days after its filing deadline. If the borrower filed an extension, a copy of the extension should be obtained.
8. Annually, all operating loans should have a budget and a projected cash flow statement.
9. Any loan to a start-up business should have pro-forma balance sheets and income statements.

#### *Insurance, inspections, participations, construction loans, etc.*

10. Loans secured by improved real estate or personal property should have proof of insurance in the file with the bank shown as loss payee.
11. All floor plan loans should have inspections done at least quarterly.

12. Loans secured by livestock should have documented annual inspections signed by the inspector.
13. Participations purchased and letters of credit should have the same in-house documented credit analysis, approval, and loan documentation as similar types of loans.
14. Constructions loans will include construction budgets (including a comparison of actual costs to budgeted costs), monthly construction inspections, appropriate lien waivers, builders risk insurance, and as-completed appraisals. After construction is completed, management will either obtain a certification of the property's value from the original appraiser, or have the property reappraised.
15. Loan files should contain current credit bureau reports (within twelve months) for all principals and guarantors when the loan is originated as well as at renewals and modifications.

#### Other Real Estate Owned

Foreclosed real estate (OREO) shall comply with W.S. 13-3-201(e). Foreclosed real estate will be entered on the bank's books as OREO:

- when bank management has obtained control over the property, usually no later than when the property goes to foreclosure sale and management obtains a Sheriff's Certificate of Sale; or
- when management receives the Sheriff's Deed if the borrowers did not vacate the property during the redemption period.

#### Abundance of Caution Valuation Exemptions

This exemption is intended to have limited application, especially for real estate loans secured with residential properties in which the real estate is the only form of collateral. In order for the real estate to be considered an abundance of caution, the loan must be made on the same terms as if the real estate is not taken as collateral. Additionally, the following must apply:

- The bank's position must be fully protected by other collateral and the file must document that the real estate is being taken as an abundance of caution.
- The extension of credit must be well supported by reliable sources of primary and secondary income.
- If the real estate is the only collateral, or the loan is not fully supported by other collateral, then the borrower must be worthy of unsecured credit in conformance with the bank's loan policy and the file must document that the real estate is being taken as an abundance of caution.

#### Real Estate Mortgages

Generally, a bank may not secure new loans with existing mortgages from earlier transactions unless the following apply:

- The contract terms must obligate future advances from the inception of the loan.
- An earlier mortgage may be used to secure a new loan if the mortgage is amended to show the new money advanced. However, investigation of the bank's lien position would be necessary.

Procedures for Adverse Classification of Agricultural Loans

The portion of an agricultural loan which is secured by livestock or crops will generally be withheld from adverse classification. However, the bank must have a properly perfected and enforceable security interest in the assets in question, and the bank must have satisfactory practices for controlling sales proceeds when the borrower sells livestock and crops. The livestock or crops must have a signed independent on-site inspection and the results must be documented.

The following are guidelines for acceptable inspections:

- Performed not more than ninety days prior to the examination start date for feeder livestock operations and for purposes of confirming crops inventories.
- Performed not more than six months prior to the examination start date for breeder stock herds.
- Copies of invoices or bills of sale within the respective three months and six months parameters above are an acceptable substitute for inspection reports.