

# **Santander Holdings USA**



## **CREDIT RISK REVIEW FRAMEWORK**

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# 1. Overview

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## 1.1 The SHUSA Credit Risk Review Framework

This document establishes the SHUSA Credit Risk Review Framework (“Credit Risk Review Framework” or “Framework”) by which Santander Holdings USA (“SHUSA”) analyzes and reviews the credit risks arising from its business activities and operations (“Business Units” or “BU’s”). This SHUSA Credit Risk Review Framework is consistent with the SAN-US Enterprise Risk Management Framework (“SAN-US ERM Framework”).

The goal of this Framework is to establish the guidelines for the Credit Risk Review function, which is tasked with completing independent review and analysis of the Credit Risk Management activities of the Business Units.

This Framework is composed of five key components that address SHUSA’s approach to robust and independent Credit Risk Review:

- **Credit Risk Review Principles**- Key principles, which are aligned with the strategy and business model of SHUSA and which take into account the recommendations of supervisory bodies, regulators and best market practices
- **Credit Risk Review Governance Structure** – The governance principles and oversight structure for Credit Risk Review at SHUSA.
- **Credit Risk Review Organization** – The structure and components of the SHUSA Credit Risk Review Organization
- **Credit Risk Review Program** – The process to fulfill the Credit Risk Review responsibilities at the Business Units.
- **Issue Management, Escalation, & Reporting** – The means through which Credit Risk Review findings are discussed, finalized, and reported to the Board of Directors and management.

This Framework is authored by the SHUSA Chief Credit Risk Review Officer (“CCRRO”), reviewed for informational purposes by the Enterprise Risk Management Committee (“ERMC”) and approved by the SHUSA Board of Directors or designated Board subcommittee (“Board”) at least annually or when significant material changes are made to ensure that it remains applicable to SHUSA’s strategy and risk tolerance. Ad-hoc Framework reviews can be performed at the discretion of the CCRRO or the Board. Any changes or updates to the Framework must be approved by the Board.

Internal Audit (“IA”) is responsible for providing an independent assessment of the effectiveness of the SHUSA Credit Risk Review Framework.

## 1.2 Definition of Credit Risk Review

SHUSA defines Credit Risk Review (“CRRVW”) as the independent review, assessment, and continuous monitoring of Credit Risk policy, procedures, and management, so as to ensure consistency with approved risk appetite, credit risk rating policy and standards, established concentration limits, and strategic business plans.

The CRRVW function is intended to identify potential or well-defined credit weaknesses that may have been caused by (not limited to) the following: deteriorating economic conditions, deficient or inadequate loan documentation, deficient underwriting support, failure to comply with policy, differences between actual practices and applicable procedures, lack of adequate staffing (size or expertise), lapse in portfolio management, failure to identify early signs of financial weakness, and/or inadequate systems and controls. The function must also identify systemic weaknesses in credit policy, procedures, new products, and management.

CRRVW is both an information-gathering process and an interpretive process designed to provide SHUSA with an early warning system. The function must gather timely and pertinent information and skillfully interpret the information to detect shifting trends. In addition, it performs periodic analyses through quality control, portfolio monitoring, and examination.

## 1.3 Three Lines of Defense

Similar to other large financial institutions, SHUSA faces a complex and ever-changing credit landscape. Such a landscape requires a multilayered system of checks and balances to effectively identify and manage risk. Reflecting leading industry practices, SHUSA and its Business Units have organized the roles and responsibilities for credit risk management into a “three lines of defense” model.

In accordance with this model, the roles and responsibilities of the critical parties involved in credit risk management are as follows:

- Lines of business: The lines of business within each Business Unit are the first lines of defense and are responsible for assessing and managing the risks associated with SHUSA’s lending activities. They are also responsible for executing the Credit Risk Mandate approved by their local committees and for developing operating policies and procedures that implement the requirements set forth in the Credit Risk Framework.
- Credit Risk Management Function: Credit Risk Management (CRM) is the second line of defense and provides independent oversight of SHUSA’s lending activities and challenges the lines of business’ assumptions and credit analyses.
- Credit Risk Review: Credit Risk Review is the third line of defense with respect to Credit Risk activities. CRRVW assesses whether the first and second lines of defense are effectively meeting their responsibilities and adhere to the Credit Risk Framework, the risk management guidelines established by the Board, and the laws and regulations governing SHUSA operations.

## 1.4 Main Objectives

The Credit Risk Review process will have the following main objectives:

- To assess the effectiveness of the Business Units' processes and practices to:
  - promptly identify accounts and portfolios with credit weaknesses,
  - accurately classify loans with well-defined credit weaknesses that jeopardize repayment to allow for timely action to minimize credit losses,
  - gather data and to project trends that affect the collectability of loans and to isolate potential problem areas early, and
  - identify complex and inter-related factors that contribute to the credit risks embedded in the portfolio
- To evaluate essential information and to validate supporting documentation and methodologies used to determine the adequacy of the Allowance for Loan and Lease Losses ("ALLL").
- To evaluate credit management by the SHUSA employees involved with credit decisions, and analysis and monitoring.
- To assess the adequacy of and adherence to internal credit policies, procedures, and loan administration practices and to monitor compliance with relevant laws and regulations
- To provide senior management and the Board with an objective and timely assessment of the overall credit quality of the loan portfolio, and of the overall quality of credit risk management, and determination of appropriate ALLL.

## 2. Credit Risk Review Principles

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### 2.1 Independence

The Credit Risk Review function reports to the Board, and its responsibilities are defined by the Board as part of its oversight requirements. It provides useful continuous feedback on the effectiveness of the Lending and Credit Processes to identify emerging problems.

Credit Risk Review independently evaluates credit quality and validates the effectiveness of the risk rating system and both portfolio risk management processes and practices through examination, continuous monitoring, and data analytics for Standardized and Non-Standardized loan portfolios. It also evaluates and opines on the adequacy and accuracy of the Allowance for Loan and Lease Losses (ALLL) process. Its findings are communicated to the Board and to Senior Management at minimum, on a quarterly basis.

### 2.2 Confidentiality

CRRVW will ensure confidentiality of all information reviewed and the conclusions reached. Final reviews will be distributed to relevant stakeholders within SHUSA and the Business Units and to the Board.

### **2.3 Impartiality, Integrity and Objectivity**

All CRRVW opinions are based on objective analysis, with no undue influence, pressure or conflict of interest. All CRRVW team members will be impartial and professional in their analysis, with qualified employees continuously trained with specialized skills in different risk and business areas.

### **2.4 Quality of Work**

CRRVW team members will produce well-reasoned and documented conclusions supported by reviews conducted with consistent criteria and methodology. The group is focused on creation of value, generating relevant and accurate reports, and supporting the management of the units reviewed in a spirit of collaboration and with the objective of effecting improvement.

### **2.5 Elements of Effective Loan Portfolio Management**

In completing credit risk assessments, Credit Risk Review will consider the elements defined by the Office of the Comptroller of the Currency (“OCC”) for an effective Loan Portfolio Management, as follows:

- Assessment of the credit culture, inclusive of its personnel, the adequacy of adherence to policy/procedures/regulations, the quality of loan approval, monitoring, and risk assessment.
- Portfolio objectives and risk tolerance limits
- Management information systems
- Portfolio segmentation, concentrations and risk diversification objectives
- Analysis of loans originated by other lenders
- Aggregate policy and underwriting exception systems
- Stress testing portfolios
- Analysis of portfolio risk/reward tradeoffs
- Identification of special attention or “watch assets”
- Identification of loans with potential or well-defined credit weaknesses
- Identification of relevant trends that affect the collectability of portfolios
- Independent and effective control functions
- Analysis of credit metric performance against peer bank performance

## **3. Credit Risk Review Governance**

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### **3.1 SHUSA Credit Risk Review Committee**

The Credit Risk Review Committee (“CRRC”) shall operate under authority granted by the Board and shall be chaired by the CCRRO. The CRRC bears full responsibility for the periodic review and approval of the Santander Holdings USA Credit Risk Review program. This committee governs the review function required to maintain the safety and soundness of the SHUSA credit function. The committee also serves as a conduit through which the findings of the Credit Risk Review teams and external regulators are synthesized, to evaluate those findings in the context of SHUSA policies and strategic objectives, and to make changes to the Annual Credit Risk Review Plan and to CRRVW Policy and Procedures, as may be

necessary. The CRRC also serves as the final escalation point to resolve disputes regarding required changes to risk ratings, specific reserves, and charge-offs.

### **3.2 SHUSA Credit Risk Review Scope & Responsibilities**

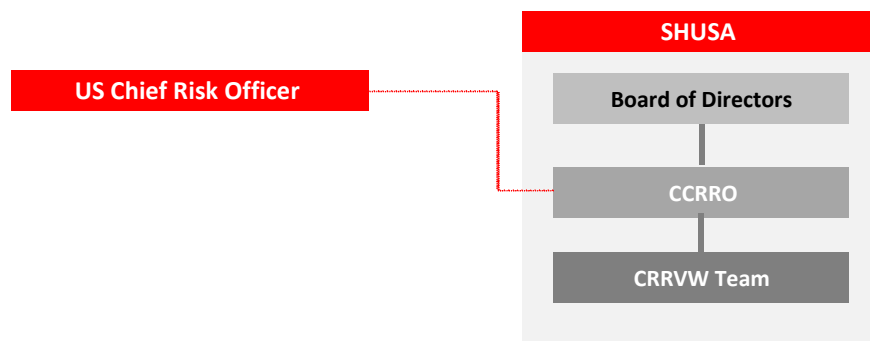
Credit Risk Review's universe is generally comprised of the Standardized and Non-Standardized loan portfolios of the SHUSA Business Units. The scope, coverage and frequency of the CRRVW activities will be customized to meet SHUSA's specific needs and the resulting evaluation will be considered in the context of economic conditions, industry trends and developments.

The scope of Credit Risk Review activity encompasses the examination and evaluation of the adequacy and effectiveness of the organization's governance, risk management process, system of internal control structure, and the quality of performance in carrying out assigned responsibilities to achieve the organization's stated goals and objectives. It includes:

- Continuous monitoring and evaluation of the effectiveness of:
  - the organization's risk management systems and the integrity of risk rating activity,
  - the organization's underwriting and new originations activity,
  - portfolio management process and practices, especially early problem detection, management of watch loans and of Highly Leveraged Transactions ("HLT") and Highly Volatile Commercial Real Estate ("HVCRE"), and
  - The organization's workout and problem loan collection processes.
- Assessment of the consistency of credit governance.
- Verification that the units responsible for exercising control over credit risk fulfill their responsibilities and comply with policies and procedures established by senior management and relevant internal and external regulations.
- Continuous Monitoring and evaluation of:
  - migration in asset quality and delinquency levels,
  - credit policy and underwriting exception levels, especially in line with risk appetites and strategic business plans,
  - concentration limits, especially in line with risk appetite and diversification strategies, and
  - New products and business lines launches.
- Review of Credit Risk reporting and information systems to ensure data quality and appropriate reporting to regulators, senior management, and the Board.
- Monitoring and evaluation of the adequacy and methodologies for the calculation of the ALLL.
- Conduct acquisition due diligence examinations and other reviews at the request of the ERM or the Board, as appropriate.



### 3.3 Accountability



The SHUSA Credit Risk Review organization is a function that operates independently of the business lines, credit risk management, and corporate functions to ensure that credit risks are reviewed and measured objectively and without influence from business performance objectives. The CCRRO reports directly to the Board, with functional reporting to the U.S. Chief Risk Officer.

### 3.4 Authority

The CRRVW team shall operate according to the following principles:

- Authority is granted for full, free, and unrestricted access to any and all of the records, physical properties, and personnel relevant to any function under review within any entity within SHUSA.
- All SHUSA employees are required to assist Credit Risk Review in fulfilling its mission.
- Credit Risk Review shall also have free and unrestricted access to the Chairman of the Board of Directors, and the Board.
- Documents and information provided to Credit Risk Review during a periodic review will be handled in the same prudent and confidential manner as by those employees normally accountable for same.

### 3.5 Assessment

The CCRRO will periodically assess whether the purpose, authority, and responsibility, as defined in this framework, continues to be adequate to permit the Credit Risk Review function to accomplish its objectives. The result of this periodic assessment should be communicated to the SHUSA CRO and the Board.

## 4. Credit Risk Review Organization

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### 4.1 SHUSA Credit Risk Review Mission Statement

The mission statement establishes both the purpose of the Credit Risk Review function and the methods through which this purpose will be fulfilled:

*SHUSA Credit Risk Review seeks to ensure compliance with Credit Risk appetite, policies, procedures, and frameworks, to ensure the integrity and consistent application of risk ratings, and to provide analysis and warning of potential emerging risks, through targeted reviews and continuous monitoring and assessment of Credit Risk Management activities.*

## **4.2 SHUSA Credit Risk Review Teams**

To ensure strong and effective credit risk review throughout SHUSA, the functions described below are performed under the oversight of the SHUSA CCRRO. The CCRRO's organization can be modified as long as it does not negatively impact SHUSA's ability to review credit risk management activities across the enterprise.

### **4.2.1 Credit Risk Review Teams**

CRRVW will include teams of Credit Risk Review Officers and Analysts responsible for the review and continuous monitoring of the various credit portfolios of the SHUSA Business Units. These teams may be segmented in order to allow focus on Commercial or Retail loans, particular geographic regions, or particular Business Units or portfolios within these Units. The Credit Risk Review teams will have responsibility for the following:

- Full scope portfolio reviews;
- Targeted reviews;
- Horizontal reviews;
- ALLL review;
- New Originations reviews;
- Continuous monitoring of assigned portfolios; and
- Attendance at and review of Credit Risk Management review meetings, including Promontorios, "Watch" reviews, HLT reviews, Workout Portfolio Reviews, and Quality Control reviews.

As a result of the above noted reviews, the Credit Risk Review teams shall document Issues Requiring Attention, which will require corrective action to be completed by the Business Units. The Credit Risk Review teams are responsible to monitor and follow-up on the Business Unit's corrective actions to ensure appropriate remediation of such Issues.

### **4.2.2 Control & Analysis Team**

The Control & Analysis team within CRRVW shall be responsible for the Business Intelligence, Quality Control, Sampling, Scheduling & Administration, and Reporting & Presentations functions, as described below.

#### **4.2.2.1 Business Intelligence**

Credit Risk Review must include an internal Business Intelligence function with responsibility for the independent gathering, synthesis, and analysis of Credit Risk data. This data may be sourced from the

information provided by the business units' systems of record or internally from Credit Risk Review. The Business Intelligence function is responsible for the following:

- Manage and maintain a database of Credit Risk information from the Business Units for the purpose of independent Credit Risk Review analysis
- Review data to analyze credit trends within portfolios, including new originations, risk concentrations, trends in transfers to Workout, non-accruals and charge-offs, deviations from Risk Appetite plans, etc.
- Provide its results to the Credit Risk Review teams to assist in review plans, sampling, and final reports.
- Develop and maintain an independent Risk Assessment process to analyze the credit risk associated with each business line.
- Synthesize data gathered from CRRVW analysis and other external reports to assist in development of annual CRRVW plan.
- Perform periodic reviews of data quality and MIS effectiveness, and deficiencies will be included in Credit Risk Review reporting.

#### **4.2.2.2 Quality Control**

Credit Risk Review must include an internal Quality Control function with responsibility for ensuring consistency of practice among the Credit Risk Review team. The Quality Control function is responsible for the following:

- Review all completed reports to ensure that the methodologies, analysis, and conclusions are of consistent quality and structure.
- Identify trends that appear in reports crossing multiple business lines and credit management groups.
- Produce quality control reports to track findings at a high level and focus on serious findings and recommendations for correcting problems. The reports will also include broad trends identified across multiple credit reviews, for evaluating and monitoring the quality of Business Unit loan production.
- Maintain unit framework, committee charter, policies, procedures manual, and standard templates.
- Provide training for CRRVW team members to ensure consistent practice across the group.

#### **4.2.2.3 Scheduling, Sampling & Administration**

The Credit Risk Review Scheduling, Sampling & Administration function will be responsible to ensure consistent credit sampling methodology for all Credit Risk reviews and for maintaining efficient production across the CRRVW teams through a centralized scheduling process. The Scheduling, Sampling & Administration function is responsible for the following:

- Manage, coordinate, and oversee sampling process for all CRRVW exams.
- Maintain schedules of exams and individual officers to ensure proper coverage and continuous monitoring
- Coordinate CRRC meetings

- Manage division budget, human resource matters, and performance management/productivity metrics

#### **4.2.2.4 Reporting & Presentations**

The Credit Risk Review Reporting and Presentations function will have responsibility for conveying the findings of the Credit Risk Review process to the Board, ERM, and senior management. The Reporting and Presentations function is responsible for the following:

- Production of summary presentations for Board, ERM, and other stakeholders
- Production of materials for discussion at CRRC
- Production of annual Credit Risk Review plan and any interim adjustments to plan
- Production of annual/quarterly reports of Credit Risk Review activities, including assessment of the ALLL, review coverage, and consolidated findings
- In conjunction with CRRVW teams, production of final review reports for each review

### **4.3 Qualifications of Credit Risk Review Personnel**

Persons involved in the Credit Risk Review function should be qualified based on their level of education, experience, and extent of formal credit training. They should be knowledgeable about both sound lending practices and the SHUSA lending guidelines for all types of loans offered. They also should be aware of all relevant laws and regulations affecting lending activities. The staffing expertise aligns with sophistication and complexity of Bank's risk profile enabling ongoing ability to provide credible challenge. Recurrent and pertinent training will be provided to keep the CRRVW team members up-to-date with the current credit analysis methodologies and changes in regulations.

## **5. Credit Risk Review Program**

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### **5.1 Credit Risk Review Annual Plan**

For each calendar year, Credit Risk Review must present to the Board for approval a plan of reviews to be completed. This plan will be based on an established calendar of review frequency by business segment within each Business Unit. The frequency of review will be determined based on a portfolio Risk Assessment, which takes into account portfolio credit metrics, prior CRRVW findings, business strategy changes, and internal/ external factors that indicate a potential for deteriorating credit quality in a particular business segment.

The length of review cycle for each reviewable entity must be appropriate in relation to the Risk Assessment and does not exceed 36 months (in rare instances). Most of the reviews will be performed within a 12 to 18 month cycle. The rank ordering of the reviewable entries is derived from CRRVW's Risk Assessment, which includes a combination of quantitative and qualitative factors.

Also included in the Annual Plan is a discussion of planned continuous monitoring activities, including the assessment of concentration of risk, review of new originations, evaluation of Business Line portfolio review committee meetings, and reporting on emerging trends. Horizontal reviews of

thematic issues across business lines may also be included, as deemed appropriate. Targeted reviews focused on selected risk elements within a portfolio that have been identified as areas of concern may also be outlined. These horizontal and targeted reviews often are determined part way through a year, as they are based on emerging risks and changing circumstances. As such, they will not always be outlined in the Annual Plan.

Any significant deviation from the approved plan during the calendar year must be presented to Board at the next meeting for approval. However, the CCRRO shall retain the right to make immediate changes to the Plan to meet the evolving needs of the organization, so long as such changes are subsequently presented to the Board for ratification.

## **5.2 Credit Risk Review Policies & Procedures**

The SHUSA Credit Risk Review Policies are developed and approved by the CRRC, reviewed for informational purposes by the ERM, and approved by the Board if needed. The Policies are reviewed and/or approved at least annually to ensure they remain applicable to SHUSA's strategy, applicable risks, and current and planned activities. As new credit risks emerge and the existing credit risk profiles change, the Credit Risk Review Framework and Policies may be modified or developed.

CRRVW shall also maintain procedures in connection with the credit risk policies. Credit Risk Review procedures provide further detail on the processes for executing upon policies. Procedures will be defined for each CRRVW function, as appropriate. It is the responsibility of the CRRC to periodically review procedures for adequacy and compliance with Policies. Any new procedures or changes to existing procedures must be approved by the CRRC.

## **5.3 Credit Risk Review Sampling**

Credit Risk Review samples will be developed as a joint effort between the Control & Analysis team and the Credit Risk Review team responsible for the review. Sampling will focus on high-growth, substantive, or high-risk areas, and any new loan products or services offered by the bank, including loans approved with underwriting exceptions and policy overrides. The use of a statistical sample, an expert selection, or a hybrid approach shall be determined based on the quantity of borrowers in the scope of the review. The selected sample should be sufficient in size to allow the review to reach supportable conclusions. Samples for full unit reviews shall typically cover 40% of unit customers and exposure for Non-Standardized portfolios and 10% of newly originated exposure over the prior 12 months for Standardized portfolios. In developing the sample, some factors to be considered include:

- Booked in the last 90 days or approved and booked within the last 90 days.
- Declined in the last 90 days.
- Non-performing and non-accrual loans.
- Classified loans.
- Credits believed to have an elevated risk of default, inclusive of HLTs and TDRs
- Borrowers with low FICO or high debt-to-income levels
- Representative of a product offering that is new to the bank.

- Loans in excess of a given percentage of the bank's legal lending limit.
- Loans in excess of a given percentage of the bank's equity capital.
- Loans defined as "structured finance" transactions.
- Loans included in an identified concentration.
- Accounts with automatic or manual line increases during the last 180 days.
- Loans with multiple approval requests (inclusive of covenant waivers)
- Loans that have stale financial reporting
- Loans that are past due with FEVE reviews
- Loans with policy exceptions
- Loans that have experienced loan or FEVE migration
- Loans that have experienced delinquency or overdrafts
- Loans that are maturing in the near term
- Loans that are approved outside of normal committee protocol.
- Loans from an industry or sector that has been experiencing stress (as evidenced by transfer activity into Workout)
- Loans that have remained special mention or substandard longer than regulatory guidance deems reasonable
- A statistical sample of all remaining loans. The statistical sample of remaining loans will be weighted so that loans with the greatest risk are more likely selected. The remaining loans are divided into 4 segments, with the best group rated "1" and the worst "4". CRRVW will randomly select 1x% of a sample from Group 1, 2x% from Group 2, 3x% from Group 3, and 4x% from Group 4.

#### **5.4 Review Scope**

CRRVW will perform full, targeted and horizontal reviews. The scope of the review within the selected portfolio shall be defined by CRRVW based on findings from the continuous monitoring process and trends identified by the Business Intelligence function. The percentage of the portfolio selected for review should provide reasonable assurance that the results have identified the major problems in the portfolio and reflect its quality as a whole. Reviews shall include assessment of approval and monitoring documentation, credit file contents, loan documentation files, and MIS reports being used to manage the portfolio.

#### **5.5 Credit Loan Reviews and Portfolio Risk Assessments**

As part of the Credit Risk Review process, selected credits will be reviewed in depth to ensure the overall risk assessment, loan decision, and portfolio management activities are consistent with prudent lending practices. Each review will:

- Assess appropriateness and timeliness of all risk ratings assigned
- Assess appropriateness and timeliness of identification of problem loans
- Assess appropriateness of developed and implemented action plans on problem loans.

- Assess appropriateness of identification of individually impaired loans, measurement of estimated loan impairment and timeliness of charge-off
- Validate the existence, completeness, accuracy, and timeliness of the information contained within the credit file, including legal documentation, financial statements (borrower and guarantors inclusive of global debt service analysis and contingent liabilities), projections, covenant compliance, and verified collateral values through borrowing bases, rent rolls, leases, engineering reports, appraisals and environmental reports.
- Evaluate the credit analysis/underwriting decision. Adherence to underwriting policy standards appropriate to current conditions.
- Evaluate the identification, tracking and monitoring of concentrations and underwriting/ policy exceptions
- Assess whether credits conform to SHUSA policies, insurer or investor requirements, and regulatory guidance.
- Assess whether credit policy is consistent with risk tolerance limits and provides complete and clear directives
- Assess adequacy of monitoring system/internal controls, inclusive of basis/methodology of risk ratings
- Identify trends and internal/external factors affecting portfolio risk levels
- Identify and assess “Spilled Milk” case for further review by Credit Risk
- Identify areas in which training is needed.
- Monitor the quality of credit portfolio production.

In addition to identifying the risk in individual loans, Credit Risk Review will pinpoint the sources of risk exposure in the work flow, in specific loan segments or products, or in loan concentrations. The summary Credit Risk Review assessment will take into account a number of factors, including:

- Accuracy, integrity, and timeliness of internal risk-rating processes.
- The effectiveness and independence of controls, including but not limited to the lending activities exceptions and concentration limit monitoring systems.
- Underwriting standards and the volume and extent of exceptions and overrides.
- Changes to underwriting standards, credit policies and concentration limits and impact on credit quality in terms of quality and direction of risk.
- Conditions in loan agreements that weaken the bank’s protections (i.e. permitted adjustments to EBITDA for covenant purposes, ability to incur additional indebtedness, etc.)
- Strategic objectives (target markets, product mix, mergers/acquisitions, third-party originations, concentrations, and securitizations)
- New products
- External factors (local and national economic/market conditions, competitive challenges, regulatory changes, and technical advancements)
- Factors influencing credit quality (delinquency trends, nonperforming/problem assets, loan losses, weighted average risk ratings, and reserves)

- Trends in borrower performance (abstracted from credit analysis including a comparison of borrower projections and actual performance) Trends in risk ratings assigned by account officers.
- Board-approved credit policies consistent with strategic goals and risk tolerance limits.
- Development/implementation of action plans to facilitate timely collection of problem loans.
- Method of evaluating the ALLL in compliance with both regulatory and accounting guidelines.
- The timeliness, accuracy, completeness, and relevance of MIS reports.
- Adequacy of credit risk procedures to effectively identify, analyze, track, monitor, and mitigate risk

Each full, targeted, or horizontal review or portfolio continuous monitoring report shall conclude to ratings of the four categories outlined below:

- Portfolio Credit Quality is an assessment of credit metric trends and is characterized as either strong, satisfactory, marginal, or unsatisfactory.
- Quality of Credit Risk Management is how well risks are identified, measured, controlled and monitored. It is characterized as either effective, adequate, challenged, or ineffective.
- Quantity of Risk is the level or volume of risk that exists and is characterized by either low, moderate, elevated, or high. Direction of Risk is the probable change in the risk profile over the next 18 months. It is characterized as decreasing, stable, increasing, or rapidly increasing.

## **5.6 Loan Documentation Review**

For certain Credit Risk Review activities, the Credit Risk Review officer will evaluate the security instrument and loan documentation files to determine whether the appropriate security interest has been adequately documented. In addition, the officer will review the appropriate documents, including notes, loan agreements, guarantees, etc. to ascertain whether or not the legal documents are consistent with credit approvals. Loan documentation should contain minimum requirements for timely submission of sufficient information regarding the borrower and guarantor (as applicable) to adequately assess and monitor performance throughout the life of the loan. An assessment of the quality and validity of loan documentation will be included in summary reports provided to the appropriate stakeholders.

## **5.7 Allowance for Loan and Lease Losses Review**

CRRVW will verify the sufficiency of the ALLL following federal bank regulatory agency guidelines and policy statements governing the ALLL. The theme of the policy statement is that all federally insured depository institutions must maintain an ALLL at a level adequate to absorb estimated credit losses associated with the loan and lease portfolio, including all binding commitments to lend. CRRVW will perform a focused review on the ALLL composition and process to validate compliance with regulatory guidance.

CRRVW will review supporting documentation for techniques used to develop its loss rates, including evidence of average and range of historical loss rates by common risk characteristics over the historical



use period. CRRVW will also review supporting documentation for management adjustments to the historical loss rates in terms of the factors that affected the analysis and the impact those factors had on the measurement.

CRRVW will review if the ALLL was reviewed/ modified in the context of changes in lending policies and procedures. CRRVW will assess if changes made by management in the ALLL allocations are reasonable in light of CRRVW findings, the adequacy of monitoring systems, the competency of management to implement remedial action, decreasing/increasing trends in classified loans and institution's overall asset quality.

## **5.8 Stress Testing**

CRRVW will include stress testing as an integral part of the overall Credit Risk Review governance and risk management culture. The analysis of stress testing results will be used to inform management decisions and the strategic plans. The loan portfolio stress-testing results provide a measure of the depth and breadth of a bank's vulnerability to changes in product mix, interest rates, loan concentrations, troubled debt restructures (TDRs) and reserves, as well as vulnerability to specific markets and economic conditions.

The results of stress testing an individual loan add another dimension to risk identification and credit analysis without diminishing the importance of other elements essential to the underwriting process. Projections are important as loans are repaid in the future, not the past. Stress testing loan-specific variables (interest rates, occupancy or vacancy rates, various expenses, rents, or revenues), and analyzing the potential range of change within such variables, by such traditional measures as the impact on loan-to-value ratios (LTVs) and debt service coverage ratios (DSCRs), ensures a more reliable assessment of loan and project exposure. The greatest strategic value of stress testing is during an expanding business cycle when losses are minimal, profits are increasing, and property values are rising.

## **5.9 Watch List**

As part of the Continuous Monitoring process, the Credit Risk Review function will review Credit Risk Management's maintenance of a "watch list". The watch list is a listing of every loan above a specified dollar amount that warrants additional scrutiny or more frequent monitoring so as to ensure expected performance of the borrower. Each loan on the list receives extra attention until the borrower's situation no longer requires such elevated monitoring. Each watch list loan is monitored closely until it has improved sufficiently to no longer warrant watch list status, until it has been paid, or until it has been designated as non-accrual. For the purposes of SHUSA, the watch list will be defined as customers with a FEVE designation. Credit Risk Review continuously reviews various credits throughout the portfolio to assess whether the watch list population is accurate.

## **5.10 Scrutiny of Products New to the Bank**

CRRVW will verify that appropriate risk management efforts have taken place for loan products that are new to the bank; specifically, that the bank has performed a risk assessment based on:

- A business plan with well-researched projections regarding the target market, budgetary requirements, strategic objectives, and an exit strategy. The new product should be compatible with business strategies.
- Internal staff competencies or the availability of experienced third-party providers. Input has been received from managers of relevant functions
- Financial goals consistent with strategic goals and risk tolerance levels, i.e. realistic potential return vs. potential risk
- Quantitative benchmarks for evaluating the success of the product or service.
- Controls, including checklists and formulation of MIS reports with specified indicators that allow the Board/ management to monitor product performance and control risk.
- Monitoring systems requirements.

### **5.11 Continuous Monitoring**

CRRVW engages in Continuous Monitoring of all credit portfolios outside of the full review cycle. CRRVW officers are assigned to specific portfolios and Business Units and are responsible to remain in continuous contact with management of these units. Continuous monitoring will include, but not be limited to the following activities:

- Observation of Credit Approval Committees
- Review of Management Presentations and reports on portfolio activity, including rating migrations, credit scoring, problem loan migration, NPLs, and charge-offs.
- Review and analysis of New Loan Originations and associated trends
- Attendance at and review of portfolio review committees
- Review of external audit findings
- Observation of industry trends
- Review of changes made to relevant policies and procedures, inclusive of underwriting guidelines

## **6. Issue Management, Escalation, and Reporting**

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### **6.1 Work Paper and Report Distribution**

To substantiate assigned classifications, a list of loans reviewed, the date of the review, and documentation, including summary analyses, will be prepared on all loans reviewed. A report that summarizes the results of the Credit Risk Review will be submitted to the Board on at least a quarterly basis, or more frequently when material adverse trends are found.

In addition to reporting current credit quality findings, comparative trends will be presented to the Board that identify significant changes in the overall quality of the portfolio. Findings also should

address the adequacy of and adherence to internal policies, practices, and procedures and compliance with laws and regulations, so that any noted deficiencies can be remedied in a timely manner.

CRRVW will maintain well-documented reports on its quality control activities, which document the results of file reviews and origination processes as well as management action to correct identified deficiencies. Reports are regularly provided to senior management within 30 days of completing the review process.

## **6.2 Review of Findings and Follow-up**

Findings will be reviewed with the appropriate stakeholders and members of senior management. Any existing or planned corrective action, including the time frames for correction, should be elicited for all noted Issues Requiring Attention. All noted deficiencies and identified weaknesses that remain unresolved beyond the assigned time frames for correction should be promptly reported to senior management and the Board.

## **6.3 Escalation Appeal Process**

An escalation appeal process shall be instituted under which Business Unit personnel can appeal findings of CRRVW teams to the CRRC. CRRC shall be the final arbiter of all CRRVW decisions.

## **6.4 Credit Risk Review Reporting**

A written report will be prepared and issued by the CCRRO or designee following the conclusion of each examination and will be distributed to Senior Management. A copy of each report will be forwarded to the Chief Executive Officer, the Chief Risk Officer, Chief Credit Officer, Chief Internal Auditor, and the Chairman and appropriate members of the Board.

The CRRVW Report is an assessment of the SHUSA's exposure to credit risk and serves to identify significant changes in the SHUSA's performance, products or market. It is an independent assessment of the functional adequacy of internal controls as well as an independent evaluation of asset quality. It sheds light on deficiencies in SHUSA's policies, underwriting procedures, credit analysis capability, documentation, risk rating, governance and management's effectiveness. The reports will include a summary of findings from the reviews and ratings for various categories, including underwriting, credit analysis, portfolio monitoring, rating accuracy, and administration/data quality. All deficiencies, identified weaknesses, existing/planned corrective action will be discussed. In addition, the report will provide an assessment of the quantity, quality and the direction of risk for the portfolio.

The report includes an executive summary of the findings, statement of the purpose, objective and scope of the review. It addresses the comparative trends that identify significant changes in the overall quality of the portfolio, adequacy and adherence to internal policies and procedures, and compliance with laws and regulations in order to facilitate timely correction of any noted deficiencies. In addition to the findings, if appropriate, the report includes root causes of the deficiencies and recommendations for improvement. Management should provide a timetable for anticipated completion of any Issues

Requiring Attention and should provide explanation for any recommendation not addressed. CRRVW shall be responsible for appropriate follow-up on examination findings and recommendations.

The report also includes a list of loans reviewed and a discussion of the sample and scope. An individual credit analysis would include comparison of the rating assigned and the rating assigned by CRRVW, and the reason for any differences.

The Chief CRRVW Officer shall periodically provide summary reporting to the Enterprise Risk Committee containing observations from reviews, concerns, and identified trends within the portfolios.

## **7. Document Administration**

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### **7.1 Ownership and Authorship**

<b>Version</b>				
1.0	10/8/14	CCRRO		

### **7.2 Sign-Off**

<b>Approving Body</b>		<b>Final Approval Date</b>
SHUSA BERC		12/10/2014