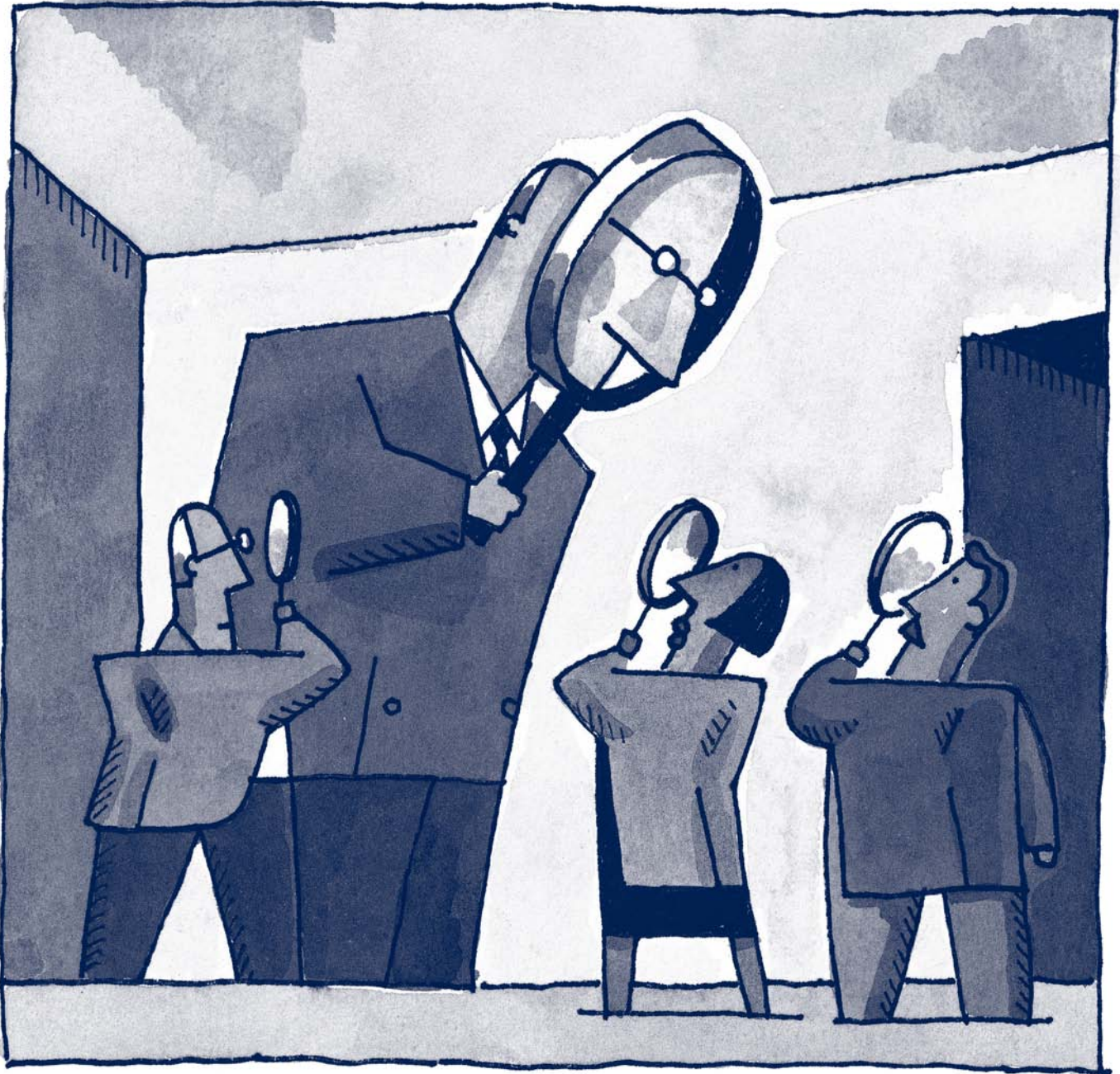


Loans Gone Bad

Does someone – or something – have your back?



THE RULES HAVE CHANGED.
Community banking used to be done with a smile and a handshake. Today, it's about information, verification and documentation.

Not that community banking has ceased to be about personal relationships. But the environment around those relationships has changed. In our mobile society, consumers move in bigger circles. They live, work, have a second home, retire and do business in many places. They also borrow money from many sources, and increasingly so given the ease of shopping rates and terms

courtesy of the Internet. All of which requires the community banker to be considerably more careful, more knowledgeable about his customers than in the past.

So sayeth the regulators. Community bankers subject to recent examinations are finding examiners holding them more accountable to more exacting standards. The subprime disaster might have ignited that fire, but the bigger picture is a more complex environment that requires more sophisticated methods to watch as well as make loans. Avoiding subprime loans is only one way to placate examiners; the broader and more critical issue is having access to timely, accurate and comprehensive loan portfolio information.

The proof is in the headlines. Well-intentioned CEOs – from large banks and small, in metropolitan and non-metropolitan communities – have been the unwitting victims of “not knowing.”

A lack of information has been at the bottom of some of the most publicized of recent bank debacles.

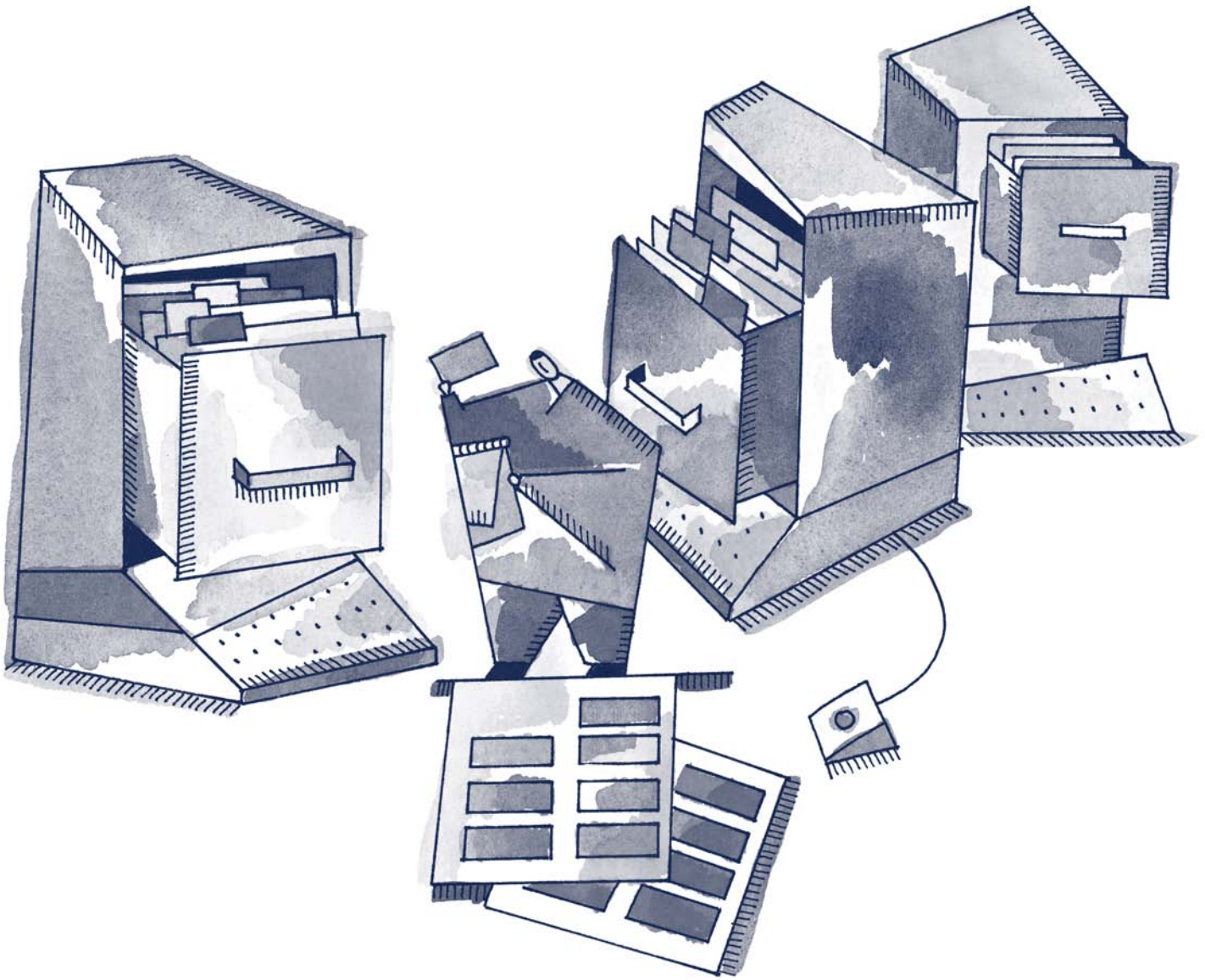
- **NetBank** was the pioneer and darling of Internet banking with a share price that once soared to nearly \$80. Today NetBank is better known as the biggest bank failure in 14 years. NetBank, which failed with assets of \$2.5 billion, had multiple problems, including its late entry into the subprime mortgage loan pool. But according to the Office of Thrift Supervision, NetBank’s Achilles heel was sloppy underwriting of loans, specifically cited as “poor documentation,” which caused NetBank to suffer more than \$200 million in losses in 2006 alone.
- In an action that might have caused its subsequent sale, **GB&T Bancshares, Inc.** (Gainesville Bank & Trust), then with assets of \$1.9 billion and 31 locations in 14 Georgia counties, was ordered by the FDIC to increase its loan loss reserve by nearly \$10 million (to nearly \$25 million). The result: a reduction in net income of nearly \$4 million for 2006, about half of what the bank had reported previously for that year. The loss was attributed to loans approved personally by the president of a

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subsidiary, which were specifically noted by the FDIC as violating bank policies for “collateral requirements” and were supported with “inadequate documentation.”

Though the bank vowed to tighten controls and more stringently enforce its policies, the problem was rooted in its lack of access to timely reports on loan exceptions and deviations. The bank had grown exponentially in recent years, and without a system to track its loans, was unable to monitor its branches’ practices sufficiently. Alerted to the subsidiary’s practices too late, it couldn’t act in time to head off the loan losses before the blow was dealt.

- The impact of the declining real estate market might be most evident in Florida where the economy’s growth has been fueled by soaring real estate prices for decades. When the “bubble burst,” the impact of the explosion was felt most by banks that did not secure or track loans well. One of the most publicized was the 20-branch **Coast Bank** of Bradenton in Southwest Florida, which had loaned over \$110 million to buyers, mainly speculators, on homes being built by a single construction company. When the construction company halted operations after drawing more than \$66 million on those loans, the bank was cited for slopping lending practices, including loose collateral requirements. The bank’s TheStreet.com rating was pummeled to an E-minus, the lowest ranking available, and Coast Bank wound up being sold at auction.
- **Coast Bank** was just one of many community banks that had staked their fortunes on the Southwest Florida real estate market. First Priority, also of Bradenton, saw its bad loans soar by more than 500 percent in the third quarter of 2007, including “eight to ten loans ranging from \$2 million to \$4 million . . . (which is) significant for a bank with \$276 million in assets,” the *St. Petersburg Times* reported. Its punishment was a grade of D-minus from TheStreet.com and a required increase its loan loss reserves by 235 percent.



In each instance, the bank would have been well-served by adequate and timely information on its loan portfolio. From loan officer to chief credit officer to CEO and the board, the bank with the MST Loan Administration System in place has instantaneous and comprehensive information about the current status of their loans and the significance of each loan's position in the portfolio. With absolutely current information on exceptions and deviations, bank officials are able to address and resolve problem loans proactively, before they become inadvertent losses.

It is noteworthy that the most aggressive lenders, the fastest growing institutions, are most at risk of catastrophic losses due to bad loans. A lack of timely and accurate information on their loan portfolios is

their silent killer. Many banks simply chalk up such losses as part of the cost of doing business. GB&T's chief credit officer told a reporter looking into the bank's loan problems that, "given the current

economic climate, the bank's numbers were well within acceptable ranges."

Does this new environment signal the end of community banking as we have known it, and with it the community bank CEO's traditional role of building the *bank by building relationships?* *Hardly. Personality is what*

differentiates community banks from large, impersonal banks. What has changed is that the community bank CEO needs someone to have his back – or something that provides a thorough knowledge of the current financial condition of his loans and lenders.

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“It’s like insurance; you simply have to have the right coverage,” notes Wes Dodd, DFO of Community Bankshares, Inc., with \$1.2 billion in assets. “All bad loans have one thing in common,” adds Bonnie Bowling, COO of Habersham Bankcorp in North Georgia, “poor documentation.”

Resolving the Documentation Dilemma

For Dodd, Bowling and an increasing number of community bankers throughout the Southeast and now beyond, it is the MST Loan Administration System (LAS) that is providing the comprehensive and current information they need to see that loan policies are being adhered to and that loan deviations and exceptions are dealt with expediently, before they turn into catastrophic losses.

The MST Loan Administration System is a complete program that includes evaluation, training and automation of the bank’s processes for managing risk and minimizing loss. The heart of the System is MST’s proprietary BankTect software, which automates the documentation, tracking and reporting of critical information such as loan exceptions and deviations. BankTect notifies key bank personnel when documents are coming due or are about to expire. Reports provide lenders – and bank executives – real-time access to information in the ways they use it: organized by loan, customer, exception and other bank-selected categories.

“Historically, community banks have struggled to keep up with loan documentation,” MST CEO Dalton T. Sirmans explains the reason for the MST LAS. “They either do it manually or use spreadsheet software to try to keep track. Missing or expired documents often go undiscovered for days or weeks, and reports on exceptions and deviations are typically out-of-date before they are issued. Banks have had to live with a lot of risk in their loan portfolios, and most have suffered losses from time to time as a result.” ■

Unacceptable Risk: the Warning Signs

How do you know when the information you have on your loan portfolio is insufficient? The following Warning Signs will tell you your risk is on the rise.

- You’ve been cited by regulators for, or notified by auditors of, an unacceptable level of loan exceptions.
- Regulators have informed you that you must increase your loan loss reserve.
- Loan portfolio reports are out of date by the time you see them.
- You’re not confident that the exception reports you get are accurate.
- When you need a report, it takes more than the click of a computer key and a second to get it.
- You can’t get one report that shows all your exposure to a single relationship.
- Tracking and reporting on loan documentation depends on an individual as opposed to an automated system.
- You, your senior managers, your lenders lack immediate access to loan files and exception reports.
- All your loan files aren’t gathered in one place and aren’t accessible from your computer.
- Access to customer and loan information is not protected from unauthorized people as well as you’d like.
- Evaluation of your lenders and loan staff are subjective due to lack of objective data.
- You and your team typically react in response to problems with loans as opposed to having the information you need to be proactive.

To schedule a presentation or for more information, call MST today at 877.910.9789.



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