



Environmental Risk Management in Commercial Lending

Building a Regulatory Compliant Program

Presented by:

Daria Milburn, CEC, CEM

Housekeeping

- Q&A
- Presentation materials/recording
- Sessions 2 & 3



Overview

Environmental Risk

Regulators

Environmental Regulations

Assessment Tools

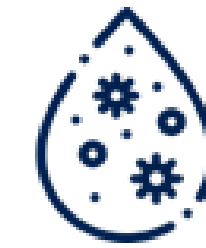
Establishing a Matrix

Program Considerations

Bringing it Together



Environmental Risk



THREAT OF CONTAMINATION

From the use, storage, handling and disposal of chemicals at a property.



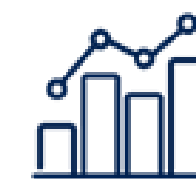
POTENTIAL LIABILITY

For known or potential contamination conditions. Can be Legal (third party claims) or Regulatory (cleanup).



POTENTIAL FINANCIAL OBLIGATION

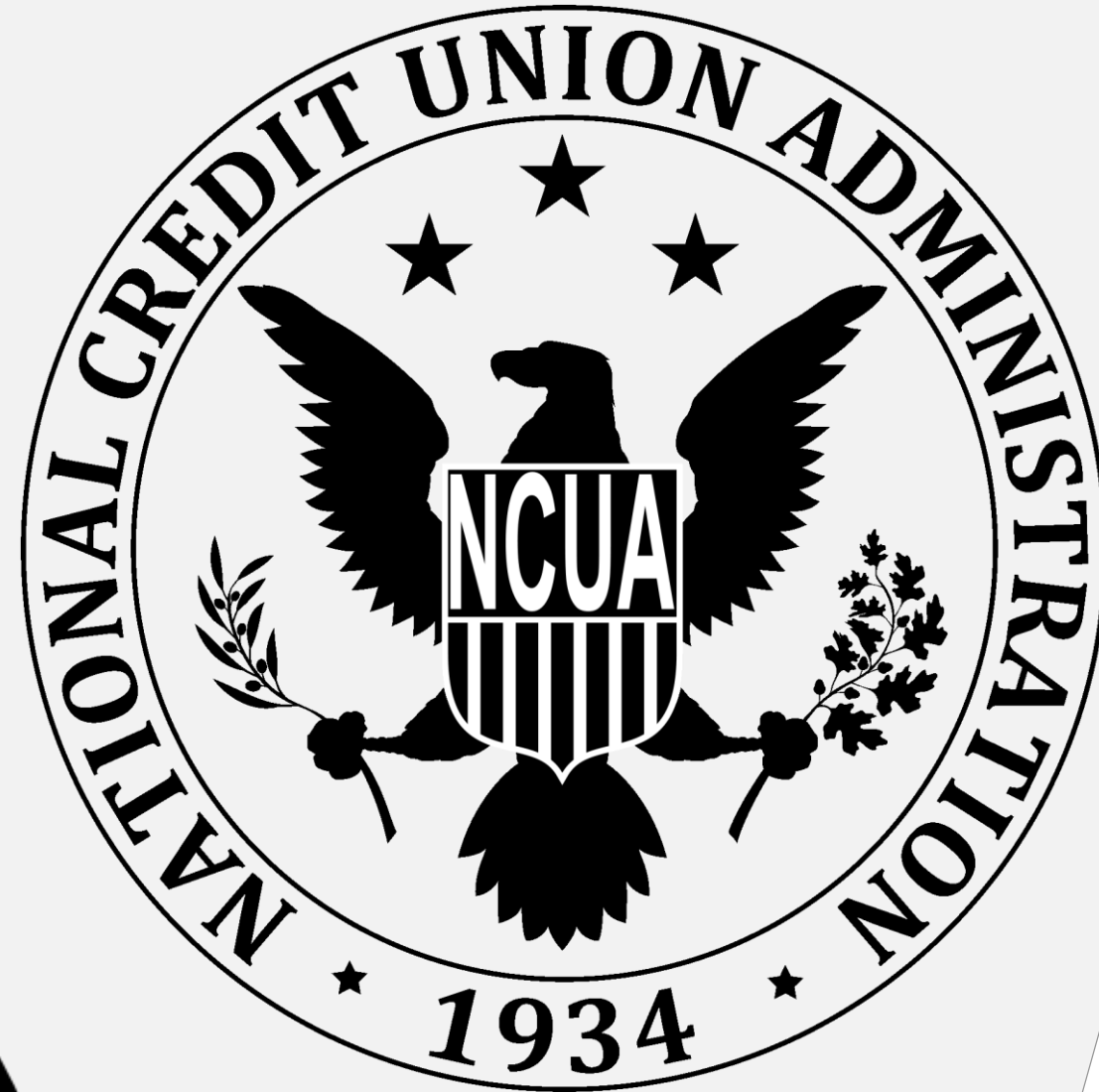
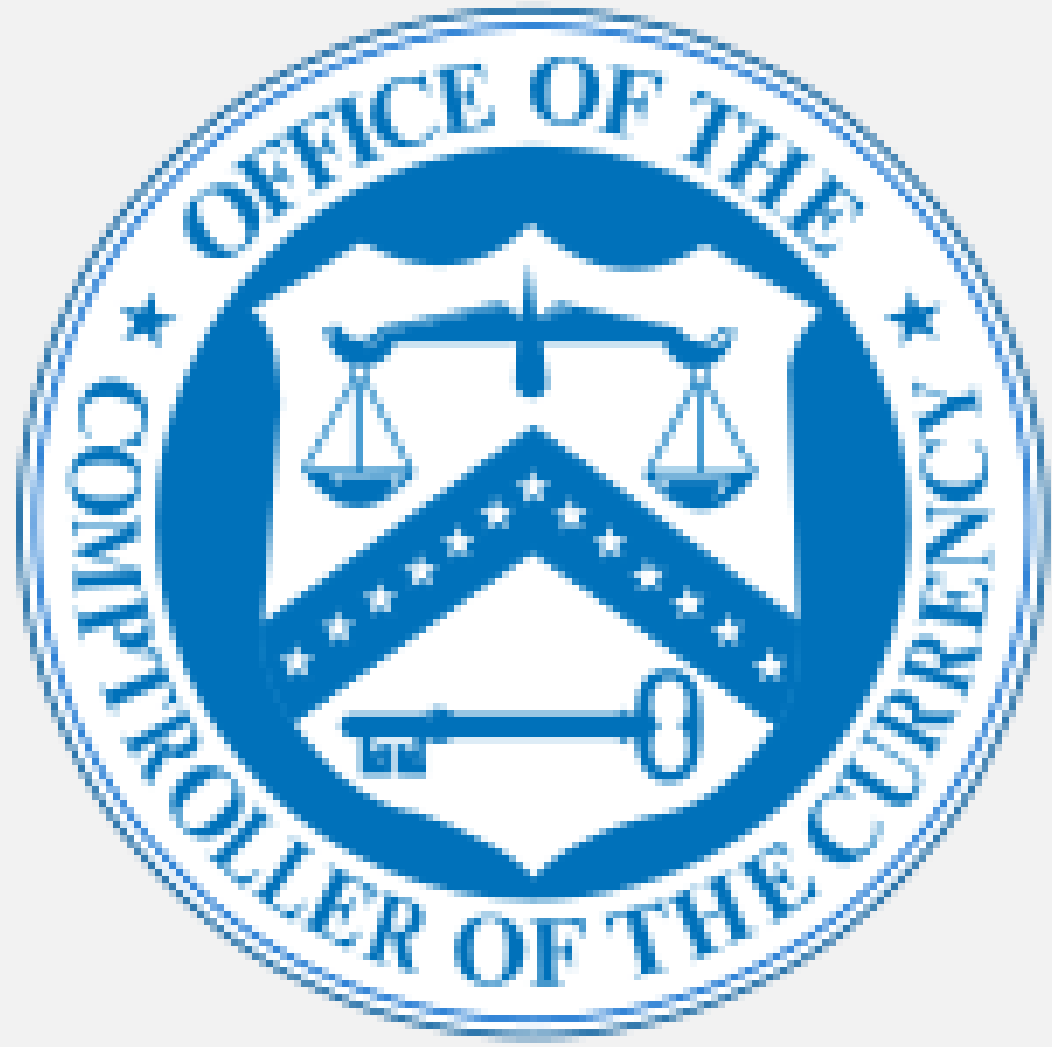
For cleanup of adverse conditions.



MARKETABILITY, REDEVELOPMENT & RESALE

Impacts at a property can make it difficult to market and sell a property at full market value.

Regulators



Regulators

Regulatory guidelines issued by different agencies include provisions for the following program components:

Policies & Procedures
Risk Review & Analysis
Training
Qualifications of Staff
Collateral Monitoring
Loan Documentation
Foreclosure
Vendor Management
Program Auditing

Regulatory Guidance Comparison

OCC (updated 3/2022)
[Comptroller's Handbook A-CRE](#)

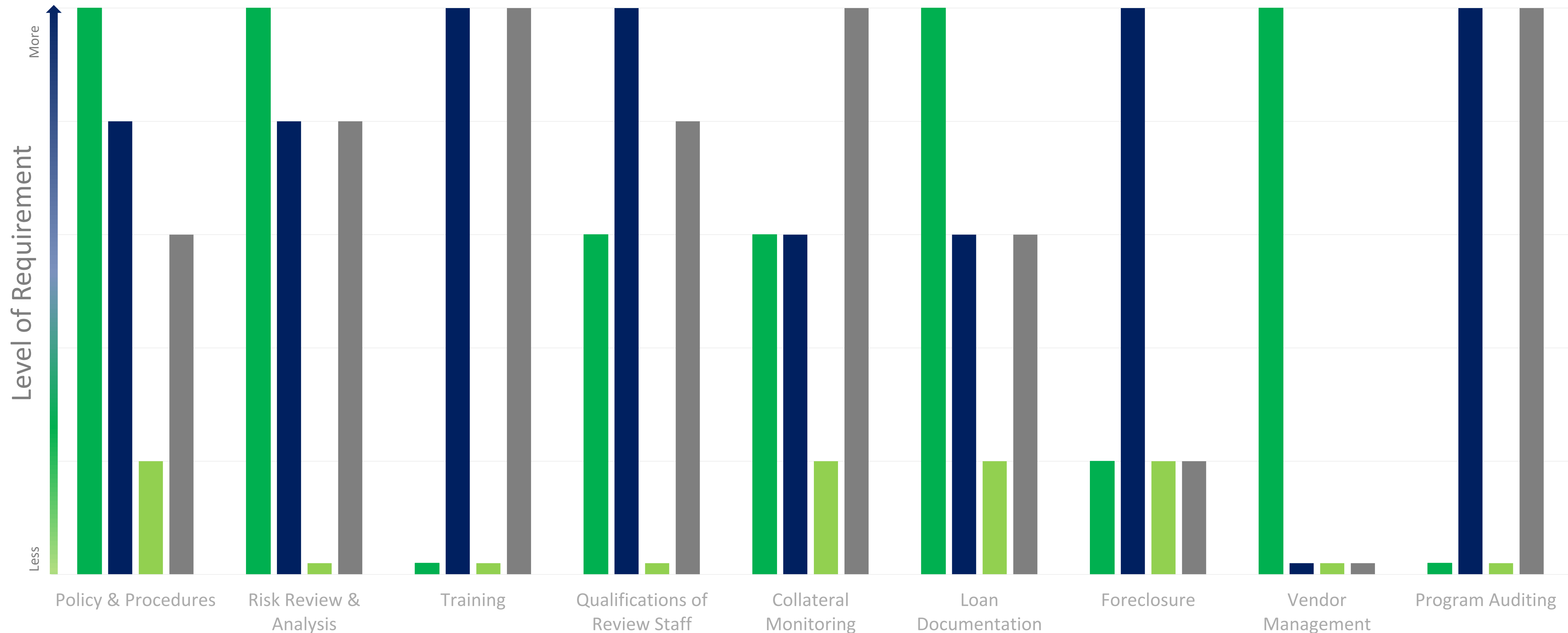
FDIC (11/2006)
[Statements of Policy - Guidelines for an Environmental Risk Program](#)

Federal Reserve (10/1991)
[SR 91-20](#)

NCUA (2008)
[LCU2008-13ENC Guidance for an Environmental Risk Management Program](#)

Requirement Intensity by Regulator

OCC FDIC Federal Reserve NCUA



OCC

Leader

- Policy & Procedures
- Risk Review & Analysis
- Loan Documentation
- Vendor Management

Moderate

- Qualifications
- Collateral Monitoring

Fewer

- Foreclosure

None

- Training
- Program Auditing

FDIC

Leader

- Training ^{w/ NCUA}
- Qualifications of Staff
- Foreclosure
- Program Auditing ^{w/ NCUA}

Moderate

- Policy & Procedures
- Risk Review & Analysis
- Collateral Monitoring
- Loan Documentation

Fewer

None

- Vendor Management

Federal Reserve

Leader

Moderate

Fewer

- Policy & Procedures
- Collateral Monitoring
- Loan Documentation
- Foreclosure

None

- Risk Review & Analysis
- Training
- Qualifications
- Vendor Management
- Program Auditing

NCUA

Leader

- Training ^{w/ FDIC}
- Collateral Monitoring
- Program Auditing ^{w/ FDIC}

Moderate

- Policy & Procedure
- Risk Review & Analysis
- Qualifications
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Fewer

- Foreclosure

None

- Vendor Management

Policy & Procedures

	OCC	FDIC	Federal Reserve	NCUA
Environmental Issues & Lending	Reflect potential environmental risks associated with lending in markets and to industries served by the bank.	Loan policies, manuals and written procedures should address environmental issues pertinent to the institution's specific lending activities.		the Policies loan policy may identify the types of environmental risks associated with industries and real estate in the credit union's trade area.
Statement re: Risk Analysis	Procedures include guidelines that the lending staff should follow in conducting an initial analysis of potential environmental impact	Provide guidelines for conducting an analysis of potential environmental liability.	Conducting an appropriate analysis of potential environmental liability. Such analysis should be more rigorous as the risk of hazardous substance contamination increases.	Provide guidelines for conducting an analysis of potential environmental liability and describe procedures for the resolution of potential environmental concerns.
Procedures	Establish procedures for assessing environmental concerns associated with assets before acquisition by the bank in workout or foreclosures as well as the bank’s investment in real estate assets for its own use.	An institution's environmental risk program may be tailored to the lending practices of the institution. Thus, an institution should make its decision concerning when and under what circumstances to require a borrower to perform an environmental property assessment based on its own environmental risk program as tailored to the needs of the lending practices of the institution.	Establishing guidelines and procedures for dealing with new borrowers and real property offered as collateral.	Procedures for the resolution of environmental concerns might also be developed for credit monitoring, loan workout situations, and foreclosures.
Requirement for Risk Determination	Specify the bank’s requirements for determining potential environmental concerns.			
Environmental Regulations Affecting lender	An analysis of current environmental laws and due diligence requirements for borrowers and the bank .			
Appraisal Considerations	Specify appraisal requirements for disclosing and taking into consideration any environmental risk factors			
Criteria for Evaluating Env Risk	Specify criteria for evaluating environmental risk factors and costs in the loan approval process			
Criterial for Declination	Specify criteria for determining the circumstances in which the bank would normally decline loan requests based on environmental factors			
Procedures for Mitigation		Describe procedures for the resolution of potential environmental concerns. Procedures for the resolution of environmental concerns might also be developed for credit monitoring, loan workout situations, and foreclosures.		

Risk Review & Analysis

	OCC	FDIC	Federal Reserve	NCUA
Review Before Lending	Provide for the receipt and evaluation of environmental risk assessment reports before the bank's final commitment to lend on a transaction.	An environmental risk program should be designed to ensure that the institution makes an informed judgment about potential environmental risk and considers such risks in its overall consideration of risks associated with the extension of credit.	When reviewing individual credits, examiners should determine that the loan policy has been complied with, particularly where the borrower's activities or industry are associated with hazardous substances or environmental liability.	Prior to making a loan, an initial environmental risk analysis should be conducted during the application process. Most of the information needed may be gathered by the loan officer when interviewing the loan applicant concerning his or her business activities... ... Whenever the application, interview, or site visit indicates a possible environmental concern, a more detailed investigation by a qualified individual may be necessary.
Policy & Procedure	Provide means of evaluating potential environmental liability risk and environmental factors that could impact the ability to recover loan funds in the event of a foreclosure.	Institutions should maintain an environmental risk program in order to evaluate the potential adverse effect of environmental contamination on the value of real property and the potential environmental liability associated with the real property.		The credit union's policies and procedures should reflect adequate consideration of the EPA's AAI Rule. The decision to require a member to perform a property assessment that meets the requirements of the EPA AAI Rule should be made in the context of the credit union's overall environmental risk management program and should be made on a case-by-case basis.
Asbestos & Lead	Evaluate the potential for significant impact resulting from the presence of hazardous building material such as asbestos and lead-based paint.			

Training

	OCC	FDIC	Federal Reserve	NCUA
Program Implementation Training		The environmental risk program should incorporate training sufficient to ensure that the environmental risk program is implemented and followed within the institution.		The environmental risk management program should incorporate training sufficient to ensure that the program is implemented and followed within the credit union, and the appropriate personnel have the knowledge and experience to determine and evaluate potential environmental concerns that might affect the credit union.

Qualifications of Review Staff

	OCC	FDIC	Federal Reserve	NCUA
Relevant Knowledge	Ensure that persons responsible for evaluating environmental risk possess relevant knowledge, skill, and competence.	Appropriate personnel have the knowledge and experience to determine and evaluate potential environmental concerns that might affect the institution.		Appropriate personnel have the knowledge and experience to determine and evaluate potential environmental concerns that might affect the institution.
Third Party Engagement		Whenever the complexity of the environmental issue is beyond the expertise of the institution's staff, the institution should consult legal counsel, environmental consultants, or other qualified experts.		Whenever the complexity of the environmental issue is beyond the expertise of credit union staff, the credit union should consult legal counsel, environmental consultants, or other qualified experts.
Program Owner		Designate a senior officer knowledgeable in environmental matters responsible for program implementation. Individuals involved in administering an institution's environmental risk program should become familiar with environmental statutory elements.		

Collateral Monitoring

	OCC	FDIC	Federal Reserve	NCUA
Monitoring	Provide guidelines that the lending staff should follow for monitoring potential environmental concerns for the duration of loans held in the bank’s loan portfolio.	The environmental risk assessment should continue during the life of the loan by monitoring the borrower and the real property collateral for potential environmental concerns. The institution should be aware of changes in the business activities of the borrower that result in a significant increased risk of environmental liability associated with the real property collateral. If there is a potential for environmental contamination to adversely affect the value of the collateral, the institution might exercise its rights under the loan to require the borrower to resolve the environmental condition and take those actions that are reasonably necessary to protect the value of the real property.	Reviewing existing loans to identify credits having potential environmental problems.	The environmental risk assessment should continue during the life of the loan by monitoring the member and the collateral for potential environmental concerns. The credit union should be aware of changes in the business activities of the member that result in a significant increased risk of environmental liability associated with the collateral. If there is a potential for environmental contamination to adversely affect the value of the collateral, management might exercise its rights under the loan to require the member to resolve the environmental condition and take those actions that are reasonably necessary to protect the value of the real property.
Higher Risk Properties	Include periodic inspection requirements throughout the loan term for properties with higher environmental risk			In monitoring a loan for potential environmental concerns, and resolving those environmental situations as necessary, a credit union should evaluate whether its actions may constitute “participating in management” Involvement in the Member’s Business Operations 3 of the business located on the real property collateral within the meaning of CERCLA. A lender “participates in management” (and may not qualify for the exemption) if the lender “actually” participates in the management or operational affairs of a property. Merely having the capacity to influence or the unexercised right to control the property does not constitute “participating in management.”

Loan Documentation

	OCC	FDIC	Federal Reserve	NCUA
Safeguarding	<p>Maintain guidelines for loan documentation that protect the bank from environmental liability and related losses</p> <p>Loan documentation should ensure that contractual provisions, including rights of access, are sufficient to facilitate AAI-compliant evaluations A bank's policies and procedures should reflect adequate consideration of the EPA's AAI rule.</p>	<p>Loan documents should include language to safeguard the institution against potential environmental losses and liabilities. Such language might require that the borrower comply with environmental laws, disclose information about the environmental status of the real property collateral and grant the institution the right to acquire additional information about potential hazardous contamination by inspecting the collateral for environmental concerns.</p> <p>Loan documents might also provide that the institution has the right to call the loan, refuse to extend funds under a line of credit, or foreclose if the hazardous contamination is discovered in the real property collateral. The loan documents might also call for an indemnity of the institution by the borrower and guarantors for environmental liability associated with the real property collateral.</p>	<p>Developing recordkeeping procedures to document the due diligence efforts taken at the time of making loans or acquiring real property.</p> <p>Including warranties, representations, and indemnifications in loan agreements designed to protect the banking organization from losses stemming from hazardous substance contamination. (Although such provisions provide some protection for the lender, these agreements are not binding against the government or third parties. Such contractual protections are only as secure as the borrower's financial strength.</p>	<p>Loan documents should include language to safeguard the credit union against potential environmental losses and liabilities. Such language could include requiring the member to comply with environmental laws, disclosure of information about the environmental status of the collateral and granting the credit union the right to acquire additional information about potential hazardous contamination by inspecting the collateral for environmental concerns.</p> <p>The loan documents may also require that the credit union has the right to call the loan, to refuse to extend funds under a line of credit, or to foreclose if the hazardous contamination is discovered in the real property collateral. The loan documents may call for an indemnity of the credit union by the member and any loan guarantors for environmental liability associated with the collateral. Credit unions are encouraged to consult with an attorney knowledgeable in federal and state environmental laws to help ensure loan documents are properly worded to help safeguard against environmental liability.</p>
Manage Expectations	<p>Provide environmental provisions for incorporation into transaction documentation:</p> <ul style="list-style-type: none">– for commitment letters: extent of due diligence required, borrower costs, approval contingencies, reporting obligations, documentation requirements.– for loan documentation: representations and warranties, inspection requirements, reporting requirements, lien covenants, indemnification provisions, and provisions allowing for the acceleration of the loan, refusal to extend funds under a line of credit, or exercise other remedies in the event of foreclosure.			

Foreclosure

	OCC	FDIC	Federal Reserve	NCUA
CERCLA Liability	Provide guidelines for maintaining lender liability exemptions, avoiding owner/operator liability, and for qualifying for Landowner Liability Protections under CERCLA and AAI if the bank acquires ownership of the property	<p>A lender's exposure to environmental liability may increase significantly if it takes title to real property held as collateral. An institution should evaluate the potential costs and liability for environmental contamination in conjunction with an assessment of the value of the collateral in reaching a decision to take title to the property by foreclosure or other means. Based on the type of property involved, a lender should consider including as part of this evaluation of potential environmental costs and liability an assessment of the property that meets the requirements of the EPA All Appropriate Inquiry Rule.</p> <p>An institution should evaluate whether its actions may constitute "participating in the management" of the business located on the real property collateral within the meaning of CERCLA. If its actions are considered to be participation in the management, the institution may lose its exemption from liability under CERCLA or similar state statutes.</p>	Banking organizations must be careful that the actions undertaken to make, administer, and collect loans--including assessing and controlling environmental liability--cannot be construed as taking an active role in participating in the management or day-to-day operations of the borrower's business, which could lead to potential liability under CERCLA	A credit union's exposure to environmental liability may increase significantly if it takes title to real property held as collateral. A credit union should evaluate the potential costs and liability for environmental contamination in conjunction with an assessment of the value of the collateral in reaching a decision to take title to the property by foreclosure or other means. Based on the type of property involved, a credit union should consider including as part of this evaluation of potential environmental costs and liability an assessment of the property that meets the requirements of the EPA AAI Rule.
Operational Control		An institution should evaluate the potential costs and liability for environmental contamination in conjunction with an assessment of the value of the collateral in reaching a decision to take title to the property by foreclosure or other means. Based on the type of property involved, a lender should consider including as part of this evaluation of potential environmental costs and liability an assessment of the property that meets the requirements of the EPA All Appropriate Inquiry Rule.		*see Collateral Monitoring

Vendor Management

	OCC	FDIC	Federal Reserve	NCUA
Performance	Program should specify selection criteria to evaluate and monitor the performance of third-party professionals, such as environmental experts or legal counsel, who may be consulted to assess environmental risk			

Program Auditing

	OCC	FDIC	Federal Reserve	NCUA
Auditing		Examiners will review an institution's environmental risk program as part of the examination of its lending and investment activities. When analyzing individual credits, examiners will review the institution's compliance with its own environmental risk program. Failure to establish or comply with an appropriate environmental program will be criticized and corrective action required.		

Environmental Regulations

Federal Environmental Regulations

CERCLA (aka Superfund)

Comprehensive Environmental Response, Compensation & Liability Act

- Clean up uncontrolled or abandoned hazardous-waste sites as well as accidents, spills, and other emergency releases into the environment. EPA will seek out those responsible parties for any release and assure their cooperation in the cleanup.
- Secured Creditor Exemption (aka Lender Safe Harbor)

EPA All Appropriate Inquiry- 40CFR 312

- Help prospective purchasers of a property preserve their “Innocent Landowner Defense” under CERCLA.

Small Business Liability Relief and Brownfields Revitalization Act (aka “Brownfields Law”)

- Amendment to CERCLA to provide funding for cleanup and redevelopment of contaminated sites.

CERCLA Secured Creditor Exemption

Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996

Lenders that hold property as security for a debt may be spared CERCLA liability in the event of foreclosure provided that:

No Operational Control

Lender does not participate in the management of the facility prior to its foreclosure.

Timely Disposal of Facility

Lender offloads the facility at the “earliest practicable, commercially reasonable time, on commercially reasonable terms,” after foreclosure.

Important to note :

Spared Liability Doesn't Guarantee No Cost to Lender

Regulatory agencies may require actions to prevent exacerbation of a condition or maintain minimal safety levels for the community.

Example: https://www.epa.gov/sites/production/files/2014-03/documents/component_concepts_155.pdf

Fun Facts

OCC (updated 3/2022)

Although the most recent of documents, still references an outdated ASTM standard for Phase I ESAs.

FDIC (11/2006)

Predates existing ASTM standard. Predates existing ASTM standard.

Federal Reserve (10/1991)

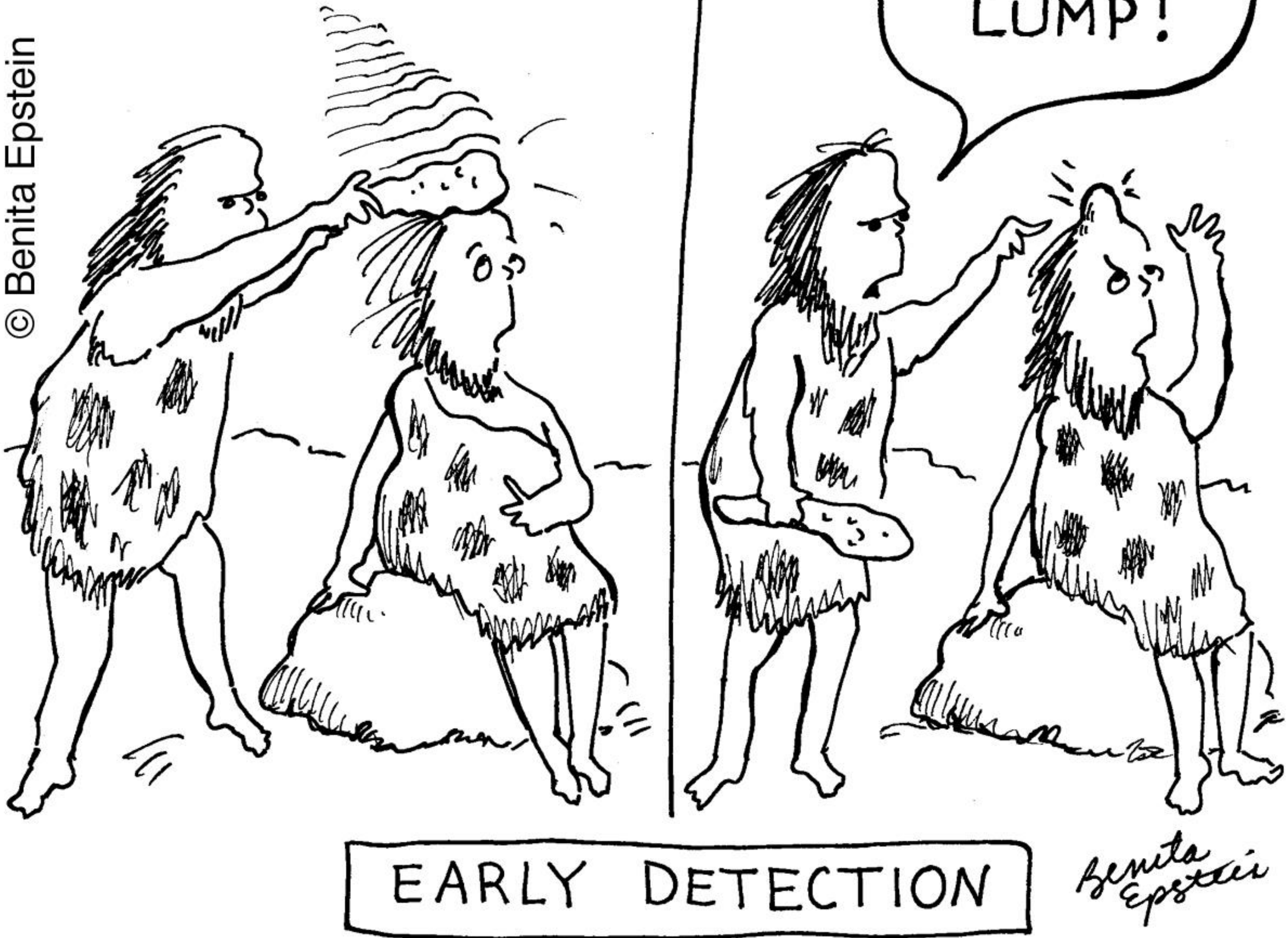
Predates AAI and ANY ASTM Phase I ESA Standard.

NCUA (2008)

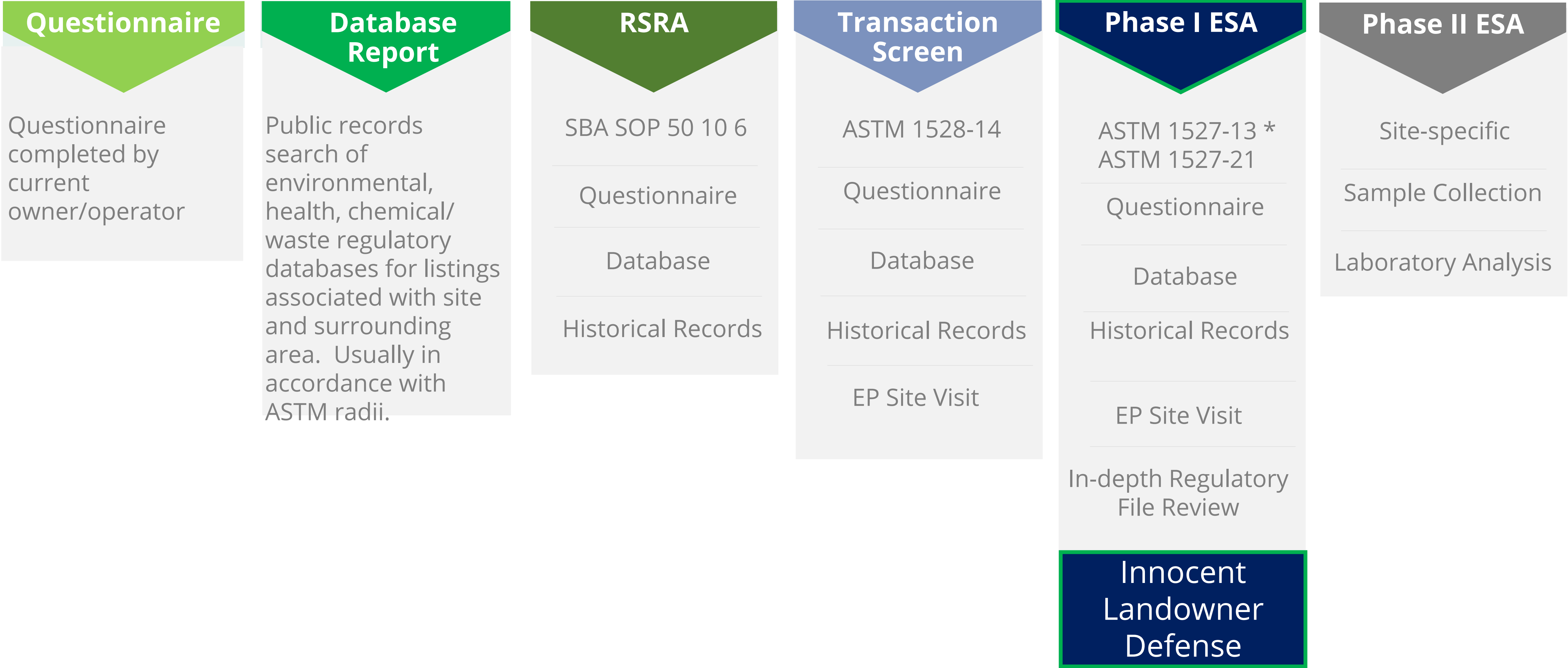
Predates existing ASTM standard. References AAI but not the ASTM.

Assessment Tools

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Risk Identification Tools

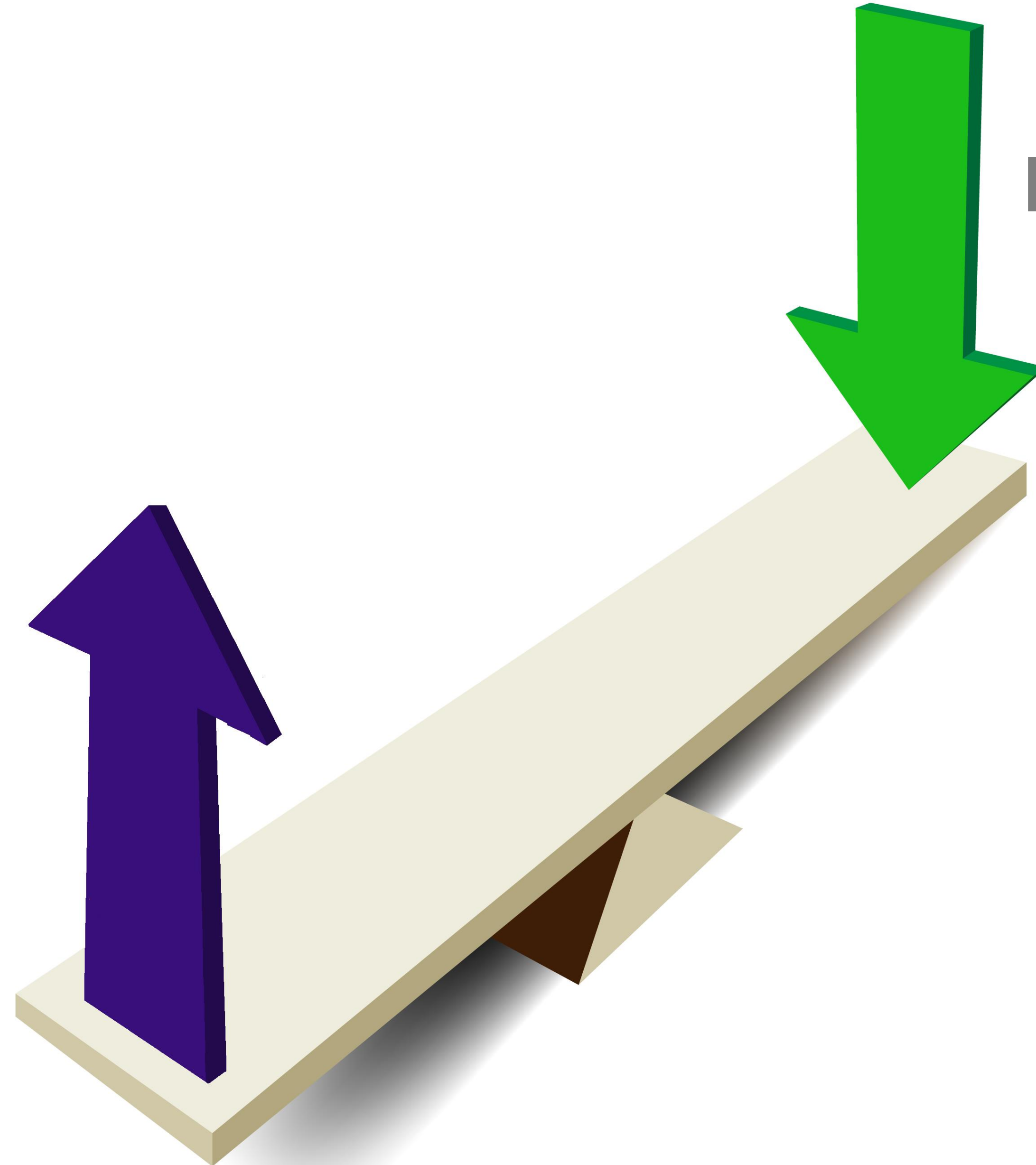


Matrix

Building a Matrix

Understandable tolerance Efficient
communicate Clear **RISK** foreclosure MONITORING
RENEWAL
New Loan SBA USDA
Portfolio Analysis property use loan amount
default rates by loan amount foreclosure trends abundance of caution
exceptions Consistent
Easily Implemented

Exceptions



Program Integrity

Sample Matrices

SIMPLE MATRIX

	Risk Level	Loan Amount	Requirement		
			Lenient	Moderate	Conservative
New Loans & Renewals w/ New Money	Low	≤\$5MM	Database Report	RSRA-Equivalent	Transaction Screen Assessment
		>\$5MM	RSRA-Equivalent	Phase I ESA	Phase I ESA
	High	≤\$5MM	Transaction Screen Assessment	Transaction Screen Assessment	Phase I ESA
		>\$5MM	Transaction Screen Assessment	Phase I ESA	Phase I ESA
Renewals w/ No New Money	Low	Any	Questionnaire	Database Report	RSRA-Equivalent
	High	Any	Database Report	Database Report	Transaction Screen Assessment
Pre-Foreclosure	Any	Any	Phase I ESA	Phase I ESA	Phase I ESA
Abundance of Caution	Any	Any	Nothing	Nothing	Nothing

COMPLEX MATRIX

	Risk Level	Loan Amount	Requirement		
			Lenient	Moderate	Conservative
New Loans & Renewals w/ New Money	Low	<\$1MM	Database Report	RSRA-Equivalent	Transaction Screen Assessment
		\$1MM - \$5MM	RSRA-Equivalent	RSRA-Equivalent	Phase I ESA
		>\$5MM	Transaction Screen Assessment	Phase I ESA	Phase I ESA
	High	<\$1MM	Database Report	Phase I ESA	Phase I ESA
		\$1MM - \$5MM	Transaction Screen Assessment	Phase I ESA	Phase I ESA
		>\$5MM	Transaction Screen Assessment	Phase I ESA	Phase I ESA
Renewals w/ No New Money	Low	Any	Questionnaire	Database Report	RSRA-Equivalent
	High	Any	Database Report	Database Report	Transaction Screen Assessment
Pre-Foreclosure	Any	Any	Phase I ESA	Phase I ESA	Phase I ESA

Start
Simple

Not sure where to begin?

The [SBA SOP 50 10 6](#) is a great place to start.

Implementation

The more complex, the harder to implement, the harder to be consistent, increased exceptions, decreased program integrity.

Know your limits!

Are there any circumstances under which you would not accept a property as collateral?

Manage expectations!

Keep communication clear – this will allow better communication to the LOB and client.

Brought to you by.....

Moment of Affirmation

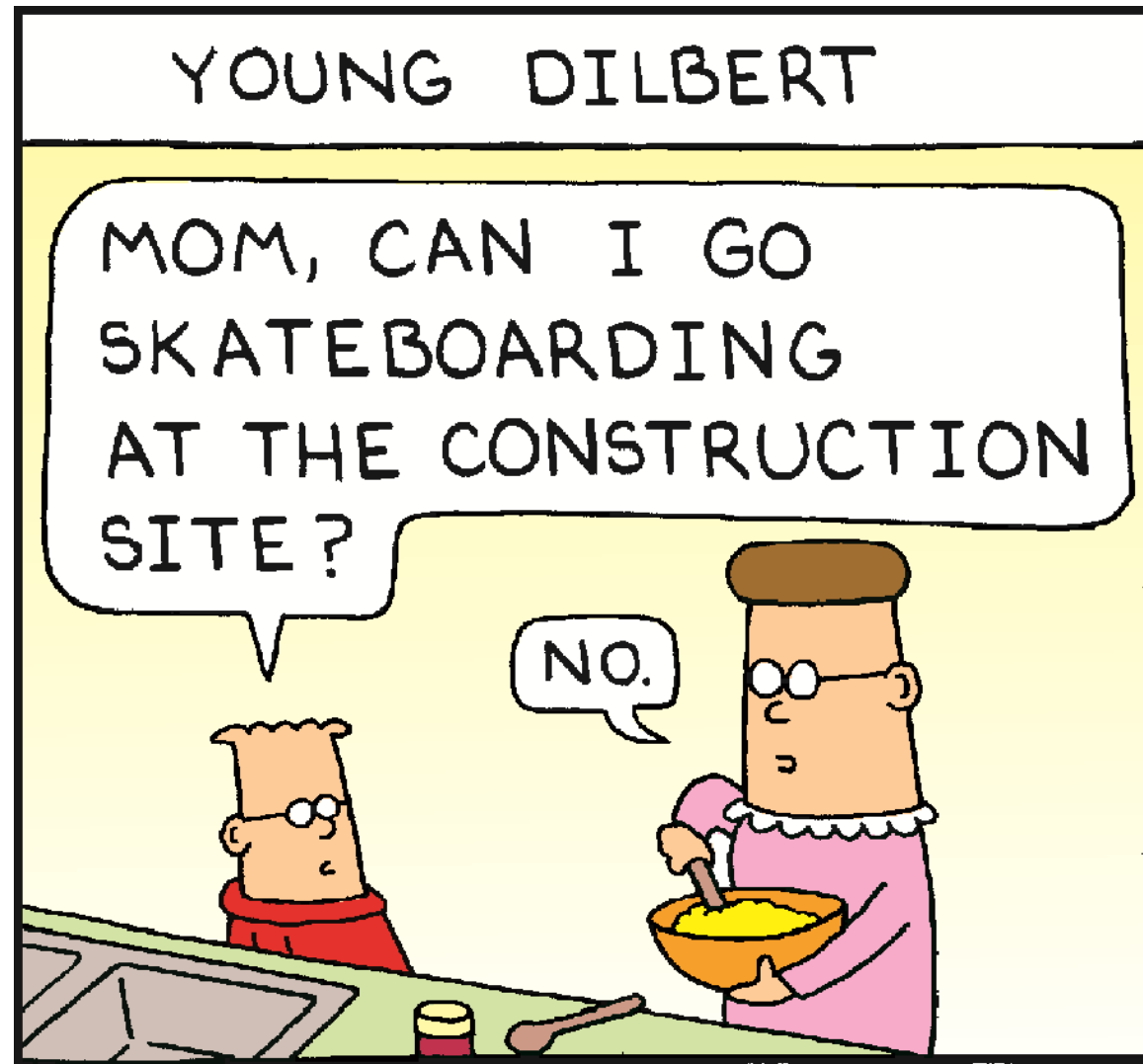


CREtelligent

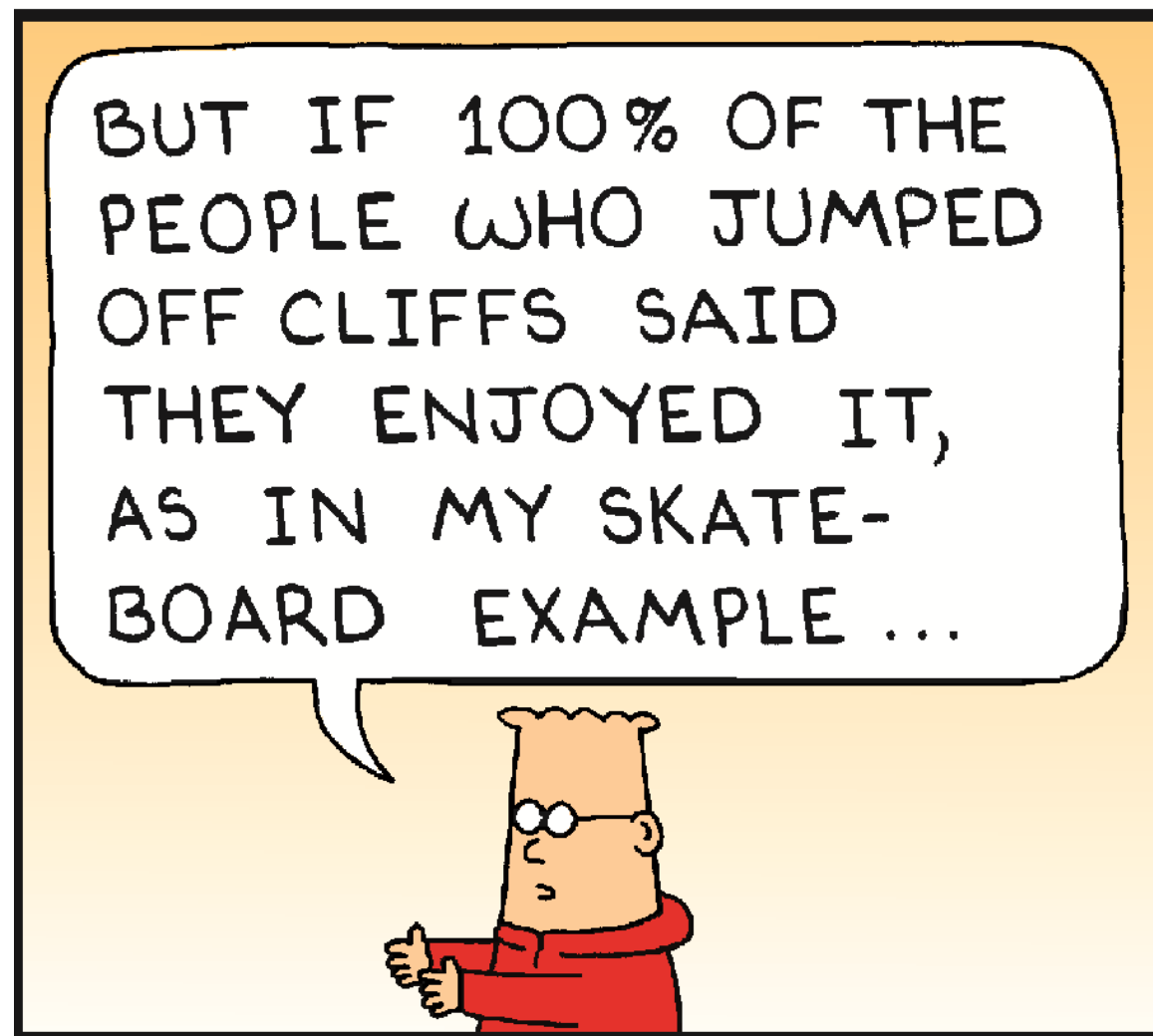
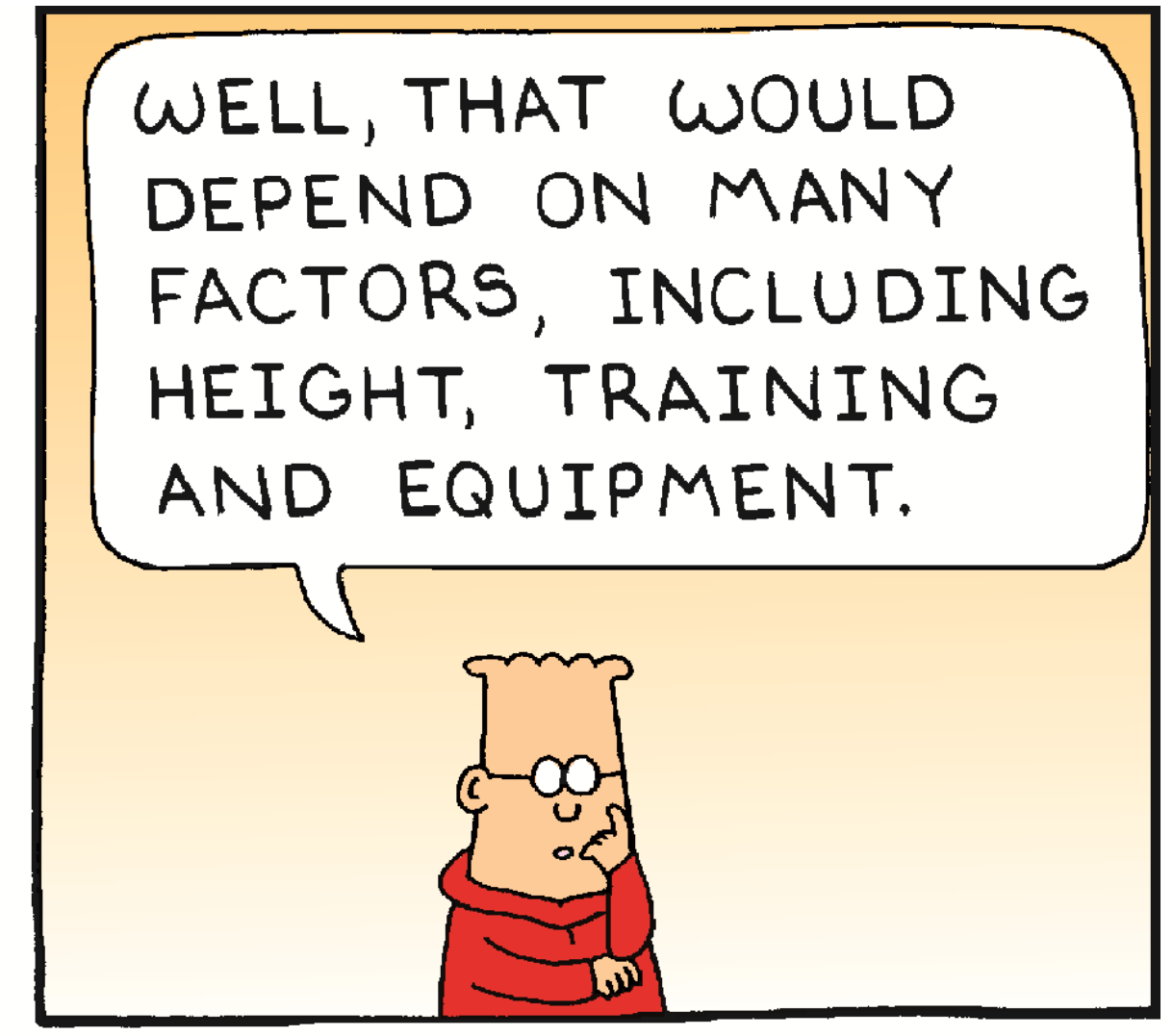
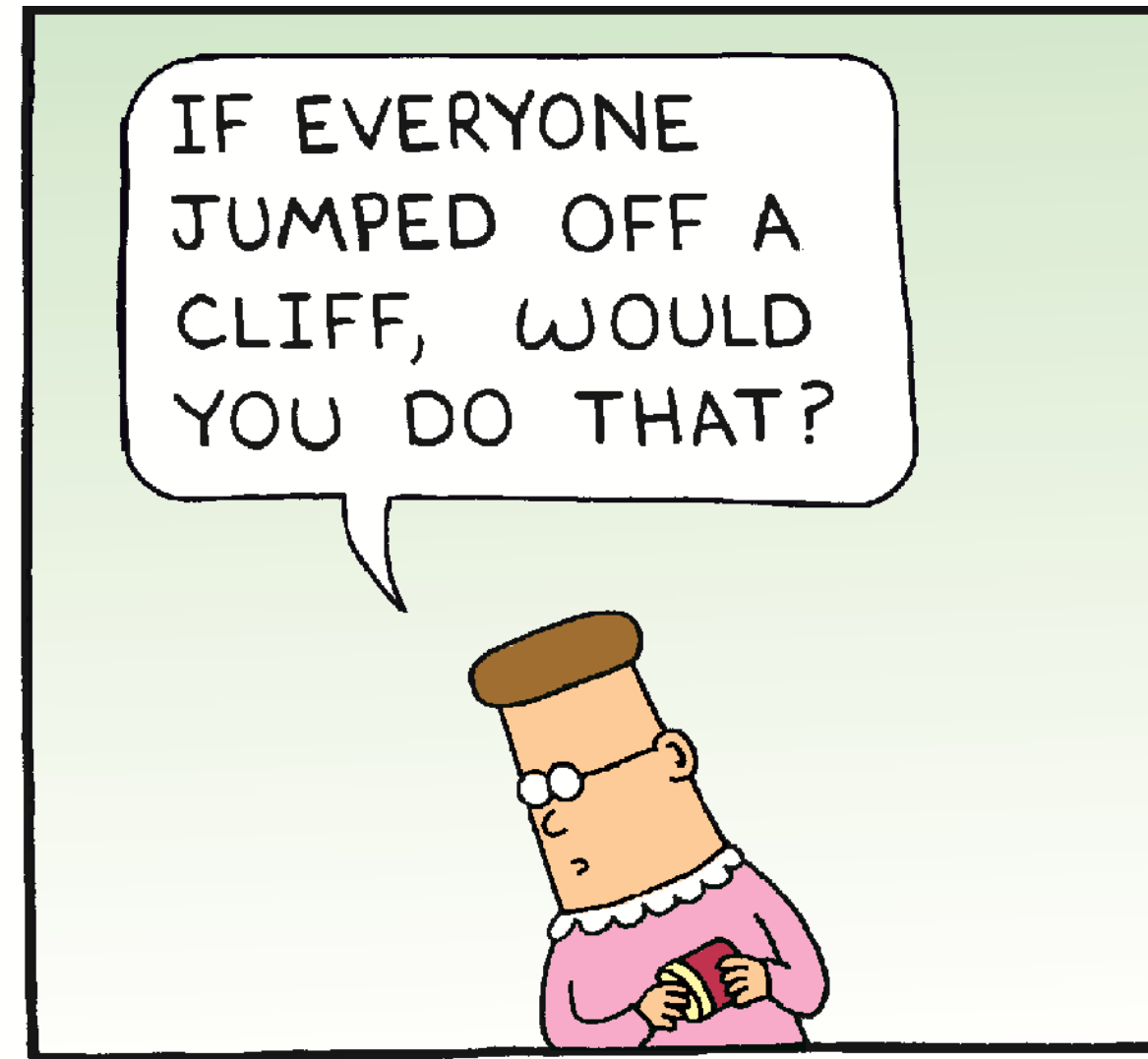
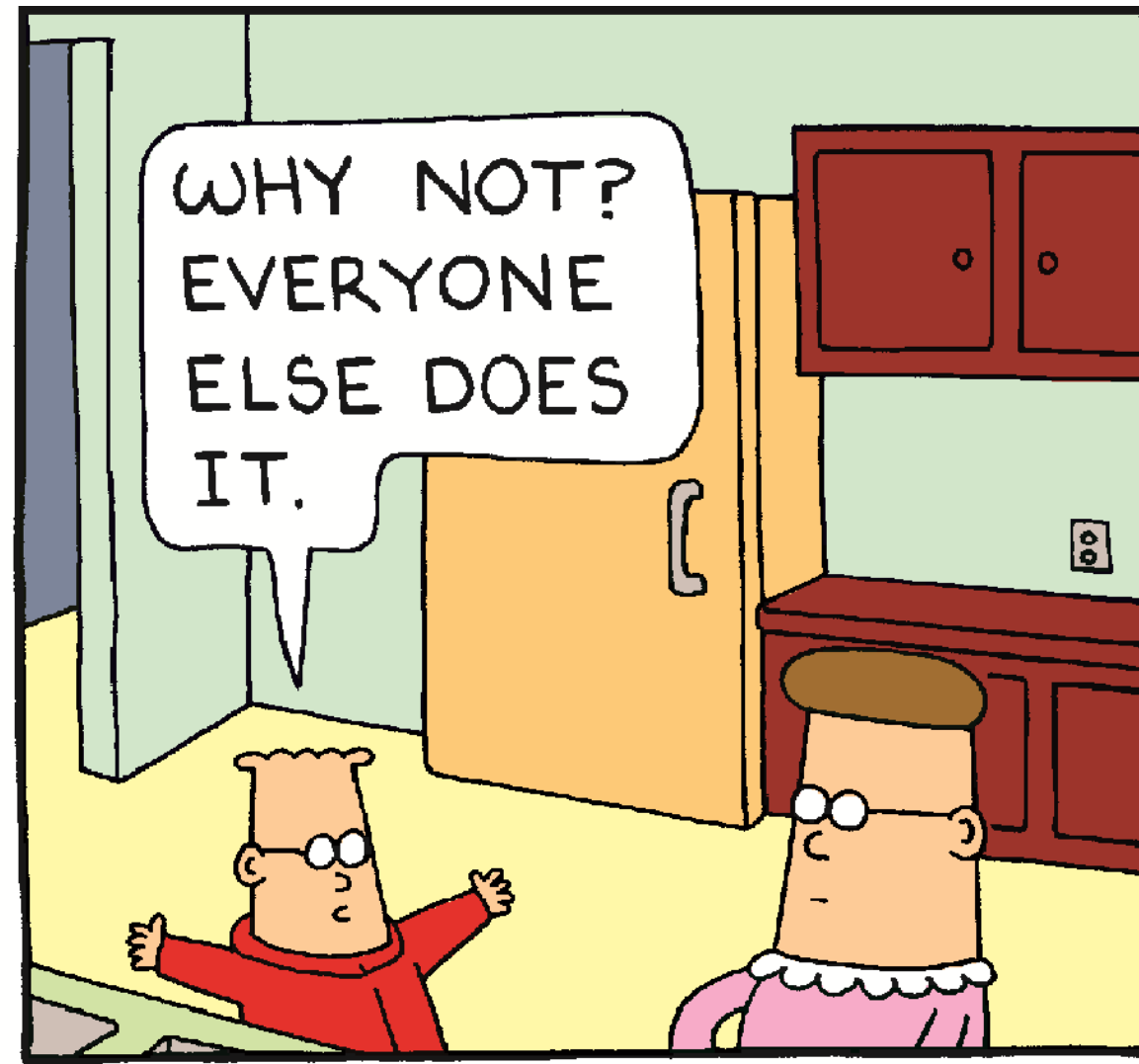
Commercial Real Estate Due Diligence. Simplified.

Risk Management \neq Risk Elimination

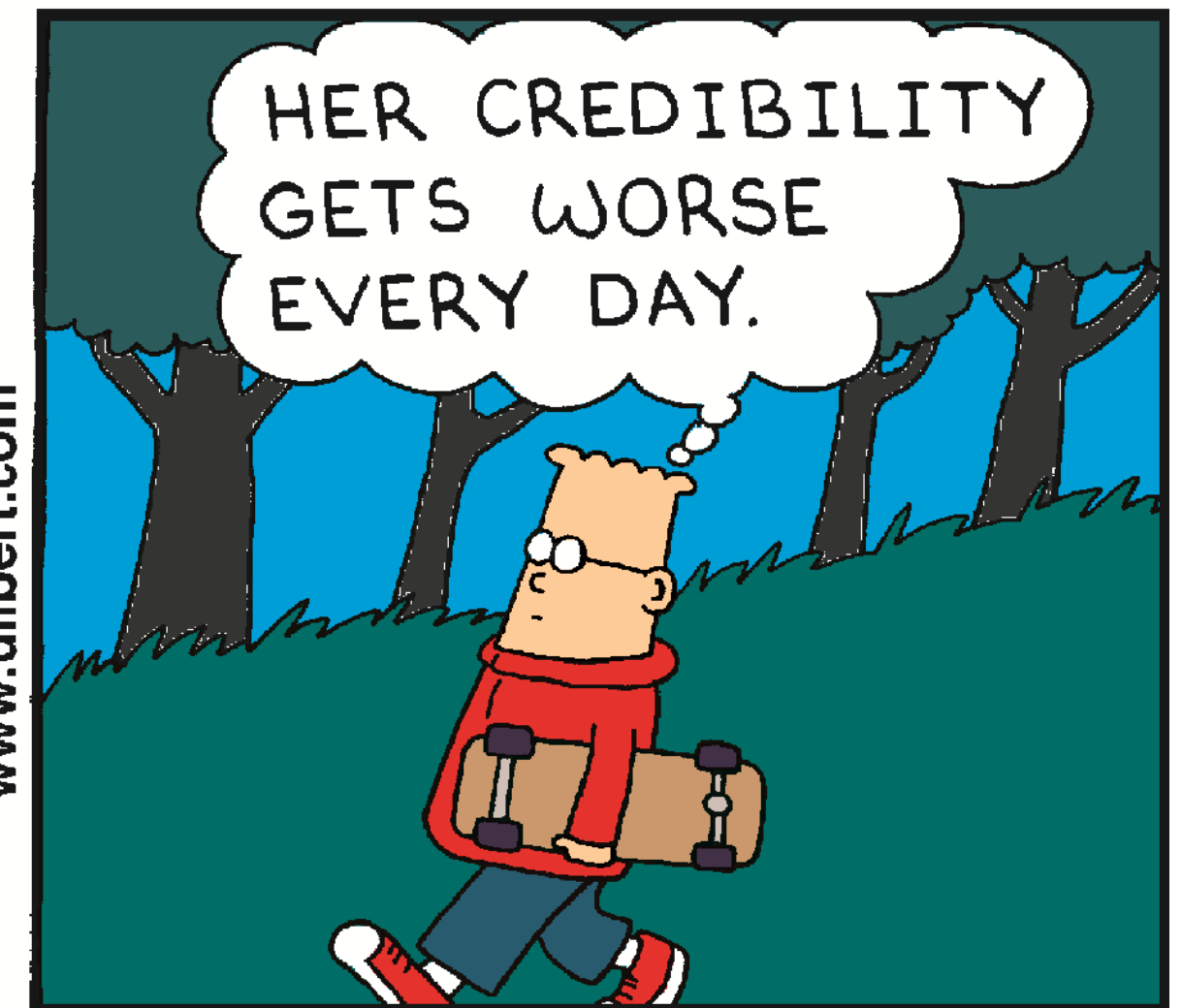
You cannot account for risk management practices of other lenders.



E-mail: SCOTTADAMS@AOL.COM



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Policy & Program Considerations

Policy Document

WHY

- Mission Statement: Identify the purpose of the policy
- Regulatory drivers (Federal Reserve, FDIC, OCC)

WHO

- Party/Position responsible for owning /implementing the Policy
- LOBs which must adhere to Policy Requirements
- Party/Position responsible for tracking/maintaining Policy updates

WHAT

- Definitions (risk, report types, environmental terms, acronyms)
- Policy Matrix
- Criteria for Acceptability
- Procedures (conventional lending, SBA, foreclosure, deviations)

WHEN

- Effective date of policy
- Policy review and updates (annual, bi-annual, 5-year)
- Revisions dates of policy

WHERE

- Organizational structure
- Location of Policy (intranet, credit resources)

Establishing A Successful Program

Define Risk Tolerance

How much can be tolerated without presenting excessive risk to portfolio integrity.

Considerations:

- Portfolio demographics.
- Trends in default
- Recent losses
- Terms for declination
- Reliance
- Outside reports
- Operational control

Establish A Matrix

Be clear. Simple is best.

Considerations:

- Define “High Risk” list
- Practicality
- Cost
- Sufficiency of information
- New Loans
- Renewals
- Foreclosure
- Construction
- Abundance of Caution
- Condominium
- Waivers

Implement

A successful program should consider:

- Consult with stakeholders
- Socialize program
- Training
- Accountability
- Vendor vetting
- Tracking
- Consistent application
- Centralization
- Segregation of duties
- Decision authority
- Well-defined waiver process.

Monitor

- Balanced outcome?
- Waiver frequency
- Policy updates
- Collateral Monitoring

Additional Program Considerations

Regulators are looking for adherence and consistency in policy implementation.

Develop a regular monitoring plan to review the policy effectiveness.

Document the rationale for all decisions.

Vendor Management

- Collecting SOQs, Errors & Omissions or Professional Liability Insurance Certificates
- Clear terms of engagement and scopes of work.
- Scoring
- Managing Terms & Conditions

LOB Training

- Review Staff Training
- Policy Training
- Subject Matter/"Topic" training.

Bringing it Together



Know your regulator's expectations.

Understand your portfolio.

Establish a matrix that can be easily implemented.

Be consistent.

Spared liability doesn't guarantee no cost to lender. Beware Operational Control.

Train, train, and retrain!

QUESTIONS?

Next Session:

Risk Tolerance, Management & Mitigation Strategies
August 17, 11 am Pacific/2 pm Eastern



| THANK YOU

📞 (252) 461-4861

✉️ d.milburn@cretelligent.com

📍 11344 Coloma Rd., Gold River, CA

🌐 www.cretelligent.com