BANK ANALYSIS

Loan Policy

Loans are usually not only the main asset of a commercial bank, they are also the main basis to generate revenues. Therefore, a bank´s loan policy in regards to both, issuing loans as well as managing them is most of the time at the heart of its business strategy.

Banks can broadly be distinguished between wholesale banks, mostly focused on lending to (larger) corporates and retail banks, focused on lending to individuals and (smaller) corporates. However, most banks make loans to both types of borrowers.

In formulating a loan policy, a bank will have to define both, the volume and the quality of loans issued. A bank will have to strategically decide whether to foremost focus thereby on: credit quality, profit, or market share. In parallel the bank will have to balance these aspects with constraints, such as:

- Liquidity requirements: As most loans are medium- / long-term, the bank has to assess whether sufficient as well as adequate maturity of funding is available. However, most banks are usually characterized by a vast short-term deposit funding base
- Capital constraints: As a bank has to always (also by regulatory standards) maintain an adequate base of long-term as well as equity and equity-related funding, such may forbid extending loans of a certain quality, or even at all
- Risk constraints: Loans and whole loan portfolios can differ in quality, such as: The standing of a borrower, loan currency, industry exposure, loan portfolio diversification or simply loan terms in view of risk assumed. Such constraints may limit further exposure
- Return objectives: Obviously, an acceptable return has to not only adequately reflect and compensate for loan risk assumed, but also match yield expectations by investors, such as the bank´s shareholders

In implementing a loan policy, the marketing, issuance, monitoring / administration and – if required – restructuring of loans is managed by separate divisions, not least to address possible conflicts of interest. In setting loan terms as well as adequately monitoring them, scoring schemes are applied to assess the quality of a loan and its borrower. Technology has enabled loans to be increasingly offered on a standardized basis. This has also increasingly facilitated the securitization of loans which are subsequently sold in marketable packages.

LOAN POLICY ELEMENTS

- FEATURES OF A GOOD LOAN PORTFOLIO
  - TYPES
  - MATURITIES
  - SIZES
  - QUALITY
- LENDING AUTHORITY OF OFFICERS AND COMMITTEE
  - SIZE
  - TYPE
  - SIGNATURES AND APPROVAL
- REPORTING AND INFORMATION
- PROCEDURES
  - SOLICITING
  - EXAMINING
  - DECISION MAKING
  - MONITORING
  - WORK-OUT, RESTRUCTURING