Loan Policy

Loans are both, a commercial bank´s main asset as well as its principal basis for generating revenues. Therefore, a bank´s policy and standards in issuing loans as well as managing them is the essential component of its business strategy.

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

In formulating a loan policy, a bank will have to define both, the volume and the quality of loans issued. Thereby, a bank will have to decide whether its main goal is pursuing:

- Credit quality, or
- Profit, or
- Market share.

At the same time, a bank will have to balance these aspects within a network of constraints, such as:

- Liquidity requirements: As most loans are medium- / long-term, a bank has to assess whether sufficient capacity as well as adequate maturity of funding is available. However, most banks are characterized by a vast overhang of short-term deposit funding.
- Capital constraints: Not least by regulatory standards, a bank has to constantly ensure an adequate base of long-term as well as equity and equity-related funding, which may forbid extending loans of a certain quality, or even at all.
- Risk constraints: Loan portfolios can differ in quality, such as borrower standing, 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 adequately reflect and compensate for loan risk assumed, as well as match yield expectations by investors, among them a bank´s shareholders.

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

LOAN POLICY ELEMENTS

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

For more concepts click on: