Portfolio Servicing and Management for Commercial Lenders

By Mark Caulfield

Effective management of the loan portfolio and the credit function is fundamental to a lender's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is a primary supervisory activity. Assessing LPM involves evaluating the steps management takes to identify and control risk throughout the credit process. The assessment focuses on what management does to identify issues before they become problems.

For decades, good loan portfolio managers have concentrated most of their effort on carefully approving loans and carefully monitoring loan performance. These activities continue to be mainstays of loan portfolio management. Traditional practices rely too much on trailing indicators of credit quality such as delinquency, nonaccrual, and risk rating trends. Commercial lenders have found that these indicators do not provide sufficient lead time for corrective action.

Good loan portfolio managers have focused most of their time on diligently approving loans and monitoring loan performance. Although these activities continue to be relevant today, analysis of past credit problems, such as commercial real estate lending in the 1980s, has made it clear that portfolio managers can never take their eye off the ball. Lending practices that rely too much on trailing indicators of credit quality such as delinquency, nonaccrual, and risk rating trends can be faulty.

Commercial lenders have found that these indicators do not always allow enough lead time to take action when there is an increase in risk. An effective loan portfolio management strategy starts with oversight of the risk in individual loans. Careful risk selection is important to maintaining favorable loan quality. The historical importance on controlling the quality of individual loan approvals and managing the performance of loans continues to be vital. But better technology and information systems such as LeasePlus from Lease Team, Inc have opened the door to better management methods. A portfolio manager can now obtain early indications of increasing risk by taking a more comprehensive view of a loan.

To manage their portfolios, commercial lenders must understand not only the risk presented by each credit but also how they are interrelated. These interrelationships can multiply risk many times beyond what it would be if the risks were not related. Until recently, few commercial lenders used modern portfolio management concepts to manage credit risk. Today, many commercial lenders view the loan portfolio in target segments and as a group and consider the relationships among portfolio segments as well as among loans. These practices provide management with a more complete picture of the commercial lenders credit risk profile.

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