Portfolio Management: Using the Right Tool

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While using a wrench to hammer in a nail may work some of the time, it will not work all the time. Especially, if it is a delicate job and you don't want to risk bending the nail. So why do banks use a paper based process to manage their loan portfolios, a task that may clearly be one of the more important and fundamental parts of the credit process?

Based on our research and a sampling of banks in and around the western states, banks are using everything from a manual paper based process to Excel to their Core Banking System to manage their portfolios. While in some cases this may work, it doesn't position the bank for long term growth nor does it help when the regulators require details.

What is Portfolio Management?

Portfolio management may mean different things to different people. The ability to track various components of the loan, reporting requirements, covenants, conditions and data metrics are all part of the process of managing the bank's portfolio. We found that while all banks are managing their portfolio at some level, not all banks achieve the appropriate level to satisfy their internal operating procedures, the board, the regulators or any combination thereof.

Prudent management of the process requires the following concepts:

1. Ensuring a solid customer database of information as a basis or baseline.
2. Ensuring the flexibility to not only capture data but also extract/report on data for ongoing use.
3. Ability to have a multi-dimensional view of your customer, loan and portfolio.
4. Ability to generate output at various levels; customer officer, branch, division, bank etc.
5. Correspondence mechanism to generate letters and emails.

Some banks argue, that based on their volume, they are able to track the portfolios in a manual or a paper based format. The question then is; how long can that be sustained? There is a point of diminishing returns and the time is now to automate when the volume is not keeping bankers busy on other tasks.

In order to have an effective portfolio management and tracking policy, banks need to review the process by which they will track the loan. This begins with the loan agreement. The conditions, covenants, ticklers, terms are all detailed within the loan agreement. This would be the best place to start to develop a categorical ranking of the items needed. It is especially important in today's economic climate to be proactive in managing the portfolio and not just ask your borrower for items that are now more than 30 days past due.

The items extracted from the loan agreements need to be logically aggregated within a system that is specifically built to track these types of metrics. Often banks rely on their Core Banking platform to manage a critical component of the credit process such as tickler and covenant compliance. At most these core systems offer a rudimentary approach to managing these covenants with no automated schedulers and no ability to report from various levels of the portfolio.

Currently, there are a number of tools in the marketplace, some of which work well, and others that are sub-par. The following types of technologies are available to manage the portfolio:

- Paper based process
- Excel
- Outlook
- Core Banking
- Third-party Tickler System
- Proprietary System

Using the right tools takes some analysis and thought process by the bank. First, determine the business need. Define the steps in the process of managing your loan portfolio that are the most critical. Then rank those requirements to ensure a priority is established. Banks are quick to jump into a technology solution quickly. Rather, the requirements and processes of the bank are most important. Map and document those, and then weigh them against the proposed technical solution. This will save a tremendous amount of time and money after a software product has been implemented.

After the bank has decided on the priority of functions needed to manage their portfolio, evaluate vendors that specialize in tickler systems. These vendors will typically have additional functionality over other ancillary software providers that do not specialize in tickler tracking and covenant monitoring. Evaluate whether the software has the ability to create schedules, waive items, create step-up/step-down covenants, generate reports, interface with Core Banking solutions, etc.

By matching the bank's unique requirements to the software product, the bank will have greater success in implementation, adoption and usage of the new platform.

Using the right "tool" for the specific job is as important as having a well thought out credit policy. By having the right type of technology, it will avail the bank to provide better insights into the portfolio at all levels; operational, board, regulatory, etc. Better tools will also allow for potential loss prevention by highlighting early warning indicators that may surface due to violated covenants, missed payments, etc.

Timing is also critical to the process. Implement a solution based on the bank's requirements not when you are busy trying to balance your portfolio but when you are in the process of "re-shifting the balance and ensuring a good mix of C&I, CRE and other loans., etc.