Use Multi-Dimensional Portfolio Analysis to Minimize Surprises

By Dennis Child, Marketing Director, Thompson Consulting and Training

I am a 40 year veteran credit union CEO. Like all CEOs, there were many situations that raised my stress level. The number one stressor came in the form of surprises. Since it seemed pleasant surprises were so far and few between, I came to dislike all surprises.

There will always be surprises it seems, but there are some steps that can be taken to minimize the number and impact of surprises. Probably the most important area one does not want to experience significant surprises is in the loan portfolio. This is primarily because surprises in a loan portfolio could be disastrous. That is why knowing what issues might be lurking in a loan portfolio and preparing appropriately are extremely important.

A number of reports and analyses are available to perform tests and forensics on a credit union’s assets and liabilities. One such analytical process that is gaining attention is referred to as Multi-Dimensional Portfolio Analysis (or Multi-Dimensional Portfolio Management). We’ll refer to it as MDPA for short. MDPA comes in many forms and some are certainly of more value than others. The best MDPA processes not only identify specific embedded losses in a loan portfolio, but also provide insight into potential loan growth opportunities. A good starting point in the MDPA process is having a robust credit migration tool that is empirically based and statistically validated. Our experience at Thompson Consulting and Training after many years of consulting with credit unions on lending matters leads us to recommend credit migration tools that at a minimum provide:

- Adherence to GAAP and Regulatory guidelines
- The ability to be run at least semi-annually
- The ability to upload the most up-to-date credit score for every loan in the portfolio each time the process is run
- Detailed reports broken out by credit score grades
- Reports that identify loans individually and by loan type where significant credit-score deterioration (digression) is taking place
- The ability to use these digressed loan reports to quickly re-assess the unsecured amounts (embedded losses) for each loan (individually and in total for each loan type)
- The ability to track credit quality trend lines (by loan type and overall portfolio) – which help to quickly determine the effectiveness of policy and procedure changes
- Reports for loan collection staff identifying borrowers who are most likely to need attention before they show up as delinquent
- An empirical method that assesses trends in a credit union’s market area as well as the credit union’s delinquency/charge-off experience (environment) to project impacts on loan portfolios and potential losses
• An integrated process supported by an empirical method for accurately determining amounts to be set aside in the ALLL
• The ability to identify borrowers whose credit scores are improving so appropriate marketing can be implemented

Minimizing surprises requires management tools that utilize empirical, statistically driven processes that take place on a regular basis, use a credit union’s unique data, and are validated at least annually. TCT’s Credit Migration model meets these standards and the bullet-point criteria listed above.

For more information about TCT’s Credit Migration tools, or its MDPA services, please contact Dennis Child at dennis.child62@gmail.com or 435 770 0178