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CRITERIA FOR ASSESSING THE EFFECTIVENESS OF THE BANK'S LOAN PORTFOLIO

The structure of the bank's loan portfolio is also influenced by the requirements of borrowers regarding the volume of credit demanded. The set of loan applications submitted to the bank by potential borrowers comprises the requests that can be satisfied only in full or rejected, and those involving alternative volume of lending.

The set of operations types and instruments of the monetary market that comprise the loan portfolio, has the characteristics determined by the nature and purpose of the bank in the financial market. Lending operations and other credit operations are known to bear high risk. However, they must meet the aim of the bank activity, *i.e.* to maximize profits with an acceptable level of liquidity which implies credit risk, profitability and liquidity as the elements of the loan portfolio (Fig. 1).

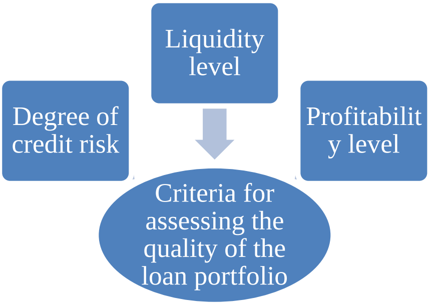

Fig. 1. Criteria for assessing the effectiveness of the loan portfolio

Source: formed by the authors on the basis of their own research

The quality of the loan portfolio can be implied as its structure characteristics of the ability to provide the maximum level of profitability with an acceptable level of credit risk and the balance liquidity [2].

The following paragraphs consider the content of some criteria applied for assessing the effectiveness of the loan portfolio.

1. The degree of credit risk. This criterion is closely related to the loan portfolio since there arises a risk of losses resulting from the lender or counterparty's default, which is cumulative. Assessing the loan portfolio risk degree has some characteristic features. First, the aggregate risk depends on the degree of credit risk of individual units of the portfolio, where assessment methods have both general features and those related to the specifics of the unit, as well as diversification of the loan portfolio and its individual units.

Second, a system of indicators should be applied to assess the degree of credit risk, taking into account a lot of aspects that need to be considered.

2. The essence of the bank loan portfolio profitability level is obtaining maximum profit at an acceptable level of risk, and the profitability of the loan portfolio is one of the criteria for assessing its effectiveness. Elements of the loan portfolio can be divided into liquid and non-liquid assets. The latter group includes interest-free loans, loans with frozen interest rates and long-term interest arrears.

It should be noted that the loan portfolio profitability level is determined not only by the level of interest rates on loans, but by the timeliness of interest payments and the volume of the loan principal as well. The profitability of the loan portfolio has a lower and upper limit. The lower limit is determined by the cost of credit operations (staff costs, loan accounts running, *etc.*) and the interest payable for the resources invested in this portfolio. The upper limit is the level of sufficient margin.

3. The content of the loan portfolio liquidity level involves determining the effectiveness of its assets and, above all, the effectiveness of the loan portfolio. The higher is the category of loan efficiency, the higher is the bank's liquidity.

In turn, the bank liquidity provides the ability to quickly and easily convert their assets into cash. Liquidity requirements compliance with the definition of the maximum volume of highly liquid, liquid and low-liquid loans contributes to the creation of a rational structure of the loan portfolio (Fig. 2).

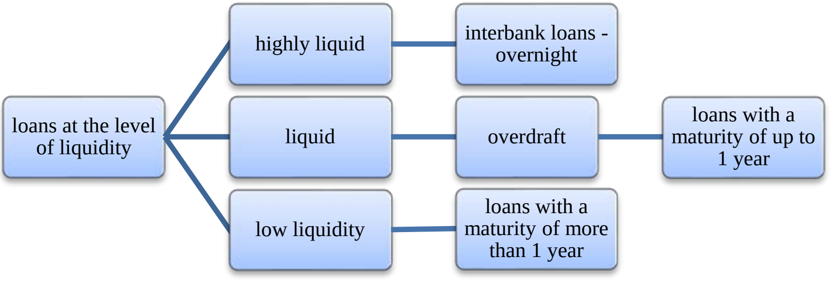

Fig. 2. Classification of loans according to the level of liquidity

Source: formed by the authors on the basis of their own research

Therefore, we can conclude that the loan the portfolio liquidity depends on the borrower's payment discipline or individual credit risk (the lower the probability of non-payment, the greater the liquidity), speed and schedule of cash flow generation through the lender-borrower channel (short-term loans are more liquid compared to long-term and thus loans repaid in installments are more liquid than loans with one-time repayment at the end of the term). The loan portfolio liquidity also depends on actions of the lending bank on the loan portfolio (the ability of the bank to return the invested resources in a short time increases the liquidity).

Thus, the loan portfolio should be considered as a structured set of loans provided by a commercial bank reflecting the socio-economic and monetary relations between the bank and counterparties in ensuring the reverse movement of debt. The quality of the loan portfolio is a special feature of its structure that provides maximum profitability under the allowable level of credit risk and liquidity of the balance sheet. Therefore, a commercial bank must do a structural analysis of the loan portfolio in order to reduce the total credit risk. The formation of an optimal loan portfolio as one of the main areas of financial resources, as well as effective loan portfolio management is the most important issue for any bank.

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