

SHUCKING OVER THE CREDIT SCORING DEBATE

by [Steve Brown](#)

After an Iowa banker shot his mouth off about the quality of his state's corn being undeniably the best – the game was on. You don't just come after California produce and expect to get away with it (not to mention a banker from New Jersey reminded us that they don't call it the "Garden State" for nothing). After collecting corn samples from CA, CO, GA, IL, IA, NE and NJ (thanks to those that sent samples) we recently had a "corn-off." Being the quantitative types we are, the first order of business was to create a methodology to objectively evaluate the corn. We used a double blind process and devised a 10 point scale rating firmness, color, shape, initial, intermediate and after taste. Now, if we can rate corn, you can rate anything and small business credit is no exception. If you don't already have small business/commercial credit scoring as an initiative for 2007, we strongly recommend you do. When we first wrote a credit scoring piece back in 2004, our informal survey revealed less than 10% of banks were using commercial scoring. Our latest survey of 40 banks from around the country reveals that more than 25% are already using scoring. If you quizzed your loan officers, could they tell you the difference between a "3" and "4" rated credit? In loan committee, does your bank have adequate differentiation between credit types to distinguish what should be priced at Prime and what warrants Prime + 1%? Is a "3" rating just slightly better than a "4," or is it geometrically better? How do you quantify the loan officer's "gut" feel? Regardless of whether you believe in scoring, it does 2 very important things: 1) It provides a common platform to communicate both risk and return; and, 2) It produces a consistent measure to compare multiple credits. A bank's scoring methodology may only be 50% accurate, but at least it can be discussed, improved upon and allows credits to be compared unemotionally against a common yardstick. While loan scoring accuracy is beyond the scope of this article (but look for it in the future), we can tell you that it gives your bank a quicker turn around time for loan approval and a basis to discuss options with a borrower. For those banks that are complaining about how competitive loan pricing has become, here is another chance to do something about it. Approving loans faster and taking a more "consultative" approach with the borrower on how to improve their credit (f.e. decrease accounts receivable, grow revenues, etc.), provides a valuable service worthy of increased pricing. Almost as important, developing some quantitative method for evaluating credit gives insight into what is really important when it comes to structuring a loan. Banks need to gain experience with credit scoring now, in order to fine tune their model for the future. As corny as it sounds, with an average score of 8.8, Iowa sweet corn really is the best. Instead of arguing over subjective taste, we can now debate the true attributes of this golden cob of satisfaction. This summer, grab yourself some Iowa corn as you consider using a credit scoring system for small business credits under \$250k.

BANK NEWS

Merging

A group of ten banks in VA have announced plans to merge into a new single entity to be called Carter Bank & Trust. The banks are: Blue Ridge, Central National Bank, Community National Bank, First National Bank, First National Exchange Bank, Mountain National Bank, Patrick Henry National Bank, Patriot Bank, Peoples National Bank and Shenandoah National Bank. The new entity will be the largest state chartered commercial bank in VA, with 126 branches and \$2.5B+ in assets.

ILC Decision Delay

The FDIC has put a six-month moratorium on ILC applications, including those of Wal-Mart and Home Depot. The agency said the moratorium will allow for further assessment of any emerging safety and soundness issues from ILCs and give Congress the time to further evaluate the risk and benefits of the proposed legislation.

Mortgage Developments

Electronic mortgages are gaining momentum and will soon be more readily available to consumers. Homebuyers will still have to go through the traditional application process, but standardization is allowing them to complete the paperwork online. It is estimated that loan processing time will soon be cut in half.

Mortgage Competition

Wells Fargo will add 40Y mortgages to its menu of financing options for homebuyers. Smaller monthly payments make this financing option more affordable, particularly in high-cost markets.

Credit Card Competition

Wachovia announced that it would a new Visa Credit Card. The card offers a reward/point program, which allows users to combining credit and debit use in order to reach rewards faster. The card will not have any annual fees and would allow one late fee and one over-limit fee waiver every year.

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