LOAN COMMITTEES OF THE ROUND TABLE (PART 1 OF 2)

by Steve Brown

Somewhere in the late 1100's, King Arthur got sick of his knights wasting meeting time fighting (literally) over who was going to sit at the other end of the table opposite of him. Out of necessity, he had created a round table to solve the problem. This was the first and only improvement in meeting productivity until the early 1700's when the meeting agenda was invented. Unfortunately, meeting productivity has not come too much farther since then. Consider your loan committee meeting. While many bankers would label their loan committee as one of the most productive in the bank, we see it as an area of improvement. Let us assume that your loan committee meeting is a paragon of meeting planning. You have an agenda, loan information is disseminated in proper time for most parties to review, your meeting starts on time and the meeting leader moves things along so you don't get bogged down discussing the World Series. Despite all these flourishes, there is still room for improvement. For one thing, most banks take their largest credits to committee. Because of the size, lenders usually make sure these loans are well structured and so by the time they get to committee, they are some of the safest loans in the bank. A 10Y look back of loan defaults for banks under $15B in asset size show that problem credits are usually not the largest credits in the bank. If you are looking for a single metric, statistics show that you are better off taking loans with debt service below 1.23x coverage, as they are more correlated to defaults. The explanation of this is simple - notional or principal value while a major factor in risk, is just one of many components. For example, since there is more risk in a 3Y, $500k unsecured loan to a 2Y old restaurant than a $5mm, 7Y loan to refinance an office building that cash flows at 1.65x, it is the former loan that should go to loan committee instead of the later. Users of our Loan Pricing Model understand this, as the model puts out an expected loss for each loan that takes into account many components including the latest default rates. A $4mm self-storage loan may not have to go to Committee, while a $2mm loan to an assisted living facility might because of the latest credit quality trends. Another way to look at this is your loan committee's approval rating. Banks that pat themselves on the back where their loan committee approves more than 75% of the loans should be doing the opposite. While many bankers would argue that they do a good job at vetting loans prior to committee (and that is why the percentage is so high), we would argue that loan committee is probably not spending enough time on the loans with the highest risk. Loans that contain lower risk, regardless of size, should be approved at the CCO level. Only loans that contain above a certain risk threshold should make it to Committee. This allows the collective intelligence of the organization to focus on the higher risk loans making for a more productive meeting. By doing so, more resources can be focused on fewer loans, hopefully resulting in better decisions. Before you go out and get yourself a round table to improve loan committee productivity, we have a host of other ideas that we will discuss tomorrow that should make your committee as strong as King Arthur's Court.

BANK NEWS

Acquisition

Old National ($8.2B, IN) will acquire St. Josephs Capital Corp ($488mm, IN) for $71.2mm in cash, or a little more than 2.0x book.

Jail

The ex-CEO of Sunbelt Savings was sentenced to more than 8Ys in prison and ordered to pay $2.3mm for defrauding the FDIC. The twice-convicted Ed McBirney has a long history of banking abuses going back to the 80's.

Awards

The American Banker honored John Eggemeyer 3rd (Castle Creek Capital, bank investor), Jerry Williams (CEO of Orion Bank ($2.1B, FL)) and Luz Lopez Urrutia (El Banco Financial, Hispanic focus finance company) with its 2006 Community Bankers of the Year award.

Fed Reserves

The new Reserve tiers are out and for Fed net transaction accounts in 2007 that go up to $8.5mm (from $7.8mm in 2006) there will be no reserve, amounts between $8.5mm and $45.8mm will face a 3% assessment and amounts over $45.8mm will be charged at the top 10% rate. Of course, our Deposit Relcass product takes care of all these hassles for you. Contact us for more information.

Military Loans

The FDIC will be holding a roundtable for banks with interest in military lending in order to share ideas on how to better serve the military consumer that tends to use small denominational loans, but requires reasonable fees. The move is in light of the new legislation that caps interest rates on loans and the military customer's growing dependence on high-cost payday lending and check cashing services.

Tis the Season

A recent retail survey shows consumers plan to spend $791.10 each this holiday season, up 7% from last year. The number one planned present for 2006 Â– the gift card.