LOAN COMMITTEES (PART 2 OF 2)

by Steve Brown

If your loan committee approves more than 75% of the presented loans, your approval process might need a revision. In other words, if loan committee is just a rubber stamp to the CCO, why waste the committee's time? Yesterday, we discussed how a bank's loan committee should be reviewing the riskiest loans that are not necessarily the largest loans. By looking at the overall expected loss of a credit exposure (such as output derived from our Loan Pricing Model), loan committee resources can be focused on the tough decisions, hopefully increasing effectiveness. The tacit assumption for loan committee is that its collective intelligence is superior to the CCO (otherwise they would be better off in letting the CCO make the tough credit decisions). If true, then it stands to reason that the CCO inaccuracies run both ways. This points to the fact that loan committees should also be reviewing loans that have been turned down at the CCO level. Reviewing the turned down loans is almost equally important to better understand what credits the bank is passing on, as it represents a loss of a potential revenue stream (opportunity cost). If risk tolerances are set correctly and the loan process is efficient, then statistically speaking, turndowns and approvals will happen with equal frequency. Therefore, approval rates should be between 30% and 70% depending on where the loan risk tolerance levels are set. In summary, the less risky loans should receive faster approvals that should hopefully translate into better pricing because of superior customer service. The more risky loans should face more accurate decisions, as more resources are spent analyzing these credits for both approval and disapproval. Of course, as stated earlier, all of this is predicated on the fact that your loan committee can make better decisions than the CCO or other less formal credit authority. This we realize is a celestial leap of faith, which brings us to our last point in analyzing loan committee efficiency. In a majority of banks, officers and/or the loan committee can approve loans up to some threshold, with the board approving anything above this number. The board, which is mainly a group of non-bankers, has the approval to make a bank's riskiest loans, while the professionals of the loan committee are relegated to lower approval status. This is mis-use of resources, as the board's role should be in the setting and monitoring of policies and risk/return limits in order to ensure the safety, soundness and profitability of an institution. This is a check mechanism against management, not an operational function. The board should have the right to change management, limits or policies, but not approve loans. A board extending beyond this introduces the very risk that they are seeking to eliminate Â– namely poor loan judgment and the potential for a conflict of interest. Board members that approve loans have a stake in the loan process and may not be able to render judgment in a fair and impartial manner. More importantly, if part-timers override the decisions of full-time professionals, then either new professionals or a new board is needed.

AVAILABLE LOANS

Â· Trucking: We have a 2.3mm, 2Y lease participation for a Tulsa based borrower. The triple net lease has a residual value of $0 (pretty much a loan), has a 50% LTV and guarantee from the principals. The rate is 9.0% fixed for 24 months. Â· Church Loan: We have $3mm participation available in a 5Y loan to finance a FL church facility. LTV is 50%, coverage is 1.65x and the track record of the congregation is impressive. 50bp upfront and a 7.45% fee produces an estimated 27.5% risk-adjusted ROE. Â· Sales Finance: We have $9mm available (minimum $2mm) of these home improvement loans that have a 2Y estimated life priced at a 7.125%. This portfolio is diversified, has credit support and has a long track record of strong performance. For more information on any of the above, send an e-mail and we will get you further information.

BANK NEWS

Acquisition

Security Bank Shares ($155mm, WI) will acquire an undisclosed number of branches from QCR Holdings ($1.1B, IL).

Acquisition

QCR Holdings ($1.1B, IL) will purchase Farmers State Bank ($32mm, WI) for an undisclosed amount.

Credit Cards

A report released last week by the GAO found late fees on credit cards have risen by 162% in the past decade and that some issuers are charging as much as 30% for late payments or for exceeding credit limits.

Contingency Plans

Almost a dozen banks in the Buffalo area enacted their Bird Flu/emergency contingency plans when a freak snowstorm prevented employees and customers from coming in. Most armored deliveries/pick ups stopped and the Fed suspended cash operations. As a result, banks were updating their plans to include enhanced operational guidelines for reduced staffing and cash in isolated environments.

Banking Terrorism

A recent study by FINCEN found that 20% of Suspicious Activity Reports actually contained subjects of open FBI investigations.