NO TIME TO CLOWN AROUND

by Steve Brown

Banking is a funny business Â– perhaps not as funny as a clown in a circus, but funny nonetheless. To some, clowns can also be scary. Unfortunately, recent demands of community bank customers probably fall under the latter categorization, so bankers aren't laughing. Loyalty has gone out the window and pricing discussions have become as contentious as entering the lion's cage. Whether your clients are smearing on face paint or not, there is no doubt that this is one of the roughest banking environments in history. Net interest margins sit at a 17Y low and significant technological breakthroughs are pushing everyone into new and rapidly changing territory. Most bankers can adapt, but it will require adopting new methodologies toward many things we have taken for granted over the years. The best way to adopt change, the experts will say, is to take it one small step at a time. Taking that approach, we urge community bankers to take a small step and consider using credit scoring more when underwriting certain small business loans. Consider a recent study that found 65% of small business loans from $100k to $1B were originated by banks with assets above $5B in total size. This is about an 18% increase over the prior 5Ys or so and shows large banks are making a concerted push into the small business lending space. Once way these larger banks have been able to originate so many small business loans and lower their costs is by placing a heavier emphasis on credit scoring. Consider that about 50% of banks these days use credit scoring as a significant or primary component of their small business lending decision. Interestingly, while only 10% of banks using credit scoring rely on business credit scores, close to 90% incorporate the score of the business owner(s). Further, banks seeking to ramp up loan production should know that studies also show that banks that use credit scoring for their small business loans increase their origination percentages over those banks that do not use scoring. As community bankers know, large national banks are very willing to use credit scoring on small business loans as large as $1mm in size - a primary reason competition on these credits has risen exponentially. To find out how powerful credit scoring can be, we structured 2 floating rate CRE loans on our Loan Pricing Model. These were 10Y loans with a 25Y amortization schedule, something typical that community bankers are seeing in the market these days. We calculated a risk-adjusted ROE for the first loan and then adjusted the cost to originate the second loan to approximate a bank that puts a heavy emphasis on credit scoring. The results were surprising. A lower cost to originate allowed the credit scoring bank to offer its customers a rate 25bp below that of the more traditional originator (roughly a savings of $2,500 per credit). That was on a 10Y credit, so imagine the impact on one with a maturity of about half that (nearly 60bp). Understand we are not saying community banks should rely solely on credit scoring to make business lending decisions. But, does it really require a 5 page write-up and a bunch of committee meetings when everyone is going to lean on the guarantee or credit score anyway? Competition is fierce and customers want answers much faster than they have in the past. If community banks are going to hold on to the center ring of small business lending, adapting the rules of the game to meet competitors head on, while reducing costs to support margins are a few small ways to get started.

BANK NEWS

M&A

First Citizens Banc Corp. ($753mm, OH) will acquire Futura Banc Corp. ($279mm, OH) for about $63mm, or roughly 3.05x book.

Related Party Heat

Commerce Bank ($48B, NJ) will sign a consent agreement with both the OCC and Fed (technically, an informal MOU) over weaknesses in policies and procedures relating to 3rd party transactions. It is speculated that the regulatory actions come about as a result of business relationships with a design firm owned by the wife of the CEO, Vernon Hill.

FCRA Ruling

Last week's Supreme Court ruling that a lender is in willful violation of the Fair Credit Reporting Act only if it has knowingly violated the law or acted in a reckless manner with regard to it, had banks breathing a sigh of relief. The ruling raises the bar for the courts and makes prosecution more difficult. At issue are 198 cases pending where banks have potentially violated FCRA laws largely as a result of "prescreened" credit card offers.

Fraud

The House Financial Services Committee told federal bank regulators they are concerned with increasing reports of scams involving telemarketers calling consumers and informing them of cash prizes. To claim the prize, consumers must provide bank information. Scam artists then empty the account using unsigned fake checks.

Consumer Slowing

Spending by consumers slowed in April to 1.3%, down from a 7% growth pattern in March. In April, it was the first time in more than a year that consumers had less credit card debt at the end of the month, than at the start.