Standardizing Underwriting Standards

by Steve Brown

Baseball is a favorite summer sport. Some people may also think baseball is a bore. We agree that a when a game becomes a pitcher's duel with no hits or base runners, you have to be into the battle to understand the nuance of it all. We are a big fan of small ball though, the offensive strategy of getting base runners around by a variety of means including bunts, stolen bases, blooper hits and walks. Certain teams manage to manufacture runs by playing small ball even though they don't have marquis name sluggers. While it may not always be elegant, it sure is fun to watch.

Community banks specialize in small ball by originating loan business from small business borrowers that the largest banks tend to ignore. It's not always easy for small business borrowers to get approved and without community bankers; we expect loan sharks would be the primary feeder for loans to some small business customers.

The 2014 Independent Business Survey by the Institute for Local Self-Reliance found that 42% of small business owners who had applied for a loan in the past 2Ys had not been approved. The same study found that community banks continue to provide a disproportionate share of small business loans and the decline in the number and market share of community banks has at least in-part caused constriction in small business lending. The top 4 banks control 43% of banking assets in the U.S., but account for only 16% of small business loans. Above that, small business loan approval at big banks (those over $10B) fell to 18.8% in March, dropping from previous months according to analysis by Biz2Credit.com, even as the economy expanded.

Loan approvals for small businesses by community banks rose to 51.6% over the same period and a large part of this is due to the SBA programs. In fact, the SBA announced some steps that are designed to increase small business lending by ensuring that risk characteristics primarily achieved through the use of a borrower's credit score and available through the SBA will take into account both personal information and the attributes of their business. Given this change, banks may be able to automate lending processes even further.

One aspect of the SBA's effort is the release of an automated lending platform called "SBA One". Many community banks already know about this, but its goal is to automate much of the labor involved in underwriting by generating forms and allowing electronic signatures. While there has been some reaction against the idea here and there, we think this will be a step forward for many banks. At PCBB, we have long been advocates of measuring initial credit risk by using metrics that can be easily replicated and applied consistently, and then overlaying more human elements to get a complete picture.

Indications are that the new scoring model covers the 4 lending criterion that were previously required within the credit memo that was sent to the SBA. If the applicant meets the minimum score, nothing further needs to be done. Otherwise if the applicant doesn't meet the minimum, the memo is still required. Nothing prevents banks from having a strict underwriting policy, but the scoring just provides a consistent measurement. If applied correctly, the new platform should help banks make SBA loans more efficiently.

Baseball's most successful small ball players tended to be quick, nimble and adaptable. Those same characteristics should help your bank as well - whatever lending you do.

BANK NEWS

M&A

First Security Bank and Trust Co. ($464mm, IA) has announced it will acquire Hampton State Bank ($74mm, IA) for an undisclosed sum.

Q2 Earnings

Bank of America reported net income of $2.2B in Q2, as it set aside $4B in litigation expenses. On a YOY basis: assets (+2%), loans (-1%), deposits (+5%), revenue (-4%), net interest income (-5%), noninterest income (-4%), provision for credit losses (-66%), allowance to loans 1.75% (-25%), ROA 0.42% (-43%), return on tangible common 5.47% (-45%), efficiency ratio 84% (+21%), employees (-9%), U.S. branches 5,023 (-6%), ATMs 15,976 (-2%). U.S. Bancorp reported net income of $1.495B in Q2. On a YOY basis: assets (+10%), loans (+7%), C&I loans (+14%), CRE loans (+7%), deposits (+6%), revenue (+5%), net interest income (+3%), noninterest income (+7%), provision for credit losses (-10%), allowance to loans 1.82% (-10%), ROA 1.60% (-6%), return on common equity 15.1% (-6%), NIM 3.27% (-5%), efficiency ratio 53% (+3%). PNC Financial reported net income of $1.1B in Q2. On a YOY basis: loans (+6%), deposits (+5%), revenue (-6%), net interest income (-6%), noninterest income (-7%), loan loss allowance (-8%), allowance to loans 1.72% (-14%), ROA 1.31% (-11%), return on average common 10.12% (-14%), NIM 3.12% (-13%), efficiency 61% (+3%), percent of consumer customers using non-teller channels 45% (+22%).

Rising Rates

Fed KC President Esther George said she feels the economy would be "best served" if the Fed got "interest rates off zero relatively soon" and raised short term interest rates in a steady and gradual approach.

Settlement

AIG announced it has reached a $650mm settlement with Bank of America related to mortgage guaranty claims disputes.

FOMC

In her most recent speech given this week, Chair Yellen said the economy continues to improve but that the recovery is not yet complete.