Loan Pricing - Do You Have Consistency?

lending performance risk management

Summary: If you are like most community banks, communicating your appetite for risk consistently is a challenge. How can you ensure consistency in loan pricing at your bank?

Everyone knows that risk and fear are different things. Yet, people often do not take risks because they are afraid. That is because the human mind twists things around. In short, fear causes you to overestimate a given risk and the absence of fear leads you to underestimate a given risk. Bankers know risk is everywhere and it must be weighed continually because it is just part of the business.

If you are like most community banks, communicating your appetite for risk consistently is a challenge. Layer on top of that changes in personnel (both senior management and line officers) and it becomes even more challenging. All other things being equal, the larger the bank and the more geographically spread out your offices are, the more difficult it will be to bring conformity and consistency to your risk and pricing decisions.

For example, consider what would happen if someone asked one of your employees if the bank wanted a certain type of loan vs. another type of loan? Or would they know whether lowering the price for any given customer would be worth it?

You would be surprised how many employees would say they don't know or are not sure. On the pricing front, banks that have a pricing and risk model in place like ours, start with a mathematical basis of standardization. This provides a foundation to level set things.

Most banks have seasoned senior staff members who have a very good intuitive understanding of the profitability of customers and deals. But, markets move, conditions change, competitors change and a host of other things happen too. How can good information be passed along consistently so more junior staff or those in other departments can leverage this depth then?

Given shifting demographics, it is critical for banks to train and inform new staff of current policies towards loan origination. Of course, to do this a bank needs more than a model, but having a model greatly enhances the process and gives everyone a starting framework to have a robust conversation.

Most of our clients have multiple branch locations and in some cases those are across multiple states. Although many have a good system for meeting regularly at a central location, it is still a challenge to make sure decisions are being made consistently all the time for all loan types and structures.

A good model that is reviewed regularly by management can also inspire confidence in frontline officers and empower them to make decisions in the field. That shortens the customer sales cycle and provides a basis for discussion too. Good models allow for on the fly decisions and calculations that tell customer-facing staff how much a simple change in a prepayment or reset date can affect the value of the loan. If the answer is a lot, then the customer contact person can offer other options that may help the bank's performance.

No model can replace a person, but done right, the model can become a great tool in the toolbox and set a good foundation to build on. That gets everyone moving in the same direction from the outset, as your teams work to keep customers happy and retain value for the bank.

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