RMPI Consulting, LLC

"Risk Management for Community Banks"

WHITE PAPER

Better Loan Growth In 2013

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The past five years have been a period of retrenching for most of our Community Bank clients, and now that property values have stabilized in most lending markets, it's time for many banks to begin lending again in earnest. So, as you prepare your budgets for 2013, here are some guidelines for getting the most out of your loan growth next year.

First, congratulate yourselves for surviving the past five years. Your credit underwriting and controls should now be in excellent shape. You've addressed all of the regulatory concerns from your last two exams and you've lowered your cost of funds to the best quartile of your peer group. Your lending team is trained on all of the latest regulations and ready to put loans on the books.

So, where is the demand? Unfortunately, today's economy is anemic and the days of customers walking in the door to borrow money are long gone. According to most realistic economists, the U.S. economy is probably going to stink for a few more years. It is beset by short-term problems (low consumer demand, uncertain housing prices, too much debt) that are not going to go away in 2013 (and possible not in 2014), regardless of who wins the election in November.

But what is a smart Community Bank to do? You can't stay on the sideline for another year, watching cost of funds drop so that a widening net interest margin can offset steady or declining asset growth. That was 2010 to 2012. Loan portfolio runoff is now exceeding natural loan replacement, and as your assets continue to decrease, interest income declines as well. Never mind ROA, how do you generate sufficient net income to maintain profitability without cuts to staff and overhead?

As a sharp CEO, you know that once you start cutting critical employees, you'll be well behind the curve when the economy finally gets traction. So, let's get those lenders out there and find some new loans. But before your team starts throwing anything (and everything) they find at your underwriters and credit committee, here are three steps your Senior Loan Officer and Chief Credit Officer should take before you finalize your lending goals and targets for 2013.

Review Your Bank's Strategy and Risk Appetite Plan

Make sure that everyone – retail and commercial staff – knows how your bank wants to make money and what types (and amounts) of risk your bank is willing to take.

When we work with new clients, it is surprising how often junior lenders and credit staff have not read their bank's strategic or risk appetite plans. These documents should not be secrets. If your front line staff do not know how you want to succeed, how can expect them to help you reach your goals?

Naturally, this means that your strategic plan clearly articulates how your bank intends to make money – what types of loans you're good at, what markets you want to penetrate, how much market share is acceptable in certain products or geographic locations. And your risk appetite plan should detail the types of risk and the concentration limits that your organization is capable and willing to accept.

Once everyone is on the same page with your strategy and risk appetite, it will be a lot easier to explain to everyone how 2013 goals were developed and how your bank intends to grow profitably over the next 12 months and use its capital judiciously.

Ensure Your Compensation Plan is Aligned with Your Business Goals

We all love our bank, and we all want our bank to succeed and beat the competitors. But there is a reason you have a compensation plan for lenders. It motivates people to hit loan portfolio growth targets. So, since you've already decided to have incentives, let's make sure the growth you get is the growth you want.

Ensure Your Compensation Plan Rewards Lenders for the Right Mix of Loans and Credit Quality

Compensation plans should have specific targets by loan type (and credit quality). And each lender should be asked to promote and successfully sell a broad portfolio of the bank's loan (and other) products. Also, there should be minimal or no financial incentive to exceed targets in one area unless all targets are met. So while it is nice that a junior commercial lender says she can make construction loans "all day with her eyes closed," growth and development of young staff requires that lenders learn about and promote multiple products in order to meet an array of customer demands. The long-term viability of your bank requires that you develop people to support a variety of customer needs. "One trick ponies" make poor senior lenders and terrible Senior Loan Officers. Plus, your comp plan is about meeting the bank's portfolio and profit goals, not feathering your lenders' beds at the expense of the organization.

Too many banks ignored their concentration of credit guidelines in the last economic cycle, only to face the wrath of regulators and investors as poorly balanced loan portfolios resulted in higher than expected losses and poor bank performance when measured over the full economic cycle. A well-designed compensation plan can help promote even growth across all desired loan categories.

Know For Sure What Products Meet Your Return Targets

If you actually lost money on your auto loan portfolio last time around, you shouldn't be asking retail loan officers to push more auto loans unless you've fixed your underlying credit or processing issues. And that requires you to understand what is the true risk-adjusted profitability of individual product loan portfolios.

That means you should have your Chief Credit Officer review the losses of your loan portfolio over the last complete economic cycle and present a complete and realistic picture of what the true risk adjusted return was for your various loan products.

Once you understand where you made and lost money, your CCO can analyze the reasons you had greater than expected losses and make recommendations to processes and product details to fix the underlying issues. When we've done this analysis with various clients, we've discovered issues as

simple as changes in underwriting standards or documentation. We've also uncovered problems in the way loan products were sold (right product but sold to the wrong person).

So figure out what products your bank can sell profitably and fix the issues before you send out lenders to hit goals in 2013. You definitely don't want a comp plan that rewards staff for selling unprofitable or low margin products when you have profitable loan products that customers want and need.

Go Out There and Succeed in 2013

So before you finalize your 2013 lending goals, consider these three guidelines. Make sure everyone has read your strategic plan. Know for sure what products are profitable. And ensure your compensation plan is linked to your growth goals.

With a lending and underwriting staff that knows and understands your bank's strategic and risk appetite plans, a compensation plan that rewards team members for hitting the right goals and a clear understanding what products can successfully promote profitable growth, your bank will have an excellent chance of meeting your 2013 loan growth and mix targets.

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About the Author

Jay Gallo is a partner in the Boston office of RMPI Consulting, LLC, where he specializes in business strategy and enterprise risk consulting services for the firm.

Experience the RMPI Difference

With offices in Boston, Tampa and Chicago, RMPI Consulting provides risk and credit management services to Community Banks across the credit life cycle. The company also helps clients with interim, outsourced staffing, and its thought leadership has defined industry "best practices" on a broad range of risk management services. Recognizing there is no "one size fits all" solution for all Community Banks, RMPI will work with each client to develop an appropriate, custom solution to solve their specific problem at a reasonable cost in an efficient manner within a schedule deadline.

For more information, please call us or visit rmpiconsulting.com