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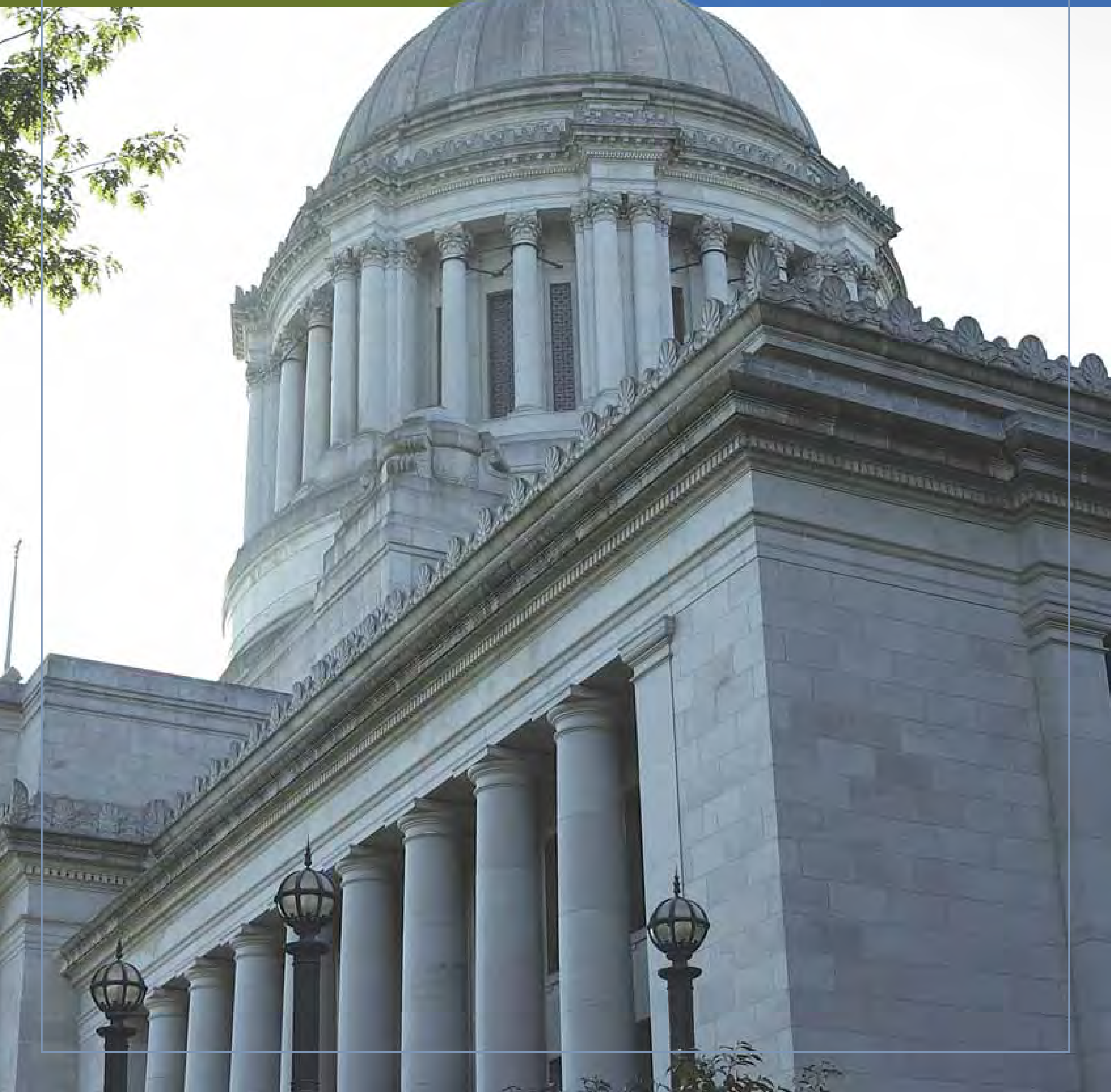

Get Disciplined—Maximize Loan Yields

By ALAN SMITH, Senior Bank Strategist, Bank Intelligence Solutions from Fiserv

Many factors are out of a bank's control in today's market, but loan pricing is one area that an institution can command. A strategic, disciplined approach can help you maximize loan yields.

So, it may be time to revisit your credit pricing procedures to see if your bank is being adequately compensated for loan risk and higher costs of funding. Here's what you need to consider.

Ask the right questions

- *Does the current process give the lender the final authority and the prerogative to price a credit, or does that reside elsewhere?* At what levels of exposure does that authority extend ($10K, $100K), and what pricing committee structure is in place after those levels of exposure?
- *What is your negotiating strategy when rates are objected to and has the lender been trained on that strategy?*
- *Is there a process in place to evaluate returns on each loan, at the recommended pricing?* Do you calculate an estimated ROA/ROE on larger commercial credits, and does that evaluation incorporate a value for deposits? Does the recommended pricing achieve your bank's financial goals?
- *Do you differentiate pricing strategy and processes on consumer vs. commercial credits?*
- *How does the bank's loan yield performance compare to other institutions with similar loan composition?*

Apply best practices

Take a page from the high performers.

Price the relationship—consider that a relationship encompasses much more than money.

However, be willing to "say no" when the risk is too high.

Treat consumer and commercial credits differently—use distinct pricing tools because there is a significant jump in the revenue and profitability generated from the former to the later credit. Also for commercial credits, use 360 day accruals (vs. 365 days) and have checks in place to identify exceptions to this.

Deploy fractional pricing—and determine what percentage of the loan portfolio is priced at standard intervals of 25/50/75 basis points. Simple covenants (i.e., minimum net worth or profitability) can allow you to change pricing if borrower performance declines.

Utilize rate floors wisely—whether at inception and/or at renewal. Consider how the percentage of credits with floors will increase over time and how that will impact your bottom line as interest rates change.

Establish a policy for prepayment penalties—as rates decrease, borrowers frequently refinance with other institutions and pay off initial loans before the end of their terms; this leaves you with a higher cost of funding loans you no longer have. Consider allowing borrowers of a fixed rate debt to prepay with cash flows from the business. Also, ensure you have an adequate fee strategy/routine that compensates for late payments.

Track profitability by lender—monitor and report on loan spreads (performance) by lender and establish specific incentives that will ensure that the lender is working primarily for the bank and not the borrower.

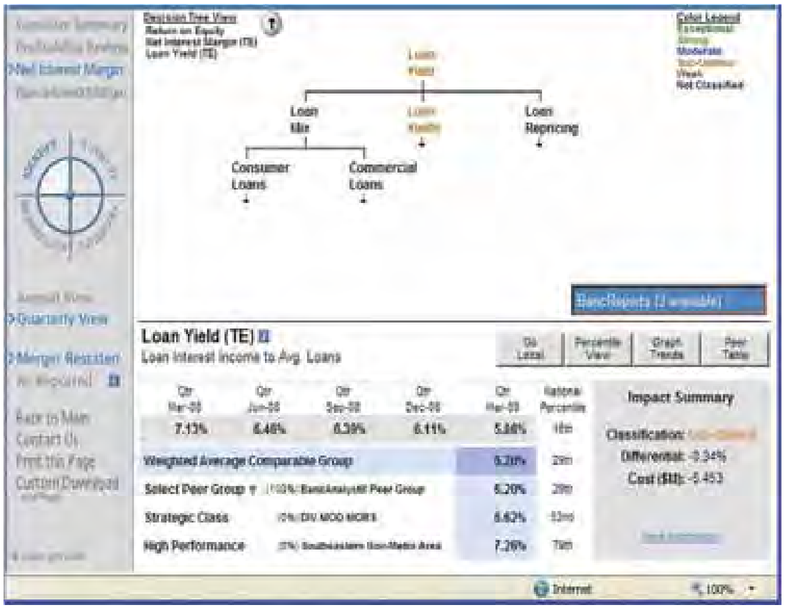

figure 1

Compare to your peers—it's absolutely crucial that you know how your loan yield performance stacks up against banks with similar loan composition. (Please see figure 1)

Close deals, reap better returns

In building your bank's business, few processes are more important than the procedures and tactics deployed to manage loan pricing. Take a more calculated approach—with greater discipline, your institution can progress towards maximizing returns on its loan portfolio.

Smith is part of Fiserv's Business Intelligence and Optimization core competency group, which delivers the tools and expertise banks and credit unions require to: analyze financial, customer and market data; draw valuable insights; and apply them toward generating revenue, margin improvement and savings for clients. He can be reached at alan.smith@fiserv.com.