

Banking Industry Group

2100 Clearwater Drive
Oak Brook, IL 60523
630-545-4500
www.wolfcpa.com



IN THIS ISSUE

Bank Competition: It's Not What it Used to Be

**In the Spotlight
Illinois**

BANKING BRIEFS

Options for Distressed Debt



Member of the
Wolf Financial Group

community Banking

Better Ways ▲ Better Results

A NEWSLETTER FOR THE BANKING INDUSTRY

FALL 2008

HR STRATEGIES

Hiring Lenders in Today's Environment



For many community banks, hiring and retaining qualified commercial lenders remains one of their biggest challenges.

In the past, large commercial banks served as the "farm system" for training and developing new lenders, and community banks were often able to recruit well-trained lenders from them. But with fewer big banks now providing this kind of training, there are fewer qualified lenders – who possess both sales/relationship and technical credit and underwriting skills – for community banks to choose from.

"Hunters and Skinners"

These challenges have led some community banks to separate the sales side of lending from the credit analysis and documentation side. Centralizing the credit function by allowing a credit analyst to do the "heavy lifting" is one way to accomplish this, thus freeing up commercial lenders to concentrate on business development.

There are risks in this "hunter and skinner" model, however – namely, that lenders with inadequate knowledge of credit analysis will bring in loans that are fraught with problems. Many bankers are familiar

with "two-year wonders": lenders who quickly grow large portfolios and then leave the bank about the time all the problems with the loans start to arise. That's why lenders should receive at least a minimal level of credit training, even if they will be concentrating primarily on sales.

So the first step in hiring and retaining qualified lenders is to define your model: Is it a

traditional community bank model in which lenders do it all, or a centralized credit function that separates sales and credit analysis? If you choose a traditional lender "do it all" model, your primary challenge will be either finding lenders who have the training to pull this off, or training them yourself.

Level the Playing Field

As noted earlier, finding well-trained lenders who can do it all is getting more difficult, and recruiting them may be even harder still. Few community banks can match the compensation potential offered by most large banks, so you must compete on a different playing field. For example, stress the lifestyle advantages you may be able to offer lenders. High income potential is usually accompanied by high stress and long hours. Does your position offer less stress, fewer hours, a shorter commute, more flexibility – in short, a better quality of life?

Another strategy is to hire relatively young and inexperienced lenders and teach them fundamental lending skills yourself – cash flow, loan structure, financial and tax return analysis and

It's Not What it Used to Be



The competitive landscape for community banks today looks very different from what it did just a year or two ago.

The fallout from the sub-prime mortgage collapse and ensuing credit crisis has claimed its share of non-bank credit providers, such as mortgage bankers and specialists, captive finance companies, and monoline credit card companies.

Many of these lenders arose because they could take their products to the secondary market, but the turmoil in securitization has dried up many of their funding sources, either putting them under severe constraints or out of business entirely.

Repackaging Consumer Credit

The good news is that this dynamic environment may present unique opportunities for community banks. In many markets, there is demand for certain types of lending that is not being met — especially certain kinds of mortgages, auto loans and home equity lines of credit.

Commercial lenders can take advantage of this by looking at their small business borrowers in a different light.

For example, many small business owners — especially of start-up firms and micro-businesses — use HELOCs and personal credit cards to fund their businesses. But this type of lending is being severely curtailed in some markets. To help meet this need, consider repackaging consumer credit options like these into a small business package.

Facing Threats

In addition to presenting opportunities, this changing environment is also posing new threats to some community banks. In an effort to deal with their own challenges and grow market share, some large regional and super-regional banks are making inroads into smaller banks' territories, especially on credits of more than \$1 million.

Larger community banks are also a relatively new form of competition. Those with multiple branches and ATMs (including grocery store branches) within a defined geographic area are able to offer customers a level of convenience closer to that offered by big banks.

The real competition today is for deposit dollars — and the more locations and convenience a bank offers, the harder it is to pry their customers away.

To better compete, some community banks are expanding their electronic banking and cash management capabilities. Acquiring low-cost deposits is a primary but hard-to-achieve goal, made more difficult when customers are tied to their existing bank via these services.

Remote Deposit Capture (RDC), for example, is becoming a much more common offering from community banks — in fact, it has almost become a “price of admission” service for the small business market.

Working Together

Of course, there are some non-banks and credit providers that specialize in working together with banks to meet small business borrowers' needs. Asset-based lenders and factors are the best example of this.

Sometimes, small businesses find that they can no longer qualify for traditional bank financing, usually due to rapid growth or other temporary circumstances that have adversely affected their balance sheet. Referring customers like these to a commercial finance company for accounts receivable financing or an asset-based loan creates a win-win scenario:

The customer gets the financing necessary to continue to grow, while your bank likely retains the deposit relationship and goodwill with the customer.

In short, today's volatile credit environment presents competitive risks and opportunities for community banks.

Now is the time to take a fresh look at the landscape and determine how you will take advantage of the opportunities — and minimize the risks. ■

*For more information contact
Tim Johnson at 630-545-4594.*

problem loan identification. This can be accomplished through a combination of online training programs (like those offered by state banking associations and also found at <http://www.rmahq.org> and <http://aba.com>), conferences and workshops (like those offered by the ABA and BAI), lending schools and community colleges, and mentoring by more experienced lenders.

If you plan to train lenders yourself, realize that it will require a heavy investment of time and energy by your bank. A chief credit officer or senior lender with credit training experience should be in charge of the effort. Take advantage of as many opportunities as you can to participate in industry association events (e.g., conferences, seminars, trade shows) that will help your new lenders get up to speed as quickly as possible.

Also allow them to attend loan committee meetings so they can see firsthand how loan requests are structured and presented. By letting them underwrite smaller accounts and work on loan spreads early on, you'll help them gain confidence and can increase their responsibility gradually as they demonstrate increased ability.

More Tips

Here are a few more pointers for hiring and retaining lenders in today's environment:

- Turn to your network. This is the first step in filling any key position, as the professional networks you and other managers have built over the years are usually your best source for qualified lenders.
- Look closely at troubled banks. Lenders at banks undergoing turmoil as a result of the credit crisis may be more inclined now than they were a year ago to consider making a move. This includes lenders at some troubled large banks, who might not have been willing to consider moving to a community bank before.

- Hire lenders who can bring customers with them. The mindset of the best lenders is that "borrowers do business with bankers, not banks." Ideally, lenders you hire should be able to bring some customers with them. It's hard to carry a new lender for a year or longer waiting for him or her to build a portfolio from scratch.
- Structure compensation to incent retention. Compensation plans that feature "golden handcuffs" like deferred compensation will give lenders strong incentive to stay with you for the long haul, rather than jump to the next attractive offer that comes along (see sidebar). Similarly, consider having new lenders sign an employment contract to help protect your investment in their training.
- Acclimate new lenders to your bank. Once they are hired, there should be some kind of structured program to help orient lenders. This includes educating them on your culture, credit philosophy, approval process, risk tolerance, etc. Don't let them "learn" by getting beat up in loan committee during their first year.
- Offer a clear career path. This is one of the most important keys to employee retention. For commercial lenders, this path should require a commitment to continuing education — such as membership and activity in industry organizations like the ABA and RMA — in order to keep their skills sharp. ■

In the Spotlight Illinois



The commercial banking industry has been experiencing difficulties and Illinois is facing declining investment revenue and unemployment rates among the highest in the country. Illinois-based banks have had increases in net charge-offs on real estate loans (.30% in Q1 2008, up from .05% a year ago) and credit cards (5.02% up from 3.16% a year ago).

We have also seen a 2.2% decrease in bank industry employment in July of 2008 compared to the prior year, one of the greatest decreases of any industry sectors in the state. Only construction (-3.7%) and transportation equipment (-2.9%) had greater employment declines.

Even with the troubles of the banking sector, however, smaller banks are able to compete successfully in segments where customer service or knowledge of the local market is important. Despite the market turmoil, many Illinois community banks have high quality loan portfolios, sensible underwriting standards, and the liquidity to take advantage of lending opportunities.

Banking Industry Group

2100 Clearwater Drive, Oak Brook, IL 60523
630-545-4500 www.wolfcpa.com



A Wolf Financial Group Member



BANKING BRIEFS

Options for Distressed Debt

One result of the credit crisis that has rocked the nation's financial system over the past year has been an abundance of distressed debt for sale in the commercial marketplace. Well, one man's trash may indeed be another man's treasure, since a growing number of firms are interested in purchasing this debt.

Buyers of distressed debt strive to purchase non-performing loans at a discount and then use their experience in working out problem loans to collect them and turn a profit. They are set up with the infrastructure, expertise and personnel (e.g., attorneys, professional liquidators) to do this more cost-effectively than most banks can.

For community banks holding non-performing commercial loans primarily secured by real estate or equipment, this may be a viable option worth considering. However, you must take emotion out of the equation and reduce it to a simple business decision. What will result in the most money to your bank, present-value, for the least time, cost and risk – selling the debt in the commercial marketplace, continuing to work with the borrower toward a resolution, or liquidating it?

As the number of firms buying distressed debt grows, so do the options for sellers, who may have more bidders to choose from. Buyers need to build volume, so increased

competition may drive the price for non-performing loans higher.

Several different clearinghouses have also emerged to connect sellers of distressed debt with potential buyers. The most popular is DebtX.com, which operates the world's largest online marketplace of buyers and sellers of commercial debt. Think of it as an eBay for debt: You simply input broad data on loans you want to sell into the website, and buyers come back to you with bids, with DebtX taking a fee for successful matches. ■



A Wolf Financial Group Member