

Best Practices: Benefiting from a Pricing Discipline

By Larry McGrath

In my capacity as a SMS facilitator for the Senior Lending Officer (SLO) Affiliation Program meetings and Chief Operating Officer of Riverside National Bank, I'd like to share some observations with you from the Fall SLO meetings I attended. What first struck me was that the tenor of the meetings were quite familiar. We once again discussed the benefits of a pricing discipline, which was a topic we've revisited regularly during the last five years. It occurred to me that although it was on everyone's mind—then and now—obviously not much progress had been made outside of the confines of our yearly meetings. This is not to suggest there weren't some success stories—those banks that had instituted an effective pricing model/discipline clearly expressed their delight with their newly found, enhanced loan profitability.

The reality is that many banks say they have a pricing model, but they either don't use it or if it is used, they admit it isn't used properly. What appears to be missing is a context for the model—why it is needed, what appropriate pricing accomplishes, and how it influences the lenders negotiation efforts. This noticeable gap leads us to why it is so significant that you cultivate a discipline or culture within the bank that reinforces pricing and its direct relationship to loan profitability. Remember however that without complete support from Executive Management, it would be difficult to envision this discipline getting off the ground or at best adopted by the lenders who most need to buy in to the concept.

Three Components of Loan Profitability

It is well recognized that the three components of loan profitability are the interest rate, loan fees, and the customer's deposits. Without maximizing each of these components, a bank is normally disappointed with their loan portfolio's profitability.

Another well recognized fact is that banks and their lenders aren't very effective at obtaining and maximizing their borrower's deposits, which substantially impacts the loan's profitability. It also is recognized that this is a consequence of the lender's inefficiency not the customer's unwillingness to establish and maintain their accounts with the bank.

What to Look for in a Pricing Model

You want a pricing model that uses data specific to your institution, not peer averages built into the software. For instance, you want your pricing model to reflect your employee loan personnel costs, your institution's cost of funds, and other pertinent non-interest expenses. You also want your lenders to be able to "negotiate" the loan by determining alternative scenarios for interest rates, fees and compensating balances.

This feature would enable the lender to price each relationship consistent with the Bank's profit objective.

An effective pricing model should offer these benefits at a minimum:

- Pricing consistency
- Increased pricing focus

- Enhanced profitability
- Influence loan officer behavior
- Maximize cross-selling
- Encourage relationship management versus transaction processing
- Provides comprehensive management information

In the end, loan profitability should be at the top of your lender's agenda and that of bank management. And the most expedient way to accomplish this is to create a pricing discipline and culture in your bank that supports this goal.

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Most recently, Larry was a Senior Loan Consultant with Sheshunoff Consulting + Solutions, where he represented the company on loan related consulting assignments and served as a facilitator for the Senior Lending Officer Affiliation Program and as an instructor at the Academy of Professional Banking.

Larry has more than 36 years of banking experience, primarily in lending. Prior to joining Sheshunoff, he served for more than two decades as Executive Vice President and Senior Loan Officer. In this capacity, he was responsible for all aspects of his bank's lending activities. These accountabilities included commercial, consumer, leasing and residential lending. His successful career has resulted in developing sound and profitable loan portfolios, as well as maximizing operating efficiencies. During his tenure as Senior Loan Officer, Larry was directly involved in production forecasting, customer and loan officer profitability and product development. He also developed his bank's loan officer compensation and incentive models.

Larry has extensive experience with both community and regional banks. He served as the Senior Loan and Credit Officer for a multi-bank holding company in the Mid-West followed by a similar position with a Southeastern Florida Bank. During his nine year tenure in Florida, the bank's assets grew from \$340 million to over \$3 billion. In addition to his lending role, he served as a Regional President and a member of the Executive Management Committee.

Larry has been a member of various American Bankers Association loan school faculties and is currently a faculty member of The LSU Graduate School of Banking. He is a graduate of Southeastern University (Washington D.C.) and the Stonier Graduate School of Banking.