Observations & Insights

from

Jeff Judy & Associates

Your Business Lending Policy

Careful Plan

or

Accidental Outcome?

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Let me tell you a story ...

One day, a credit union decided that offering business loans to members would be a good idea. It would be a service to existing members, and it would attract new members. It would generate interest payments to strengthen the credit union for all members. It would diversify the credit portfolio.

So the credit union's board took careful stock of this idea and fleshed out guidelines. They discussed what kinds of businesses were appropriate. They had serious and extensive debates about this new form of risk, Member Business Lending. They charged credit union senior staff with working out just how MBL would be done, and with whom.

Then the credit union leadership took the time to craft a sound credit policy for business lending. They devised standards and processes and procedures and safeguards to make sure that the larger amounts they'd be lending would not put the assets of *all* the members at risk. After all, they had discussed this thoroughly with the board, and everyone understood that this was a whole new type of risk, one that the credit union had limited experience with, one that needed to be handled pro-actively.

With all their homework done, their i's dotted and t's crossed and everything double checked, they acquired experienced commercial credit staff and announced they were ready to make Member Business Loans.

Is this your story ... or is it a fairy tale?

Action Or Reaction?

The truth, as you know, is that many credit unions have taken a more hurried and, shall we say, accidental, or at least opportunistic, approach to Member Business Lending.

They may have received requests from members for help with their businesses. They may have seen other credit unions (and banks, of course) gathering revenue from business credit. They may have latched on to MBL as a great way to bring affluent new customers into the credit union.

And with those incentives commanding their attention, they leapt in with both feet. They quickly staffed and launched a business lending service. They reacted to demand and opportunity.

They made a loan, and then another, and it didn't seem like a big operation. Then one day they woke up to find they had perhaps hundreds of thousands of dollars outstanding in business loans.

But each of those member business loans was almost unique. There was very little in the way of guiding policy, in deciding who to lend to, in structuring loans to protect the credit union, in monitoring business activity, in detecting problems early, in reacting to issues promptly. The files on these loans varied in their content, their format, their usefulness.

Maybe, at some point, they realized that they needed to get a handle on all this business activity. They needed a clear credit policy, unambiguous underwriting and structuring standards. They needed consistent processes and procedures.

In effect, they had arrived at some sort of standards and policy, not by forethought and careful strategizing, but by "creep": the effect of incrementally adding one unique transaction after another, and then trying to make them all fit into the same-shaped holes.

Risk Imbalance Needs Deliberate Attention

Most of your members are not using your credit union for business loans. The small subset of members who do MBL with you, however, are borrowing larger amounts than your typical consumers who are buying a boat or a car or even using a home equity loan to do some remodeling.

In other words, just a few MBL defaults could have a much greater impact compared to the failure of even an unusual number of your other members to make their payments. In many cases, a handful of MBL defaults could put the credit union in serious jeopardy.

Your responsibility is to protect the pooled assets of *all* the members. But it is easy to get distracted by the bigger revenue numbers – along with the marketing advantages of being involved in MBL – to overlook the wide difference in risk associated with MBL versus your traditional loan products.

When a credit union "creeps" their way to policy, to standards, to process, toward their business lending culture, the process is so gradual that no one may realize what's happening ... until a big credit (or two) goes bad! One day they wake up to find that the risk in their portfolio has somehow crossed a threshold that no one saw coming. Instead of having prepared responses ready to deploy, it's a mad scramble to fix the situation and preserve the credit union for its members.

Accidental Policy, Accidental Results ...

If your story is like the first one I told, if you carefully built your policy and standards and procedures to guide you from the start of your MBL activities, congratulations. That doesn't mean your policies do not demand frequent and careful thought, but you're off to a good start.

If your policy was more accidental, patched together in response to one business loan after another, then your MBL efforts may be an accident waiting to happen. It is not easy, but it is well worth taking the time and effort to step back and design your MBL operations from the ground up.

Your members deserve no less.

Jeff Judy's booming voice and unique instructional style have been enjoyed in classrooms and auditoriums across the globe. Jeff is in demand as a trainer for individual financial services institutions as well as regional and national trade associations. His practical, down-to-earth approach consistently wins him high ratings from participants in his seminars and workshops. Jeff also consults on policy and process, as well as educating audiences through his frequent interviews and articles in trade journals and through his own biweekly electronic newsletter, Jeff's Thoughts. For information about Jeff's work with credit unions, visit www.JeffJudy.com/creditunions.html.