



Commercial Renewals: Market Best Practices

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FEATURING



Gita Tholleson

SVP of Client Success & Market Insights
PrecisionLender

Methodology

- The data presented in this webinar covers **renewals and term extensions** from January 2018 through February 2019
- Data source: **PrecisionLender's proprietary database**, reflecting **actual commercial relationships** (loans, deposits and other fee-based business) from **over 200 banks**
- Renewals and term extensions were identified by **comparing the maturity dates** on all credits which existed as of December 2017 with the maturity dates as of February 2019
- Credits extended six months or less were considered **term extensions** while those over six months were counted as **renewals**
- **Risk migration** was determined by identifying **changes in one-year probability of default (PD)**, and excluding cases where the risk rating description remained unchanged

Perception vs. Reality

Live Poll

- Does your bank revisit pricing on renewals even where **credit quality remained stable**? (Yes/No)
- Does your bank typically adjust pricing on **downgraded credits**? (Yes/No)

Key Takeaways

#1

In the vast majority of commercial renewal scenarios, bankers opt to stick with legacy pricing – even if market and risk factors have shifted.

#2

When renewal spreads are changed, too often they're moved in the opposite direction of the deal's risk migration.

#3

Repricing a renewal upward CAN work, provided the increase is reasonable.

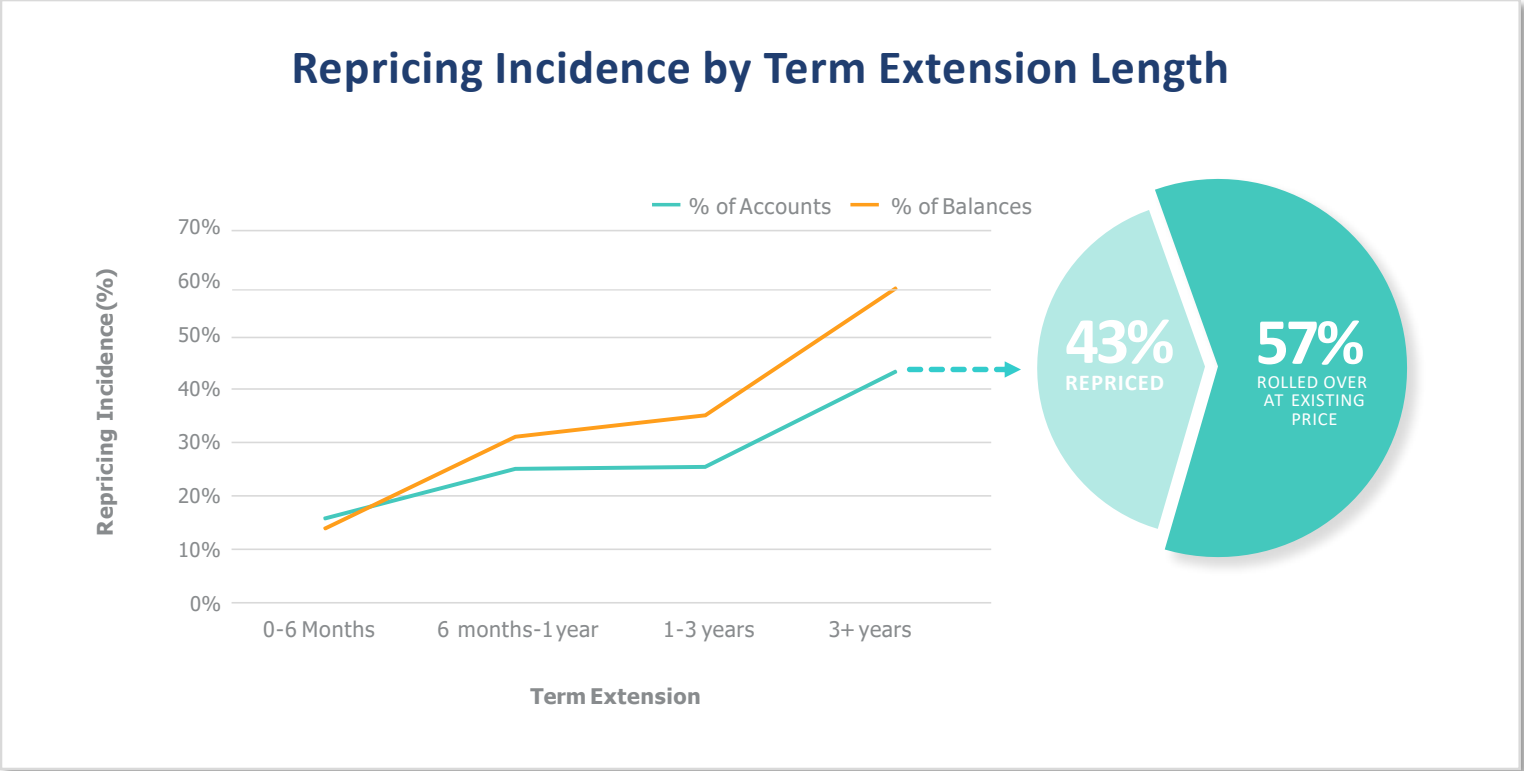
#4

The banks with successful renewal programs equip their relationship managers with the right negotiation tools and tactics.

Primary Reasons for Repricing Renewals

1. **Change in Market Conditions since Origination**
2. **Credit Risk Migration**
3. **Anticipated Cross-Sell, Not Realized**
4. **Direct Competitive Threat**

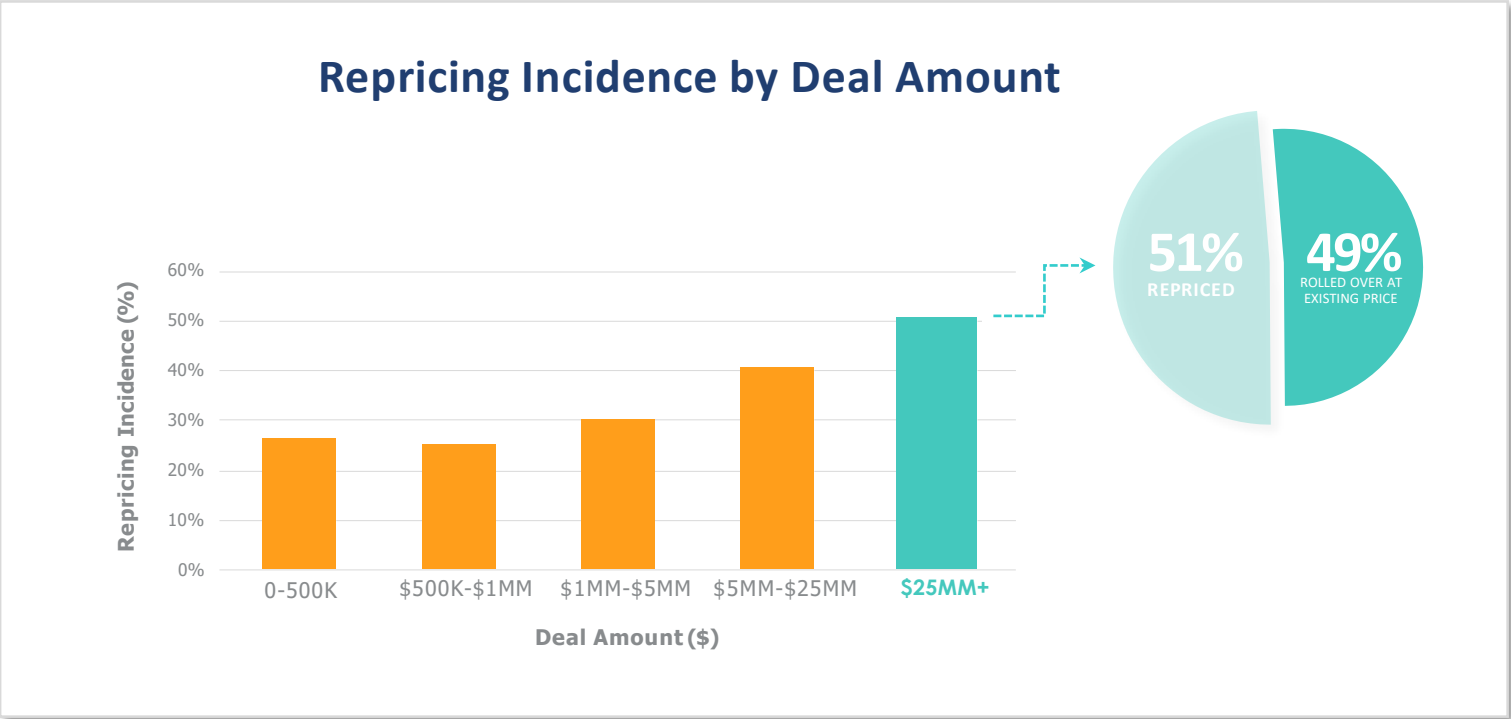
More than half of long-term renewals get rolled over



- As expected, incidence of repricing increases as terms get longer
- But is the curve steep enough? Legacy pricing preserved on nearly 60% of long-term renewals

*Analysis reflects floating rate credits that were renewed or extended between January 2018 and February 2019 and shows the percent of accounts and outstanding balances where pricing was adjusted upon renewal. Repricing incidence includes cases where the pricing adjustments were triggered by grid pricing. Source: PrecisionLender.

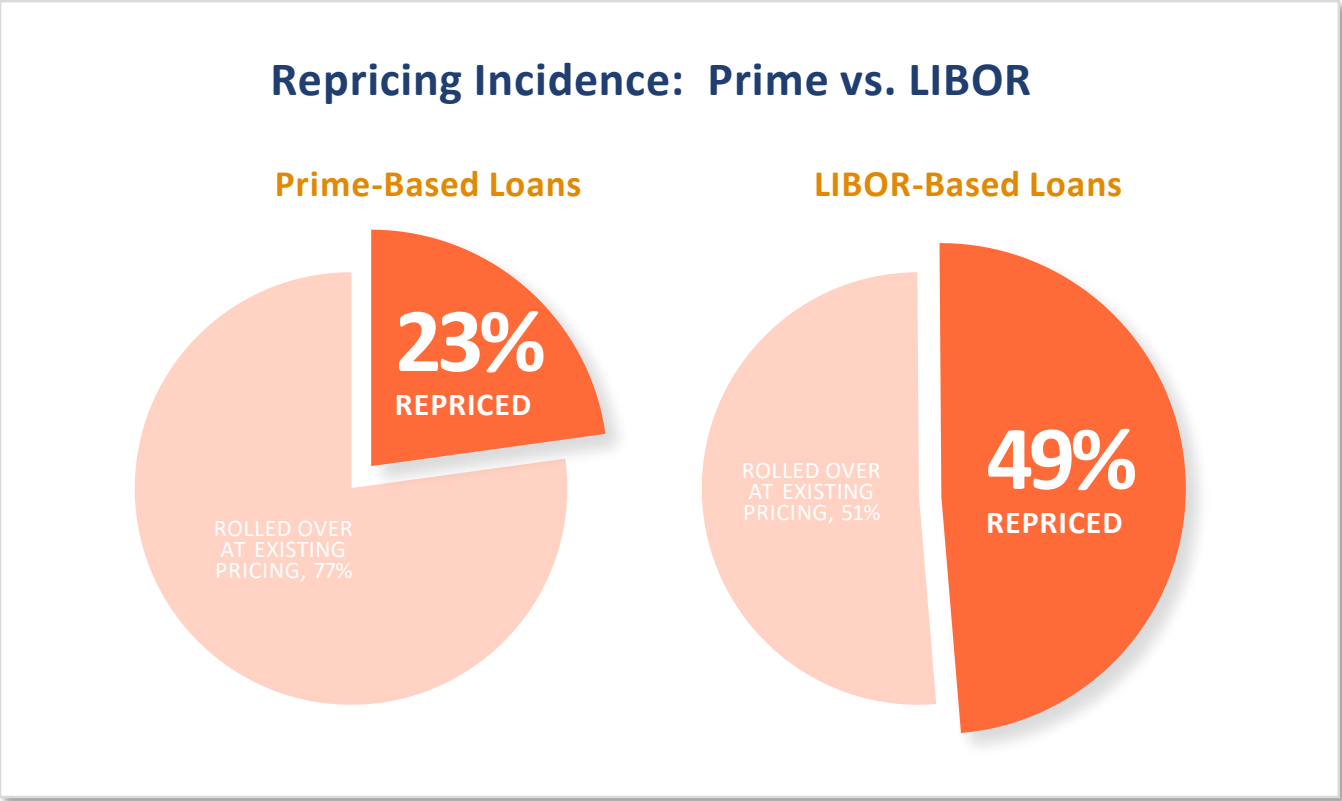
A high percentage of large deal are not being repriced



- Not surprisingly, the incidence of repricing rises as deal size increases
- Still, the rate of increase is lower than what many banks would prefer

*Analysis reflects floating rate credits which were renewed between January 2018 and February 2019 and excludes short-term extensions of six months or less. Repricing incidence includes cases where the pricing adjustments were triggered by grid pricing. Figures are weighted by outstandings. Source: PrecisionLender.

In renewal pricing, index matters

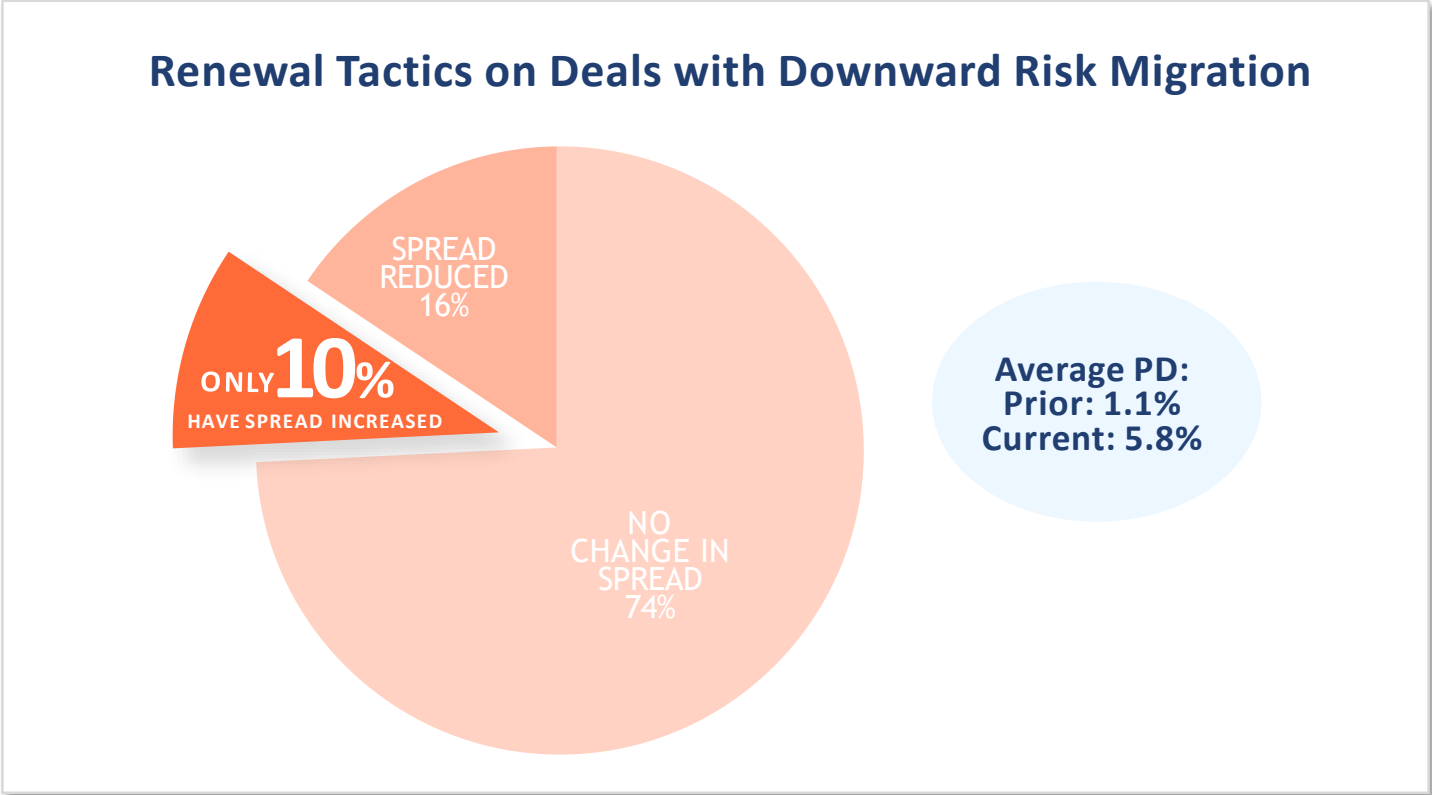


Key Drivers

- Preponderance of auto-renewals on smaller, Prime-based deals
- Greater focus and oversight on larger deals which have more of an impact on the bottom line
- Higher incidence of performance-based pricing on larger facilities

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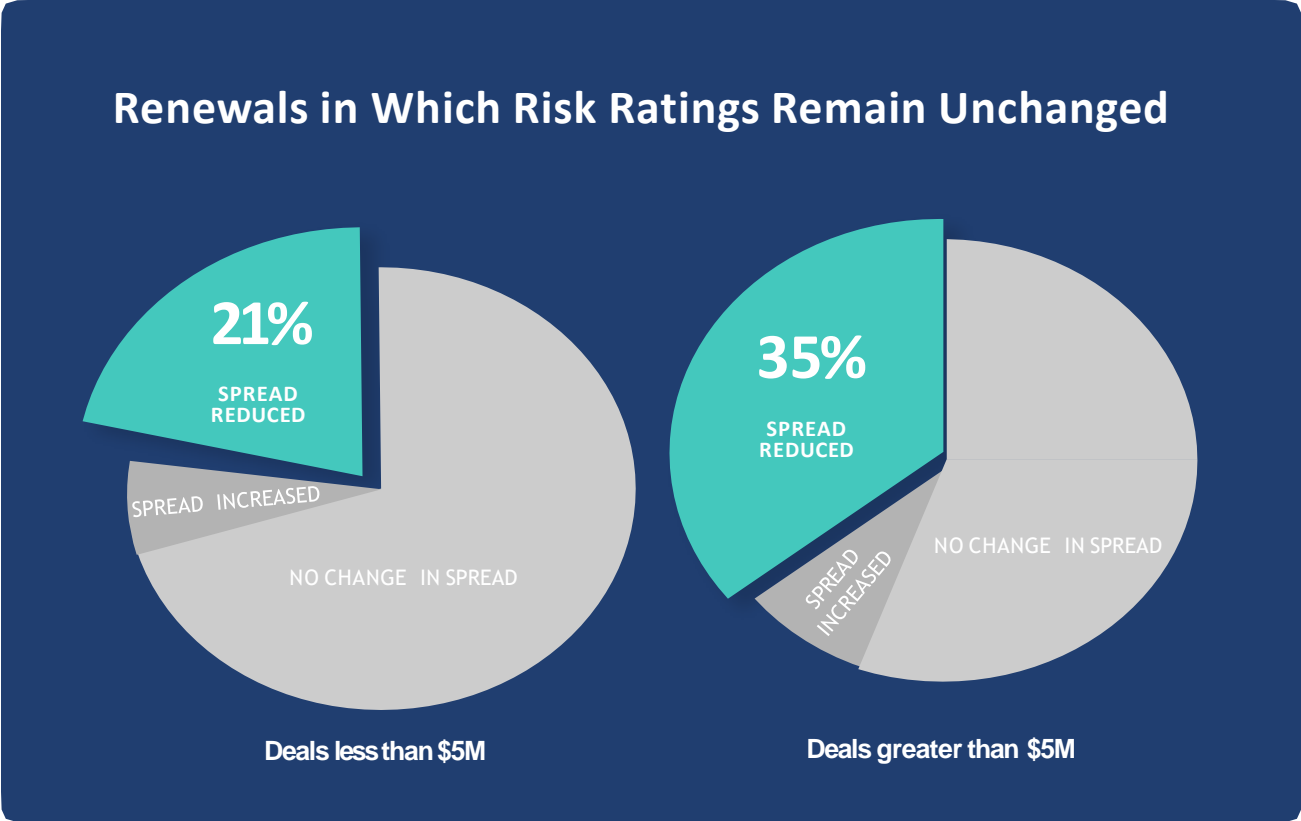
Higher risk isn't leading to more repricing



- Even in cases of downward risk migration, most credits under \$5 million are being rolled over at legacy pricing levels
- Notably, these rating changes are not minor: average PD rose from 1.1% to 5.8%

*Analysis reflects floating rate credits under \$5 million which were renewed between January 2018 and February 2019 and downgraded, and excludes short-term extensions of six months or less. Repricing incidence includes cases where the pricing adjustments were triggered by grid pricing. Figures are weighted by outstandings. Source: PrecisionLender.

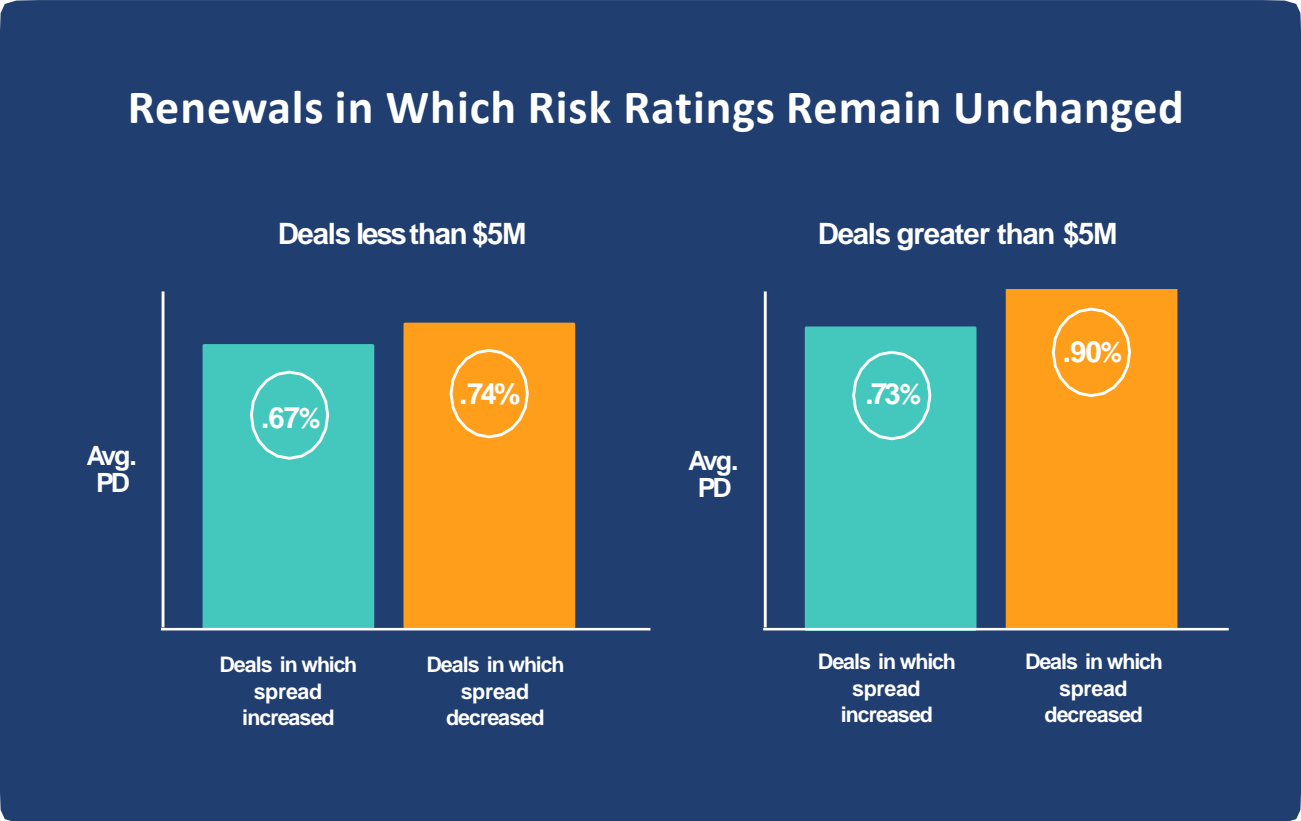
Banks are proactively reducing margins on stable quality deals



- Without any significant change in credit quality – at least not enough to trigger a rating change – banks are trimming spreads on a considerable volume of renewals

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When repricing occurs, it's often out of step with risk



- Pricing reductions are not being reserved for the best quality borrowers
- Rather, average PD was comparable to slightly weaker on the deals repriced downward

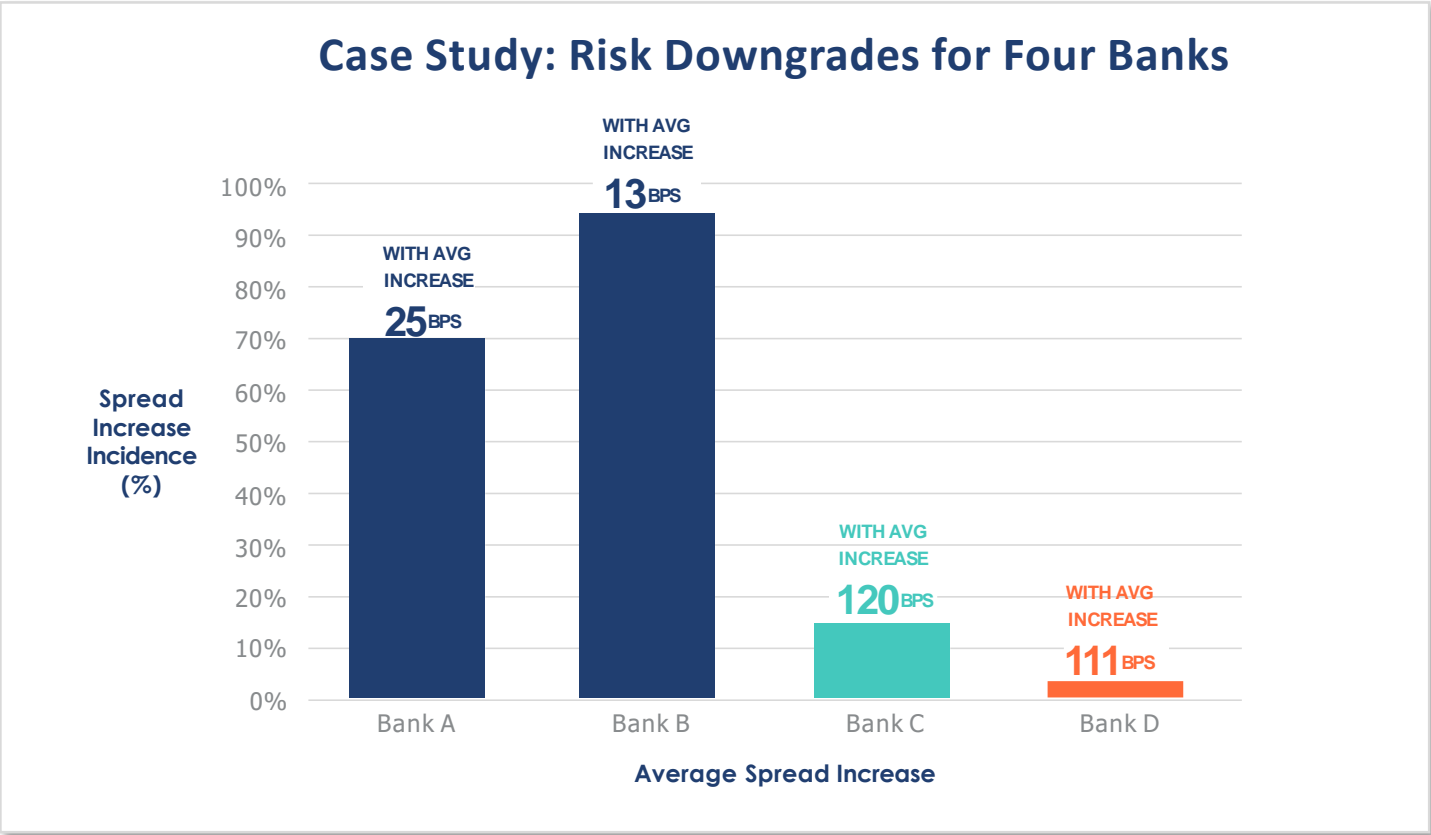
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Banks attribute spread reductions to competitive pressure

Customer retention cited as key reason for cutting renewal spreads:

- **Taking a defensive posture to minimize the risk of runoff**
- **Lowering spreads in response to a direct competitive threat**

Repricing works – when the ask is reasonable



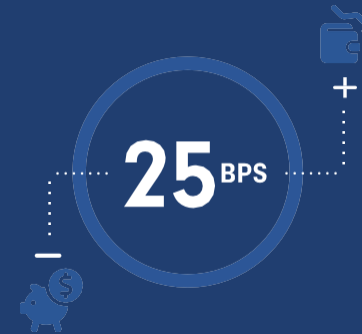
- Aggregate results belie sharp differences in repricing rates across banks
- A striking similarity between the banks with high repricing frequencies? Average increases are a quarter-point or less

*Analysis reflects floating rate credits under \$5 million for four banks, which were renewed between January 2018 and February 2019 and downgraded, and excludes short-term extensions of six months or less. Repricing incidence includes cases where the pricing adjustments were triggered by grid pricing. Figures are weighted by outstandings. Source: PrecisionLender.

Finding the right tipping point

Case Study: One Bank's Journey

- Pilot program in a single region required bankers to present adjusted renewal pricing under four scenarios:
 - Risk migration
 - Market movements
 - Unrealized cross-sell
 - Mispricing
- Results:
 - More than 25 bp increase: borrower shopped credit
 - Increase 25 bp or less: borrower accepted or negotiated down



6 Reasons Why Banks Still Use Legacy Pricing

Setting a high bar is only one of several factors impacting renewal performance. During our work with commercial banks across the country, six key reasons have emerged as the drivers behind the preservation of legacy pricing on renewals.



1. Deals set up on auto-renewal or handled by a Portfolio Manager rather than a Relationship Manager



2. Lack of oversight and intel; tendency to rubber-stamp renewals



3. Competition and concern over potential runoff



4. Sales Incentives, or lack thereof



5. Absence of grid pricing



6. Negotiation skills and tactics

10 Tactics Top RMs Use for Renewals



1. They verbalize the pricing rationale, including changes in the company's financial performance.



2. They propose performance-based pricing.



3. They communicate that the customer is still getting a good deal, even if the price is slightly higher than before.



4. They set expectations early, and don't wait until maturity to discuss pricing.



5. They make modest pricing adjustments, even if the gap to target is wide.

10 Tactics Top RMs Use for Renewals



6. They utilize non-standard pricing increments, rather than taking an all-or-nothing approach.



7. They take a matter-of-fact approach and avoid excessive discussion.



8. They explain relationship pricing, especially in cases where cross-sell expectations have not been met.



9. They deliver value on an ongoing basis – such as new ideas, introductions, and creative solutions to business challenges – to build loyalty and minimize competitive vulnerability.



10. They avoid a “take it or leave it” approach and ensure last look.



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Ned Miller

Senior Adviser
MZ Bierly Consulting



