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Will competition for C&I loans lead to looser underwriting?

By Alissa Kline   February 9, 2021

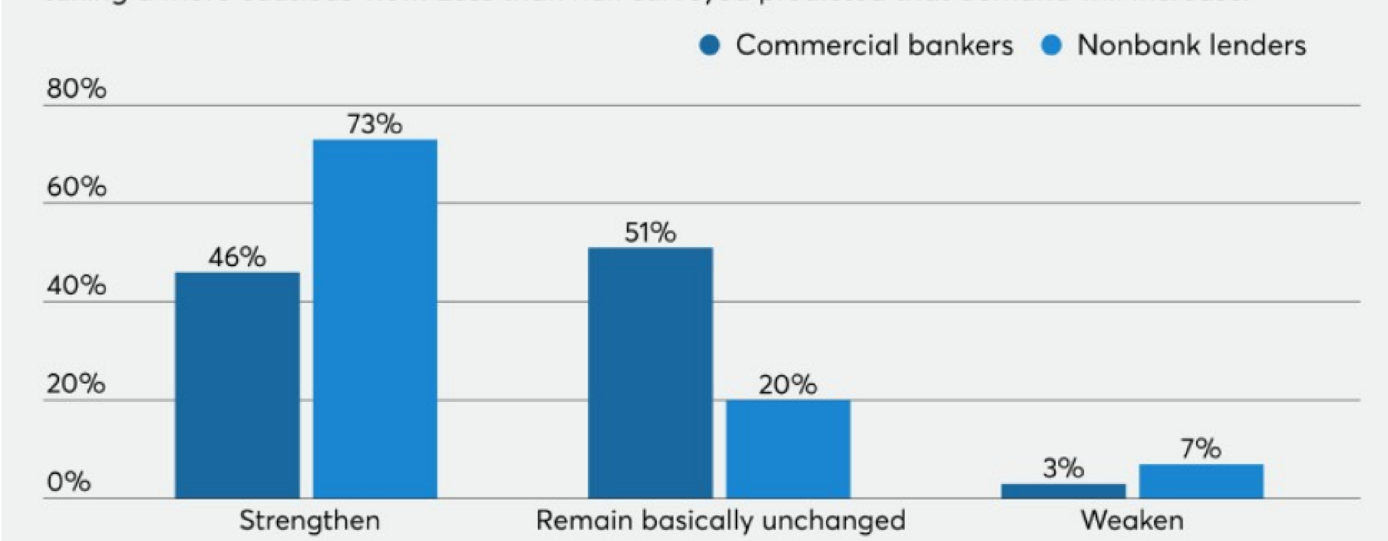
Competition for business loans is poised to heat up as banks look to reinvest deposits and alternative lenders remain open to taking on more risk.

The pandemic led commercial banks to tighten underwriting standards, sending more business to nonbank lenders. But a strengthening economy, paired with high levels of liquidity, could lead banks to make more commercial-and-industrial loans.

At the same time, nonbanks seem willing to continue making accommodations on loan terms, according to a survey of 64 lenders conducted in January by Cerebro Capital, a digital lending marketplace in Baltimore.

"Banks are flush with funds," said Kenneth Singleton, an economist and professor emeritus at Stanford University. "That would suggest some natural interest on the part of banks to supply lending terms that would be attractive to bring corporations back in."

Differing Opinions



While most nonbank lenders expect commercial loan demand to strengthen in 2021, bankers are taking a more cautious view. Less than half surveyed predicted that demand will increase.

Sources: Federal Reserve, Cerebro Capital

"Suddenly, commercial banks can help corporate borrowers with loans again," said Matthew Bjonerud, Cerebro's CEO. Borrowers "don't have to look at just nonbank lenders, which now have to face the terms that commercial banks can offer."

Loan portfolios at U.S. banks shrank considerably last year, even with their participation in the Paycheck Protection Program, falling to 50.4% of total assets on Dec. 31 from 56.4% a year earlier, according to Federal Reserve data. Bankers have pointed to tepid demand.

Nonbank lenders, meanwhile, have been offering more accommodations to potential and existing borrowers that include bigger loans and interest-only structures, Bjonerud said. Increased risk appetite is one reason why nonbanks are willing to keep easing standards in coming months, he said.

It is unclear how much demand exists for C&I loans, which could influence how competitive banks and nonbanks must be to add new relationships. Only 46% of the 73 banks included in the Fed's fourth-quarter senior loan officer report, released on Feb. 5, expect C&I demand to increase this year, and nearly 51% said demand will "remain basically unchanged."

Nonbanks have a different view. Nearly three-fourths of the nonbanks surveyed by Cerebro to complement the Fed report expect C&I demand to rise in 2021. Roughly two-thirds said it should increase "somewhat," while 8% said it would increase "substantially." More than 70% of nonbanks reported increased demand in the fourth quarter, with much of it tied to mergers-and-acquisitions activity.

There are early signs that loan demand is coming back, Bjonerud said. Loans are starting to pick up, even at commercial banks, following last year's economic and political uncertainty. "It's too early to call it, but right now we see promising signs," Bjornerud said.

Cerebro's report is the second of what will be quarterly reports tracking nonbank lending for middle-market C&I loans. The first, which covered the third quarter, showed that demand for C&I loans from alternative lenders would likely surge over a six-month period as borrowers left commercial banks to nd relaxed covenants and flexible loan structures.

It seems as though banks will continue to be more reluctant than nonbanks to relax standards. Ninety-three percent of nonbanks that responded to the Cerebro survey said greater risk tolerance was a somewhat or very important factor for relaxing standards over the last three months. Just 6% of commercial banks told the Fed it was a somewhat important factor. "That's a stark contrast," Bjonerud said.