Fee-income engine helps drive turnaround

Some might call it "sleeping with the enemy," others a "smart move." Either way, working with credit unions, along with forays into insurance and investments, has pushed University Bancorp into the black

Many community bankers would rather eat eggshells than make life easier for credit unions.

But working closely with more than 100 credit unions isn't troubling Stephen Lange Ranzini's digestion one bit.

In fact, community bank president and chairman Ranzini *touts* his bank holding company's extensive involvement with the credit union industry to potential investors in his 2002 annual report:

"University Bancorp [holding company for $42.9 million-assets University Bank, Ann Arbor, Mich.] is one of the few ways that investors can invest in the success of the credit union industry as credit unions increase their share of mortgage loans made to their members."

There is precedent here. For years banks made money clearing credit union share drafts.

What Ranzini's holding company is doing, through its bank's 80%-owned subsidiary, Midwest Loan Services, Inc., is giving credit unions a tremendous leg up into the mortgage lending business. It's part of a broad push into fee-income businesses by the one-bank holding company.

Interestingly, Ranzini says he hasn't taken any flak from fellow bankers objecting to his working with this serious rival.

"I think people feel it's a big market," he says. "I don't think that the bankers in the mortgage business feel that scared of the credit unions because they don't see them as that experienced and they don't see them therefore as much of a threat."

Pausing, Ranzini admits, "they really should." Credit unions are well placed to be doing mortgage business," he says.

It started in the U.P.

Not surprisingly, for those who know the state, the story of Midwest Loan Services success began in the latter 1990s in Michigan's Upper Peninsula, or "the U.P.," in Michigander's parlance. It's a region where the sparse population has long prided itself on being different not only from much of the country, but from the southern portion of its own state.

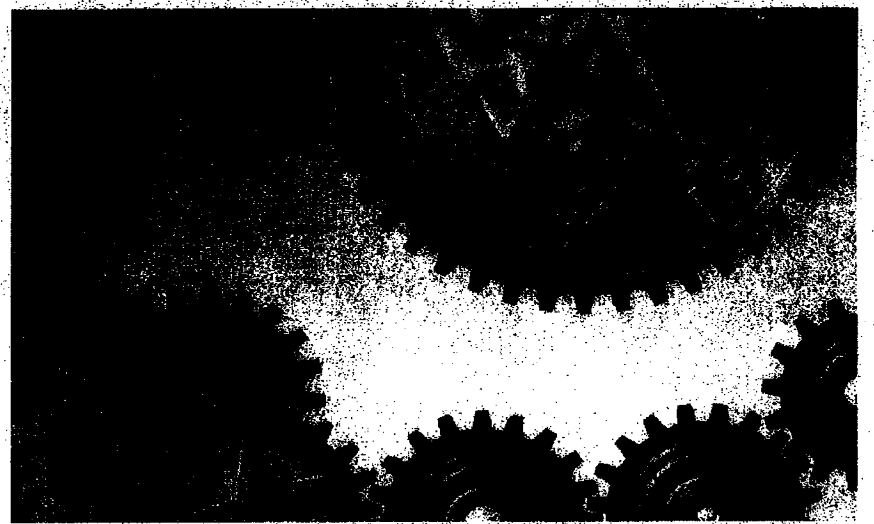


ILLUSTRATION BY TOMEK OLBINSK

At the time, Ranzini's company owned a small bank in the U.P.

A friend "talked my ear off about how great the mortgage business was," says Ranzini, so he hired the friend to start an operation for the holding company. Through a confluence of events, the bank holding company in time found itself the 80% owner of a subservicing company.

At the start, the firm didn't work with credit unions. But then one became a customer and that led to another, and then things began to snowball.

"Midwest Loan has tremendous positive word of mouth among credit unions," says Ranzini. Without any advertising, he says, the subsidiary was able to build up a customer base of

By Steve Cocheo, executive editor

more than 100 credit unions. Furthermore, the company is cultivating credit union service organizations, which are often used by multiple credit unions for shared expansionary efforts. Ranzini says that one CUSO that's looking seriously at engaging Midwest Loan Services has 200 credit unions under its umbrella—a potentially huge increase in Midwest's volume.

Part of the appeal of outsourcing to the community bank's operation, says Ranzini, is that the credit unions can retain as much or as little of the mortgage process as they care to.

"We offer this on an à la carte basis," he says, and all of it is unbranded.

Ranzini says it helps that Midwest brings a record of low delinquency rates and a high degree of mortgage borrower loyalty to the servicing table. The company offers a web-based interface into its operation for borrowers, and also a call center for those who don't like computers.

From Midwest's perspective, there are some heavy duty advantages to doing business with credit unions. It's very common for credit union loan customers to accept ACH payments, which in this case would be funneled to Midwest Loan Services. Such automated payments make the front end of servicing that much easier. Meanwhile, having a home base in the U.P., a lower-salary market, helps contain the subsidiary's costs.

Midwest has grown to be the nation's 17th-largest subservicer, doing business with nearly 14,000 households representing $2 billion in mortgages, according to Ranzini. (This includes the mortgages it originates itself or that are originated by the bank.) It represents the largest source of fee income among the various sources that University Bancorp enjoys.

However, Ranzini says management recognizes that the refi wave that has helped sustain the subsidiary's growth is dwindling. But plans have already been made to counteract the expected shortfall in volume by adding a new product line that will enable credit unions and other customers to sell larger, nonconforming loans to the secondary market, with Midwest Loan performing the servicing.

"We think that is going to pick up the slack," says Ranzini.

Fee income leads recovery

In 1996, Ranzini transferred the U.P. bank's charter to Ann Arbor, becoming University Bank. The servicing operation stayed in the U.P. For several years things went poorly, leading to losses. At the end of 2002, the holding company's annual report noted that it marked the firm's first profitable year since 1996.

This was the result of a major increase in loan quality and improvement in net interest margin. The latter was brought about in part through the use of full-commission deposit sales people, which helped reduce the bank's dependence on brokered funds. Net interest income improved 23.9%.

However, what improved by an even higher rate in the turnaround year was non-interest income, rising in 2002 by 40.1% over 2001 levels. (At the end of 2002, the company reported that the company's noninterest income, not even counting Midwest Loan Services, was 184% above the bank's peer group.)

The top two contributors to noninterest income are fee income from Midwest Loan Services and from the bank's own mortgages, and insurance sales and investment securities sales, both handled through University Insurance & Investment Services, Inc.

Insurance just scratches the surface

Ranzini, in his late 30s, made a point of studying the experiences of banks in states where insurance was always a permissible activity for banks, notably Iowa. He says he found that Iowa banks that pursued this product line typically brought in 10% of their income from sales of insurance. Ranzini set that as a goal for University Bank.

The bank bought a "shelf" agency license from the state's thrift association, which enabled it to save much of the time that might have been required to go through a full-bore regulatory application process. This was used to launch a *de novo* agency, run by Edie Kingsley, president of the insurance operation and

FEE INCOME *continued on page 56*

"PASS THE ASPIRIN"

THE HEADACHE

A Connecticut bank CEO asks:

"I've been in the banking business for about three decades and I was 'raised' to hold onto the trash from the teller stations and similar parts of the bank for two weeks or so just in case some question came up, or some document was found to be missing. After those two weeks, the material gets shredded.

"Am I old-fashioned or is this still the 'state of the art?"

REMEDY 1

Thomas Sherman, president and CEO, $133.2 million-assets Coast National Bank, San Luis Obispo, Calif., answers:

We still retain the "trash" and the "to shred" for up to two weeks. We keep it locked up away from the janitors after hours for privacy reasons. Every two weeks, we have a mobile shredding service visit us with their on-site shredding truck. The shredding service takes our "retained" paper work, shreds it immediately in our parking lot (it takes about 5 minutes), and moves on.

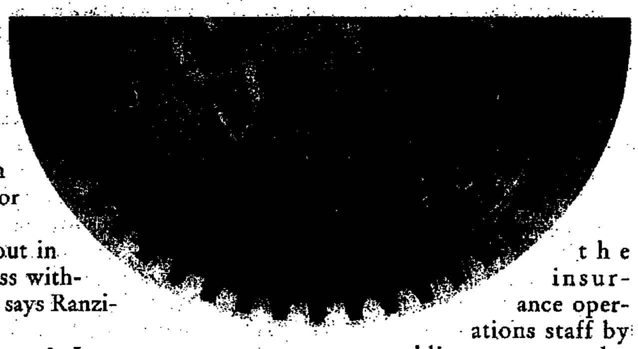
REMEDY 2

Karen Besthoff, senior vice-president, $280 million-assets Mount Prospect National Bank, Mount Prospect, Ill., answers:

Currently, any sensitive documents are put in a separate container behind the teller line and then in our locked shredding container. We have an outside service that collects these locked containers once or twice a month. As for the regular teller garbage, the cleaning people empty it daily and it is not saved. Also, we do offer a service to our customers two or three times a year that we call "shredding day." We have a truck from the shredding company in our parking lot and customers can bring in up to 100 pounds of personal material

ASPIRIN *continued on page 62*

FEE INCOME,
Cont'd from p. 22



an experienced insurance executive. She had been serving as the number-two in a nearby agency prior to joining the bank.

"You can't start out in the insurance business without the right person," says Ranzini.

University Insurance & Investment Services, Inc., sells a full line of personal and business insurance for 20-odd insurance companies in Michigan.

The agency began to turn a profit in its third year of operation, and in 2002 it made a profit of $15,982 on sales of about $114,112 (on written premium of about $1.25 million). In addition, because losses were low on policies it wrote, the agency has received profit-sharing funds as well. Ranzini says the agency is expected to produce a profit of about $40,000 on sales of about $130,000 (on written premium of about $1.5 million) in 2003.

In spite of these numbers, Ranzini believes the bank has only started to see the potential results it can expect from insurance. He points out that the bank has 4,000 bank customers and 3,500 insurance customers, and that there's only about a 10% overlap of bank customers to agency customers and a 25% overlap of agency customers with bank customers.

One notable effort was the bank's working with municipal unions in Detroit to do some network marketing of policies.

"A lot of insurance companies look on Detroit as a 'no go' area," says Ranzini, but one of the carriers that the bank's agency represents was willing to take on good risks in Detroit. The program gathered further momentum when a member of Detroit's City Council began praising the bank agency's offerings and rates in public.

The effort pulled in some strong business, notes Ranzini, though fraud pulled down the results that the bank might have seen.

Longer term, Ranzini wants to expand the insurance operations staff by adding more sales agents. Acquisitions of established books of business through acquisition of smaller agencies in the bank's market area is also being explored.

Securities with a twist

Investments are a personal interest for Ranzini, who says he was reading the stock tables at 12 and compiling a collection of annual reports that reached the thousands by the time college was over. Ranzini holds both securities and insurance sales licenses and is a registered investment advisor.

Thus far, Ranzini is a one-man band on the investment side of University Insurance & Investment Services. He manages $5 million in customer funds, all accounts obtained by word of mouth and all opened within the last two years. As evidence of what he can bring to clients, he points out that his average account holder saw an increase in holdings value of 29.58% in 2001, and a return of 6.06% in 2002, "despite the fact that the average diversified U.S. mutual fund was down 22.4% that year."

University Bank has an interesting approach to the business. Technically, when wearing his investment advisor/stockbroker hat, Ranzini is working for Equitas America, LLC, Farmington Hills, Mich. Equitas (www.equitasusa.com) is a cooperative of many other standalone advisors and brokers. (University Bank customers' accounts are held by institutional broker Pershing, a division of Bank of New York.)

"Equitas has brokers all over the country like me who are self-sufficient and find their own investment ideas," says

University Bank CEO Steve Ranzini is more than just a talker about fee income. He's the bank's licensed securities seller and investment advisor.

Ranzini. "Because Equitas is structured as a cooperative, I get a much better payout than under traditional arrangements." He says that his payout comes to 80% of the commissions he generates and, at yearend, he obtains a payment based on his share of the cooperative's overall business volume.

"Typical broker payouts are in the range of 50%," says Ranzini.

Ranzini, who owns about a third of the bank holding company, currently signs his Equitas checks over to the bank and so his commissions are actually going towards the insurance and investments subsidiary's results.

More sources of fee income

What of the future? Ranzini's been in the midst of several other projects—the fee-income effort has included getting into a new bounce protection product, the ABA-endorsed Business Manager, and a web-based currency exchange idea that he's been tinkering with—and hasn't been able to expand much beyond his one-man act thus far on the security front. But he hopes to hire additional advisors in the near future so they can handle sales and customer relations and he can concentrate on investment strategies. Long term, he would like to establish a mutual fund for the bank.

But that's a long way off, he admits, with more work needed to develop the existing securities business model. "First I have to get to the point of critical mass," says Ranzini. Then he'll have the luxury of time for expansion. *BJ*