
FIVE REASONS WHY TODAY'S WORKOUTS ARE DIFFERENT

Survivors of today's challenges can learn both credit and ethical lessons

On Monday, Nov. 16, I'm presenting at the ABA's National Agricultural Bankers Conference in San Antonio. My subject for the morning is "Organizing for Loan Workouts: the Long Road," and in the afternoon I'm co-presenting with my business partner on "Ethical Risk—Life in the Glass House."

What does one subject have to do with the other? Unfortunately, quite a bit.

Why today's workouts differ from the immediate past

First, there are several important points about loan workouts that make any discussion of the subject this year, and perhaps next, different from any previous year since the 1980s.

Here are five reasons why things are different today:

1. Loan workouts used to mean working on troubled credit in the bank's portfolio. Today, it often means trying to save the bank.
2. Problem assets lately seem to have relatively few causes. While overall economic activity has always been a significant factor, recently the causes increasingly are concentrated in overt violations of credit policies and a lack of managerial will to enforce credit standards.
3. Practitioners (like you and me) saw this coming. How can any of us today say that we were ignorant of the screwy loan terms some were booking in residential real estate; oblivious to concentrations of credit many were loading into their portfolios; and unaware of the underwriting lapses occurring at many institutions?
4. There are concentrations of credit and concentrations of credit. Community banks have concentrations due to their geography, and larger banks have both the geography issue and core-product-line issues. Expansions of uses of funds into non-traditional products for a particular bank or new and less-familiar products are hazards that have been obvious for years. Where were our collective antennae as we were growing the bank and raising the dividend?
5. The examiners began to talk about concentrations of commercial real credit and issued written guidance on the subject nearly three and a half years ago. Action back then might have saved a lot of grief.

Why were the examiners ignored by management and boards?

Or perhaps more to the point, why did the regulators permit themselves to be ignored?

Where workouts and ethics intersect

As an industry, we have given back most of our industry's earnings of the current decade in the form of charges to the loan loss reserve or writedowns of asset values.

Not all banks have lost money, and quite a few—probably the majority—never joined the rush to the bottom, though all are affected by it. But many did, setting aside their better judgment in the process.

Where this becomes "ethical" is in the area of our individual and collective responsibility for safety and soundness.

Bank credit cultures are a series of shared expectations regarding outcomes of our lending activities. Good outcomes require management focus and effective internal controls.

We have not had good outcomes the last two years. Why? Because management took its eye off the ball in terms of what makes credit culture have good outcomes. The industry wanted earnings, times were good, the results were easy to produce.

What was compromised were the internal controls.

How things deteriorated

Loan policies are not typically silent on concentrations, underwriting standards, credit and collateral exceptions, and the like. Unfortunately, training at many banks consists of repetition and the acquisition and reinforcement of habits both good and bad. Mentoring is uneven and inconsistent. Loan committees at many banks have been allowed to deteriorate into "lowest common denominator" forums.

Actions have consequences. We make choices, though they don't always seem as explicit, as we go about our day-to-day activities, as they seem in hindsight.

As an industry, we have not been good stewards, and, as a result, our stockholders, our local communities, and the Deposit Insurance Fund have not been well served.

When a bank goes under an administrative agreement, management and loan officer discretion is negatively, if not severely, impacted. And then, customers will not be well served, because the bank is under pressure.

It will be some time before we sort all of this out and by then, we'll be well into the next economic cycle.

Bankers can't afford to forget the lessons of the last few years. To do so would truly and aptly be called

“unethical.”

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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