
PART 2: SEVEN MORE THOUGHTS ON WHAT WE'VE LEARNED

And these seven lessons come down to one inescapable conclusion...

Second in a series

Before turning to New Year's resolutions as we inevitably must after enumerating our lessons learned, it seemed important to list a few more of these lessons that were omitted from the earlier list of Dec. 17, 2009.

1. Past performance is not always a reliable indicator of future activity.

Often it's the best predictor we've got. Yet we'd never experience a bad year coming off a good one if performance alone were the metric. We have to look at our underwriting assumptions more carefully.

2. Concentrations of credit abounded, but were either ignored or not detected.

An important question to ask: Which is worse-not knowing at all or ignoring painful, but learned, lessons from the past?

3. Concentrations of credit, especially in commercial real estate, will severely impact community bank loan growth prospects.

Perhaps we should say that these concentrations will "stunt" growth. After all, many community bankers say that there aren't many other types of lending opportunities available to many of them. What does this portend, then, for our local communities and their economies? Is there a greater good that we are about to shun? Is something about to be thrown under the bus?

4. Speculative lending has no place in a commercial bank loan portfolio.

How many of our loan policies speak of lending for productive purposes, but our actions often speak silently and primarily to profit? Where is the old-fashioned idea of more employment and economic activity for the benefit of the many? These are not new ideas, but are urgent ones nonetheless, particularly since we seemed to have forgotten them.

5. If we can't do our own due diligence on the risks involved, we probably should take a pass on the lending opportunity.

Rating agencies were often shown to be derelict in their duty in this sense. Independence and transparency were missing in many cases, and we, the lenders and our banks, were the losers. Incidentally, this is one of the principal risks in buying participations from correspondent banks. We expose ourselves to their possible underwriting lapses. We've got to know what the risks are and not just assume that someone else is looking out for our best interests.

6. Stress testing across all components of our loan portfolios is coming of age.

Stress testing is now being viewed as much more than just exposure of our assets and liabilities to changes in interest rates, but of those same impacts on our customers' assets and liabilities too. We also have to stress the assumptions we make on credit and these are not confined to interest rates.

7. Securitization of loan assets is not a reliable risk modifier.

We found that out with sub-prime mortgage credit where the problem quickly became the fact that no one knew where the "Old Maid" was (referring to the children's card game).

This is another facet of concentration risk. There's an expression in environmental engineering science that says "the solution to pollution is dilution." But you can't turn lead into gold. The central truth here is that junk is junk and banks should know it for what it is and avoid investing in it.

2009's lessons sound familiar, and why

Looking over this list is instructive, because it underscores that, in the sense, there's not a great deal of new material to be learned. Instead, this largely represents the accumulated wisdom of the past that (1) we didn't recognize in its new garb, or, (2) ignored as an irrelevant historical artifact.

Most of us can't work much harder. We have been stressed and strained enough in the last several months. But we've got to work smarter. That's what the New Year's resolutions are all about and how much more urgent they are for this year to come than they have been in the past.

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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