
SHOULD LENDERS HAVE UNLIMITED TURNDOWN AUTHORITY?

Are two heads better than one? Or just two heads?

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A few weeks ago I came across an unusual fact-there are actually banks that have established a rule that no lender can decline a credit request single-handedly.

That sounded strange in today's environment of newly found conservative credit attitudes and examiner scrutiny of lending decisions. What could the logic possibly be? Does that ultimately infer that every loan request should be granted?

Two minds on one matter

When I was actively participating in my company's lender training program I often told trainees that lenders have unlimited turndown authority. If in the course of our prospecting any of us finds an unworthy borrower, as determined by financial condition or past record of performance problems, we should decline the request forthwith. If it's a consumer request within certain size parameters, we need to send an "adverse action notice" but that's it. Why should you or I spend our time with something that we won't, or shouldn't do?

Then I remembered something else I used to tell trainees and new lenders:

"Don't say no, say how."

If we can't do the credit this way, maybe we can do it some other way. Different collateral, a co-signor, or a different structure might transform a "no" as requested to a "yes" as negotiated.

Is collaboration ultimately a plus?

In this environment, two votes to decline any credit certainly sounds counter cultural. Earning assets are and will likely continue to be difficult to generate and where the competition for creditworthy applicants is often ferocious, maybe it makes sense.

Yet the case for two affirmative votes might include training and mentoring opportunities, or could be an occasion where an additional set of eyes might catch something the other misses.

In the days when I chaired the senior credit committee at a large bank, I sometimes saw credits presented with structures that could be improved. I thought that a little more work before the committee presentation could have saved the committee some time and burnished the reputation of the presenter.

The big fish that got away

Finally, I must relate a reason from my days as an oil patch banker for a "two votes to decline rule" on new credit.

The First National Bank of Midland had a traditional and vigorous rivalry with the Midland National Bank. Each bank, through the 50s, 60s, and 70s was highly specialized (and very good) in lending to oil field borrowers.

In 1968 or so, a substantial customer of Midland National came into First National and asked to see the senior oil and gas lender. The two men were acquainted socially but had never done business together. The lender was out of the office and the visitor was introduced to one of his assistants, a competent but less-experienced lender.

After inspecting the visitor's financial statements and oil and gas engineering reports (appraisals of oil and gas properties), the younger lender declined to consider further the oil man's oral credit request. The meeting concluded cordially and the visitor left. That should have been the end of the matter, correct?

It was anything but.

When the senior lender returned and was told what had happened, he was reported to be as angry as any human being had ever been in a business situation.

Instead of declining a marginal or unworthy borrower, the young lender had declined one of Midland's premier oil and gas operators, but one with a very low-key profile and whose conservatism tended to understate the values reflected on his financial statements.

This was, in other words, the decline of an opportunity the senior lender had been personally pursuing for nearly 20 years. When Midland National's customer decided to seek alternative financing, First National missed the opportunity and the loss was acutely felt.

Within a day, First National's president decreed that no lender could decline any credit of any size without the concurrence of another lender. That rule continued in effect for many years and was still in effect when I arrived there in 1980. That may have been an extreme reaction within First National but opportunities to move customers entrenched at a competitor bank are relatively rare.

Blackberries are great. Brains are better

Technology and internal practice can find solutions to plug gaps like I've just described, without creating additional effort or recordkeeping. But this example also highlights where banks need to be proactive and vigilant. They must consider:

- Who are a bank's best prospects?

- What sort of formality exists within the bank to constantly refine and identify attractive credit and deposit prospects?

- For existing customers, do you know whether each is getting treatment commensurate with either the current or future value of the relationship?

I constantly hear about community and sometimes larger banks that have no well-defined customer profitability profiling capability. Sometimes accounts that appear to be profitable are not what they seem and other marginal accounts with a little more internal analysis can be identified for additional cross sell opportunities and made much more profitable. It's hard and it's expensive to generate new customer relationships. Are we doing the right kind of prospecting, including within our own customer ranks in a regular, systematic way?

It's hard to turn away business. But ultimately, would you rather work for the biggest bank in town? Or the most profitable?

- 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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