SIX TIPS AS YOU ENTER WORKOUT MODE

Think of workouts as a journey, not a quick trip, and you'll make better progress

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Recently I participated in a panel discussion at a New Mexico Bankers Association meeting on the subject of "Working Out Problem Loans." Fellow panelists were Vic Carlin, an attorney with extensive experience restructuring problem loans, and Bill Verant, the New Mexico regulator of state-chartered banks. About 75 community bankers attended, and problem assets were clearly on everyone's mind.

As I prepared my thoughts and comments for the panel and for an ABA credit group a couple of months before, I wondered what I could say that would be useful. Based on these two recent experiences, here's my advice for anyone involved in working out troubled credit.

Assembling your workout resources

First, be sure you have the tools to do the job-a first-class attorney, experienced lenders, and specialized resources to evaluate and monitor collateral.

Second, be sure that you have access to the board of directors or to a committee of the board.

As regulator Bill Verant put it, "Don't let any ‘happy talk' EVP get between you and candid discussions with the board." The directors must receive the unvarnished truth and they can only get it from the people with direct experience with the issues.

Third, realize that problem credits require skills in analysis and negotiations, skill sets that most experienced lenders already possess.

Fourth, create a focused environment-one in which those charged with the responsibility of dealing with the problems can focus on them without the distractions of other duties and responsibilities.

Beware of "modern" lender liability

Attorney Vic Carlin noted more than once that lender liability issues are one of the biggest risks facing banks today in the current environment. Let's examine that concept.

"Lender liability," 30 years ago, was code. It referred to lender control over the affairs of the borrower, and the resulting liability to the bank for decisions in the administration of credit.

Today, "lender liability" means dealing in good faith, and in a consistent and reasonable manner with the borrower.

Banks often end up conflicted in this very way. A lender wishing to negotiate the cure of documentation deficiencies may promise specific forbearance, while a nervous directorate may "mandate" aggressive collection activity that will negate the banker's promises.

A 30-day demand letter is probably as effective as a 10-day letter, but will be received by the borrower as less abrupt and precipitous.

This is modern-day lender liability and it's a real risk to all banks, especially those under administrative regulatory agreements designed to expedite the collection of troubled debt. [Editor's note: See a special link below when you've finished Ed's column.]

Cultivate a long-term workout attitude

The very term, "workout," connotes the passage of time. You must develop an institutional attitude and expectation that this will be a marathon-not a sprint.

Problem assets arise from deficiencies in documentation, structure, or borrower performance.

Assuming a cooperative borrower, structure and documentation issues can be quickly resolved. But performance requires an economic environment that is favorable to business. Business cycles typically extend over several calendar quarters. No amount of hustle applied by the bank can make much of a change in the external environment, locally or regionally.

What's needed is time-and the realization by the board and staff that patience is a necessary pre-condition to a favorable outcome.

But the time necessary for an improvement in the economic environment should be the impetus for prompt acknowledgement of credit problems by both the borrower and the bank.

Quick action by the bank and the borrower can soften the harmful effects and keep a difficult experience from becoming a disaster. Time is of the essence and the bank and the lending staff should act decisively and quickly at the early signs of deterioration.

Getting your workout act together

One consistent concern of bankers, and one I'm asked about often, is how to best organize internally for the necessary focus and concentration on problems.

Each bank's culture will partly determine the appropriate response. However, there are a few principles to keep in mind.

1. Separate the sheep from the goats.

Don't expect lenders to operate in an environment where they are developing or administering good business one moment and dealing with problems and corrective activities the next. Help them organizationally from having identity crises. You should also try to keep credit approvals on uncriticized assets separate from the problems. Even if the committee composition is the same, call the committees by different names and have them meet on different days or times. Don't forget that you'll get the best results by putting your best credit people on your biggest problems.

2. Recognize that there are new realities and heightened risks in the modern-day workplace, such as borrower rage.

Workplace rage has manifested itself recently in such diverse places as Fort Hood, Texas, and the IRS office in Maryland. Remember the Edmond, Okla., post office massacre of several years ago, too. These problems are not new but they seem more prevalent today. The stress on employees might also give rise to special workplace considerations and need for resources of a psychological nature.

3. Accept, and embrace, that a problem loan workout environment is a series of learning opportunities.

Every decision on a workout credit represents a de novo underwriting decision.

We have the tools, some of them quite old, but still of great value such as the "Cs of Credit," loan policy manuals, and tried-and-true ways of reinforcing good credit discipline and behaviors.

Use what works. Fix what's broken as you go along. Maintain a sense of urgency in your work.

This process will take a long time.

And there are no genuine alternatives nor short cuts.

[Editor's note: Read an
interview with noted attorney Barry Cappello, who sues banks for lender
liability. Click here to read the March 2009 interview.]

- 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 free audio 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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