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## DON'T LET DODD-FRANK DISTRACT FROM A KEY INTERNAL CHALLENGE

Dodd-Frank is a migraine. But don't fail to solve tomorrow's loan troubles now. (Before it's too late again!)

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President Obama recently signed the controversial Dodd-Frank financial reform legislation. Does that mean that the problems producing the financial malaise have been fixed?

The legislation seemed rushed. Many competitive ideas were considered, sifted, and crafted into legislation in a compressed time period. They were then pushed through the legislative mill by what seems to have been brute partisan force.

Even more troubling, the Presidential Commission that was named to review the causes of the financial system's recent problems has hardly begun its deliberations. What does Congress know that the commission doesn't? It seems like the process has been implemented in reverse.

But have we, as lenders, perhaps, not completed our own deliberations about the future, either?

Beginning with the beginnings

For the purposes of our discussion, I want to focus on how community banks train lending officers.

Let's be very simplistic and say that the banking industry is divisible into either large banks or small banks.

Further, the experience of the last two years seems to show that there were many more casualties, in relative terms, among the smaller banks than among the larger. Some of this may be the result of "too big to fail" concerns. The likes of Citibank and others at the top of the size pyramid were too large to collapse without systemic risk to the system.

Instead, the community banks-managements and owners-seem to have borne the brunt of closures, regulatory sanctions and the financial hits to equity capital.

What conclusion can be drawn from that?

It is: How the community banking segment of our industry trains and develops its lenders needs to be very carefully and critically examined.

Yet this is a problem like an iceberg-it's what you don't see that can be so problematic.

The bottom of the iceberg

Having been the product of a big bank training program, as well as a credit trainer by virtue of my various capacities in community and regional banks, I have a perspective on the credit and the credit training issues.

Frankly, I'm concerned about the future.

The large banks all have internal training programs to serve their unique needs, markets, and product lines. These programs are usually effective and produce results capable of sustaining decent performance results in the analysis of credit risk on a customer-by-customer basis. While there are specific differences bank to bank, content and technique are more similar than dissimilar across the industry.

Community banks and bankers face a different market reality.

First, they have limited resources for training and development.

Second, they operate, usually, with simpler business models considering product lines, geographic dispersion, and types of technology deployed.

Third, while they have been classified as smaller banks by total asset size, they too have seen remarkable growth in recent years from both external and organic growth.

A young person starting out as a lender in a community bank 15 years ago may have been trained to a particular set of standards appropriate to the bank's size of that day. However, without ever having changed employers, this person may now work for a bank of relatively substantial size with considerably more sophisticated customer and market types of demographics. Has this so called "experienced" lender's technical proficiency kept pace with the market reality and the reality of the bank's own portfolio?

Delving deeper into a shortcoming

In my book, any industry that views its training budget as a variable expense inversely proportioned to profitability has a credibility issue.

We cut training when profits shrink.

And when times are prosperous? We often send lenders to schools as "spiffs" or rewards, rather than to specifically expand competence along predetermined functional or product lines.

How many mid-career community bank lenders believe that their employers have a skills-based career development plan in place for them? Is anyone bothered by such an omission?

To say that community banks didn't squander their capital by reckless risk taking isn't the same thing as saying that

underwriting practices were always conservative, consistent, and prudent.

I think standards and practices were in some, if not many, smaller banks quite the opposite: inadequate, naïve, and dangerously ignorant of the fundamentals of analyzing cash flow repayment sources.

Ignorance is not necessarily negligence. But community banks as a now somewhat-endangered industry segment have not been very critical or attentive to the needs of the skill sets among lenders. Underwriting lapses were in hindsight egregious and make us look like we are unable to learn anything substantive or incapable of remembering the hard lessons of the 1990s. We simply have too few examples of sustained training and development activities that seemed to produce anything of a systemically valuable nature. Many banks have largely permitted one year of experience to be replicated 10 or 15 times and call that "experience."

#### Avoiding infectious enthusiasm

We have customers that tried to lead us over the cliff. Not intentionally, nor by design-by enthusiasm. Customers in their excitement for their business ideas and their projects can do that. Yet we have trouble saying "no" and even worse, don't always understand in sufficient detail what we are agreeing to underwrite when we approve their deals.

In other words, we are not always reliable judges of worthy or unworthy loan requests.

I think it's this last point that bothers me more than any other. We chased deals in our anxiety to maintain our earning assets and, under the guise of being "competitive," allowed our banks to join the rush to the bottom of the market in the quality and pricing of credit. We have got to do better than that.

If there were only isolated examples from the current business cycle, that would be one thing. But there appears to have been no recent move towards internal change of any magnitude among community banks in addressing what's needed in skill sets and attitudes of their lenders on the question of what constitutes "good" credit.

Without such a review and restructuring of our training activities, we are only a relatively few years away from directly experiencing the unhealthy effects of the next cycle of bad credit.

Will we ever learn?

It's past time that we start to figure out how.

We didn't get here deliberately, but we won't get out of the current ditch without some hard and creative thinking about the needs of the future.

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- 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.

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