
THE LENDER'S EYE: PROPOSITION: HE WHO LAUGHS FIRST LENDS BEST

Can you spot the incongruous?

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A number of years ago I was the manager of a relatively small group of credit professionals working on reorganizing and collecting our bank's problem assets. It was one of the most enjoyable periods of my professional life for the diversity and creativity of the work and the collegiality of my coworkers.

We couldn't have been more different as members of a group: young, middle-aged, former clergyman, petroleum engineer, commercial finance lender, school teacher ... and even two bankers by formal training. But what distinguished the group in my mind was the normal level of intellectual energy and curiosity represented among the group members.

That kind of quality makes a big difference in lending, both at the front end and the back end.

Using your radar, and acting on what it shows

This came to mind the other day in the context of further consideration of the continuing story of Berkshire Hathaway's David Sokol, a senior manager who had an alleged conflict of interest over his ownership of Lubrizoil, a company under consideration for purchase by Berkshire Hathaway. I talked about this in some recent blogs: Sokol had made a personal investment in Lubrizoil and when the company was formally proposed for acquisition, he correctly and appropriately informed Warren Buffett of his ownership of the stock.

All of this appears to be legal but the missing-and apparently important detail-was the close connection in time of the personal investment by Sokol and the company's acquisition by Berkshire-Hathaway. It would be one thing to have owned the stock for an extended period, but in this case, timing changed the nature of the issue. That question of timing apparently never got asked.

This information came out very recently in an internal report on whether Berkshire's conflicts of interest policy had been violated. The report's conclusion was that a violation was committed in that not all the details surrounding the situation had been divulged. (It is a piece of wisdom contained, I think in the Talmud, that teaches that "a half truth is a whole lie.")

Communications are multi-party experiences. There's an originator and one or more receivers. In this case, Warren Buffett himself was the recipient of the information and he failed to ask any further questions. Some might argue that he was under no obligation to inquire further. That's probably where the matter would end at most companies.

Another troubling aspect of this issue for Berkshire relates to the public relations flip flops that Warren Buffett himself seems to have committed. Buffett's first public reaction was contained in the press release of the details surrounding the

potential conflict. It was intended to minimize the incident and contained praise and support for his former colleague. Subsequent reactions following the release of the company's internal report were less benign and seemed considerably more forthcoming than the original comments. The lessons and potential embarrassment for all companies regarding the relationship of reputation risk and the handling of sensitive information of a possible ethical nature are clear.

What makes a "nose for credit"?

As I read in the financial press about these events I thought back to that group of hard charging workout men 25 or so years ago. This is exactly the sort of detail that these people would almost certainly have picked up on.

That bunch had a "nose" for the incongruous-something that didn't seem to fit neatly into a box or compartment with other facts or information. That's what made working around them such a learning experience for me and for each of us interacting with each other.

I think that another way to describe this quality is "intellectual curiosity." These men were constantly curious and that is to my way of thinking one of the key elements for success in a lending career.

Humor has been defined as "the perception of the incongruous." Something-an event or the juxtaposition of information-becomes funny because it is incongruous.

Have you ever noticed sitting in an audience how one or two people are always the first to get a humorous point made by a speaker?

Their reactions, typically an audible laugh or chuckle, precede those of the rest of the audience by a second or two. These are the people who are the quickest to pick up on an incongruity. I personally think it's an indication of high intelligence and I believe that it is directly linked to the ability to see information in ways that others never seem to be able to.

Some years ago I was taught that information only has "value" if you do something different for having it in the first place. Perceiving the incongruous can be viewed as gaining useful information that maybe has not been noticed or appreciated by others assessing the same facts or observations.

Sharp eyes make for sharp lending, and vice-versa

The best credit people I've known are the ones who are the keenest observers. They often take disparate facts and put them together into information that others simply don't see. They can walk through a customer's place of business and observe things that send signals of comfort or alarm about the health of the business.

I don't specifically know how to develop that sort of ability other than to appreciate it and encourage it when I see it.

Unfortunately, what we so often see is a conspicuous absence of that particular talent.

One of my colleagues in that workout environment years ago was a decent, hardworking, mid-career banker. But he was

lacking in any particularly evident sense of intellectual curiosity. He'd never get the bank into much trouble but he wasn't particularly creative in helping the bank clear out problem assets either. (This might sound like "damned with faint praise" and I don't want to leave anyone with that sole impression. There was more to the man.)

Bank credit and lending staffs are an amalgam of personalities and talents and normally they are complementary, rather than contradictory. The contradictory talents that should be guarded against and eliminated include:

- Tendencies to casual risk taking

- Inadequate credit analysis

- Corner cutting for the sake of speed or volume.

Virtually any other personality trait except laziness or dishonesty has a possible value in any bank.

Value the quick-witted

What I'm suggesting is that we be alert to the unique insights of those who are quick to sense incongruities or inconsistencies in facts and circumstances. The insights and contributions of these people can be enormously valuable to the credit function and to the business of the bank as a whole and their skills in these sorts of perceptions should be encouraged and valued.

Each of us may see a different thing, which is why many sets of eyes focused on a particular problem or opportunity can be so useful.

But the individual who perceives the incongruous circumstance or fact can often bring the most important insight to credit analysis or to the growing discipline of enterprise risk management.

Such people may be the most valuable members of the staff in the fast-paced and rapidly changing environment of the evolving business cycle. When you hear a colleague making an "off the wall" sort of observation, pay attention.

It might just be enormously insightful.

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 has been 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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