

THOUGHTS ON HOW NOT TO FAIL

It isn't rocket science, but it does take commitment

* * *

Last week's blog involved the question of "Why do banks really fail?"

This week, let's take a more positive spin, and answer the question, "How do you keep a bank from failing?"

The answer is easy.

That is if you are clairvoyant and are not a mere mortal banker or consultant to the industry. Assessing a bank failure with 20/20 hindsight is easy. Preventing a bank failure is more difficult.

Simple answers

Oh, there are some simple answers.

Don't make bad loans.

Don't let the snowball effect kick in (asset quality deteriorates, loan loss reserve is funded, earnings go south, capital no longer grows and ultimately, the bank snowballs itself into oblivion).

The right answers

There are also some answers that aren't so obvious, but they are the ones that can work.

These involve the real preventative measures to eliminate the possibility of your bank failing.

The first real preventative measure to eliminate the possibility of bank failure is to start with having the right board of directors.

This involves a board of directors which has capability, integrity, and an understanding of the banking business. The latter comes down to things as simple as understanding that a loan is an asset and a deposit is a liability, unlike their own business. Beyond such understanding, they need to be capable of providing strategic advice and direction as it relates to the bank.

This, by the way, is the opposite of a "yes person" board.

What comes next?

A key preventative measure is the board's strategic assessment and establishment of risk parameters for the bank in all areas, including credit.

This is followed by an organizational structure that sets forth internal controls that match up with that risk profile and is complemented by appropriate senior management execution of the board's plan.

Not rocket science

Fortunately, 7,000-plus banks have managed to keep from failing during the worse economic meltdown since the Great Depression. They must all be doing something right--maybe not everything, but a lot of things.

As you are looking to move forward into the next three years and optimistic that your bank will thrive, instead of just avoid a failure, you can start with the enterprise risk management piece, followed by internal controls. Controls rank particularly importantly in the areas that can hurt the most, which in this day and time are credit and compliance.

Bad loans are and always will be the cause of bank failures, due to their impact on capital and earnings.

And, as noted in previous blogs, a compliance problem can "freeze" the bank in time and prohibit it from taking any strategic initiatives requiring regulatory approval.

Does a community bank need some enterprise risk management function? Probably. Things are simply too difficult in this day and time to fly without a compass, radar, and owner's manual.

About the Author

Jeff Gerrish is chairman of the board of Gerrish McCreary Smith Consultants, LLC, and a member of the Memphis-based law firm of Gerrish McCreary Smith, PC, Attorneys. He is a frequent contributor to ABA Banking Journal and ABA Bank Directors Briefing, and frequently speaks at ABA events and telephone briefings.

Gerrish formerly served as Regional Counsel for the Memphis Regional Office of the FDIC, with responsibility for all

legal matters, including cease-and-desist and other enforcement actions. Before coming to Memphis, Gerrish was with the FDIC Liquidation Division in Washington, D.C. where he had nationwide responsibility for litigation against directors of failed banks.

-

Gerrish can be reached at jgerrish@gerrish.com, and the firm's website, www.gerrish.com.

You can get word about these columns the week they are posted by subscribing to ABA Banking Journal Editors Report e-letter. It's free and takes only a minute to sign up for. [Click here.](#)