

BANKERS FACE A TIME FOR CARE AND VIGILANCE

European developments get Ed O'Leary thinking of two long-ago debacles he lived through

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Part of what commercial lenders are supposed to do is think about what can go wrong.

That may mean with a lending deal ... or developments that can affect the health of the entire portfolio.

Such developments include local or regional market conditions or adverse developments within a borrower's business, like a loss on a major receivable or the loss of a major account that can affect credit integrity.

Enough of those concerns and they roll up into a portfolio quality worry.

Now there's enough going on the keep the makers of Bromo, Nexium, and Scotch going for some time to come.

For several months, the world has watched sovereign debt issues developing on two continents: North America with our budget and federal debt ceiling gridlock and Europe with its sovereign government default risks. The latter has threatened the solvency of several European banks as banks are the major acquirers of sovereign debt securities.

It's not a pretty sight on either shore and much as it might not be evident from a high altitude perspective, these dilemmas are linked by the same ultimate cause: deficit government spending.

For any monetary system not founded on convertibility of its money supply into a commodity such as gold, the entire system requires the confidence of the participants to survive and function over the long haul.

Looking back on bad times

In thinking about these growing problems, I've marveling at how our capital markets can seem so relatively unaffected by the concerns of the possible outcomes of what's happening.

I have also thought back to two really perilous banking situations that I lived through.

In one, the bank died in 1983 as a direct consequence of the collapse of oil and gas prices; in the other, the bank survived to be the first major bank recapitalization without federal assistance following the nadir of energy prices in the late 1980s.

Both situations experienced depositor runs that I'll remember to my dying day.

Ticking minutes left of life in Midland

The first bank's story took place in Midland, Texas, in the fall of 1983 in the early years of the profound malaise in the oil and gas business.

The run started in the wire room . . .

- • My boss gave me a heads up as I ran into him in the main bank lobby, sometime in the mid-morning of the Monday of the week the bank failed.

He was headed for the wire room in the cashier's department and I hurriedly walked there with him. The room was a beehive of activity, in part because many senior officers had gathered to watch the "spectacle." It was always a busy place, but that day there was a growing stack of outgoing wires to process. The ALCO manager assured us that he'd been in touch with the Dallas Fed and our principal upstream correspondents and everyone was alerted to what was unfolding.

I found the atmosphere very disturbing. After watching it a few minutes, I realized there was nothing I could personally do to help--except stay out of the way.

So I went back to my own departmental issues. These included coping with the increasing totals of problem loans associated with oil and gas production.

- • By midafternoon, we were feeling a little better as the volume of transfers had slowed and business was returning to a sense of normalcy.

What none of us knew at that moment was that FDIC had come to a decision.

Based on the flurry of activity that morning and the net outflows of previous days, the agency determined that the bank was doomed: A closing was scheduled for Thursday evening, just three days later.

- • Lobby traffic at the teller lines on Wednesday morning was heavy, much heavier than a typical mid-month Wednesday. Volume and urgency grew as the day wore on.

- • By lunch time, we had all available teller lines open, probably 30 or so, and the lines were 10 and 15 people deep.

Texas was a unit banking state in those days so we were looking at all the retail activity right there or at the Texas-sized drive-up of 20 lanes down the street.

My most vivid memory of that Wednesday in the lobby was the sound of the crowd. It was a lobby that had a two-story ceiling and lots of marble on counters and floors. Our customers were orderly, but they were anxious and agitated. There was a growling sound to the babble of conversations made all the more surly by the lively acoustics of the place.

- • By Thursday evening it was all over.

The bank had been closed and the new owner was Republic Bank of Dallas. The run which started weeks before in the wire room but accelerated precipitously early in the week had decimated the bank's wholesale deposits. The consumer run on Wednesday and Thursday finished us off.

I hoped I'd never experience the like of this again.

Oklahoma déjà vu that stopped short of the edge

My next encounter with a run was three years later in Oklahoma City. The bank was significantly less distressed than the Midland bank had been, but the business community was very nervous.

- • Then suddenly, on the morning of New Year's Eve, the run began.

That, too, was a wire-room run, with large balances being transferred out to other depositories by telephonic and wire instructions.

- • Fortunately, the bank closed for the New Year's holiday and the long weekend.

- • When we reopened the following week, the crisis had passed.

We all knew that we had experienced a close call and that if the holiday hadn't intervened, we might not have made it.

We never learned, or at least I never did, what triggered the skittishness on the morning of the 31st. We had nervous customers and a very nervous public. It was not too many months after that the largest bank in the state was closed due to its concentration of soured energy and real estate credits.

Bankers must be vigilant

In the last few days the Eurozone issues have finally captured the attention of the news media, and signs of fragility cause concern. In the U.S., we are in political gridlock and can't seem to get anything done on a national level. One hopes that our leaders can get their collective act together. This is a time for cooperation here, and a time for international cooperation among banking authorities.

This is why bankers have to be vigilant. One thing is likely. Any significant disruption in the international monetary system will have an immediate impact on worldwide liquidity. This at least gives us an idea where we should concentrate our thinking about possible damage control.

Maybe we'll be lucky and this situation will be quietly and calmly resolved. If not, then what we are called to do and how we do it will likely have a big long-term impact.

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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