
O'LEARY'S ESSENTIALS: 7 DEADLY HABITS THAT UNDERMINE YOUR CREDIT COMMITTEE PROCESS

Part 3 of a series: Let's hope nothing in this list looks familiar!

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Did you miss parts 1 and 2? Read "Do loan committees really work?" and "Getting the most out of your loan committee."

A comprehensive discussion of a credit by the bank's credit committee serves many useful and necessary purposes.

Talking it out reinforces the application of the loan policy; gets broad input on various aspects of actual or potential credit risk; educates and informs committee members on the risks within the credit portfolio; and creates a vehicle for illustrating and enforcing the elements of a bank's credit culture.

While these are the principal objectives, the results are occasionally disappointing. The following are Seven Deadly Habits to that impede effective credit committee outcomes. I've seen them consistently enough over the years to merit close attention by those responsible for sound credit quality. Fixing these behaviors can go a long way to improving consistency of underwriting and help create a sense of accountability for individual lending practices.

7 Deadly Habits That Harm Loan Committee Results

1. Tolerating the unprepared. The first Deadly Habit is tolerating a committee member's lack of consistent and thorough preparation for each meeting.

Materials distributed ahead of time should be read and understood, with questions formulated in advance of the formal discussions.

Preparation is also required by the presenter. Sloppy, casual, or incomplete write-ups and handouts produce discussions and sometimes results that are no better than their weakest inputs. It also wastes everyone's time and dilutes the values of the total perspective that is the principal value of the committee process in the first place.

Simply put, an unprepared member is tacitly insulting his colleagues

and displaying disrespectful behavior to them and to the process.

2. Letting the bullies control the meeting. The second Deadly Habit is the tendency of some to act in a bullying way toward other members of the committee or the presenter of a credit.

They need to leave the bully activity on the other side of the meeting room door. Individuals may be used to having their way, owing to their positions on the organizational chart. Or they may buffalo everyone else, due to insensitive behaviors, reflecting a lack of personal respect for a committee member or presenter. But both behaviors are simply unacceptable and should not be tolerated.

The loan committee chairman is the first line of defense for eliminating or blunting the impact of such behavior. Easily

said. But it's not always easy to do, not when the chairman is not superior on the organizational chart to one or more of the voting members.

This might well be a matter for resolution by the CEO or the directors' committee that oversees the credit extension process in the bank.

Bullying is unacceptable behavior or worse.

3. Uneven use of the bank's loan policy. The next Deadly Habit is the tendency to inconsistently apply the provisions of the loan policy.

This is more than simply approving credit with lots of exceptions to policy. It's also a failure to think through basic risk management practices and omit them from the explicit funding process or conditions precedent to funding.

To do a half-baked job across the full range of underwriting practices is to undermine the policy to the point that observers might conclude there is no policy in the first place. There's no quicker way to depreciate the value of the policy- or the committee process for that matter- than to freely and frequently violate its provisions.

Exceptions should be rare and explicitly and carefully documented.

4. Unwillingness to engage in full, open, and deep examination of credit risk. The Fourth Deadly Habit is to fail to identify credit risk inherent in each loan request and be unable or unwilling to fully and candidly discuss it.

All lenders are sales people. In fact, we sell in two directions.

We sell our customer's deals to our bosses and to our committee colleagues at the same time that we're selling our bank and the way we propose to structure each deal to the customer.

Problems come from one of two possible circumstances.

- • First is that either we don't understand the risks ourselves as presenters or voting members.

- • The second possibility is that we deliberately understate credit risk in our presentation.

From the bank's point of view, either can produce an unsatisfactory outcome and both are avoidable.

A companion obstacle to presentational clarity can be giving too much information.

That's the tendency of some to "describe the flood to Noah."

5. Cozy, private arrangements among committee members. The Fifth Deadly Habit is the occasional tendency toward "log rolling" among committee members. "I'll vote for your deal if you vote for mine."

This can happen where the committee deliberations produce a vote and the majority prevails for approval or denial.

This is the principal reason that I prefer an environment of consensus rather than one of just counting noses. Hardnosed lending managers are often skeptical of consensus environments. Yet anyone concerned about accountability and the formation of good lending habits, especially among the less-experienced lenders should readily see the value of consensus rather than log rolling and majority dictated outcomes.

Consensus outcomes give everyone on the committee

a sense of ownership of the final outcome.

6. Intellectual snobs showing off. The Sixth Deadly Habit is the tendency of a member to impress committee colleagues with a sense of intellectual superiority on the merits and facts of a particular deal.

The presenter should know enough about the credit to effectively present it for what it hopefully is--an acceptable credit risk to the bank. Displays of erudition for the sole purpose of inflating the perceived expertise of the speaker (as distinguished from the presenter) is egotistical and creates the impression that committee meetings are opportunities for ego building.

People with such tendencies should be made to listen to themselves.

It might be punishment enough to curb repetitions of such behavior in the future.

7. Giving the guest an open microphone. The Seventh Deadly Habit to effective outcomes is to give free rein to the opinions of guests or non-voting participants/observers.

One conspicuous example of this is to permit Loan Review to lobby for a particular outcome on a credit. If Loan Review's representatives have an opinion, they should be free and in fact encouraged to express it. But they should never be permitted, let alone encouraged, to overstep their status as guests.

The committee should have the responsibility for approving credit within the framework of the bank's delegated lending authorities and then be held accountable for sound underwriting outcomes.

Remember who is watching

Over the years credit committees have regularly shown their value as vehicles for producing and managing an effective credit culture. Credit committees are one of several internal credit controls and probably the one place where the worst examples of bad habits can be most transparently on display for all to emulate. Unfortunately, the wrong behaviors are often those most copied by the less-experienced staff.

The membership as well as the leadership of any bank's credit committee is one of the prime determinants of sustainable and acceptable credit quality. We need to pay more attention to the committee's components and inputs so that we better understand why we occasionally have unhappy outcomes.

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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