

CREDIT COMMITTEES OR LENDING LADDERS: WHICH IS THE BETTER APPROACH?

In part, the answer hinges on what you think you're trying to accomplish

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Editor's Note: Earlier this year Ed O'Leary presented a four-part blog series concerning credit committees. If you missed it, after you read this latest blog you can catch up with the popular series [here](#).

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One very durable "argument" among lenders is whether a committee produces better results than a lending ladder (combination authorities).

To do justice to the question requires taking a broader view of what the bank expects of the credit process and how it fulfills requirements associated with lending that are not directly related to the approval of specific loans.

In short, there's more to it than just cranking out the work.

My time in the industry spans the period between the beginning of changes to traditional approaches to today's mixture.

When traditions began evolving

A number of years ago when I worked for a big bank in Miami, the lending bosses noted that our major upstream correspondent banks had moved away from credit committees. (Some still brought the largest credits to committee.) As we were a pretty good-sized bank for the day, the issue seemed relevant to us.

I was fortunate enough to be on a small task force comprised of corporate business lenders and credit administrators charged with evaluating the experience of our correspondents and making recommendations for our shop. We surveyed about a dozen New York, Chicago, and Boston lenders and actually did site visits to about half.

All the bankers we spoke to had gone through generally similar experiences and had substantially modified their delegated lending authority structures. Gone were the large committees with their formal presentations to the banks' credit sachems. A few had even abolished credit committees completely for loans of any size.

Where the differences occurred were in the number of approval steps each bank felt were appropriate for deals, whether based on total size or product complexity.

Everyone pretty much agreed that credit risk was not compromised by the lending ladder structure. They also believed that considerable time was saved by skipping these "set piece" meetings. Adding to their internal pressures for change was the prevalent industry experience of an expansion of banks by size, branching, and product complexity.

Many of the large players of that time felt that the alternatives then available to being physically present to make credit decisions made the traditional approach increasingly an obsolete and unproductive way of accomplishing an important component of their banks' lending process.

I don't recall hearing whether the lenders appreciated the changes or whether there was any meaningful pushback. The basic decision metric was whether credit losses or criticized asset totals had increased in the months and years following the dismantling of the committee process. The consensus was that they had not.

But are we--have we--left the people factor behind?

Now, many years later, I've been through some experiences that add perspective to the debate. I've been a "special assets" manager. And I've been present when FDIC one Thursday night shut down my bank. Today I don't necessarily have a different conclusion to offer--but I'd start out with a much broader list of questions.

My question list would be topped by this one that primes all the others:

How would you, in the absence of a formal committee structure, conduct credit training for the newbies and reinforce credit standards among the more-experienced members of the lending line?

Next, I'd want to know how, in the absence of a committee structure, you would communicate important but useful news of conditions and the state of the bank's local lending environment?

Finally, tell me how you can provide regular opportunities for social interaction of a professional and constructive nature for your credit people, including lenders and support staff?

At The Bank of New York I remember how the head of the credit department--who was secretary to the loan committee--frequently illustrated many points in the credit discussions with anecdotes.

They were wonderful--and I remember many of them to this day for their color and humor. I was perhaps too young at that time to fully appreciate how this 60-year-old gentleman was imparting the credit standards of the bank with his font of stories.

No one had more experience or more respect as a credit professional and he made excellent use of his position in training us new lenders and drumming the lessons of the past into the consciousness of the present staff.

Whose hands stay on the steering wheel?

In Miami, we eventually scrapped the committee system but replaced it with a structure, a sort of lending ladder that had something like 11 rungs to it. It was complicated. And, to me, it didn't seem to save me any time.

One thing that ticked off lenders like me: The ladder strengthened the hand of Credit Administration in matters of pricing. Our credit administrator never saw a deal he thought was priced high enough. So we often had to have the EVP of commercial lending referee these disputes. (And we won some of them, too.)

By the latter phases of my time in Oklahoma City, I chaired the credit committee, so what could possibly there be to complain about?

Well, there was something. It's one of the occasional weaknesses of the committee structure. Not all committee members were equally well prepared for each and every meeting.

Sure, I railed against that as best I could--but I also found a silver lining in that cloud. Another member's lack of preparation strengthened my authority and influence. I was not going to allow myself to be deflected by someone ill prepared.

By the time my bank in New Mexico had been acquired and assimilated by First Security, I became aware--acutely so--of what local independence meant.

First Security was well intentioned. But as an owner it conveyed the attitude that it was boss; its culture was superior to anything we in the hinter land could offer as an alternative; and so it was a matter of following the credit policy and keeping one's opinions to oneself.

We operated with a credit committee and a lending ladder for the smaller dollar credits and actually that worked pretty well, that is, for credit purposes. But it had only limited communications value.

I never thought, though, that any credit approval system that didn't have a broad social component was superior to the committee that it replaced.

Even in OKC, the committee in my early years there was dominated by the president, an avid sports fan. He placed wagers (small money to be sure) on any sporting event that was important enough to be mentioned in the sports pages of the local paper. And one of the bank's lenders, a pretty experienced SVP, was his bag man.

There was lots of camaraderie built up within that structure and I can't think of it today without an appreciative chuckle.

Why bring this up now?

Credit is serious business. And credit quality is a shared responsibility in those banks that do it consistently well.

I want to know and appreciate my colleagues and their strengths that compliment mine and flange up* my short comings. That requires more than an occasional interaction with a credit senior who really doesn't know me very well or can share with me the stories that help me understand the credit standards-and their reasons for being-in a particular context.

Maybe it's too late to bring back the credit committee in those venues where it's been given up. Those of you who still meet regularly and formally, hold on to what you've got. A credit committee can do so much more than simply approve credit.

* Editor's note: Here Ed is showing how much his days in Oklahoma City stuck. "Flange up" is oilfield talk for "finish the job," to complete something so it can be used. It comes from fitting together pipes with flanges, so they can carry liquids.

About Ed O'Leary:

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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