Manage the pendulum

If a ship springs a leak, it's a problem. If the passengers all run to one side thinking to save themselves, the ship will capsize. Now it's a disaster.

The same can happen in the current credit crunch without some quick action.

Most lenders today have not been through a down credit cycle before. Neither have most examiners. Add to that members of the media, few of whom have likely covered a credit crunch.

There are still some “gray heads” around, fortunately, who lived through the last crisis and can recall its lessons, which could help keep this cycle from escalating. They need to speak up now, because the current situation is very susceptible to fear and rumor.

There’s no denying the financial services “ship” has leaks, and these shouldn’t be underestimated. Patches have been put in place, but they won’t stem the flow if the situation is made worse unnecessarily. One area of concern is examinations.

Examiners are in a tough spot. The last thing they want to happen is to have a bank fail on their watch, as bankers pointed out at a recent ABA meeting. While understandable, that sentiment can lead examiners to demand that performing loans be classified because they happen to fall in the increasingly broad category of commercial real estate. Anecdotal evidence indicates this is occurring, and ABA has already had conversations about it with regulatory leaders.

As in the 1980’s ag crisis, and again in the last CRE downturn, examiner overreaction forces banks to stop lending for legitimate purposes. That accelerates the downward spiral of economic contraction. It also puts unnecessary stress on borrowers who could be helped through a rough patch with patience and accommodation, bankers observed. Patience and accommodation are precisely what regulators have been calling for on the home mortgage front, but seem to have gone missing with commercial real estate.

If “irrational exuberance” got us into difficulty, “irrational caution” will only make a tough situation worse. Both represent extremes of the same pendulum swing. To be fair, banks can also become overly cautious, reining in lending too tightly, because of past mistakes.

For their part, the media must exercise caution when covering bank failures and troubled banks. Such restraint is unlikely to occur on its own. ABA has been speaking with media representatives, but bankers also need to speak with reporters and editors in their markets about facts they may not be aware of that can help balance stories of failures, quarterly losses, etc. One example that was raised at the meeting: pointing out that most banks on government troubled-bank lists don’t fail.

In addition, it was recommended that banks communicate with their customers—about deposit insurance, the strength of the bank’s reserves, etc.—and with their employees. The latter all have friends and family who regard them as informed sources.

These communications must be credible, however. You can’t deny that there are problems out there and expect people to believe your other points.

(Member banks can get additional tips from ABA’s “Safety and Soundness Communications Kit,” which can be found at www.aba.com.)

This is a high-stakes situation. Everyone who can help keep the pendulum swings in check should. To leave it in the hands of the uninformed invites a deeper economic slump.

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