

Today's Credit Challenges And The Younger Generation: What Will They Learn

Everyone's going to be learning from today's credit cleanup. But how will today's environment affect younger lenders?

I've been thinking, lately, of the impact of current loan troubles on banking's younger generation, both now, and in the future. I learned some lessons about these issues during the problems in commercial real estate and in the oil patch in the 1980s and 1990s. In the following scenario, "Dynamo Bank" tackles such issues in today's context. Read the introduction and the series of mini memos below, and tell me what you think, and how your bank is handling such challenges.

—Ed O'Leary

Dynamo Bank is a regional community bank experiencing an anticipated, but troublesome, increase in problem commercial loan assets.

The new Chief Executive Officer took over the bank about two years ago. The CEO has put considerable emphasis on strengthening the internal credit culture, including instituting a reinvigorated loan review function and a structure within which to develop and home-grow future lending talent.

Recent recruiting efforts at the state university have been successful in attracting a pool of four young graduates. These young bankers are immersed in all facets of credit underwriting, review, and booking of new and renewed loans. These young people will represent the bank's next generation of lenders and are the first to have been consciously recruited for future responsibilities.

Now, some of the directors (who are also significant minority shareholders) are concerned about the recent growth in criticized assets. They have begun to question whether additional steps should be taken, such as the establishment of separate workout function. These are also issues being discussed separately by the CEO and the Chief Credit Officer (CCO). The CCO considers the bank to be slightly understaffed for the level of activity he foresees over the next 18 to 24 months. The lending staff is seasoned, though none have worked long enough to have directly experienced the credit quality problems of the late 1980s and early 1990s.

Now things have become a bit more complicated. Due to severe, but likely temporary health issues, one of the bank's most seasoned and experienced lenders is out of action. As a result, some account reassignments, including the establishment of a more formalized workout function, are under active consideration.. The officer, who is on medical leave, is particularly adept in mentoring less-experienced credit officers. This officer shares the human resource development activities of the credit staff with the CCO.

The call report numbers for the current quarter, to be made public in about 60 days, will reflect an increase in problem loan metrics. The CEO is anxious to be "out in front" on this issue both internally and externally and have positive steps in place and underway as quickly as possible.

MEMO from the CEO to the CCO:

Let's have a serious discussion on account reassignments and the establishment of a workout function after Loan Committee on Friday. I'd like your thoughts on our current credit staffing needs and how we might constructively use the new people (I don't like our tendency to call them "trainees," given what we're likely to expect of them in coming months). Also, I'd like us to consider whether we need one or more external hires of experienced credit people. If we think we should do the latter, what sort of skill sets should we be looking for?

MEMO from the CCO to the CEO:

I'm ready to start a workout function. We've got to put the best credit people we have into it and use one or two of our new junior staff to do much of the support work. This will fast-track their learning and utilize their energy and enthusiasm. We can justify dedicating two experienced people and two trainees. I am aware of a relatively young retired examiner from FDIC who might be ready to come back to work either on a long-term basis or for the interim of the current credit problems.

MEMO to the CCO from the CEO

Go ahead and determine the level of possible interest the former FDIC examiner might have in coming to work for us. That would plug a possible hole we have in our overall experience level and give us some bench depth at an important time.

Now, if we dedicate a couple of our trainees to the effort, how do we make sure that we don't "ruin" them in terms of ever being able to develop good business when we come out on the other side of this trough?

Also: One thing we've got to do above all else is to create a sense of urgency and focus, centered on our largest and most seriously criticized loans. What are some of things we might consider doing sooner than later?

MEMO to CEO from the CCO

One of the first things we have to decide is whether we are going to try to "work with" or "work out" our problem customers.

Some credits will self-identify. But the "work with/work out" choice is an important premise to consider as an organizational attitude. We have some of the best business in town on our books, and have worked hard to build that business. Running them off because we're considered hard noses undoes a lot of work—plus it hobbles us for the future.

On the other hand, not doing enough soon enough prolongs the pain and possibly compromises the workout effort.

MEMO from the CEO to the CCO:

Let's make a clear and clean distinction between the truly problem assets and those that are not, to include a separate loan approval process. To the extent that we can, let the lenders with the clean portfolios not also be working on seriously criticized assets. That makes their jobs harder and they can easily forget whether it's time to wear the white hat or the black hat.

We will have to reassign credits from officers with long-standing relationships to those with less experience, not only to get the focus we need on problem assets, but also to be sure that the best credit people are working on our worst problems. I continue to be concerned that we not turn the natural optimism and enthusiasm of our young people into a long lasting or deep seated cynicism of human nature or the business of making loans. What other things do we need to be thinking about for our meeting on Friday?

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 a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear 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