CREDIT CULTURE REBOOT, PART V: GETTING TO THE NUB OF CREDIT CULTURE

Now we're going to get down to the central issue, credit culture, and I want to hear your thoughts on this as we go forward. The industry needs a dialog on credit culture now, while today's lessons can be freshly learned.

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Credit culture needs a “reboot,” or at least, a revisiting, in many banks today. The credit cycle’s impact has been amplified by some bankers’ exuberant belief that there is an acceptable long-term alternative to what blogger Ed O’Leary refers to as a “conservative credit culture.” This special “Talking Credit” series will examine the fundamentals of bank credit culture, and explore how management and lender can revisit how they grant credit. If you missed earlier instalments, click here for Part One, Part Two, Part Three, and Part Four.

–The Executive Editor

Bank credit people use the phrase Credit Culture frequently. What do we mean by credit culture? Does it mean the same thing today that it meant a generation ago?

First, we should try to agree on a definition and then agree on a common language or vocabulary to express our concepts. Here’s one useful definition of culture: The set of shared attitudes, values, goals and practices that characterizes an institution, organization, or group.

We should also distinguish between the overarching culture of an institution and the culture within one of its operating units.

The culture of the IT department can logically be different than the culture of Credit Administration. And the culture of the company as a whole may or may not have very much to do with its credit culture.

For our purposes, we are focusing on credit culture, that portion of the enterprise where individuals are collectively working on the development of credit “sales” prospects; credit underwriting; and administrative and support services, including those specialized areas where the standards of credit are formulated, institutionalized, and audited.

Minimally acceptable standards of credit—including an appropriate risk-return relationship—don’t happen in a vacuum.

This is a managed process, with managed outcomes ,although the outcomes can and do vary widely from time to time, bank to bank, and inside individual banks themselves.

No bank board of directors, executive, or line management wants a credit portfolio of “junk.” But how each institution approaches the task will embody and express the overall culture of the bank; the commitment of resources, such as the extent of internal controls to support and enforce credit standards; and how the entire credit function is organized to achieve certain predetermined results.

As I have said in previous columns, credit culture starts with the credit policy. Credit policy is proscriptive, authoritative, discriminating, and expositive.

But remember this, as well: Credit policies are a human work product and reflect, consciously or otherwise, the attitudes, biases, work experiences, and skills of their authors.

It is precisely these attitudes of the authors and promulgators of credit policies that we need to first examine in the light of current realities. This includes the very mixed results of the credit extension process over the last credit cycle. The results are not uniformly distinguished nor do they represent the best of our industry’s collective experience, including corporate memories especially in the area of lessons learned (or relearned).

Here’s just one example of what I’m talking about:

If an individual bank prefers to underwrite credit primarily through a system of committees, what are the experiences of the management and directors that have resulted in these structures? Do they value the role of committees in training lenders, enforcing of policies, or bring a sort of collective wisdom to bear in the credit extension process?

We all know, or can imagine, environments where these virtues are present.

But there are also credit committees dominated by a lowest-common-denominator consensus. In such environments, discussion is couched in the attitudes of the most senior person or the loudest (or longest) talker.

Yet even when the structure is not contributing to optimal results, there is seldom any qualitative examination of the process in terms of better or best practices. If credit losses and regulatory criticisms of quality are low and earnings are decent to include peer comparatives, then there’s probably no need to investigate this aspect of the environment further. But when net interest income after the allowance for loan losses is disappointing, erratic, or worse, then the entire process should go under the microscope.

Credit underwriting begins with the individual credit prospect compared to the credit standards of the bank (the policy) and then extends to those elements of support or audit to assure the application of standards both at funding and through the repayment term of the specific credit.

An Invitation to Weigh In

Each of you has your own experience to share with us as we discuss credit culture.

If you accept the premise that we periodically need to review and assess our assumptions and practices, what do you think the most important components are to assure a high level of credit quality and an acceptable return for the stockholders?

There’s an old saw in banking that says we have to be right 99% of the time because the one percent is the loan loss reserve. Where should we start looking to make the overall result better?

There are many components to a healthy and sound credit culture. In future columns I hope to pick up on your thoughts and comments and have comprehensive and productive dialogue.

Let’s hear from some of you on what you think the key elements of credit culture are.

Comment on this instalment below. Suggest future topics in the series to Ed O’Leary at etoleary@att.net

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.

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