BID Daily Newsletter

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THE BLAME GAME

by Steve Brown

Should a bank fire its chief credit officer? No matter how any bank is performing, the question may be worth asking given the state of the industry. We have devised a couple of additional questions in order to help banks come up with an answer to this thorny question.

The first thing to ask is, "do you have elevated non-performing loans?" If the answer is yes, the next question to ask is - "is your CCO taking responsibility?" If the answer is yes to that, then not only should you not fire your CCO, you should think about a promotion. Show us a CCO that takes responsibility and is not defensive about the credit portfolio, and we will show you a CCO that is most likely aggressively dealing with credit problems in an open, honest and quantitative fashion.

When asset quality erodes it is natural to seek blame. However, before doing so, consider that the CCO is responsible for adhering to and executing credit policy. If problems occurred despite the correct application of policy then if there is blame, it lies elsewhere. It is the Board's responsibility to set risk tolerances and executive management's responsibility to execute those wishes. If there was no clear understanding of risk, then you can't really hold the CCO accountable. For example, if a bank had 25% of their loans in construction, most likely the CCO is probably the last person to be held accountable.

Credit, like all other risks, is everyone's responsibility. While the CCO's charge is adhering to risk guidelines, the CEO needs to take the lead, the board must focus on oversight, and the rest of executive management should provide proper counsel and assistance. In 80% of the banks we review, we find that the reason for the bank's problems is not underwriting, but rather weaknesses in risk management.

If proper risk guidelines are set and followed, but losses exceed expected thresholds, then in our book, there shouldn't be too much blame to go around. Risk is a balance of reward and negative probabilities. Sometimes, the probabilities don't go your way and the negative outcome is greater than expected. Since no banker alive has seen this type of downturn since the Great Depression, it is understandable that the risk models vastly underestimated the extent of risk. We see this not as a failure, but rather a chance to improve.

While this acknowledgement doesn't help matters much at this point, we can tell you that looking for scapegoats and playing "pin the blame" is a waste of time at best and downright destructive at worst. Blame produces defensiveness, which distorts the problem and prevents improvement. We do think it is important to continually assess how a bank can improve its risk practices and this downturn gives banks an excellent opportunity to do so. Banks with strong management teams will spend less energy looking to place blame and more energy in trying to fix the infrastructure that contributed to higher than expected losses.

Lending by its nature is a risky business made even more so, because of the leverage banks employ. Losses are part of life. If you want to place blame on someone, first decide if there is any blame to go around and then decide who or what was really at fault. Most likely, it isn't the CCO.

REFUND ANTICIPATION LOAN FINANCING ("RAL")

As in years past, we are getting ready to release our annual RAL offering, as soon as it clears final regulatory hurdles. The financing begins Jan 17th and as structured will give community banks a unique short-term investment opportunity with fees of 20bp and a 3.25% coupon rate (for approximately 22 borrowing days). A primary risk is the purchasing of consumer receivables pending repayment directly from the IRS, in connection with a household's tax return refund. Different than in years past, financing will be done out of a bankruptcy remote subsidiary in order to give participating banks an additional layer of protection. Look for more information shortly.

BANK NEWS

6 Bank Closures (130 YTD)

On Friday, the FDIC closed: [1] AmTrust Bank ($12B, OH, 4th largest failure of the year) and sold it to New York Community Bank ($30.8B, NY) with no deposit premium. NY Community gets 66 branches and will also purchase $9B in assets, of which $6B is under a loss-share. [2] Buckhead Community Bank ($874mm, GA) and [3] First Security National Bank ($128mm, GA) and sold it to State Bank and Trust Company ($1.83mm, GA). State will assume 10 branches, all deposits of both banks for no premium and purchase essentially all assets (with $692mm under a loss-share) and $118mm of assets of First Security (with $82mm under a loss-share). [4] Tattnall Bank ($50mm, GA) and sold it to HeritageBank of the South ($467mm, GA). Heritage will acquire 2 branches, all deposits for no premium and essentially all assets. [5] Benchmark Bank ($170mm, IL) and sold it to MB Financial Bank ($14.1Bm IL). MB will acquire 5 branches, all deposits for no premium and essentially all assets. [6] Greater Atlantic Bank ($203mm, VA) and sold it to Sonabank ($462mm, VA). Sonabank will acquire 5 branches, all deposits for no premium and essentially all assets.