Looking to the Past for Lessons on Weathering a Recession

by Steve Brown economy leadership management

Summary: Economists predict that a recession is on the horizon. Given the difficulties that many CFIs experienced during the last recession, now is the perfect time to look at some of the tactics used by those that prevailed in the last recession.

When Joe and Leanna Drnec moved from California to Tennessee in 2015, one thing missing from their belongings was their cat Ebi, who had disappeared earlier in the year after wandering off and was never found. Then, seven years later, the Drnec's received a call that Ebi had been found after someone dropped her at a pet shelter. Technicians were able to pull the family's contact information from the subcutaneous microchip she had been implanted with. A few phone calls and one flight later, Ebi was returned to her owners and has since taken up residency in her new Tennessee home.

Since microchipping of pets began in 1989, countless animals thought to have been lost forever have been reunited with their owners. Unfortunately, not all things that return are as welcome as long, lost pets. Thirteen years after the Great Recession of 2007 – 2009, economists are warning that the US should be bracing for another major recession in the near future. While a recession is never good news, many community financial institutions (CFIs) not only survived the last recession, but weathered it extremely well. So, we thought it would be the perfect time to look at how they did so and what lessons CFIs as a whole should take from the past.

Sounding the alarm. In late April, Deutsche Bank became the first bank to predict that the US was heading into a "major recession" due to the Federal Reserve's efforts to stem inflation. While other banks have since chimed in with similar projections for financial turbulence, expectations for the severity of any sort of financial downturn are varied. Beyond the Fed's interest rate hikes, other factors include ongoing supply chain issues, the Russia-Ukraine War, ongoing lockdowns in China, and even climate change.

Not-so-great expectations. More than 450 US banks failed between 2007 and 2012, according to the Federal Deposit Insurance Corporation. Despite the carnage, however, many CFIs actually weathered the last recession fairly unscathed.

As your institution braces for whatever economic downturn is ahead, the following are a few lessons learned by CFIs during the last recession to keep in mind:

- **A strong devotion to monitoring credit quality.** Your institution should ensure ongoing oversight of loan applicants among senior lending staff and board members alike, as well as an in-depth knowledge of your organization's local market and customers. Having detailed credit policies and underwriting guidelines in place is also crucial.
- **Stick to your knitting.** CFIs that maintained strong loan portfolios made sure to avoid products and markets where they did not have in-depth knowledge and understanding. In their underwriting, they also remained acutely aware that bubble pricing would not be finite — something your institution today should be sure to keep in mind when it comes to inflated housing and commodity prices.

- **Quick reflexes are also key.** Given the reality that there will always be loans that fail, it is crucial to constantly monitor for signs of problems. One tactic that proved helpful for CFIs during the last recession was to address delinquent loans as soon as they were overdue for five days or more. Another important practice that some CFIs pointed to was to have staff revisit the financials of any charged-off loans to determine if they would still make those same loans now based on those fundamentals.
- **Low, or extremely selective, CRE exposure.** One way that some banks approached CRE lending was to implement limitations such as only lending to properties that are owner-occupied.
- **Not wavering on minimum down payment requirements.** This was also another common thread among CFIs that maintained stronger performing loan portfolios the last time around. While scaling down payment requirements can be an easy way to attract new customers, it is important to remember the risks of doing so.
- **A strategic approach to staffing.** In some cases, CFIs specifically limited their hiring of managers to the regions they operate. This way, they can ensure new hires have an in-depth knowledge of the community and customers. Similarly, putting a greater emphasis on strong interpersonal skills over just strong banking backgrounds is something many organizations found important. It is a good way to facilitate stronger ties to customers and the community.

While there is no guarantee that adhering to the guidelines above will help your institution cruise through the next recession, the fact that many of these same factors came up time and again among multiple CFIs means they are something that you should at least be aware of and keep at the forefront with your own plans.

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ECONOMY & RATES

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Treasury	Yields	MTD Chg	YTD Chg
3M	1.74	0.58	1.68
6M	2.32	0.68	2.13
1Y	2.96	0.88	2.58
2Y	3.30	0.74	2.57
5Y	3.52	0.70	2.25
10Y	3.44	0.59	1.92
30Y	3.46	0.41	1.55

FF Market	FF Disc	IOER (Interest on Excess Reserves)
0.83	1.00	1.65

SOFR	Prime	OBFR (Overnight Bank Funding Rate)
0.70	4.75	0.82

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