Potential Blind Spots in Risk Management?

risk management pandemic

Summary: While most financial institutions are doing all they can to manage new risks with COVID-19, here are a few that you may have overlooked.

Risks are everywhere, even during a celebration like the Fourth of July. On average, 180 people need emergency room treatment every day during the month of July, due to firecracker injuries.

There are innumerable risks with COVID-19 too of course. Some even expect its impact to lead to a deep recession, thereby increasing the likelihood that there will be more bank failures on the forefront. In light of this reality, community financial institutions (CFIs) should take the time to revisit their risk management plans.

Even before the pandemic, the number of bank failures was already inching up, with 25 community banks having $10B or less in assets closing their doors permanently in the past 5Ys -- four of them as recently as the fourth quarter of 2019. While most CFIs are doing all they can to manage some of the new risks with COVID-19, here are a few areas that you may have overlooked.

Liability. As CFI's scour their loan portfolios for possible problem loans, they should be looking for any potential liability within their loan portfolios too. This is particularly true when it comes to the types of lending where they have been most active. Portfolios that have more commercial loans could possibly be open to litigation over claims of "livelihood" issues.

Partners. You may also want to think about your lending partners, such as those with loan participations. Are those partners solid? If your lending partner is someone you have been doing business with over the years, you will likely feel more confident. But, it couldn't hurt to do extra due diligence. We have been a partner for over 20Ys and we welcome this discussion.

Insurance coverage. Regardless of how portfolios skew, CFIs also need to factor in the possibility that they will be faced with a good number of repossessions, foreclosures, and related lawsuits. To prepare for this possibility, it is key to have enough insurance in place to guard against everything from mortgage errors, to mortgage impairment. Review your insurance policies to confirm that you have proper coverage for today's risks.

Because of the negative impact the coronavirus has had on markets, some CFIs will have experienced a dip in profitability which could trigger a more granular review of management and board actions. To be proactive, CFIs should also be revisiting the liability insurance they have in place for directors and officers to ensure that any D&O issues will be covered. While many institutions cannot imagine legal jeopardy on top of everything else happening, it is better to be safe than sorry.

Objectivity. During bad times, smart lenders may not be the best candidates to review the viability of their own set of loans. With a good customer relationship, objectivity may suffer. Impartiality will be important in determining the actions needed on some loans. Make sure this is not a blind spot.

The uncertainty swirling around the coronavirus appears to be hard to shake. So make sure that your institution has covered all elements of risk management, including these four elements that could be overlooked. Stay safe and stay away from bank failures.

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