

Banking

Traditions

The Magazine of the Community Bankers Association of Alabama

Community Banking in a Changing World

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- Loan & Credit Procedures
- Capital Requirements
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Learn More About Navigating the Changes In Community Banking

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- A Positive Outlook for Community Banks
- Credit Policy? Or Business Plan?
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- A Better Way to Achieve Liquidity
- Global Cash Flow: What Is It Good For?



CREDIT POLICY? Or BUSINESS PLAN?

By Jeff Judy

In the recession, some of your business customers failed, some survived, some did fairly well. Looking back at customers who struggled, what do you think of their business plans? You will probably find that:

- Some simply had the wrong business plan.
- Some started out with a good plan, but failed to adapt to change.
- Many, many businesses had reasonable business plans, but were not following their own plans when the recession arrived.

Your Business Plan For Credit

Credit policy is your business plan for your credit business. And banks follow the same patterns with policy as their business customers do with business plans.

Some picked the wrong strategy. They bet too heavily that the good times would roll on.

But others had good strategies. Unfortunately, there was an official policy, and then there was what actually happened.

When words and actions are out of synch, your strategic plans cannot produce the desired outcomes. Problems commonly arise when:

1. The bank starts off with a weak credit policy in the first place, or
2. The bank has sound policy at one point in time, but execution “drifts.”

Off to a Bad Start

You want to see a solid business plan before you enter into a relationship with a customer. Shouldn't your own “credit business plan” provide a solid starting point for successful credit behavior?

THE COPY

Unfortunately, too many banks take the shortest path to setting policy so they can move on to “more important things.” That's when you see the boilerplate approach.

The bank buys a template or copies someone else's policy. A few tweaks, a few changes in names and terminology, and they are done.

How do you react when a potential business customer brings in a business plan that is mostly “cut and paste”?

Reviewing others' policies can help you develop good ideas, but relying too heavily on them means your policy does not reflect your unique strengths and weaknesses, your standards and values, your superior understanding of your marketplace. And there goes your competitive advantage.

ALL IN GRAY

Some banks, before the recession, deliberately provided vague or simple guidance so they “would not get boxed in.” They painted everything in gray to allow extra flexibility and — a word to be wary of — “creativity” for the lending staff.

When hard times hit, these banks had random collections of individual transactions rather than strategic portfolios, and there was plenty of the bad mixed in among the good.

Drifting Away From a Good Start

Some of your business customers put a lot of thought and effort into their original business plans, but then lost their way. If only they had remained true to the strategies and principles they started with! But remaining true to your business plan, or to your credit policy, is not always so easy.

THE EVOLVING MARKETPLACE

As your local economy and the customer make-up of your marketplace evolve, your credit policy can develop gaps. That can lead to a different approach to almost every transaction.

A changing marketplace can quickly put your credit policy out of date and out of touch. If you do not know when the last serious review of credit policy took place, it was probably too long ago.

MANAGING THE GRAY AREAS

Almost any policy serves bankers well enough for prospective customers who are either highly desirable or clearly undesirable. But when a customer does not clearly fit into a square hole or a round hole, so to speak, the solution is not to hammer that customer into one or the other.

Strong credit policies guide bankers not just to the simple decision, but to the right decision. Credit staff know when to look for more information, and what the bank expects of them when negotiating terms that protect the bank's interests.

FILLING THE VACUUM

Nature may abhor vacuums, but some bankers love them. If the “rules of the game” do not cover a customer who is not slam-dunk good or bad, they will make up their own rules.

How does management respond when a banker goes “off book”?

First, does anyone even notice? If your credit review function is not valued by the organization, that opens the back door very wide. If exceptions are routinely approved and overrides commonly accepted, bankers know they do not have to worry about policy.

Second, what are the consequences of deviating from policy? Are approvals more difficult? Do bankers who account for more than their share of exceptions get management attention? Does the dollar amount of credit business booked top all other considerations when you reward bankers for their performance?

Credit Leadership

While the details of credit policy are worked out at various levels, holding everyone in the credit function accountable for maintaining and supporting stated policy starts at the top.

In the best-run banks, the Board of Directors and the C-level executives know the answers to questions like these:

- Are exceptions and overrides increasing, decreasing, or stable over time?
- What systems are in place to monitor those trends and highlight concerns?
- Whose responsibility is it to address deviations from policy with individual credit staff?
- When is the credit policy reviewed and revised, and who performs that function?
- What changes in the marketplace and the banking industry are on the horizon that should be addressed in policy?

You like working with businesses that keep their plans up to date and make sure their employees follow them. Expect no less from your bank. III



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Jeff Judy is a frequent presenter at trade association meetings and industry conferences.

Jeff keeps very busy as a trainer and consultant

guiding banks and their employees to best outcomes for their institutions. He regularly shares his ideas through interviews and articles in trade journals and more general financial media, as well as publishing a biweekly electronic newsletter, Jeff's Thoughts. Visit www.JeffJudy.com, or contact Jeff at jeff@jeffjudy.com.



Hear Jeff Judy at the 2011 CBAA CEO, Executive Management & Directors'

Conference, August 4-6, 2011, at The Grand Hotel in Point Clear, AL.

What we know:

We know consolidation is here.

We know the regulatory hurdles, capital realities and fiduciary duties you face.

We know the journey and the destination.

We know banking.



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