The Need for Agility in Risk Management

by Charles B. Wendel

Earlier this month Jack Milligan of *Bank Director* magazine wrote an article titled, "When It Comes to Loan Quality, Who Knows?" He summarizes his view in the article's first paragraph, "It's still difficult to make an accurate assessment of the banking industry's loan quality."

Jack lists a number of elements that limit the industry's and individual bank's ability to gauge the quality of their portfolios.

Bank Forbearance Practices. Urged by regulators, banks offered forbearance deferring payments for at least 90 days. Jack quotes a Moody's analyst's report in which he compares the forbearance offered by three lenders in auto financing: "Usai cites Ally Financial, which reported that 21% of its auto loans were in forbearance in the second quarter, compared to 12.7% for PNC Financial Services Group and 10% for Wells Fargo & Co." That analyst wrote Ally was very proactive in offering forbearance to borrowers. But, are Ally's numbers high and will decline or are the other bank's numbers low and will increase. Or, none of the above. The lenders cannot know the answer to that question; only time will tell. Like many borrowers, I was offered forbearance, but refused it. I know a successful local lawyer who took it figuring, "Why not?" His paying when forbearance ends is certain, but how typical or unique is someone like him?

The Cares Act and PPP. Jack correctly notes the role of the Cares Act and PPP in assisting consumers and small businesses, but goes on, "The benefits have expired." I know many individuals who received PPP without needing it to pay bills. Jack rightly points out an issue banks will soon face: "The stimulus [makes] it hard to discriminate between borrowers capable of weathering the storm on their own and those kept afloat by the federal government." Another unknown for risk managers.

Cares Act 2.0. Depending on the day, it appears that a new package aimed at meeting the needs of consumers and businesses is either unlikely or probable. Whether, when, or what it will be are all up in the air, making it impossible to forecast with any certainty. As I write this, a CNBC blurb states, "Pelosi believes coronavirus relief deal still possible as Democrats prepare new package," but who knows whether Congress will get its act together.

CECL. That's a topic for others to focus on but, bottom line, the Moody analyst says earlier, more optimistic assumptions could result in additional provisions.

Two other factors: NIM and Loan Volumes. Bob Brown, a colleague and consultant who regularly highlights important banking news in Linked In recently featured two relevant stories. He reported on the Fed confirming low interest rates on which Bob commented, "Expect further NIM compression." Lower rates provide good news for many borrowers but put increased cost pressure on banks and may reduce their ability to build reserves, if necessary.

Another chart he featured, this one from the Fed of St. Louis shows bank credit continuing to decline in September since surging up in May 2020. Many banks have slowed down or withdrawn from generating credit, waiting for the next DC shoe to drop. Of course, reduced economic activity and the conservative nature of many SME businesses may also be impacting these numbers. Also, more quality loans are leaking out of the banking system to Fintechs, captive finance, and other alternative lenders. That represents a systemic problem for the industry that many banks ignore at their peril.

So, What Should Lenders Do? Agility is one of many over and misused terms when applied to banking. (The new term of the moment seems to be "resiliency)," but management agility in the face of continued uncertainty is exactly what is required.

Current internal numbers may be a poorer indicator of the future than ever before. Or, maybe not? From our perch, we see the economy opening up with the level of frustration at the constraints being placed on businesses greater than ever. Then again, what if a "second wave" does occur. All bets are off, particularly with weeks to an election. Good luck if you are relying solely on data analytics.

Over the past year or so we have seen a number of banks deemphasize the relationship manager model, focusing on promoting more customer self-service in part to push up the productivity of bankers now "managing" more accounts. Given the NIM compression mentioned about, that is an understandable approach.

But, the banks best able to pivot as necessary and respond effectively to an uncertain path in the future are most likely those that operate with a true relationship manager approach to banking, one in which bankers stay close to the customer, have an advisory relationship with them, and are seen by borrowers as long-term advocates working through what for most will be short-term problems. Great RMs are the gift that keeps giving back to a bank.