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Credit Risk Ready Podcast

Host Linda Keith, CPA, With Laurie Stewart

A Practical View of Regulatory Guidance and Prudent Lending

Hi, this is Linda Keith, CPA, with Credit Risk Ready, a podcast where we interview senior credit and lending professionals from community financial institutions across the United States, their regulators, and banking advisors, to better understand and mitigate credit risk.

In this episode, we will zero-in on the regulatory environment and the guidance regulatory agencies are providing as we have to move fast to try to protect our borrowers and our bank. Our guest is Laurie Stewart, president and CEO of Sound Community Bank, a \$717-million bank in Washington State with a presence in the city and in the country, Seattle, and the Olympic Peninsula. She served on the FDIC advisory committee on community banking, the CFPB Community Bankers Advisory Council, and she currently serves as the chair of the American Bankers Association.

Welcome back, Laurie.

Laurie Stewart:

Thanks for having me.

Linda Keith:

So, Laurie, in the 2018 credit risk readiness survey my company commissioned, one of the questions was about whether the regulatory environment was reasonable, clear, and well executed before and after the 2008-2009 recession. Only 23% of the 250 respondents agreed or strongly agreed that the regulatory environment was reasonable, clear and well executed.

As we dip into this recession, it is unknown territory for the regulators and for the bankers in some ways. So, what is your sense of the guidance banks are getting now? How quickly it's changing and whether the bankers are comfortable or are they cautious about what the guidance actually means on the ground?

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Laurie Stewart:

I think, Linda, that the bankers as a whole are cautious. But many of them are saying the responsiveness of the regulators has been better this time around than last time. And we've actually seen some bold action. We've seen bold action from the chair of the FDIC. She's fabulous. And she's been willing to take on FASB and she's been willing to really speak to what needs to happen to help banks be responsive to their community. What I hear on the cautious side are bankers that lived through that last recession and survived. Remember how many bank failures we had.

Linda Keith:

I do.

Laurie Stewart:

So these are bankers that lived through it and survived and had the feeling that regulators said, "Hey, work with your communities, work with your borrowers." And then when they came in to examine, their tune wasn't quite the same. And so none of us can see into that crystal ball, right? We want to believe, but a year from now, if they look at that loan that we wrote more on character than we did on cashflow, will we get dinged for it?

Linda Keith:

Exactly. I was interviewing a gentleman from Abrigo Software the other day and he mentioned how important it is to well document your thinking on these accommodations we're making and make it really clear that it was a COVID-19 issue just because, one year from now, if you didn't do that, someone would look at that, including the examiners, and say, "What were you thinking?" Well, you need to tell them what you were thinking.

Laurie Stewart:

Yeah. I think that's excellent advice. And it's certainly something we're implementing within our bank to really try and tie the modifications, documentation or whatever it is, to the cause and the effect. And how long we think the problem will continue. Right?

Linda Keith:

Right, right. Boy, that's a good question. Is this a short-term setback or is this circling the drain for this particular business? What a question to have to answer now.

Laurie Stewart:

Yeah.

Linda Keith:

I just think right now of what we didn't know even three months ago, right? And so we're looking at things now and thinking, "Why did I do that three months ago?" Well, so a year in advance when the examiners show up. Great question.

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Laurie Stewart:

Yeah. Going to be really different environment, we hope, right?

Linda Keith:

Yeah, I know. Hope is not a strategy, but it's definitely a feeling.

Laurie Stewart:

Oh, my goodness. I say that almost every day. Hope is not a strategy.

Linda Keith:

Yeah and, unfortunately, I also have the distinction to have been a shareholder of the 92nd bank to fail in 2009.

Laurie Stewart:

Oh, I'm so sorry.

Linda Keith:

Thankfully I was not a director. I was not an insider. I did lose \$25,000 and so it was an expensive lesson. So I know a little bit about what went wrong with that bank. Although not as much as I would if I was an insider, but you're absolutely right. We know that in 2008-2009, some banks did fail. And so our banks need to be cautious and do the right thing in a totally uncertain environment.

Laurie Stewart:

Right, and one of the things bankers do so well is make loans to help their communities grow and prosper. And yet when we get into recessionary times, we all tend to contract. And so we have opposing goals, our communities and the bankers. I've asked our folks to think about how we can really support communities and borrowers and not rapidly grow the bank, but not be afraid to grow.

Linda Keith:

Right. Well, aren't there going to be some opportunities? So for example, if your bank is able to make a loan because of your perspective or understanding of that particular community or type of business that maybe another bank is reticent to do, it is actually possible that you would be able to capture some strong customers who simply are in a short-term problem that maybe another bank can't, either because they are more cautious than you, or maybe they already have a concentration risk in that area, or there's some other factor at play rather than just the credit-worthiness of the borrower.

Laurie Stewart:

Exactly. And I think often it is a concentration or a variety of issues. But it's my belief that the customers we help in difficult times will be our customers for life. They will remember. And they will say, "Boy, my banker partner helped me through those tough times." And they won't be as sensitive to, "Am I getting the absolute skinniest rate on a particular credit?" They will value the relationship and the value add. So we're trying to be that partner.

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Linda Keith:

Yes and, Laurie, my husband was in construction. And so I was the de facto CFO of his construction company. We regularly had bankers that would be happy to give us better rates. And we didn't want to leave Kathy and John, the ones who understood our business and stepped up when things were goofy. I have the lived experience of appreciating a commercial banker who, when something is going wrong and you call, you don't have to think they're going to just cut you off at the knees. They know you and your business well enough that they can listen and see if there's some way they can help.

Laurie Stewart:

Right. That is the perfect community banker.

Linda Keith:

Well and I've been very fortunate to have interactions with perfect community bankers. I will also say, by the way, that in that credit risk ready study the response to the statement about the regulatory environment wasn't so positive. When you asked about the strength of their relationship with their regulator, that was more like 70-to-80% had a positive response to that. So it was like the regulators themselves are able to attempt to bridge the gap between challenges in the regulatory environment and the way they actually interact with the bank.

Laurie Stewart:

And that's great news. And I think one of the things that we're faced with now is a wave of retiring regulators and a crop of newer regulators that maybe don't have the experience of a recession or of that relationship building. So I think there's work to be done to strengthen relationships there.

Linda Keith:

There definitely is. I'm delighted to let you know that I do have some of those newer examiners in my online training on credit analysis so they are coming in. And one of the things about what I do is it is number crunching because it's tax return analysis, global cashflow. But probably at least half of it is the relationship, understanding the borrower, what kind of questions, and so forth.

So I'm doing my very best to bring along this new group of examiners and frontline loan originators to understand not just number crunching, but what's behind the numbers. And then, for our frontline, how do you then document what you're doing? Have the conversation with your mentor, lender, or credit professional about how do I write down what we just thought was a good idea to do so that when the examiner shows up, or frankly when, Laurie, you look at it later because something didn't go the way as planned, you can look at that and go, "Oh, at least I see what they were thinking."

Laurie Stewart:

Good for you, Linda.

Linda Keith:

It's also, by the way, more fun than just number crunching. So, there you are.

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All right. Well, one other question that we had in that 2018 credit risk readiness survey, which I am linking in the show notes so that anybody listening is able to get it, it's a 30-page report, and, Laurie, I'll definitely send it to you as well.

Laurie Stewart:

Great.

Linda Keith:

Because it's how the bank leaders were thinking about things towards the end of that long expansion in order to get ready for the next recession. I did ask, by the way, what they thought would start the next recession, and global pandemic was not on anybody's list.

Laurie Stewart:

I know.

Linda Keith:

All kinds of things. Well, and not only that, but global and national. I mean, I think back to 2008-2009, there are parts of the country that weren't hit bad. There were types of lending that wasn't hit bad. Ag lending didn't really take a hit in many parts of the country. It wasn't nationwide all at once. And that's what's so different about this one. One of the many things.

Laurie Stewart:

Very different.

Linda Keith:

So the 2008 credit risk ready survey. I did look at how the recession actually was improving the relationship with regulators. So 58% of bank leadership agreed with the statement, "Since the recession, my institution's relationship with regulators has improved." And only 6% disagreed with that. The rest were neutral. So I know we are not out of this yet, but is an improving relationship with the regulators a possible silver lining of this pandemic?

Laurie Stewart:

Oh, I think so, for sure. I mean, that always will serve banks and the regulators, right? We all want the same things. Sometimes I have to remind my lenders that. What the regulator wants and what the bank wants are really the same thing. Good solid loans, lower risk. Right?

Linda Keith:

Exactly.

Laurie Stewart:

Successful banks, not failing banks.

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Linda Keith:

I actually have to say the same thing sometime to lending and credit: "You guys want the same thing." We want a high volume of qualifying loans that perform. And it's not sales versus the people that won't make the loans. It's, actually, we all want the same thing.

Laurie Stewart:

Right.

Linda Keith:

Well, Laurie, thank you so much for sharing your thoughts on how we can intersect with regulators, both in terms of the guidance and how to work with the guidance that they're able to provide in this level of uncertainty. And also kind of accept the flexibility they're offering on faith and then work going forward to really document what we're doing so that the regulators, and we will know why we did what we did. And that it was a prudent move, given the information we had at the time.

Laurie Stewart:

Thank you so much, Linda. Great conversation.

Linda Keith:

Thanks for joining us on the Credit Risk Ready podcast. Subscribe, comment, or share on social media to stay connected and spread the word. Join me next time as we bring our bank, our customers, and our communities through the recession, safe and sound. Take care.

About Laurie Stewart

Laura Lee (Laurie) Stewart, president and CEO of Seattle-based Sound Community Bank celebrates more than 30 years at the helm of Sound Community Bank. In that time, she led the conversion of the organization from a \$38-million credit union to a commercial bank which grew to be more than \$717 million in assets.

Stewart maintains a long history in community banking and participation in industry affairs. Stewart currently serves as the chair of the American Bankers Association, representing the nation's \$18.6-trillion banking industry and the employment of more than two million workers. She also holds a position on the board of directors for the Federal Reserve Bank of San Francisco's Seattle branch.

Previously, Stewart served as chair of the Board of Directors of the Washington Bankers Association (WBA), where she helped create the WBA's Executive Development Program. In addition, Stewart was one of 14 bankers selected to serve on the inaugural FDIC Advisory Board in 2009 and, in 2012, she was named to the Community Bank Advisory Council of the Consumer Financial Protection Bureau.

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In 2019, she was named Community Banker of the Year by American Banker and received an Executive Excellence award from Seattle Business Magazine. American Banker also named her as one of its Most Powerful Women in Banking in 2011, 2015, 2017, 2018, and 2019.

Sound Community Bank
<https://www.soundcb.com/>

About Linda Keith

Linda Keith CPA draws on her 30+ years of experience consulting with and training lending institutions, background in public accounting, 15+ years as CFO of the family residential construction company, experience as an Examiner with the Washington State Auditor's Office, and as adjunct faculty in Accounting Principles and Managerial Accounting to help lending and credit professionals say, "Yes," to good loans.

Of course, you know those are not consecutive years or she'd be over 100 by now!

Linda is known by her clients to be both practical and funny. In fact, there is a move afoot to change the 'P' in CPA to stand for 'Playful'. The fact is, people absorb ideas and learn better when they are having a little bit of fun. So, Linda brings the fun along with her practical knowledge and depth of understanding to provide credit analysis training and presentations that make a difference.

She is the founder of [Lenders Online Training](#), a virtual classroom approach to improving tax return and financial statement analysis capabilities; the host of the [Credit Risk Ready Podcast](#); and a [consultant/trainer on credit risk](#) to banks and credit unions across the country.

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