Credit Risk Ready Podcast

Host Linda Keith, CPA, With Paula King, CPA

The Pandemic Recession: How to Shift Your Bank Strategy (Or Not)

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, Paula King and I will focus on bank strategy as it relates to the changing landscape caused by the global pandemic and the resulting recession.

Paula King, CPA, is Senior Advisor for Abrigo Advisory Services, providing services for hundreds of their bank and credit union clients. She advises on CECL and other credit processes, policies, and procedures. Her banking career spans 25 years and includes cofounding and serving on the board of a bank in South Carolina, as well as positions as Chief Financial Officer and Chief Risk and Compliance Officer for other banks.

Paula, welcome back.

Paula King:

Thank you, Linda. Glad to be here with you.

Linda Keith:

So before we dive in to how the bank or credit union strategy should be changing now, given the heightened risk and, some would point out, the heightened opportunities this recession brings, how well were community financial institutions doing in general in creating and communicating a workable strategy to guide them? Aren't the directors and leadership good at this already?

Paula King:

Well, I would have said so maybe prior to six years ago during the Great Recession, but, if you think about the last six or seven years, banks have been a source of stability. All financial institutions have been. They've got capital, strong liquidity, and so I think a lot of the board members and the executive management have just been going along these last few years. Now, they've probably been doing strategic planning like they are supposed to, but not a lot of changes or focus, I believe, would have occurred during that period just because things were so stable at that point.

Linda Keith:

Right, and so especially if the directors and that bank or credit union were in a part of the country that actually didn't have too much trouble in the Great Recession, so even if those directors and leadership were there, even in the worse of the most recent, their strategy was working fine, so why would you change it?

Paula King:

If it ain't broke, don't fix it. Right?

Linda Keith:

So at this point perhaps there are some strategies that maybe they're not broken, but maybe they are stretched a bit. So, how is, or should, the strategic plan of the bank be changing now, both because of greater risks, which are astronomical and uncertain, but also maybe some opportunities?

We are so focused on the risk right now. I'm hoping there is somebody in the bank or on the board that's thinking, "Is there a silver lining here that we can't get to right this minute, but if we set ourselves up for it, we will be able to take advantage?"

So I'm an optimist. I understand that. But there's risks and opportunities. How should their strategic plan be changing now, if at all?

Paula King:

They definitely should be. I think at this point the institutions are still trying to put out the fires, if you will. So they are being reactive. We've had some of our clients in the last month or so say, "We really need to start focusing on the future." It's not ever going to look like it did.

Linda Keith:

Right.

Paula King:

Yeah. So, let's really hone in on strategic planning and work with our board. Get them back into the fold. I think that one of the things with a such a stable environment is we would have our monthly meetings; board members would hear the same information over and over again, which was very positive and very stable. So, I think this is sort of a wakeup call to executive management, as well as board members, that things are not going to be like they were anytime soon. So, we need to step back and refocus and look at ways to have more opportunities.

Some of the things that I think we've done very recently in financial institutions is they have garnered a lot of goodwill, right, with their clients and their community. They've participated in the PPP program.

They have done a lot of in-house deferral programs. So, I think that's a really good start. And I think a lot of that strategic focus should probably be on that community outreach moving forward.

Linda Keith:

Right. Well, it sounds to me like both on the management side and on the director's side, they both need to take some responsibility to basically up the game and really think critically of, "How do we need to do something different right now than we were doing for the last five years to, again, to understand and mitigate the risk that we face?" I always think community financial institutions. They need to protect the bank. They need to protect their borrowers to the extent that that's reasonable and they can do it. When I say the bank, I'm talking shareholders, employers, and everything else, but in addition to that, the community banks underpin the economic wellbeing of their entire community.

Paula King:

They do.

Linda Keith:

So, there is so much riding on getting this right.

Paula King:

I would agree. There was good news prior to this and certainly we've seen some improvement in some areas. If you think about purely from an economic standpoint on a community bank or even a larger institution at this point, we've got a stressed economy, although we've had some good numbers come out recently, but still, who knows what's going to happen with that. We have low-to-no interest rates, so the impact on net interest income is going to be detrimental going forward. Then we have the potential upcoming credit losses, right, we haven't experienced yet, but we will be at some point throughout this pandemic. So, I think there's going to need to be a shift in strategy. A lot of that should be relatable to the community. I think a lot of that should be spent on that. So, one of the things that I think financial institutions can focus on is how will they differentiate the customer experience.

Linda Keith:

Okay.

Paula King:

They want to protect their customer base. Kind of like you talk about hiring people. It's cheaper or much less expensive to take care of someone that's already an employee than to have to go out and hire, right? So, you want to make sure you protect that customer base you have, and there are so many institutions out there already, that you have to differentiate yourself.

Linda Keith:

Right. Well, I'm thinking even of the banks that made the decision not to go hard on the PPP loans. So some of their own customers either couldn't get them or had to go somewhere else. Well, those are not happy customers now.

Paula King:

I would agree and we've had some of our community bank clients and credit unions that did support those borrowers that could not potentially get loans from their larger banks. So now these clients of theirs are saying, "We're going to move all our business to you because you helped us out during these hard times."

You always need to keep that in the back of your mind: are the decisions that I'm making now, how are those going to impact the future business and your reputation risk within the community, as well? So, it's definitely important to be thinking about that as you move forward.

Linda Keith:

Well, the salesperson in me, because there is one of those, too... I think of myself as like a diamond. I have all these different facets and they keep spinning, right? The salesperson in me says, if in fact it's a differentiating advantage for you that you did support your businesses and, in fact, helped out businesses that were with other banks get what they needed, then it's not necessarily enough to just do it.

You need to strategically look at how do we build on that? How do we communicate that? How do we take advantage of what we've done to be sure we actually do grow the bank, if that's possible, during this period of time because other people are disaffected with perhaps the financial institution they were with.

Paula King:

Yeah, and a couple of things that I can give you examples of that some of your listeners might want to think about. We've had some financial institutions that did take some of that business on the PPPs from the larger institutions and they are offering webinars now about how to apply for forgiveness. They are taking the process sort of from soup to nuts and saying, "Now that we have the attention of some of these customers we didn't have before, let's educate them." Well, I think that is very helpful and it keeps that relationship going, right?

Linda Keith:

That's right. You are more than just your loan, your rates, and terms.

Paula King:

Exactly. I think the other thing, we have all had to adjust to remote and webinars and being on Skype and Webex and some of the other vehicles out there and so we are going to have to think about nontraditional delivery. Those institutions that have done that already are really in a more advantageous spot because it takes a long time to develop digital and mobile solutions. And banking, at least my experience in banking, is that it has been a very traditional industry and sometimes it's hard to make those adjustments. When things are stable, you don't really need to make those adjustments.

Some of the things, I think, that we are going to have to do is become more innovative and more digital and do some upgrades of our systems. How can people do their banking and their financial activities without actually going into a branch?

Linda Keith:

So help me a little bit with the difference between strategy and tactics. It’s easier for me to think about tactics like, oh, let’s do webinars to capture these businesses now that we have their attention. Is the strategy that is above that tactic about growing the bank, moving into digital and online? Is that a strategy-level decision that then the details are in the tactic? I’m just thinking again as a director. What would the director be thinking of in terms of how to shift strategy a little bit so that we can take advantage of some of the things?

Paula King:

Right, and I think growth is the key. So if you are doing a strategic plan and you are breaking it out into what do we need to look forward to when we have stress on net interest income and stress on potential credit losses, et cetera?

Let’s do volume. So, let’s look at how do we grow our institutions? So, that’s sort of you top level. Then under that, some of the ways that you can grow your institution are the community outreach, the continual education of your community, and maybe you expand into different areas of financial advice, et cetera.

So, those are some things and then delivery systems. How can we improve that? I would see those as the task underneath the bigger strategy that the board would want to focus on and that would be growth of the institution.

Linda Keith:

Well, and the board is also responsible for risk appetite, yeah?

Paula King:

Exactly.

Linda Keith:

So, revisiting concentration risk thoughts that they’d had in the past. I know there was one bank when I was doing the Credit Risk Ready readiness study in 2018, which there’s links for that at the bottom of the show notes as well, but I remember talking with one of the individuals who said, “You know, most banks will skip gas stations all day long because of all the environmental stuff. But, we did one and we got really good at it, and now we are the only bank in town, and if somebody needs a gas station loan, we get to have it because we understand it.”

Paula King:

And they got repaid.

Linda Keith:

They did get repaid. They understand the environment issues now and they know how to look at it.

Paula King:

I think that's an excellent point. I think the board needs to revisit the risk appetite. Quite frankly, I think they need to take on a little more risk than they have had to do over the last few years because of that stable environment that they were in. In order for them… it's kind of like the old saying, you either grow or you die. Or you get acquired, right? Which if you are a board member of an institution that is revisiting their strategy, I think that acquisitions are good thing to look at. Certainly the board, you know, I think over the last few years, again they have come into the meetings they've heard the same information that everything is good. I think they are really going to have to revamp their structures. There's a lot of ways that board members can be more visible, too.

You take a responsibility on when you are a board member and maybe you haven't had to do as much over the last few years. Again, it's hard to be visible with a pandemic, right? It's hard to make loans with a pandemic. I think that's where we are going to have to figure out how we get that face-to-face contact in a world where we are all doing things from at home and remotely, et cetera.

Linda Keith:

It sounds like one of the questions a director could actually ask the CEO is, "What are some of the ways that the directors, at this point, can be more visible or in some ways support the strategic vision of this bank within the community in a difficult time?"

Paula King:

Exactly. I was in banking for many, many years, and I can remember in the early nineties, in my banking experience, the boards were very active in some of the smaller communities, so they actually brought in their contacts, they participated in some of the events, and went out and shook hands, et cetera. Certainly, we can't do that now. But I think there's ways that they can dust off some of their contact listings when they're having conversations with folks. And it's fun, right? So I think the role of a director has not been a lot of fun recently because, again, they showed up at meetings and they listened and they left.

Linda Keith:

Because everything was going fine.

Paula King:

Everything was going fine. So, this is a perfect opportunity for a board member to get back into the business to become a more integral part of the growth of the institution of the business.

Linda Keith:

To bring value, besides just their good name and their reputation.

Paula King:

Right.

Linda Keith:

I'm a member of a credit union. I also was a shareholder of the 92nd bank to fail in 2009, sorry to say, but I remember going to a credit union annual meeting. Members are all shareholders in that case. They are giving us a financial document and telling us how things are going and how well it is. I'm looking critically at this set of financials and what I can see is that the way they have maintained what I'll call profitability in credit unions, it isn't that, but the way they maintained their profitability the last year is they pretty much cut lots of expenses.

So, on the way out the door I sort-of caught the Chief Credit Officer on the way out. It was either the Chief Credit Officer or the Chief Financial Officer, I don't remember which. I said, "I can see what you did to maintain profitability last year. Is the horse out of the barn at this point on this one? Can you actually keep cutting expenses?" He looked at me and says, "No, the board's going to have to accept a higher level of risk."

Paula King:

Yes, and you hit the nail on the head. I mean, that's really where you are going to get your impact to your bottom line is accepting more risk. You can cut a few costs here and there, but if you continue to do that, it's going to show in your service. So I think you are exactly right. I think really the only strategy, at this point, that's going to make a lot of impact is going to be that risk appetite.

Linda Keith:

Yes, and hopefully our capital levels, our liquidity, the other things, are in place to backstop us on having to increase credit risk for some period of time.

Paula King:

Yes, I mean, the good thing about this pandemic versus the Great Recession is all institutions, most of those, were all set for strong capital and liquidity. With the Great Recession we had a lot of failures because we were taking some undue risk and some risks we probably shouldn't have been taking with regard to collateral values and things like that, and some riskier investments as well.

But in this particular situation, we hope that the starting capitol and liquidity that's out there will see us through these times and allow us to take more risks as well.

Linda Keith:

Well, we are only four months into this thing, so I'll talk to you again.

Paula King:

Ask me in about a week, right?

Linda Keith:

Well, we'll see how that worked out. Well, Paula, thank you for helping us so much with the strategic piece because somebody has got to back up and look at the big picture and say, "How do we need to change strategically?" And that's the responsibility of our management, but also our directors.

So, thank you so much for helping us think through what might need to change in terms of strategy. Especially the idea that we can't help it: we didn't choose it, but risk appetite has got to change.

Paula King:

We have got to go with it for sure, Linda. It's been a pleasure. I've enjoyed the conversation with you today.

Linda Keith:

Okay. Thanks, Paula.

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 Paula King

Paula King, CPA, is Senior Advisor for Abrigo Advisory Services, part of a team of subject matter experts assisting financial institutions nationwide in the interpretation and application of Current Expected Credit Loss (CECL), credit processes, policies and procedures, and model validations.

Paula has held executive positions, including as Chief Financial Officer, in the banking industry for more than 25 years. As a former CFO, Paula has extensive experience in the design, preparation, and reporting of the allowance for loan and lease losses, including ensuring compliance with regulatory and audit requirements, and creating allowance policies, procedures, and processes. In addition, she has served on internal credit committees and worked with loan operations and lending staffs to improve credit processes and enhance the capabilities of a variety of core loan systems.

Prior to her banking career, she was associated with a regional public accounting firm and specialized in bank audit services.

Paula has been responsible for SEC and financial reporting, strategic planning, and has served as Chief Risk and Compliance Officer. She is a bank co-founder and served as a member of the board of directors through its merger with another financial institution and has been a de novo bank consultant to boards and senior management teams.

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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