Effective Credit Risk Management
Cultural Enhancement for Divergent Views / Transcription

Objective

- *Team Approach* – Managing credit risk 'together' during stressful economic downturns
- *Open Culture* – Building on a credit culture that values and welcomes documented divergent views.
- *Monitoring Frequency and Thresholds* – Achieve timely and accurate credit risk ratings (efficient process), WLR and CLR monitoring frequency and thresholds, and recommendations to retain or exit credit exposures

Expectations

- *Senior Management* – Encourage people to express their divergent views *in writing* (not just vocally, but so that there is a documented analytical discussion on file), in a safe and respectful environment
- *All Other Stakeholders* – More fully exercise your responsibility to document your independent opinions by using supported and well-documented facts to support your own conclusions

Stressful Times

Pressures and Stresses Happen Because They Are Real

- *Be Understanding* – When banks face an economic downturn (or worse), pressures and stresses build quickly. Senior management has a huge job pulling and fitting all the pieces together to make the bank work. It is a massive responsibility and task. They handle matters that others in the bank will not even be aware of. They need to keep the ship sailing in a safe and sound manner. Employees need to be patient, professional, and understanding because a lot is happening. A lot is on the line. Everything is on the line. Normalcy, the way we have always done credit risk management, can suddenly feel like it is shifting. To the PRO, or even CA, things may not make sense. The normal approaches and all, they can become delayed or even ignored, and top-down pressures can be exerted. Not everyone will be or needs to be aware of all that's going on either

- *Signals Present?* – However, as pressures build, indirect signals or messaging can take place. For example, these signals may be directed at the usual processes used for the timing and accuracy of identifying, measuring, monitoring, and controlling credit risk. Decisions and their timing cost the bank money, money that may not readily be there. But, frankly, that's senior management's problem; everyone else must do their job under the ordinary course. Notwithstanding, pressures come. As a result of such downgrade timing delays, for example, unwarranted credit risk can build up quickly. Regulatory scrutiny increases. Senior management and the Board may ultimately be required to take (immediate) corrective action. But that doesn't mean it can become a period of intense headaches as the stakeholders each try to do their jobs. It's a rough time. Economic cycles seem to always come, and these stressful times come along with them. It happens all the time during each cycle. But note the changes in signals and messaging that come during an economic downturn. You may feel your usual voice and level of participation in credit risk discussions may be stifled, or worse.

- *Be Professional, Diplomatic, and Respectful* – As a PRO, or CA, this can be a tough period in your career. Pressures and stresses can be forwarded on to your shoulders. Through these times, it is imperative that you be professional, diplomatic, and respectful, if you have a differing opinion about credit risk from others in the bank. Hopefully, there is a culture where you can share your thoughts and written credit analysis, freely. However, that is not always the case, especially when the bank is under stress. Depending on where the culture is, you can best serve if you stick with documented and supported facts, conclusions, and recommendations. Your calls, as only you see them, may even become to look more like 'divergent views' from the signals and messages from senior management. For several reasons, these new stresses, pressures, and approaches in handling increased credit risk may change. But that does not mean you can or should change your actual thinking as a PRO or CA, even though the signaling and messaging can be compelling. The bank needs independent thought (no group think) and analytical opinions whether it realizes it or not. Facts are facts. You know the facts because of your documented due diligence work. Management still needs those facts to make appropriate decisions, even though those facts may 'cost the bank.' The PROs and CAs need to continue to do their jobs and let senior management do their job (despite the new signals and messaging that can come when the bank can't afford to address credit risk under the ordinary course). Hence, rigorous loan discussions based on documented analysis, monitoring, and reporting should continue to be the norm during stress periods. This is a good thing

- *Differences of Opinion?* – More specifically, as far as the timing goes for things like downgrades, risk ratings should be timely and accurate. But what if there are actual, or perceived as actual, pressures to delay a downgrade to another quarter, or past year-end, resulting in differences of opinion? It happens, often. Who is going to ask the deep-dive questions that nobody now wants to ask, or answer? Who will be expected to answer them? How will any of this be documented? Should or will it even be documented? Will regulators be critical of the bank for not being timelier and more accurate? Is there a reasonable period where downgrade dispositions can be made without being criticized by the regulators? What if there are differing opinions as to the timing of a downgrade, and the risk rating itself, between the PRO, Credit Administration, Special Assets, senior management, or even Credit Review? Finally, in those cases where it is, perhaps, 'culturally improper' to speak up and share your own opinion (i.e., you're not the boss 'it's disrespectful to speak up', you're supposed to 'recognize the senior person's authority and expertise', etc.), senior management should remind all the stakeholders that it is expected that they can, should, and will share their own documented opinions about credit risk; that this is one of the key reasons they are getting paid.

Why Divergent Views?

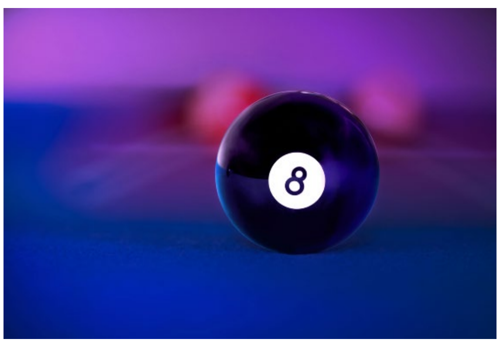
What is the Real Picture?

- *Seeing the Complete Picture* – It is best to follow the credit policies and guidance, right? If you want to get rid of a wart, you cannot just shave off the top of it and expect it to go away. The remedy requires that you get (treat) to the root/bottom of the wart so it will go away once and for all, once properly treated. Similarly, when we have a problem credit, we need to understand the facts (bottom of the wart), and eventually get to the root cause of the problem so we can apply the appropriate remedy/action plan. We need to get to the facts, and differences of opinion are beneficial to this process

- *Seeing a Different Picture* – Say, for example, the PRO writes up a WLR or CLR and obviously states the facts as she/he sees them. Or, at least that is what is supposed to happen. And what if another officer in the bank, be it from CA, or SAD, or even senior management, sees things differently? How do the stakeholders handle such a matter? How to they achieve consensus if one person sees the facts differently than the next person? Is that a bad thing? No, it's a good thing.

- *Seeing What Others Are Seeing* – Imagine a culture where divergent thinking is encouraged, say, in a WLR or CLR meeting, where viewpoints and solutions to important matters are freely shared. Things like carefully listening and asking questions about another's point of view, respectfully challenging the so-called facts, asking 'deep dive' questions, and even brainstorming. This is where and how we learn and understand from each other, in a culture or environment that is safe and respectful. This is where each stakeholder genuinely feels comfortable sharing his/her opinions. Good and rewarding work happens in this environment

The Credit Risk Ball; So, Roll It Around the Table



The Credit Risk Ball (risk rating) – Ask: "How Do You See It?"

- *Document the FACTS* – In short, the facts are the facts. Decisions should be based on facts. Facts should be documented in writing (use WLR and CLR reporting to document the facts). When stress comes to a bank, pressures build, facts can be pushed aside, or, in some cases, even ignored altogether. But responsible parties, like the PRO, CA, SAD, and senior management, should all have a 'seat or voice at the table.' And as the 'credit risk ball' or risk rating disposition is rolled around the table to such stakeholders, there is a distinct possibility not everyone will identify with the presented facts. But each has the responsibility to offer their own *documented* facts as each sees them. And there likely are, likely will be, and should be, differing opinions and points of views (however large or small) when it comes to credit risk. As the credit risk ball rolls around the table, each sees the ball from a different point of view. There better be different points of view.

- *When Differing Opinions Arise* – The PROs (and an Analyst or Underwriter) are responsible for documenting the facts as they understand them. A properly completed WLR or CLR will ensure the facts are documented. At a WLR or CLR meeting, the other stakeholders (especially senior management) may have different opinions, views, perspectives, etc. They may differ from those documented in the WLR, or CLR. The PRO will use the WLR or CLR and defend its position by the facts given. After discussion, if there is consensus, the WLR or CLR can be amended and resubmitted by the PRO.

- *The Final (Documented) Call* – However, if the PRO 'can't get there' and still disagrees with other opinions, the individual (not the PRO) with the divergent view from the original WLR or CLR will prepare an addendum to the WLR or CLR, which will be placed in the file. The bank officer with the highest credit authority may make the divergent view call (divergent view to the WLR or CLR) through the memorandum process, so there's a transparent audit trail for any changes to the WLR or CLR recommendations. Therefore, it is possible the PRO's original WLR or CLR will thereby have been overridden and reflected as such in the credit file. Subsequent WLRs or CLRs will note changes made by the senior officer, but the PRO doesn't change its WLR or CLR otherwise. The original addendum is attached to an original WLR or CLR, as applicable, by the higher-in-authority CA or senior management officer, and the decision is final. Either way, the file will reflect a healthy rigor of discussion and evidence of a divergent view culture. If desired, in such a case, the matter with differing opinions can be escalated to Credit Review for their final call to validate the best conclusion. The WLRs and CLRs, addendums, memo, will serve as a transparent audit trail.

Reminders for Senior Management – Employee Appreciation the Real Way

Valuing and Appreciating That a Human Being Employee is REAL (not pretend, not a machine or servant)

- *How Do Employees Really Feel?* – During periods of economic stress or not, bank management should often anonymously survey their employees to gauge how well things are going, culture-wise. Generally, accountability *should* reside with senior management during good times and stressed times. But what does bank leadership and management look like in the eyes of the employees? How does the average employee feel like management thinks of him/her? Does senior management take credit (and large bonuses) during the good times and blame, burden, cut bonuses, and even layoff other people during the bad times? Senior executives at banks often make more in annual bonuses than what other employees will earn in their entire 40-year careers. Does senior management even have a clue what the average employee is feeling, in terms of being valued and sincerely appreciated? Would it not be interesting to know employees' 'true thoughts and feelings' about senior management? What would they really say if the employees expressed how they really felt, with no fear of getting fired. What it be that they don't like about senior management? Many believe the so-called anonymous surveys are not so anonymous, as they later learn that feedback somehow makes its way back to department managers (it can and does). It is likely that in every place of employment, and regardless of the supposed values the company lists on their web site, there are plenty of supervisors, managers, directors, and senior leadership that many employees would want to avoid altogether. Why? Because the employees are not truly valued, appreciated, or adequately recognized, that's why. Believe it or not, respect goes both ways. Employees are dedicated and come to work each day to work hard. They are real people, each and every one of them. Preference can't be for the favorites that went to a certain school. So, what is your company's real employee valuation and appreciation culture (by senior management), notwithstanding the pulse survey results? Do all employees, even those who offer divergent views, feel truly valued and appreciated by all of management?

- *Real or Virtual Appreciation?* – Is more 'actual, real, human' appreciation needed? Sometimes out of those surveys, management will focus on improving employee-to-employee relationships. Even though pretty much every company 'states' or identifies its employees as its 'greatest assets,' do all employees feel that way? Probably not. Why is that? A few 'bad' managers/supervisors, or an 'overbearing' executive officer or two? Maybe it's a heavy-handed top-down driven culture? Probably. What is behind any so-called employee dissatisfaction? Do all employees, at every level, truly feel valued by others, and especially senior management? Does senior management even care enough to genuinely show human-to-human appreciation? Or, would it rather just punt the whole thing and go the quarterly 'virtual' appreciation list route? Like putting someone's name on a virtual recognition bulletin, say, with a few dozen other 'names'? Does senior management really believe this is supposed to be genuine appreciation, because they're too lazy to do it right? How many view this as being mechanical? Employees might say that virtual recognition is *not* real appreciation, that it's a cheap farce. Others will brag that their name made it onto a list for the 'whole world to see,' that, that somehow makes them important. A cheap sell-out? Maybe. Those who accept this nonsense don't know what being personally valued and appreciated is all about. It may work for a piece of machinery, or a season, but not for a human-being, and for the long-term. How hard is it to stop by and express personal appreciation to an individual who has accomplished something noteworthy? Apparently, it's way too hard. So sad. Some people focus too much on their millions

- *When Mistakes are Made* – When (unintentional) mistakes are made, how does management react? How does the employee feel about it? Is there an 'unforgiving' culture, where an employee might feel his/her name is now on 'Santa's naughty list'? Does the management culture demand so much time and effort from its employees that mistakes are effectively not allowed to happen (even at the expense of an inefficient process)? For whatever reason, however, mistakes do happen. Such mistakes are good opportunities to improve a process or practice, if they're handled properly. Management should use mistakes to not penalize and punish the employee, but to use them as learning opportunities to improve a process in becoming more efficient. Mistakes allow the stakeholders to build increased trust in each other when mistakes are handled as a learning experience. It should be a real team environment that everyone can feel, where mistakes can even be valued as key learning and improvement opportunities. Again, mistakes have to be made in order to improve a process. In the end, staff employees at every level need to be valued and appreciated in a culture that fosters divergent views, and learning opportunities from making mistakes. This (new) culture is necessary while proactively monitoring asset quality during an economic downturn.

Benefits of an Enhanced Divergent Views Culture

<u>Benefits of Sharing Divergent Views During Stressful Economic Times</u>
Consider these 20 divergent view benefits for the bank and its staff:[1]

- *Innovative Solutions* – Divergent views can lead to innovative solutions that may not have been considered otherwise

[1] Source: Conversation with Bing, 11/13/2023

- *Better Decision-Making* – Divergent views can help decision-makers consider multiple perspectives and make better decisions
- *Improved Risk Management* – Divergent views can help identify and manage risks more effectively
- *Increased Creativity* – Divergent views can stimulate creativity and lead to new ideas
- *Improved Communication* – Divergent views can improve communication and collaboration among team members
- *Increased Engagement* – Divergent views can increase employee engagement and motivation
- *Better Problem-Solving* – Divergent views can help identify problems and find solutions more effectively
- *Increased Adaptability* – Divergent views can help organizations become more adaptable to change
- *Better Customer Service* – Divergent views can help organizations better understand and meet the needs of their customers
- *Improved Performance* – Divergent views can lead to improved performance and productivity
- *Increased Job Satisfaction* – Divergent views can increase job satisfaction by giving employees a sense of ownership and involvement in the decision-making process
- *Better Employee Retention* – Divergent views can help retain employees by creating a positive work environment
- *Increased Diversity* – Divergent views can increase diversity and inclusion in the workplace
- *Better Conflict Resolution* – Divergent views can help resolve conflicts more effectively
- *Improved Morale* – Divergent views can improve morale by creating a sense of community and shared purpose
- *Better Leadership* – Divergent views can help develop better leaders by encouraging them to consider multiple perspectives
- *Increased Transparency* – Divergent views can increase transparency by encouraging open and honest communication
- *Better Organizational Learning* – Divergent views can help organizations learn from their mistakes and improve their processes
- *Increased Accountability* – Divergent views can increase accountability by encouraging employees to take ownership of their work
- *Better Organizational Culture* – Divergent views can help create a positive organizational culture that values diversity, creativity, and innovation