

## **Best Practices for Managing Special Assets**

By: Sandy Moll and Rich Delaney

Bank troubles continue and the industry turnaround is still over the horizon; troubled assets burden banks, while capital infusions and liquidation of assets remains difficult. This is a historic period of challenges, but not entirely unprecedented. The late 1980s and early 1990s can serve as a guide to resolving today's banking issues. That period taught us that identifying and dealing with problem assets in a timely manner is the best path to minimizing losses.

However, accurate identification of risk has become more challenging. The continuing volatile economy has made understanding asset value difficult. Adding to the challenges, many bankers have never seen times like this. Banks enjoyed strong economic times during the past few years and increased their hiring of sales people. This trend, along with the fact that in 2008 there was half the number of banks and more than twice the number of branches as in 1978, has resulted in much lower numbers of staff members with credit workout experience.

The decline in the number of banks leaves less of a market for customers to move relationships if needed. Some believe that adding to the issue is the fact that there appears to be some disparity in how banks are handled by regulators. The reality is that many regulators have not seen times like this either; many of the seasoned examiners have moved on.

Some banks are unsure of what to do or how to do it. Some are taking a wait-and-see approach or are overwhelmed and don't see a way out. Realistically, there are only a few options if the bank's problems are highly concentrated in any industry or geography. Capital infusions, reducing troubled assets or shrinking the bank are all difficult in today's environment, but not impossible.

Banks in trouble have a challenge to balance the requirements of extra regulatory oversight and reporting while continuing to serve their solid customers. All banks must have a strong strategic and operating plan and troubled banks are no different. Priority must drive resource allocation. Key elements that cannot be overlooked are:

- In-depth knowledge of customers — know their problems.
- Ensure strong policies and procedures.
- Evaluate staff and technical capabilities and expertise to handle additional requirements that come with additional regulatory burdens.
- Evaluate and strengthen communications.

Getting back to the basics of truly understanding customers is crucial. A full customer review is not only good service but also helpful in risk mitigation. Banks need to know how the customer will survive given different economic conditions.

Bankers like to say they proactively manage credits, but conditions are showing otherwise. Crucial steps include having a strong loan policy and ensuring adjustments to internal risk-rating systems for anticipated economic downturns, a strong criticized asset

tracking and reporting process and stress testing. But many banks failed to focus on these steps strongly enough during the good times.

Loan policies must include some key pieces that we are seeing missed in many banks. Overwhelmed or shell-shocked management and staff may have difficulties developing and implementing a strong and concise loan policy. And implementation with strong training is essential to working through problems.

Criticized asset tracking and reporting is always a great tool for management, lenders and the board. It supports lender performance programs and ensures timely and open communication between management and the board. However, we continue to see banks with criticized asset reporting that misses key elements. Building processes in the bank using this tool makes credit management much easier as long as the policies and processes are finely defined.

Credits that are seen as non-viable need to be pushed to special asset experts quickly. Bank owners and directors buying troubled loans is being seen more often. Getting troubled loans out of the bank into a separate entity, out from under regulatory scrutiny, can move a troubled bank forward quickly. More creative and viable workout plans may be options if the credits are not in a highly regulated environment.

Staff allocation is crucial. How will re-directing employees to handle problems impact core customers and the profitability and ultimately capital? Is there an adequate number of experienced staff? What if the answer is no? What are the options? How will the bank maintain staff that other institutions will be seeking out? A full management and staff analysis doesn't have to be complicated, but does need to be done. Outsourcing some of the functions of dealing with problem assets enables staff to focus on viable functions, reduces stress and helps to maintain customer relationships.

Will communication have to change if a bank is "troubled?" Yes. Establishing a strong communication avenue to customers, employees, directors and regulators is essential.

### **Maintain a high-level perspective**

A strong and thorough strategic and operating plan is crucial to drive resource allocation, but many banks do not have the requisite experience. Using associations, other banks, consultants and regulators is a great option for support and guidance. Although cost is important, priority should be given to partners who understand what the bank is going through and can help it move quickly through its problems. Employing outside resources can be a cost-effective, turnkey solution allowing the bank to focus on business building and profits. Working on special assets without the necessary expertise, capacity and processes is a superficial exercise.

### **Why take action now?**

In addition to the desire to have the bank survive for personal reasons, and the liability of directors and officers, bank failures have a huge impact on a community and the ripple effect can be felt for years. The survival of community banks is crucial to survival of communities.

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