Proposal: 1679 - Interagency Guidance on Credit Risk Review Systems

Description:

Comment ID: 136108

From: Baraboo State Bank, Patrick LeFevre

Proposal: 1679 - Interagency Guidance on Credit Risk Review Systems

Subject: OP-1679; Interagency Guidance on Credit Risk Review Systems

---

Comments:

Date:Nov 01, 2019

Proposal:Interagency Guidance on Credit risk review systems [OP-1679]
Document ID:OP-1679
Revision:1
First name:Patrick
Middle initial:G
Last name:LeFevre
Affiliation (if any):Baraboo State Bank
Affiliation Type:Commercial (Com)
Address line 1:101 3rd Avenue
Address line 2:
City:Baraboo
State:Wisconsin
Zip:53913
Country:UNITED STATES
Postal (if outside the U.S.):
Your comment:I would like to address Question 2 specifically: To what extent is the proposed credit review guidance appropriate for institutions of all asset sizes? What elements should be added or removed from institutions of differing sizes, and why?

From practical experience with 25+ years in credit administration and risk asset review roles, both in large banks and community banks, the appropriateness of this guidance, as is the case with many interagency guidance, is positioned via the overview's opening statement, which is, The nature of credit risk review systems varies based on the institution's size, complexity, loan types, risk profile, and risk management practices." This upfront acknowledgement essentially renders the perception there exists a purposeful delineation between larger, more complex, or riskier institutions and smaller, less complex, and less risky institutions. Further, that same perception underscores a belief that there exists a certain degree of decorum and perhaps immunity for smaller, less complex, and less risky institutions from being subjected to the type and depth of scrutiny that might be conveyed at a larger, more complex, or more risky institution; and rightfully so.

Given that the framework of this guidance has distinctly not defined tiers on the basis of size, complexity, risk profile, etc. this opening statement, while meaningful in context, probably needs interpretation; or it needs to define entitlements for interpretation. Does the Bank decide whether it's size, complexity, risk profile rises to a new tier of scrutiny, or does the Bank's examiner make that decision?

Bankers and regulators often times do not interpret the same way, and this fact can lend to industry "best practices" being described and promoted by on-site examiners in a way that compels banks that don't particularly have a practical need or means to satisfy the best practice into incurring unnecessary cost.

Using a piece of the guidance language as a specific example, here is something to consider that might be potentially problematic when contextualized across all sizes, complexities, risk profiles, etc.

"Promptly identifies loans with actual and potential credit weaknesses so that timely action can be taken to strengthen credit quality and minimize losses." That is a terrific ideal; however, it can be interpreted to mean that a $100 Million bank needs to have processes or systems in place, which may be costly and render minimal value, to always "promptly" identify loans with potential credit risk, regardless of the risk profile of that institution; because if they don't, they may be exposed to potential questioning on the basis of best practices that have been observed elsewhere.

The wording "promptly identifies" in this context seemingly implies that all banks, regardless of size, complexity, risk profile, risk management processes will institute processes to continuously, or immediately, or without gaps of time identify credit weakness. That's highly impractical.

Perhaps better wording would be: "Promptly reacts to loans identified with actual and potential credit weaknesses so that appropriate action is taken to strengthen credit quality and minimize losses." In that way, the $100 Million rural, non-complex community bank would not likely be exposed to the predilection of a metro-based examiner who is accustomed to reviewing institutions typically in the $500 Million or larger category and who may have witnessed a keen best practice, to feel obliged to hire a full-time credit review officer, for example, or spend the money on a needless software package designed to produce a red-flags reports. At larger institutions, the cost of these types of best practices can be absorbed via the girth of the earning asset base. At smaller institutions, each newly incurred, non-revenue generating asset is more pronounced respective of the bottom line. So, my point is that leaving to much ambiguity (as in not defining tiers) or allowing wording that is not particularly well-aligned with the overview's opening statement (as in "promptly identifies" which is more of a one-size fits all wording) leads to on-the-spot interpretation and can perhaps allow for an examiner's passively conveyed recommendation to be interpreted as a non-passive expectation; which in turn may invite cost that isn't warranted and impacts returns.

This same notion can then be used to assess other parts of the guidance language: in particular the area that reads "An effective credit risk rating framework includes the following attributes,..."Again, that kind of language tends to be more one-size-fits-all; and as a result may compel unwarranted costs for smaller, less complex, and less risky institutions.