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VIEWPOINT

Have You Hugged Your Examiner Lately?

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The postcrisis recovery period does not make for easy relationships between banks and their supervisors, especially when the recovery is as tentative as it is now.

Global and national economic developments are at best uneven, and banks could very well confront — if they have not already — a double dip that levels another threat at loan portfolios that have already been sapped by a long period of economic underperformance. In such an environment, examiners have naturally tilted to the conservative side of the evaluation scale.

Their own inclinations have been strengthened by media coverage that has been relentlessly negative toward financial services generally, and saved its heaviest criticism for banks. With regulators perhaps second in line in the media's assignation of blame for the financial crisis, these are hardly grounds for fostering an era of kinder, gentler bank examination.

In the midst of this challenging relationship, banking companies find themselves grappling with two occasionally conflicting priorities: They must do business to keep the economy from sliding back into a recession and they must operate in a safe and sound manner that satisfies regulatory expectations.

While it seems that many observers would prefer that banks forget the "e" in the Camels rating as they move forward, earnings are just as important to a financial enterprise as the other rating components.

Their health depends upon making loans and engaging in other sensible financial activities, including trading and, when advisable, acquiring or merging. But many bankers believe they face criticism — or outright barriers — in pursuing business strategies that they believe will assure their financial well-being. Even the banks that have maintained strong capital and turned in superior financial performance throughout the financial crisis have felt the restraints.

This perceived inability to run and expand their businesses has frustrated many bankers. How can they square the circle when they want and need to build their franchises and accommodate customers as the supervisory pendulum continues to swing in a tighter direction?

An essential first step is recognizing that the supervisory relationship is, in its way, stronger even than the bonds of matrimony. There are no divorces in banking. Despite the many temptations, and even the occasional justifications, bankers cannot indulge their passions and treat examiners harshly.

They must maintain a polite, professional relationship with their examiners at all times. In a remarkably high percentage of regulatory consent agreements I have seen, the formal order is preceded by a period of substantial deterioration in the collegiality and regard that bank executives show their examiners.

In addition, bankers are well advised to address promptly any issue raised during the examination process, even if it is not formally noted as a matter requiring attention.

When a bank genuinely disagrees with an examiner's assessment of the situation, raising concerns in a collaborative way is appropriate. These conversations, however, should be reserved for matters of substance. Banks that pick nits and constantly take issue with examiners' conclusions are taking a big step in the wrong direction.

Indeed, the most dreaded of examiner comments is about banks and bankers that "don't get it." This is reserved for those who do not hide their reluctance to acknowledge the authority of the regulator in the supervisory relationship — a particularly dangerous attitude when the agency feels strongly about a matter.

Bankers and their examiners can't always agree, and sometimes, examiners will be wrong. In some of these cases bank executives may feel a responsibility to the organization and its shareholders to voice their opinions.

That's why I have long advocated

for meaningful ombudsman programs at financial regulatory agencies. These programs enhance strong supervisory relationships and help to retain the balance the regulatory system needs. Properly administered, they are not about confrontation, but about thoughtful review and consi deration of difficult judgments. They are an avenue of redress for bankers to explore with careful and considered advice.

In sum, taking steps to carefully calibrate the supervisory relationship is is hard. However, getting the balance right is important not just to bankers and to regulators. It is important for the nation's economic well-being.

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