Since the Global Financial Crisis, lending institutions have re-examined the policies and processes that govern their management of risk. Leaders of these organizations have seized the opportunity to create or re-invigorate their enterprise’s risk culture and strengthen the understanding of credit risk among their professionals. They have also focused attention on proper processes and procedures, which, when followed, can improve loan quality and recoveries. This paper describes the “best practices” observed by Moody’s Analytics that have been most effective in creating and sustaining a strong credit risk culture. It also seeks to explain why these specific practices contribute to success.

For decades, management leaders have extolled the importance of a strong and positive “corporate culture.” A positive credit risk culture in a financial institution might be described as: “An environment of shared values and beliefs about an organization’s approach to credit risk in which people behave according to accepted standards and principles when evaluating and discussing lending decisions.” Leaders who seek to establish a strong credit risk culture have two challenges: first, creating the desired culture, and second, sustaining it. The most successful credit risk organizations combine four key elements: (1) leadership; (2) organizational structure; (3) policies, procedures and processes; and (4) people. It is noteworthy that the most enlightened leaders seem to understand that, although structure, policies and protocols are important, the performance of people is what ultimately drives and sustains a strong credit risk culture. This whitepaper discusses each of these critical aspects along with corresponding case studies based on customer experiences.
The importance of exemplary leadership in creating and maintaining a robust credit culture cannot be overestimated. Institutions that embody such cultures are generally led by managers who openly embrace a core set of values about how credit risk is managed. The following examples illustrate the effect of senior management’s actions on an organization’s credit culture.

The CEO of a large bank clearly articulates the vision, values and beliefs that guide that institution’s lending activities. Some of these qualities were in place prior to his tenure, reflecting the long-term nature of cultural evolution, and some were recently instilled to better align daily lending practices with the institution’s overall strategic goals. One of this organization’s unwritten beliefs is that lenders should always be encouraged to collaborate with other lenders or staff members on any credit decision. This practice creates synergy, which improves the quality of risk decisions and, furthermore, ingrains behavioral expectations into daily activities as skills and experience are shared among staff members.

It is important to note from this example that values and beliefs are often conveyed informally and may not need to be codified to be effective. It is also important that the CEO convey ownership of these values and beliefs, even though he or she may not have originated them or others may be primarily responsible for implementing and executing them. Without cohesive guidance from the most senior levels, individual lenders may hesitate and miss viable lending opportunities, or worse, they may act independently and incur additional risk.

Senior executives of another large bank collectively communicated the importance of balancing growth drivers (i.e., sales and marketing) with management of risk (including credit, market and operational risks)*. Recognizing the natural tension that exists between these roles, management has organized customer-facing staff in teams responsible for originating and managing business credit relationships. Incentives for teams are aligned with both growth and risk management activities, and training has become a normal expectation.

This bank achieves a competitive advantage by elevating the quality of both sales and credit concurrently. As a result of more collaborative selling efforts, a larger pipeline of viable lending opportunities is created, which enables the bank to grow while controlling credit risk. Incentives linked to credit risk management have also motivated lenders to screen prospects more efficiently.

* See Moody’s Analytics whitepaper, “Maximizing Results, Minimizing Risk”
The senior management team of a progressive regional institution communicates its deeply held belief that technology can be used to improve efficiency, manage credit risk, and gain a competitive advantage. In this organization’s credit culture, these values enable the use of technology to streamline the credit analysis process, share credit risk information efficiently among departments and manage overall portfolio risk on a variety of statistical metrics. In addition to its focus on technology, management remains highly cognizant of the role that people play in managing credit risk.

A critical cultural value accepted and understood by everyone in the organization is that no loan should be granted without applying human judgment. This value keeps credit risk under the control of people, and the investment in training sustains that control. This training, including online coursework and diagnostic assessments, is efficient and cost effective. Extensive use of technology-based learning provides skill development for lending staff at all levels. Furthermore, it ensures that all lenders are employing the same approaches, techniques and language in credit analysis.

A closely held group of affiliated community banks outperforms its competitors. The group is led by an executive team that constantly stresses a mission of balancing short-term objectives, such as revenue growth and profitability, with long-term goals of stability and market share growth. The impact of this mission on the credit culture of the affiliated banks creates a more uniform approach to assessing credit risk. It also allows lenders in each organization to accept a longer view of credit risk that aligns with management’s priority focus on effective loan relationship management. Leaders who espouse the importance of loan management while focusing only on short-term results create confusion and encourage inconsistent behavior that will ultimately weaken the credit culture.

HUMAN JUDGMENT

A critical cultural value is one stating that no loan is to be granted without applying human judgment.
The role of Chief Risk Officer (or Chief Credit Officer) is an integral part of the senior management team in organizations with a strong institutional credit culture. What tends to vary among institutions is the span of authority carried by this position, particularly the influence the position may have on the lending and selling activities of the business line. In bank cultures that emphasize credit risk management, we find, not surprisingly, many formal and informal protocols that require input from senior executives responsible for risk and credit.

Credit skills are perceived as fundamental to a successful career path in these organizations, and those who do not have a credit background are not as likely to ascend to senior positions. Ambitious employees volunteer for assignments in credit functions, including Credit Review and credit training, even when their primary career path may be in sales or non-credit products. They understand that experience gained in credit roles will improve their career prospects.

Many organizations have begun to offer credit training for employees who are not in credit roles so that they gain an understanding of credit risk and the credit process. To gain efficiency and scale, many banks have centralized the loan underwriting function to a greater or lesser extent, thereby separating it from the origination and development of new business. A select group of banks are moving experienced loan officers from central underwriting and assigning them to teams or markets that are closer to the customer, so that critical information is more directly available to them. In this way, the banks improve their response time and, more importantly, the quality of their credit decisions.

Credit skills are perceived as fundamental to a successful career path at institutions with strong credit cultures.
The traditional role of Credit Review is to review the loan portfolio, identify potential problem loans and monitor risk ratings. In a select group of institutions that are recognized for exceptional credit risk management, the role of Credit Review shifts to reviewing and reporting to senior management on the strength of the credit process**. The function of monitoring the portfolio and identifying problem loans becomes the responsibility of Credit Review. In some of these organizations, the status of this team is elevated by direct reporting lines to the CEO or Board Audit Committee.

In institutions with the most successfully ingrained credit cultures, credit training is paramount. The delivery of credit training in the structure of these organizations may fall under credit administration, line management, or human resources; however, the support for training from senior management is never in question. The Chief Credit Officer and line management champion the development of credit skills in credit-driven organizations. This commitment is conveyed regularly to trainees through the participation of senior lending and risk management executives at training events.

At one major regional bank, the focus on credit skill development remains unwavering through the decades. Here, credit training is managed by an experienced line lender (typically at VP level), who voluntarily rotates through that position for two to three years. The assignment is considered a high honor and is generally a stepping stone to promotion. This strategy serves to build and sustain the bank’s credit culture by renewing the energy around skill development every few years while also allowing line lenders to immerse themselves in and influence the organization’s credit culture.

At another regional institution, the Chief Credit Officer has direct supervision of credit training. Members of her staff are primarily responsible for the content and delivery of credit training and, most importantly, for the performance of trainees. Because this group is held to a high standard, as judged by the trainees’ performance on the job, there is a strong alignment of the skills developed in training with the actual needs of the line. In this structure, training professionals in human resources have substantial input regarding design and learning management, but decision-making related to content is exclusively in the purview of the credit management team.

** Specific issues and practices concerning process are discussed in the following section: “Policies, Procedures and Process.”
POLICIES, PROCEDURES AND PROCESSES

An institution's policies, procedures and processes transform the way that values and beliefs govern daily activities. Institutions that lack a strong credit culture often make most credit decisions at or near the top of the organization. When vision and values are not effectively translated into practice by all levels in the organization, the staff tends to lack confidence in credit judgment and risk management, resulting in responsibility for these decisions “falling up” to senior levels. Organizations that are exceptional at managing credit risk are able to balance centralized risk management with empowerment of line lenders by ingraining clear expectations regarding policies and processes.

The most effective loan policy statements clearly guide responsibilities; for example: “All signatories on a credit bear individual accountability for the quality of that deal, regardless of the presence of other recommenders or approvers.” An effective policy document is also concise and manageable; some of the best are fewer than a dozen pages long, making it more likely that everyone in the organization will read and embrace it. Many credit policy documents are unfortunately referred to as “manuals”, comprising many dozens of pages. To put this in perspective, the United States Constitution, one of the most powerful culture-governing documents in the world, contains only 4,400 words, the equivalent of approximately 18 single-spaced pages of text.

EMPOWERING LINE LENDERS

Organizations that are exceptional at managing credit risk empower line lenders by ingraining clear expectations in terms of their policies and processes.
Institutions that focus strongly on managing credit risk tend to make credit decisions through both central credit administration authority and line authority, with full accountability to both divisions. In the most competitive organizations, management seeks to empower and authorize line staff who are closest to the customer to make credit decisions. Management believes that this strategy results in better-informed decisions and shorter response times.

There seems to be a fine balance between empowering staff and maintaining appropriate oversight of credit risk. A common characteristic of well-balanced credit cultures is that credit approval authorities are carefully delegated, monitored and adjusted based on performance. These institutions carefully determine and clearly convey the requirements for obtaining concurrence and approvals by more senior-level authorities. Ongoing training for both junior and experienced lenders appears to be a critical factor in sustaining the performance of these credit-driven organizations.

The Chief Risk Officer of one regional bank strongly believes that the credit approval process should be efficient and unambiguous, and this belief is reinforced by a clear statement of policies and practices. This bank avoids the term “procedures” when describing its credit policies because management wants to encourage lenders to apply their judgment and not simply follow a script. Among the culturally-ingrained behaviors is the practice of completing the following exercise: “In one sentence, describe what you believe the action should be on this credit, and explain why.”

Management of this bank believes that the organization’s credit culture improves over the long term by being open to dissenting opinions about credit decisions and receptive to constructive suggestions to improve the decision-making process. The culture allows for opinions to be heard, and differences in judgment are accepted as part of the process. In this way, management feels that dissent, which is always expected to be supported by reasoning, helps the organization avoid group-think when managing risk.

At another well-respected financial institution, the process of credit analysis and decision-making is culturally driven and close to sacred. Here, lenders consistently approach credit risk by first gaining a solid understanding of the customer. Factors considered are the reasons behind the need to borrow, the characteristics and strategies of the business, industry issues and trends, and other qualitative factors. This analysis is generally done before lenders examine the numbers in detail. Management believes that this approach is critical to the development of insights that improve quantitative analysis. This process also helps lenders identify potential deal-killing borrower issues at an early stage, which results in more efficient decision-making. Finally, good customer relationships are strengthened through a deeper understanding of the borrower’s business and financial performance.

Understanding the Customer

Good customer relationships are strengthened through a deeper understanding of the borrower’s business and financial affairs.
The measure of a strong culture is best reflected in the willing behavior of the people who live within it. Policies and processes are undeniably important, but managers of the most highly-regarded institutions seem to agree that the daily, routine application of skills and judgment by individual staff members is essential for sustained excellence in credit risk management. The best performing organizations embrace enterprise-wide credit skill development as an integral part of the culture. **High standards are set and expected to be met for proficiency and performance.**

One of the issues organizations face today is the rapid pace of retirement or exit of experienced lenders. These lenders have seen many down cycles that have helped to shape their credit risk assessment skills. They are being replaced by less experienced lenders who have never seen a recessionary environment and who lack the experience that their predecessors had before taking on higher levels of responsibilities. Finding ways to build experience is a challenge for many institutions. One remedy is to hire experienced employees from other financial institutions. However, this remedy is expensive, and many organizations have found that the new employees don’t live up to expectations. In addition, they may have difficulty adapting to the new credit culture. For those reasons, a lot of organizations have turned the focus to training and promoting from within.

Institutions with the strongest credit cultures recognize the importance of early immersion of new hires. For these organizations, training includes skill-based content, along with orientation to the expected practices and informal routines of the credit culture. Recent studies have shown that training and development programs help motivate younger employees and improve employee retention. In this way, credit training reduces turnover while enhancing individual credibility with regard to risk management. One of the most effective management practices among credit-driven institutions is an objective assessment approach, where the skills and knowledge of staff engaged in lending activities are periodically evaluated. The results typically provide data that can be used to focus training on select groups and skill areas. These organizations seem to understand that credit training is not a one-size-fits-all endeavor.
A few exceptional organizations require that credit staff at all levels, including the Chief Credit Officer, participate in a periodic assessment of their credit skills. This kind of action seems to clearly convey the institution’s conviction that certain competencies and standards are vital to the enterprise. Even experienced credit professionals are expected to keep their skills current.

Even when all lenders in the institution follow a consistent approach to analyzing credit risk, they may not all arrive at the same conclusion. However, management can be assured that the analysis has been conducted in a rigorous and disciplined fashion and that judgments are based on uniform criteria. Institutions that exemplify effective credit management are most likely to deploy training that attempts to develop consistent analytical skills and uses a cohesive strategy for credit decision-making.

At organizations with deeply rooted and consistent credit practices, these training approaches closely align with the leadership message, organizational structure, and policies and processes of the institution.

Top-performing institutions tend to build on basic skills. Foundational credit skill development, now commonly delivered in the form of self-paced online learning, ensures that all staff involved in the lending process understand the fundamental credit risk issues and use a common language to communicate effectively with each other. This approach creates an environment where people feel a shared responsibility for credit risk, even though they may only have a supporting role.

Many leading organizations have leveraged their investment in foundational skill development by implementing a blended approach to learning that emphasizes the application of skills. The basic skills and knowledge gained through e-learning are applied to specific lending opportunities in a dynamic group environment where analysis and recommendations are presented and discussed, creating a mutual learning experience.

**SHARED RESPONSIBILITY**

Create an environment where people feel a shared responsibility for credit risk even though they may only have a supporting role.
For any credit culture to sustain its strength, the skills and knowledge gained through training must be translated to performance on the job. Organizations that achieve this connection and have people consistently applying skills with actual customers are maximizing the return they see on their training investment.

Some of the most enlightened credit-focused institutions have engaged management and senior lenders in active coaching and mentoring activities. These select individuals are assigned to work with junior lenders on the job to help them transfer their skills and knowledge to actual performance.

It is often the case that senior lenders have credit expertise but lack the ability to coach and mentor others. Rather than ignore this gap, elite risk managers have chosen to invest in training that is specifically designed to develop coaching and mentoring skills. The benefits are far-reaching and long-lived as key resources are empowered to share their knowledge and experience with others using techniques that further strengthen the credit culture.

Strong cultures embody rituals and ceremonies. Some organizations use recognition and rewards creatively to sustain their credit culture. In one institution, special recognition is given to effective credit relationship managers based on the quality of their relationship planning and monitoring, their ability to detect potential problems, and the appropriate action taken. Another institution balances its goals of long-term relationship building with risk management by rewarding both behaviors with incentives based on pre-established criteria. These risk-focused organizations recognize that people ultimately play the most important role in shaping the culture.

COACHING AND MENTORING

Empower key resources to share their knowledge and experience with others using techniques that further strengthen the credit culture.
According to Harvard Business School professor James L. Heskett, culture "can account for 20–30% of the differential in corporate performance when compared with ‘culturally unremarkable’ competitors." The examples discussed in this paper provide insights into the various approaches to creating and sustaining a strong and remarkable institutional credit culture. Throughout these examples some common hallmarks of effective credit risk management become apparent.

Four factors combine to produce top-performing credit cultures: (1) leadership; (2) organizational structure; (3) policies, procedures and processes; and (4) people. The unquestioned commitment of senior management is one critical characteristic of strong credit cultures. Exemplary organizations align their structure and policies with core values and beliefs about how risk is evaluated, discussed and managed. In all examples, the strongest driver is people applying strong credit skills to achieve sound credit judgments.
Moody’s Analytics provides financial intelligence and analytical tools to help business leaders make better, faster decisions. Our deep risk expertise, expansive information resources, and innovative application of technology help our clients confidently navigate an evolving marketplace. We are known for our industry-leading and award-winning solutions, made up of research, data, software, and professional services, assembled to deliver a seamless customer experience. We create confidence in thousands of organizations worldwide, with our commitment to excellence, open mindset approach, and focus on meeting customer needs.

As the training partner to many of the world’s leading banks and financial institutions, we have proven experience and expertise in delivering worldclass learning solutions that enhance resource proficiency and drive lasting business impact. Our objective is to elevate skills in the industry and promote a culture of risk awareness. We do this by delivering world-class learning solutions that drive lasting business impact.

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