The Next Banking Crisis TALENT RISK?

A talent shortage is already bedeviling banks. And unless financial institutions take action, it will only get worse when experienced baby boomers retire in droves.

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BY RICHARD J. PARSONS

IN 1997, THE McKinsey & Company consulting firm proclaimed that "the war for talent" would separate winners from losers in the years ahead. Sixteen years later, the banking industry is on the cusp of losing the war.

To understand the issue, consider a talent management planning session conducted by a community bank a few years before the financial crisis hit. Like many community bankers, the CEO of this bank started his career in the credit department of a bigger bank in the 1970s. Confident in his own background, over the years he had hired commercial bankers with similar training and experience.

As the CEO evaluated his bank's talent, he discovered good and bad news. The good: He had a solid team. The bad: No one was under the age of 40. Concerned, he instructed his HR manager to build the bench of commercial bankers. To his surprise, HR came back and said it could not find one well-trained, experienced commercial banker under 40 in the marketplace.

Why were there no young and well-trained commercial bankers in his market? The CEO discovered that the bigger banks in the region had stopped running traditional credit departments back in the 1990s.

Reasons for the Current Situation

At least five factors drove the change. First and foremost, much of the industry was in bad shape at the time, which drove consolidation. Some 3,000 financial institutions failed from the early 1980s to 1993. Industry profitability was anemic. Banks responded as expected; weak ones merged into stronger ones, and hiring and training slowed. As the industry started to heal around 1993, mergers accelerated. As merger mania struck full force in the mid-to-late 1990s, many banks found themselves with excess talent.

Second, credit departments began to morph into centralized risk management functions, overseen (so we were told) by risk experts. The evolution of credit scoring models and more technical credit products led to a concentration of top credit experts in risk management departments. Bankers in the field evolved into "relationship managers" who didn't need an understanding of how to analyze loan applications. In truth, they were sales representatives who relied on product specialists and credit underwriters to support them when customers and clients wanted a loan.

Third, in the late 1990s—despite a rebound in bank hiring from college campuses—new recruits explored different career paths. Trainees no longer moved into general management with an emphasis on credit training. Instead, they took on specialist careers in bank disciplines including human resources, supply-chain management, finance, and so on.

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Fourth, some banks that retained general training programs discovered that the programs were not cost effective. The key to the economics of training is the income realized when graduates serve clients and build revenue and profits. Smart competitors without programs realized that they could recruit newly minted trainees and benefit from their training without paying for it. Banks that lost talent grew tired of aiding competitors.

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And fifth, and arguably most important, starting in the late 1990s bigger banks shifted profit and loss (P&L) responsibility from local markets to centralized functions. Driven by the presumed efficiencies, they centralized such decisions as deposit and loan pricing, marketing, branch planning, and credit underwriting. As a result, fewer and fewer bankers gained broad P&L management experience early in their careers, as the P&Ls got pushed higher and higher in organizations. It is not easy today to find a banker hired after 1995 who has managed a true end-to-end bank P&L

After these seismic changes, the financial crisis struck in 2008, triggering nearly 500 bank failures and turning nearly 1,000 institutions into "problem banks."

What do bank failures and problem banks have to do with the talent war?

Everything.

When banks fail and cause a material loss to the FDIC, federal bank regulators must conduct a material loss review (MLR). More than 100 MLRs have been written to date. Nearly all cite weak management as the leading cause of failure. The talent issue extends to problem banks, too. Their directors get enforcement action letters from their regulator. The most common theme of the letters is the need to upgrade management.

Five Actions for Banks to Take

Between now and 2020, many baby-boomer bankers, born between 1945 and 1965 and trained in the 1970s and 1980s, will retire. In my national database of 399 community banks with fewer than $10 billion in assets, the average age of those banks' CEOs is nearly 59. Fifty of them—about 13%—are younger than 50. Another 40% are 60 and older.

Are the directors of banks confident they have adequate succession plans? Do they know the depth of their talent bench? Who will run the nation's community banks in 2020? In 2030? What should directors of financial institutions do about the talent issue?

Every bank should consider taking these five actions in 2013:

First, *identify, measure, monitor, and report on the state of talent.* Though the talent assessment process doesn't need to be overly elaborate, it must be formal, disciplined, and documented. A good process must include timely and accurate performance assessments for all employees, including senior management. These performance assessments must be honest, fair, accurate, and actionable.

Do independent board members have a strong handle on the bank's talent gaps? Can they show the bank has concrete steps in place to close the gaps? Too often directors find out about their bankers' skill gaps only after there is a problem. Unfortunately, in the buildup to the financial crisis, too many bank examiners missed the weak-management issue in their CAMELS ratings. Directors must be able to judge whether their banks have the appropriate processes in place to evaluate talent independent of regulators' judgment.

But talent planning must be about more than performance problems. It should also be about retaining and developing your best talent. Directors should ask whether the bank has talent-development plans to advance the skills of its most promising employees. These discussions should focus on multiple generations of bankers. A well-managed bank should have a coherent plan for building the skills of those who will run the institution now as well as in 2020 and even 2030.

Second, on a related note, *make sure you have succession plans in place for all key leadership roles.* It is more important today than a year or two ago to take succession planning seriously. Why? As bank balance sheets heal and stock prices rebound, you can expect an upward trend in retirement announcements, just as happened in the period from 1993 to 1998. A banking crisis takes a toll on people. Even the best Eveready bankers can only run so hard for so long.

But retirement is not a board's only succession plan issue. As the industry moves forward and profits return, expect the war for talent to translate into a greater demand for a diminishing population of real bankers. You can be sure the best executive search firms are calling on your bankers, telling them about jobs down the street and across the nation.

It's not just CEOs who get these calls. Recently, in the Southeast, a five-person loan platform of commercial bankers moved en masse from one community bank to another. Is your bank prepared to lose all its commercial lenders? If you succeed in keeping them, are you prepared to increase their pay in a world of growing demand and shrinking supply?

Third, bank executives and directors need to *invest time and money in developing employee skills.* Banks built to last must commit to continuing education and, where possible, certification of their employees' knowledge. Cutting back on employee development is tempting when net interest margins are tight, loan demand is sluggish, and fee income is trending the wrong way. However, the short-term gain often proves penny wise and pound foolish over multiple economic cycles.

Fourth, the best bank directors not only examine their bank's talent, but also look candidly in the mirror and *assess overall board skill and experience.* In December 2012, *American Banker* reported on an OCC study of board oversight at the nation's 19 largest banks. The study revealed that only two of these bank boards were demonstrating strong bank oversight, while 14 were at least a year away. What are the chances that thousands of other banks in the country might share the same board oversight issues as the largest banks?

Directors at all banks would be well served to conduct a candid and thorough self-assessment. Gaps must be identified and documented. My own analysis of 435 banks smaller than $50 billion in size shows that more than 50% of the independent directors of these banks lack professional backgrounds in banking, accounting, law, investments, or bank regulation. Some banks do not have one independent director with experience in any of these five fields.

Fifth and finally, here is another action directors should take. Let's return to a decade ago and the bank and CEO introduced at the beginning of this article. When the bank's CEO and board realized they had a talent issue, they decided to entertain offers to sell. The bank was indeed sold a few years before the crisis to a regional institution. Being ahead of the curve, this bank was paid a rich premium to book value.

Today, after confronting possible talent gaps, succession planning issues, and concerns about bench talent, *bank directors need to determine if selling the bank is the best way to mitigate talent risk.* Expect to see more bank mergers in 2014-18 because of the need acquirers and sellers have to mitigate talent concerns. Acquiring banks would be wise to carefully assess the depth of talent in potential acquisitions and know if the talent they are acquiring is likely to stay on after the merger. Sellers of talent-laden banks should be able to earn a richer valuation.

Conclusion

There are hopeful signs that the banking community is beginning to recognize the talent issue. CEOs of a few community banks have resurrected college recruiting programs and instituted general management training. A growing number of banks have made progress in closing director skill gaps by providing training and bringing in directors with the experience to govern banks. In addition, the boards of a small number of leading banks have formed human resource (or human capital) committees.

The war for talent in banking is here. As in any war, there will be winners and losers. Winners will be the banks whose leaders recognize that concrete steps are needed now to attract, develop, and retain talent.

Here are the questions that directors, CEOs, chief HR officers, and chief risk officers need to ask and answer today:

1. Should the bank have a board committee focused on human resources?
2. Does the bank have an effective performance management system in place?
3. Have talent gaps been identified and is there a clear-cut plan to close the gaps?
4. Does the bank have a succession plan for key management positions?
5. Is there a pipeline of next-generation talent being developed? Looking ahead to 2020 and even 2030, is the bank developing the general management skills of future CEOs and other executive officers?
6. Just as the bank employs external auditors to attest to the integrity of financial systems and reporting, has it conducted an external audit of its critical talent management systems and processes?

Like financial markets, the market for talent is dynamic and ever-changing. Great banks will act immediately to make sure they have the rigorous systems and disciplined processes in place to win the talent war. ❖

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Published by RMA and written by Richard J. Parsons, *Broke* recommends systemic improvements to basic banking in America and offers a common sense approach to transforming the industry.