

The Bank Manager's Dilemma

Topic: Institutions and Markets (Loan Covenants)

Characters: Sara, A branch manager at a large commercial bank

As a young branch manager at a relatively small retail office within a large bank holding company, Sara has been challenged by her superiors to increase loan and deposit volume within her local banking market. In Sara's first year on the job, she has designed and implemented an aggressive calling program in which she visits local businesses and solicits new corporate accounts for the bank. Her initial efforts have been most successful. In spite of strong competition from other local financial institutions, Sara has managed to land a new \$2 million deposit account from a local apartment management firm, Silver Valley Estates, and she is currently negotiating with Silver Valley's president to provide a \$300,000 mortgage loan for his new personal residence.

After a recent credit committee meeting at the bank's regional headquarters where Sara presented the mortgage loan request and received approval from the bank's senior leaders for this loan, Sara is called to her boss's office. She can hardly contain her excitement in greeting her boss, telling him of the new mortgage loan she is planning to make. Upon hearing the news, Sara's boss frowns and tells her of a mistake that occurred in the bank's deposit operations center several weeks ago.

It seems a group of checks worth \$20,000 deposited into Silver Valley's rental collection account two months ago were returned to the bank for nonsufficient funds by the Federal Reserve. Instead of promptly deducting the bad checks from Silver Valley's account and returning them to the firm, one of the deposit operations clerks at the bank inadvertently placed the checks in his bottom desk drawer and forgot about them. After several weeks, the bank's auditors located the checks, and now Sara must debit Silver Valley's account and return the checks to the firm.

Sara protests to her boss that this action would clearly be wrong, because the bank's written policy states that checks accepted for deposit cannot be returned after the tenth business day following their date of deposit. In addition, Sara explains that one condition of the bank's mortgage loan approval to Silver Valley's president is that the firm must maintain a major deposit account with Sara's branch. She knows that if she charges the Silver Valley account for the bad check loss, she will anger Silver Valley's president, lose the \$2 million deposit account and the new mortgage loan, and sacrifice all future business from Silver Valley to competing financial institutions in her local market.

Sara's boss claims that he understands her dilemma, but he is adamant in his instruction to her. The bank cannot afford a \$20,000 loss to a new corporate depositor, and she must debit Silver Valley's account to cover the bad check loss. Moreover, Sara is quietly warned that discussing this matter with any other senior officers of the bank will prove most damaging to her career. What should she do?

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