

A Conversation with Dick Evans

Texas Banking Legend Shares Lessons Learned

Richard W. (Dick) Evans Jr. will retire in March 2016 as chairman and CEO of San Antonio-based Cullen/Frost Bankers Inc. Over his 44-year tenure, he helped Frost Bank navigate the difficulties of the 1980s and emerge as one of Texas' largest financial institutions. He discusses what he has learned during this time, which included serving on the Federal Reserve Bank of Dallas board and the Federal Advisory Council, and his views regarding opportunities and challenges facing Texas and the banking industry.

Q. During your career, you have seen a lot of turmoil and growth in the Texas economy. What makes Texas different from other states?

I think at the core, what makes Texas different are the people and a can-do attitude. Our state's history is a big part of that. Our background as an independent country (the Republic of Texas) and strong ties to agriculture and nature have instilled a certain Texan spirit. We believe that you have to take responsibility to make things better every day. You could call it an attitude of not making excuses.

When you live in this state, you see how nature plays an integral role in shaping the Texas mentality. What we learn about living through vicious cycles in the weather, of good and bad times—these become lessons that we apply to business. We have learned that ups and downs are inevitable, but being prepared for them is what allows you to work through and endure hard times.

Q. Looking ahead, what factors will be the most important for the state to maintain relatively high job growth?

I believe that Texas cannot continue to grow and prosper unless we solve our problems in two key areas.

The first is education. We need to focus on teaching more effectively. While

a college education is important and a great goal for many Texans, not everyone needs to have a PhD. We also need to think more broadly about refocusing education and developing respect toward the trades. Even today, we continue to hear about the lack of skilled workers. We have to understand the needs of the job market and match education to it, not just assume that any degree will do. It's all about learning skills.

The second issue is water. Water can be a very emotional subject in Texas. To many people, everything seems OK until water doesn't come out of the faucet. By then, it's way too late to act. We have to be sure that through every possible avenue—whether it be conservation, water markets or new technologies—we have a secure supply of water to continue to grow. We need collaboration, especially between regulators, inventors and investors, so that we can find new solutions to our water problems.

Q. The dramatic oil price decline over the past year is negatively affecting the state—but nothing like the drop in the 1980s did. What's different this time?

Comparing the situation today to the 1980s is really comparing apples to oranges. In the '80s, oil prices dropped but in an environment where most people were expecting them to contin-

ue to rise. So the drop was not expected and not planned for. In the most recent oil price decline, lenders' expectations were much more rational, and when oil was at \$100 a barrel, most anticipated a downward slide to \$70 or \$80. So, while the magnitude of the recent price crash was larger than expected, both borrowers and lenders were better prepared.

Along with the oil price drop, there was an overbuilding in real estate in the 1980s. Many lenders were making deals without any equity. That couldn't work. Real estate was chasing oil, but because of the nature of the business, it couldn't react as quickly to the change in oil markets. That left lenders in a bad position. On top of that, there was a change in the real estate tax laws that tightened the rules on write-offs. That took the passive investors out of the market and sent real estate crashing. Neither of these factors has been an issue this time around.

Finally, the technology component has been hugely transformative to the energy landscape. Wildcat drilling and speculation were common in the '80s, but today it is much more of a science. Efficiencies in exploration and production have taken quite a bit of the volatility out of the industry.

Q. Frost Bank is the only top 10 Texas bank to survive the 1980s. What are the key reasons?

I think the main reason is that we knew and worked with our customers through the difficult times. The truth is that when a borrower gets into a ditch, it takes both the borrower and lender to get out of it. I believe that we made it through because we had the right kind of customers—people who were willing to try their hardest to work through their debt. We had a good enough relationship with our customers that we were able to work with them and make it through the tough times. We understood what our customers were trying to accomplish and did our best to give them the tools they needed to succeed.

Between 1980 and 1990, we charged off \$400 million. If you had told us in 1980 that we would go through something like that, we would have said



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that we couldn't do it. But what you learn in times like that is to take things one step at a time. We just went to work, every day, to solve the problem piece by piece. A friend of mine once asked me if I ever considered quitting the banking business during that time. Despite all the struggles, I never thought about quitting. That never occurred to me. It was not a fun time, but the experiences and challenges made me into the banker I am today.

Q. How has banking changed since 1971, when you started as a commercial loan officer at Frost?

Both banking in general and Frost in particular have been through a lot of changes, thanks to technology. We've gone from a \$350 million bank to a \$28 billion financial services company. When I started at Frost, the rule was to have one employee per \$1 million in assets. If we followed that rule today, we would have 28,000 people. But because of advances in technology, we can run our company with just 4,200 people, without any reduction in service level. The technology has transformed how we do business and how we interact with and serve the customer. Staying ahead of the curve is more important now than ever if you want to be a successful banker.

Q: How has the structure of banking shifted in Texas?

Up until the 1980s, Texas was a unit banking state. (Branch banks weren't allowed.) This led to a larger proportion of small and mid-sized banks making up the Texas financial system. After the crash in the 1980s, the laws changed to allow branch banking and out-of-state

banking, which brought more large banks into the mix.

Recently, there has been a lot of consolidation of Texas banks as they struggle under additional regulation. A lot of this has been in the form of smaller banks merging to try to get over the \$1 billion mark (asset value) and remain viable in an increasingly burdensome regulatory environment. I think that as compliance becomes more costly, we will continue to see these bank mergers. Today, we have one-size-fits-all regulation, but smaller banks can't operate that way.

Q. What advice can you give to bankers from your many years of experience?

Foremost, I would tell bankers to work for an organization that is committed to the development of human capital and cares about your growth as an individual. Communication is a very important part of that. We are at a point in time where cross-generational communication is a challenge across all sectors of business and will only continue to get harder unless we all work to improve it.

A successful bank has to be able to meld the intellect and skills of young people with the wisdom and experience of those who have been in the industry a long time. There must be a mutual understanding and communication, with established bankers working with the younger generation to mentor them and guide their dynamism and skill in constructive directions. Both the young and the old have to realize that they can't do it all alone and that working together, exchanging ideas and being open in our communication is the key to our future prosperity.

Q. What did you gain from your experience as a Dallas Fed board member? What key challenges face the Federal Reserve?

I am an ardent believer in the benefits of a strong, independent central bank. That is why I spent nearly 16 years serving in some capacity in the Federal Reserve. I was honest, direct and sometimes controversial in my role because I wanted the Fed to understand what was going on beyond the data and what was happening in real life with the businesses and individuals that make up the economy. I think the Fed is very well-designed in its balance of data-driven economists who look at the numbers behind the economy and the bankers and community leaders who deal with the day-to-day workings of the economy and help the Fed interpret the "straws in the wind."

My concern is that the Fed is moving away from a model of leadership and guidance toward an analytical, model-driven one. Nobody questions the importance of data, but part of being a central bank is about leading, inspiring confidence and bringing a human element into the mix.

Lately, there has been this "analysis paralysis" where the focus on data has taken precedence over leadership, and it has led to a lot of confusion. When analysts need to parse through every phrase of every press release that the Fed puts out in order to try to figure out what they are going to do, that isn't leadership. It has become so technical that nobody really knows what is going on. Nevertheless, I think that the Fed is a strong, resilient institution, and it will be able to adapt to the needs of the public and the financial industry as times change.