BREAK DOWN THE SILOS

by Steve Brown

Older bankers will recall that back in the 60's, when the Cold War was raging, the government built hundreds of missile silos. Today, most of those silos are abandoned; filled instead with dirt, cement, or even water. Yet despite this lesson in history, many banks readily admit they still have groups that operate within their own silos. This can be particularly true when examining the risk of an institution. In particular, a transition that has already occurred at national banks will slowly permeate independent banks over the next 5 years or so. National banks no longer simply hold risk, but rather, they have shifted to a process of actively originating, purchasing, measuring and deciding which risks they wish to keep and which ones they wish to remove from their balance sheets. These banks have integrated risk management and tied it back to capital usage and costs. In short, larger banks have found that by providing a standardized format across the organization for managing credit exposure, risk can be leveraged and shared by groups as diverse as loan traders, structured finance, securitization, ALM managers and others. In this way, data can be shared and such information on ratings, spreads, loan pricing, and even allowance sufficiency. National banks have been working for years to integrate models, methodologies and assumption sets and now regulators are requiring independent banks follow suit (i.e. annual risk reviews, credit stressing, ALLL testing, model validation, etc.). Heck, even FRB Governor Susan Bies stated in a recent speech that banks "must keep up with the latest developments in risk measurement and management" and that "one of the most important sound practices for a banking organization is the tying of risk exposure to capital." Lest anyone think this is some far out idea that won't happen in their lifetime, consider the rapid competitive changes already occurring in the industry. By shifting away from a traditional silo model, national banks have significantly reduced their reliance on NIM; shifting instead to fees, risk transfer, servicing and improved delivery options. The harder it has become for these banks to sit back and "clip a coupon," the more they have transitioned to actively buying and selling loans, ramping up securitization, analyzing customer/product profitability and otherwise proactively managing and re-managing various portfolios. Nothing is sacred, risk is fungible and ALM, CRM, capital management, liquidity, profitability and other components all reside under one roof. By tying origination and sales groups into a more robust risk management function, banks can increase leverage and overall profitability. Independent banks still have ground to cover to catch up to their larger brethren, but a gradual shift is occurring. The first step is to design a program to support changing the credit environment to one designed to optimize portfolio risk within preset tolerance boundaries, rather than trying to avoid it. In this manner, independent banks stand a better chance of boosting overall profitability, increasing performance, enhancing their competitive posture and reducing overall risk. After all, it is now summer, so what better time to shut down the silos, fill them with water and take a nice cool swim around the bank.

BANK NEWS

Acquisition

Cathay General Bancorp ($6.3B, CA) will acquire New Asia Bancorp ($139mm, IL) in a deal valued at nearly $23.5mm or 1.84x book.

Online Interaction

According to the WSJ, nearly half of the 12 largest banks in the U.S. have or are in the process of introducing live-chat capabilities for their online banking customers. Such advancements seek to add a more human interactive feel to Web sites and personalize online banking.

Check Cashing

Zions Bank announced it has begun rolling out biometric fingerprint check cashing. The technology electronically scans a person's fingerprint and matches it to records retained by the bank and marks the first time that a major financial institution will use biometric tools.

Housing

A national study finds 71% of 299 top metro housing markets are considered "extremely overvalued" compared to only 7% as of the end of 2003. CA and FL have 18 of the 20 most overvalued markets according to the study.

Recession

Research by the FRB of financial and macroeconomic indicators finds there is somewhere around a 20% chance the economy will experience a recession in 2007.

Small Business

Studies find that 57% of small businesses use internet banking services on a daily or weekly basis, 50% use online bill payment and 83% use corporate credit cards.