
A SMART GUY ABOUT RISK MANAGEMENT

by [Steve Brown](#)

Banking is all about taking risk, but it is also about people. The problem with this interconnectivity is that people inherently have psychological biases that impact the management of the institution. It is important for bankers to recognize these biases in order to better manage the institution. Psychological studies show that while people have an inherently distorted reality that causes them to think irrationally and sometimes make poor decisions, they rarely recognize it. We can't help it because we are human, but we can work toward changing our behavior. To begin, studies show people tend to be overconfident in their abilities. While inexperienced managers learn from their mistakes, experienced ones do not see ways to improve significantly and as such, will rarely embrace additional learning. After all, people that have been doing the same job for 20 years or more, feel they pretty much have it down. Most in this group also feel they can learn very little by changing the status quo and are very comfortable in their existing processes. This bias is actually a combination of loss aversion and the fact that people tend to attach value to something the longer they are attached to it. Studies show this status quo group won't make a change unless a new product, service, or process is perceived to be at least 10x as good as the existing one. We remind people trapped in this cognitive whirlpool to consider a quote from Albert Einstein who said, "Never regard study as a duty, but rather as the enviable opportunity to learn." As one ponders that thought, consider that studies also show humans are risk adverse. Throughout childhood and the working career, people are rewarded for making good decisions and penalized for failures. This being the case, management must foster a business culture where failure is acceptable. Managers must also strive to keep their egos in check. Studies show people spend inordinate amounts of time trying to be right, rather than openly listening and learning to opposing viewpoints in an effort to find the best path overall. This is not only counterproductive, but harms the institution. People do this because emotion is a primary component of our psyche. Rather than examining cold, hard facts and rendering a decision, people are drawn to making emotional decisions that support their original opinion. In short, being right is often more important for human beings than doing the right thing. Here, Einstein offers a thought worthy of consideration as well, stating, "Whoever undertakes to set himself up as a judge of truth and knowledge is shipwrecked by the laughter of the gods." A third cognitive bias people should recognize and work to overcome is a tendency to seek out evidence that confirms our belief. People tend to favor information that supports their position, while discounting or ignoring data that does not. Studies show people will actively seek out and assign more weight to evidence that confirms their position and either ignore or underweight evidence that could point another way. Unfortunately, self serving perceptions usually occur at an unconscious level, making them harder to recognize and avoid. The bottom line is that because we are humans, we need to recognize our frailties and build a supportive culture to offset them. Remember the only thing that interferes with learning is one's education.

BANK NEWS

M&A

Sandy Spring Bancorp (\$2.6B, MD) will acquire CN Bancorp (\$145mm, MD) for \$43.2mm or about 3.3x book. The high multiple largely stems from a geographic position, low cost of funds and under-leveraged position.

Insurance

Monday is the last day for banks to check with the FDIC to assure that deposit insurance credits have been correctly calculated for any mergers or "de facto mergers."

Customers

Banks struggling to attract new customers should note that a new study found some of the primary reasons were due to too many financial options (36%), low awareness of entities existence (28%) and telling a weak story of value added proposition (21%).

Inuit

The popular software company announced it will acquire Electronic Clearing Housing for \$142mm. After picking up Digital Insight, this puts the Company squarely in electronic banking commerce.

Holiday Gifts

A new survey by CareerBuilder.com finds 56% of bosses and 29% of workers plan to give gifts to their fellow workers. In the boss group, 52% plan to give employees cash, 10% will spend more than \$50 per employee and a cheap 33% will spend \$10 or less.

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