SPRINGING BANK PROFITS

by Steve Brown

Asset liability management (ALM) usually isn't a topic that springs to mind when community bankers are dreaming of fun and exciting things to do. In fact, despite being woven into the very fabric of the banking industry, most executives we know would rather watch paint dry than sit through most of their ALM meetings. In an attempt to help community bankers find excitement in the ALM process, we will explore the concept this morning with a jaded eye toward leveraging the process to make more money for the bank. After all, we haven't met a banker yet that doesn't like the smell, color, taste and texture of money. Here are some tips: Tip #1 Â– Be sure to include growth in the modeling process. We have been to many banks on consulting engagements where they are modeling an unchanged balance sheet. For a bank growing at a 20% annual clip, significant changes are occurring each and every day. The entire risk structure is shifting, yet the corresponding modeling process and board reporting remain the same. How can a banker be expected to leverage up capital efficiently if growth is ignored? For many banks, this occurs because budgeting is usually handled in another system entirely. For the industry in general, there are good ALM systems and good budgeting systems, but the combination of the two is extremely rare. Model growth and product mix shifts to understand the risk, then allocate resources and leverage up to maximize return within policy and risk limits. Tip #2 Â– Fix prepayment projections. Many community bankers believe they are capturing loan prepayments in their modeling process. Yet, we see countless instances where most either do not model prepayments at all, or fail to change them as interest rates move around. Let's face it, if interest rates drop 300 basis points, loan refinancing is going to spike and fixed rate demand is likely to increase sharply. We often see no usage of bank history or single family residential loan prepayment rates being applied to commercial real estate Â– this is a complete disassociation from what the modeling process should capture. Prepayments on loans are extremely important and drive much of the profitability profile. A report with some nice graphs may be entirely inaccurate. Understanding and testing prepayment assumptions can give banks a better handle and help identify the customers most likely to refinance. Armed with that data, community banks can shift resources as rates shift to ensure top clients are actively retained. This in turn puts money in the bank. Tip #3 Â– Get a better handle on loan optionality. Community bankers are usually very good at inserting floors into loans, but most NII-based risk analysis and reporting only capture a 2Y period. Given the flat yield curve as of late, we know scores of banks that have put loans with reset dates of 3Ys and 5Ys on their books. Understand that the monthly NII analysis and risk reports probably do not capture these loans, which is why regulators want bankers to also focus on EV (which goes out to the maturity of each loan). On the floor front, calculate and track how well these are enforced when customers complain and how far the floor may be from becoming engaged. A loan with a 3% floor that has 5 more years to run is a great candidate to be called on by a loan officer. Call the client and offer to remove the floor in their current loan if they transfer an account to your bank or refer another small business that subsequently opens an account. The value of the floor is low anyway, so the bank isn't giving up much for the possibility of increased funding. These are but a few ways the ALM process can be made more exciting. While it will probably never compete with the excitement of funding a new loan, leveraging and refining the ALM process can boost profitability and reduce risk. Keep focused on generating profit and wonderful things will spring to mind.

BANK NEWS

M&A

Banner Bank ($4.2B, WA) will acquire NCW Community ($90mm, WA) for $18.5mm, or about 2.1x book.

M&A

BB&T Insurance Services, a wholly owned subsidiary of Branch Banking & Trust Co. ($118B, NC) will acquire regional commercial and P&& C insurance company, Carswell Insurance Services for an undisclosed amount.

Regulatory Action

New Jersey's biggest bank, Commerce Bancorp, has been hit with a C&D, removed its CEO and agreed to eliminate transactions between directors and vendors. The bank reportedly leased land and space from partnerships run by members of the CEOs family.

Exemption

The Fed finalized a rule to exclude consumer electronic transactions of $15 or less from Regulation E that would require a receipt. The rule, which takes effect next month, is intended to make debit-card use more efficient.

Fed Cuts Check Sites

The FRB will cut the number of full service check-processing sites from 45 to 4 by mid-2011, according to a new plan. The change underscores the importance of check imaging and is another step towards the central bank's strategy of electronic clearing.