MANAGING RISK

by Steve Brown

These days, you can't turn on a television, listen to the radio, or talk to anyone with a financial background; without hearing something about the credit crisis. During the drive into the office this morning, pundits were on the radio saying the FRB would have to cut rates 50bp at the December 11th meeting in order to fix the credit crisis. Anything short of that these experts felt would lead to a protracted problem that would grow with time.

Community banks are not immune to the problem brought about by weak lending and risk management practices. While community banks are not historically large single family residential lenders when compared to the largest institutions (banks under $1B hold only 12% of total SFR loan exposure for the industry), they do represent about 25% of the overall construction and development exposure in the industry (much of which is tied to single family residential). The question at this point is how much the abrupt slowdown will spill over into the general banking system.

The regulatory response can be easily predicted and community bankers should expect examinations to be focused on credit risk and risk management processes overall. Bankers can get ahead of the curve by focusing efforts on enhancing asset monitoring, stress testing and contingency planning. To help, we outline specific steps community banks may want to consider.

To reach the pinnacle of risk management success, community banks can begin by deploying a formal risk management policy, assessment process, monitoring and reporting structure throughout the organization. Understanding where risks are coming from, monitoring changes in them and reporting the information to management and the board allows the bank to take more proactive and preventative steps.

Next, banks should formally integrate risk assessment into the strategic planning process. Understanding the impact on risk related to growing loans 20%, opening 5 branches, changing the loan portfolio mix from construction to C&I and other shifts can have a significant impact on risk. Bankers should ensure that the organization has the required risk management skills and capability to support its business strategies. Preparing, testing, evaluating and reporting such proposed changes before they are implemented is the hallmark of a top performing bank.

Banks should also assign a chief risk officer ("CRO") the primary responsibility for ensuring risk management practices are comprehensive and consistent throughout the organization. Coordination, reporting and detailed risk analysis are all required for this person to be effective. They should play a critical role in developing and maintaining the risk framework for the organization, while ensuring controls are in place. In general, a primary role of the CRO is to help define the bank's risk appetite in terms of loss tolerance, leverage and impact on capital. Establishing an organizational risk structure, defining the roles and responsibilities of risk management, establishing assessment and audit processes and benchmarking to industry best practices are all suggestions that will enhance performance.

In closing, we strongly believe banks should review their current risk management practices to determine appropriateness in the current environment. It is anyone's guess what the FRB will do on the 11th, but community bankers that prepare themselves for ongoing volatility and a more dangerous environment in the upcoming year by embracing risk management, are positioned well ahead of many peers.

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BANK NEWS

Perspective

Citigroup lost more money this year in subprime mortgages than it made in the prior 4Ys.

BB&T

Rolled out its mobile banking platform that includes 2-way messaging for customer service, mobile web access and mobile banking applications.

National Bank Fees

The OCC will raise the 2008 Federal assessment 2.7% for community banks to reflect inflation.

Branches

Choice Bank ($224mm, AZ) announced it has opened a new branch in Chandler, a Phoenix suburb. Additionally, Evergreen Bank ($408mm, WA) said it will open a new branch in Kent, WA. Finally, Eastern Virginia Bancshares ($902mm, VA) will purchase 2 branches (in Henrico & Colonial Heights, VA) from Millennium Bankshares ($554mm, VA) for an undisclosed sum.

Kid Branch

North Fork Bank (now owned by Capital One) will open a branch staffed with high school seniors in the NY area. The branch will be operated as part of an educational and leadership project in conjunction with the local community.