

CHANNELING DICK VITALE IN BANKING

by [Steve Brown](#)

While running an office pool will give you more power than a CEO, it is worth noting that (aside from being a felony offense) this year's NCAA basketball tournament will sap some \$1.5B of productivity from offices across the country. However, entering an office pool can be an instructive exercise in risk management and game theory. Here are our tips that are as applicable to loan pricing and risk management as they are to NCAA pools.

First, it is not about winning, but rather, maximizing your expected outcome. You might win if you pick all the #1 seeds in the Final Four, but so will everybody else and their executive assistant. To avoid ending up splitting the pot 20 ways, it is best to be driven by a return maximization strategy. Loan pricing models operate on the same theory and take into account return, the probability of a loss and the expected amount of such a loss. Whether you are managing loan pricing or NCAA brackets, understanding the probability of winning (or losing) and the expected associated reward should be the decision.

For the NCAA's, pick all #1 and #2 seeds to win their first round. Then start in the center by picking the Final Four and working backwards. These are the highest probability plays and are rarely wrong. If you need help in determining probabilities, use Sagarin Ratings, win/loss records, or our favorite, Vegas odds. Put emotions aside. Getting married to a borrower or a team comes at a price.

Once you have some meat on your brackets, then choose your upsets. This is where you go from winning to return maximization. Every year a #9 seed beats a number #8 seed and makes a name for themselves. In fact, there is a 40% probability that this will occur. Pick the #2 or #3 teams and hope for an upset. Pick teams that are on a recent roll, teams that play near their home for an added advantage, or teams with strong guard play (we like Western Kentucky and West Virginia this year).

Like in banking, winners over the short-run (like a single game) are usually those that play the best offense. However, in a tournament, like over a 10Y period of time, organizations that rise to the top always are able to play aggressive defense. In the long-run, it's executing the banking basics, solid risk management and diversification rules. The same is true in college basketball. Teams that do better over several games are usually the ones that have better defenses. Given the choice, statistics support the picking of defensive over offensive teams.

While we are talking statistics, all else being equal (and similar to banking), pick the team with the most Tournament experience. Experience does count (although only slightly) and teams with veteran coaching staffs or players tend to outperform.

Another tip is to wait until the last minute to submit your entry. Information is power and picking up last minute tidbits from other office mates or ESPN can always help. As with NCAA pools, unless there is an advantage to be gained in acting first, submitting loan term sheets quickly deprives you of an option and allows the term sheet to be shopped to competitors.

Finally, don't pick by committee. Sports Illustrated used to do that and had to abandon it several years ago when it became the laughing stock of the sports world. Not to draw any parallels to loan committees, but individuals in groups end up promoting their own agenda and no one takes ultimate

responsibility. Choosing by committee usually gets you either an ultra-conservative solution that fails (because you get no further than the crowd) or a solution with too much risk and not enough return.

While there are over 9.2 quintillion (yes, 18 zeros) outcomes in the NCAA Tournament, like banking, taking a methodical and risk-based approach should help drive bottom line earnings.

BANK NEWS

Bernanke

FOMC Chair Bernanke broke the traditional "period of silence" before an FOMC meeting and said on 60 Minutes that he expected the recession to last most of this year with a recovery in 2010.

Small Biz Lending

Look for more info out today by the Obama administration on raising the SBA guarantee to up to 90% of the loan for what was formally the 7(a) program. In addition, look for fees to be reduced.

Wells Fargo

Chairman Kovacevich took the Treasury to task for applying retroactive conditions to TARP capital. The money quote - "We do stress testing all the time. We share those stress tests with our regulators, but it is asinine that somebody would announce we're going to do stress tests and give you an answer in 12 weeks."

D&O Insurance

Insurance premiums are expected to increase 15% to 40% over 2008.

Biz Customer

Banks seeking to help their clients capture more business may be interested to know that 40% of small businesses plan to add a section for customer reviews onto their websites in 2009.

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