STRATEGIC OPPORTUNITY PLANNING

by Steve Brown

One of our favorite parts of banking conventions are those roundtable sessions where you sit around and hear what others are doing. These are excellent ways to gather information on important and current topics. The last session we attended was on "Opportunity in Transition" and was typical of what high-powered professionals do when they get together to discuss a troubled industry. Specifically, we compared cell phones. This was worth the price of the conference alone, as some of us found out that we had Bluetooth capability without knowing it.

After debating whether it was better to e-mail or text, we moved on to where everyone was going to dinner and then spent the last 15min talking about the issue of who was taking advantage of what opportunity. As we went around, 8 of 10 bankers wanted to take advantage of opportunity, but they didn't want to take the chance of extending themselves in a still deteriorating economy. At the end of the hour, we learned very little about setting strategy, but had dinner nailed down.

This was unfortunate, as opportunities abound. Whether purchasing troubled banks, buying cheap assets or making inroads against competitors, options are everywhere. At the roundtable, we realized that bankers often treat opportunity as a digital outcome - either you take advantage of it, or you don't. The reality is that there are all sorts of ways to capitalize on the current market.

However, before you go after strategic opportunity, a couple of questions should be answered. The first question to ask is - What you would like to do in order to better accomplish your already stated goals? If your main goal is to increase 2010 earnings, then maybe purchasing a troubled institution doesn't work. The first warning sign is banks that want to jump on opportunities just for opportunity's sake. There are lots of places to purchase subprime mortgage loans for cents on the dollar, but does that accomplish your goal of building a powerful banking franchise? This question is designed to weed out any opportunities that are not conducive to long-term objectives.

The next question to focus on is - what capacity does your bank have to take advantage of opportunities? There is little point in expending resources reviewing opportunities that the bank is not in a position to take advantage of. Capital, people, risk appetite, financial performance, ability to manage change are all items that must be honestly assessed. The more stable a bank's position and outlook, the more a bank is likely to be in a position to dramatically increase risk.

Finally, it is time to put the two questions together and ask - What is the resource gap between what you might like to do and what you have the capacity to do? Many banks would love to pick up a failing institution for a fraction of book value but some are not capitalized enough to do so. The question here is - Can you acquire the capital, talent or approval from your board to carry out potential opportunities? If the answer is "yes" and the sacrifice of acquiring those resources is worth it, then the bank may be in a strong position to capitalize on market dislocations.

The time and place to ask these questions is at your next strategic management meeting, before the upcoming board retreat. The trick is to formulate a strategy and not to spend endless hours of the board's time framing a debate. If management decides to move forward on an opportunity, the above questions should be asked of the board and then the premise should be supported by a base, best expected case and worst expected case budget and risk analysis. Once compiled, a board can then review the findings and offer direction.

By utilizing this structure, hopefully your next discussion will be more efficient than our recent roundtable experience. Putting the process in place to take advantage of market change is a best practice attribute of top performing banks and one worth keeping in mind to ensure the bank remains on course.

BANK NEWS

FDIC Classification

The FDIC has revised their "Problem Banks" to now include 305 institutions (up from 252), the highest level in 15Ys. These banks total $202B in assets, up 45% from 4Q.

Longer

A senior Fed economist is now projecting that the Federal Funds rate will probably remain near zero "not just for the next six or nine months, but for several years." He also indicated that the Fed's balance sheet (now $2T) will "only slowly return to its pre-crisis level" once economic stability begins to stabilize again (so a sharp rise in Fed Funds/Prime rate may occur over a protracted period as well).

Clarification

This clarifies a story that was published recently regarding FHLB, Seattle. Regulations subject FHLB banks to 3 capital requirements: risk-based, capital-to-assets and leverage. While we reported on FHLB, Seattle's $467mm risk-based capital deficiency, we should have noted that the bank met its requirements in the other 2 categories. The noted capital deficiency was largely a result of fair value accounting associated with private-label MBS.