ENERGETIC IRR ACTIVITIES

by Steve Brown

Studies show it isn't what you say in business, but how you say it that matters the most. Your tone of voice, how close you are to someone else in proximity, how much you gesture and other factors send social signals that people either like or don't like. Those opinions, in turn, form the basis for whether or not you will get the business. To tilt the scales of potential success to your side of the ledger, studies show the best characteristics to adopt are being energetic, talking about 40% of the time and listening 60%; spending more face-to-face time with customers, drawing people out and being positive in your demeanor. Doing these things increases the chance of success by 250%. In the simplest of terms, people are social animals and face time (plus other factors) matters.

A few weeks ago we energetically delved into the just-released FFIEC Advisory on Interest Rate Risk Management. We covered corporate governance; policies; procedures; models; measurements; stress testing and assumptions. Today we focus on risk mitigation.

When it comes to risk mitigation, regulatory agencies in the advisory remind bankers that when risk exposures approach or exceed limits set by the board that prompt attention and action is need to correct the problem. It is not enough to simply report month after month that risks are out of compliance.

One way regulators indicate banks can mitigate their risk in the balance sheet is through hedging or by altering the balance sheet mix of assets or liabilities. While both are effective and each one may need to be used given specific circumstances, achieving an appropriate distribution of asset maturities or repricing structures is an ongoing process. It isn't that easy to change the maturity or repricing mix of liabilities or assets when customer demand requires certain products and services that inherently carry with them repricing or maturity mismatches when absorbed into the fabric of the balance sheet. Nonetheless, it is important for bankers to be aware of the potential for severe maturity or duration mismatches between assets and liabilities and take appropriate action as may be necessary to correct them.

Another way to address mismatches and interest rate risk is through hedging instruments. As of the 3Q, in fact, the FDIC reported that some 1,066 banks across the country had about $171T in interest rate hedges outstanding. These tools have become more commonplace as banks seek to control risk. Of note, regulators also indicate in the advisory that these tools are appropriate for banks looking to mitigate such exposures, but they also reiterate that bankers should have the knowledge and expertise to be sure these instruments are handled properly. Making sure the board and senior management understand the bank's hedging strategy, including the potential risks and benefits of the strategy, are important to a well developed approach. Banks utilizing hedging instruments should also be sure strategies are designed to limit downside earnings exposure, manage income or protect the economic value of equity volatility.

Finally, when it comes to controlling interest rate risk, every bank will need to have an independent review of the logical and conceptual soundness of the model being used. That makes sense, when you consider that the board and management are relying on the model's output to set strategy and take specific action. For validation, banks will need to be sure assumptions are reviewed for reasonableness, the process to determine assumptions is reviewed and both assumptions/results are back-tested to highlight potential issues.

There are many issues to consider when it comes to measuring, monitoring, managing and controlling interest rate risk. Our advice is to keep your wits about you, stay energetic and socialize with other bankers to see what they might be doing on this front to make sure a good approach is followed.

BANK NEWS

5 Banks Closed (9 YTD)

On Friday, the FDIC shuttered: [1] Premier American Bank ($351mm, FL) with Premier American Bank NA (a newly chartered firm and subsidiary of Bond Street Holdings, LLC) assuming all deposits (for no premium) and acquiring essentially all assets (with 92% under a loss-share agreement). It should be noted that this is the first time a "shelf" charter has been successfully used by private equity. [2] Bank of Leeton ($20mm, MI) and sold to Sunflower Bank NA ($1.73B, KS). Sunflower will purchase all deposits for a .59% premium. The FDIC will hold most of Leeton's assets. [3] Charter Bank ($1.2B, NM) with deposits and assets (no premium) under loss share going into a newly chartered federal savings bank called Charter Bank, Albuquerque, New Mexico, which is a subsidiary of Beal Financial Corporation ($10B, TX). [4] Evergreen Bank ($489mm, WA) with a portion of the assets and all deposits under loss share going to Umpqua Bank ($9.2B, OR). While no premium was paid Umpqua entered into a cash participation agreement with the FDIC. [5] Columbia River Bank ($1.2B, OR) with all deposits and approx. half of the assets assumed by Columbia State Bank ($3.2, WA), for a 1% premium. The 5 banks closed are expected to cost the DIF $532mm.