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## MANAGING RISK - A PRACTICAL APPROACH

by [Steve Brown](#)

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Some people really like to take risk, while others try to avoid it. If you have ever read literature about risk management, it also becomes readily apparent that such information has been designed to work quite effectively as a sleep aid. We wanted to turn that idea on its head, so we focus today on how to use risk management more practically in a community bank.

Whatever you currently know about risk management, consider that a new survey finds 62% of people say poor or lax risk management at financial institutions was the single largest cause of the current financial crisis. Other reasons cited included complexity of financial instruments (59%), market speculation (57%), predatory lending (50%) and misaligned incentive compensation practices (44%). One could argue all of these other factors are also risk management related in one way or another, so it is good to have this discussion to get a better handle on things.

It is important to realize early on that risk management concepts, measurement tools, models and other components are still in their infancy. That is good, because no one can really rebut what you are saying when you are caught spouting risk management concepts in the lunch room. Since few will be able to challenge your thesis, have at it as you enjoy the camaraderie over a tuna sandwich.

As we have all learned from the credit crisis, some key concepts have surfaced that bear consideration when it comes to risk management, however. The first of these, from a practical standpoint, is to set a process whereby management team members periodically conduct an analysis defending the business model and strategy. It is up to the entire team to press buttons, consider weaknesses and review strategy to make sure you are setting the bank up for as much success as you can. Things change as we have all seen and some change quite rapidly, so bankers have to test, challenge and probe each and every facet of the bank to make sure it still holds up given the changed environment.

Next, bankers should take a close look at strategy through the lens of volatility of earnings. The key is to balance risk and reward, but the way each bank does that can vary widely. Consider whether your bank is best positioned to focus on specializing, diversifying (by region, business line, etc.) or otherwise. Think about the business model, figure out how you will track and monitor volatility of earnings and develop a plan that works in multiple scenarios to ensure you are prepared.

The third area to consider relates to disruption. This can be business disruption due to regulation, economic conditions, credit quality, competitors, or other factors. Stress testing various areas of the bank to understand what events cause strain on capital so you can prepare for such events in advance is critical to ensuring long-term viability in any situation. Remain flexible, know what steps you will take before the storm clouds show up on the horizon and continually test and retest and you are well on your way.

### BANK NEWS

#### **Closed (64 YTD):**

The FDIC closed: 1) Eurobank (\$2.6B, PR) was sold to Oriental Bank and Trust (\$1.2B, PR). Oriental will obtain all deposits for a 1.25% premium and virtually all assets with \$1.6B under a loss share. 2) R-G

Premier Bank of Puerto Rico (\$5.9B, PR). Scotiabank de Puerto Rico is (\$1.8B, PR) purchasing all deposits for a 1.35% premium and basically all assets with \$5.4B under a loss share. 3) Westernbank Puerto Rico (\$11.9B, PR). Banco Popular de Puerto Rico (\$23.3B, PR) will assume all assets for no premium and \$9.4B in assets with \$8.77 under a loss share. 4) CF Bancorp (\$1.7B, MI) was sold to First Michigan Bank (\$91mm, MI). First Michigan will buy all deposits for a 0.75% premium and \$870mm in assets with \$808mm under a loss share. The FDIC will hold the remaining assets. 5) Champion Bank (\$187mm, MO) with Bankliberty (\$406mm, MO) acquiring all deposits for no premium and \$153mm in assets with \$114mm under a loss share. The FDIC will hold the remaining assets. 6) BC National Banks (\$67mm, MO) was sold to Community First Bank (\$123mm, MO). Community First will receive all deposits for no premium and essentially all assets with \$38mm under a loss share. 7) Frontier Bank (\$3.6B, WA) was shuttered with Union Bank of CA acquiring most assets under a loss share and deposits for no premium. For more details on the failed banks go to the bottom right of: <https://biganalytics.bancinvestment.com/>

### **Unemployment Improves**

The latest report from the Labor Department finds unemployment rates fell or remained the same in 75% of the 372 largest metropolitan areas measured in Mar, an improvement from Feb. The data shows economic recovery may be starting to take hold, albeit in a nascent stage.

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