TEAM EFFECTIVENESS AND REGULATORY FOCUS

by Steve Brown

Research by Harvard finds the effectiveness of teams working together reaches its maximum performance level when about 65% of the team is made up of "stars." At higher levels the research found effectiveness falls, as people begin to jockey around and boost their own status. That, in turn, disrupts information sharing and other vital processes. This might be something to think about when you are trying to improve the bank and setting up teams to attack problems, help set strategic direction or solve other sticky issues.

Yesterday we highlighted some areas of regulatory focus identified by the Deputy Director for Credit and Market Risk at the OCC. We also pointed out that while this was the OCC, other banking agencies were closely aligned and we have also seen and heard directly very similar feedback from all, so the information that follows should be applicable in large part to all community banks regardless of your primary regulator.

When it comes to funding, regulatory focus has increased on banks that rely too much on short term or volatile funding sources to fund asset growth. This spills into over use of wholesale funding sources such as brokered CDs and FHLB Advances, as well as holding securities that are less liquid. The lesson learned from the crisis is that when markets and banks deteriorate, they lose access to wholesale funding and less liquid securities are more difficult to sell or borrow against. This can lead to added liquidity pressure, so banks that choose to run outside of the norm in this area can expect additional scrutiny and should have robust contingency plans that have been thoroughly tested. In addition, all banks should have enough short term liquidity to offset outflows even under acute short term stress environments.

Another area regulatory agencies have sharpened their focus is on loan loss reserves. This was in part driven by the accounting rules that did not allow banks to save for a rainy day and the resulting negative impact to capital that resulting charge offs created when they occurred (increased the spiral into insolvency for many institutions). All of these factors have led regulators to push for a revised accounting model for reserves that would supplement capital cushions and be more forward looking. We have heard many issues from many community banks around the shifting nature of reserve adequacy and this is one area that will likely remain in flux as using forward projections is an inherently difficult problem to solve when loans come in so many flavors and structures. Bankers have indicated that even when they receive new appraisals where the ink is still wet, they have been required in some cases to set aside additional reserves (due to downward trends or projected future weakness in the credit). Our advice is to focus more efforts on the underlying (and global) cashflows of your problem (and all) loans than the value of the collateral, when preparing for your next exam.

The good news is that the regulatory agencies are acutely aware that community bankers in particular react strongly to regulatory criticism and change their behaviors quickly. They also know that actions on both the policy side and on-site examinations strongly influence bank behavior and appetite for taking risk, which can lead to the proverbial brakes getting slammed on lending. That awareness is leading to changes that include more transparency; extending timelines to correct issues; more frequent communication with banks; increased efforts to enhance risk management processes in the industry; a desire to improve consistency and continuity in supervision; and a shift to evaluate bank risk profiles using more forward looking analysis to uncover developing migration trends that can be more quickly addressed with a targeted exam (and a specific area of focus).

Regardless of the number of stars, bank management teams and regulators have a symbiotic relationship that is built into the fabric of the industry. Learning how to work together better and communicating more effectively in times of crisis is a good idea.

BANK NEWS

M&A

United Federal Credit Union ($1.4B, MI) agreed to buy Griffith Savings Bank ($86mm, ID) for an undisclosed sum. While credit unions have purchased banks before, this is the first time we have seen a Federal credit union purchase a state chartered bank.

Beige Book

This compilation of regional data used by the Fed to help set policy showed that the economy expanded only slightly for the month of June. Of particular note - marked slowdowns in the Mid-Atlantic, Minneapolis and Dallas regions (most other areas were either just slightly up or flat). The Fed noted that in several areas competition was intense for quality borrowers, which served to reduce bank margins.

Debt Ceiling

Many bankers have said the Fed and the Treasury have not been instructive in discussing contingency plans for a potential US default or downgrade. It is now less than a week before a potential debt restriction and very little insight is available as to the priority of payments, structure to handle missed payments, or what planning banks should be doing to address a downgrade. Customers are also turning to banks for answers and there is little to say to help calm fears.