

A BROUHAHA AROUND RISK, DISCLOSURES & CARE

by [Steve Brown](#)

Harvard University researchers have found that people who took a 10 minute break to surf the internet after doing a tedious task were 16% more productive than those who rested by talking on the phone or texting. No one is too sure why this is the case, but it is nice to know you can wind down more effectively by surfing the internet after finishing projects. This is good news because after writing this article this morning, we will certainly be taking a break to check out the internet and now it is legit! This morning we take a close look at the brouhaha surrounding FNMA and FHLMC, the large mortgage and Wall Street players and the Federal Housing Agency (FHA). The FHA regulates FNMA, FHLMC and the 12 FHLBs. In case you missed it, the FHA and The Federal Housing Finance Agency on Friday filed lawsuits against 17 financial institutions (noticeably absent were Suntrust and Wells Fargo) for losses FNMA and FHLMC incurred on about \$200B in mortgage securities packaged and sold by the institutions. We took a quick look at the suit and some interesting warnings surface for community banks, their executives and directors. The FHA accuses this group of large financial institutions among other things of failing to conduct proper due diligence; systematically ignoring their own underwriting guidelines; making false and materially misleading statements; omitting facts and generally passing risk to others without using "reasonable care." This final piece is important because in law, the standard of care refers to the degree of attentiveness, caution and prudence that a reasonable person in the circumstances would exercise (failure to meet the standard is negligence). In business, the duty of care also addresses the "attentiveness and prudence of managers in performing their decision-making and supervisory functions." That means people doing business presume directors and officers are carrying out their functions in good faith, after sufficient investigation and for acceptable reasons. As a result of this legal wrangling, we suggest now might be a good time for your bank to review all marketing and sales materials to be sure you are comfortable that a reasonable person can follow them and proper disclosures have been included. In addition, the FHA accuses the former CEO of FHLMC of establishing and maintaining an unsafe and unsound "tone at the top" that fostered a corporate culture of intense and improper efforts to manage earnings. This failed strategy focused on maintaining steady earnings growth, while neglecting key elements of enterprise risk and internal controls needed to support such growth. As such, the strategy was unsustainable and FHLMC was eventually placed into receivership. He reportedly even had his financial team devise transactions to move income forward to support current earnings while cutting administrative expenses to the unit that was responsible for internal controls. This resulted in too few qualified personnel; resource shortages; fragile accounting controls and over-reliance on manual systems. Here, our best advice is to review your support personnel to be sure they are up to the task and add resources where necessary. Setting the right tone from the top, supporting risk management, ensuring enough accounting staff and having strong internal controls are all important factors to review now and again for sure. Perhaps now more than ever, it is important to understand that because taking and managing risks are fundamental to the business of banking; it is critical to have strong risk management processes and internal controls to avoid missteps. As the legal issues outlined this morning show, the industry remains under pressure and even the very materials you hand out to customers can get you into trouble down the road. Even if you don't want to hear it and

no matter how you relax afterwards - perhaps it is time to take another look at your marketing materials given this.

BANK NEWS

Closed (70)

Patriot Bank (\$151mm, GA) and CreekSide Bank (\$102mm, GA) were closed with operations assumed by Georgia Commerce Bank (\$419mm, GA); for no deposit premium and a loss share totaling 90% of Patriot's assets and 68% of CreekSide's assets.

BofA Correspondent Rumors

Rumors are making the rounds that Bank of America will sell its mortgage warehouse business along with its correspondent mortgage business.

Basel

Rumors are active that the Basel committee is considering softening the liquidity coverage ratio in order blunt a possible contraction of corporate (100% weighted) lending that it might cause.

Muni Risk

A new Moody's report on municipal rating revisions during the Great Recession notes that municipal credit risk has not succumbed to the doomsday forecasts that many predicted. While downgrades are exceeding upgrades, since Jan. 2010, only 6% of the 18k muni ratings have been revised down and most of those have been limited to one notch.

Competition

US Bank has expanded its mobile alerts from credit card holders to customers with ATM and debit cards as well. The alerts notify customers of potential fraudulent activity, as well as ATM withdrawals, debit and check transactions.

Free Checking

At the end of Aug, only 36% of the top 50 banks offer a completely free checking option. This is down from 64% last year.

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