REGULATORY EXPECTATIONS AROUND NEW PRODUCTS

by Steve Brown

We hear from banks all the time that in order to reduce concentrations, they are thinking of or are already beginning to dabble in C&I and other types of lending. To avoid regulatory trouble down the road, we offer up some tips bankers should consider in this regard.

To be sure, community bankers all over the country are feeling the pinch of new regulations and a weak economy, so it is only natural that they would begin to explore new income producing opportunities. Many community banks are already underway working to rebuild earnings, but many also worry that shifting to another sector or exploring new products could get them into trouble with regulators, so most are treading carefully. As you continue to work on loan quality, loan growth, controlling risk and move forward the strategic planning process, it is important to gain differing perspectives.

First, understand that regulators (and directors for that matter) view expansion of existing business lines and adding new products (or entering into new markets) mostly through the prism of risk management. Regulators want to be sure the bank has experienced and qualified people in place to manage new products or business lines and that also understand the risks. Specifically, regulators will be looking closely at how well banks handle up-front due diligence, control risk and how products or services perform compared to original expectations. In short, regulators will look closely at the risks of new and revised products or services, as they evaluate compliance, legal, credit and reputation risks, for example, so bankers should be prepared in advance and thoroughly document processes along the way.

Next, before jumping into a new product, or modifying an existing one, make sure you have thoroughly explored the risks and rationale. Take steps to assess how the risks associated with the product or service fits with the bank's business strategy and risk profile; consult with functional areas (such as credit, compliance, finance, IT, legal, etc.) to determine risks and ensure controls are in place and determine requirements needed to make sure the bank complies with all laws and regulations. Then, be sure the bank has the expertise needed to effectively manage the product or service and develop a business plan. That plan should establish objectives and strategies for how the product or service will be brought to market, along with measureable financial hurdles.

Further, understand that policies and procedures are the backbone of banking and critical in this process. Banks should expand or amend policies and procedures if needed to ensure they adequately address the new/modified product or service. These should not only establish accountability, but also provide for exception monitoring, reporting and be supported by systems that allow the bank to properly supervise the product or service. The key here in regulatory parlance is to make sure the board and management can effectively identify, measure, monitor and control risk around these new endeavors. Finally, be sure to incorporate the product or service into the audit process.

Finally, it is important to measure performance of any new product or service from multiple angles. Here, banks should have a way to assess whether the product or service is meeting both operational and strategic expectations. To do that, make sure you have included limits on the size of acceptable risk exposures the bank is willing to assume; identify specific objectives and performance criteria to evaluate success (including quantitative and quantitative benchmarks); have a process in place to periodically compare actual results to projections and benchmarks in order to detect and address adverse trends or concerns and don't get emotionally attached to anything. Products or services that don't meet expectations should be readily exited to make room for new ones and free up valuable management time.

It is always fun to open something new that is nicely wrapped, so having a foundation to do so, as we have outlined here, makes certain it remains a gift that keeps on giving and not a gag gift that causes problems when the regulators arrive.

BANK NEWS

Earnings

Suntrust reported earnings came in higher than expected at $2.19B, or 2.6x more than last year. While revenue was flat, improved credit quality and moderate loan growth in both consumer and commercial loans helped. Margins remain steady at 3.49%. Capital One beat estimates and produced $813mm in earnings, up 1.3%. Earnings were driven by lower provisions, falling delinquencies and about 1% credit card loan growth.

Oops

Wells Fargo mixed up thousands of consumer bank statements in FL and SC. Blaming the mix up on a faulty printer, the Bank said there is no significant security risk. That said, Wells offered 1Ys worth of ID protection to those affected.

Mortgage Purchases

In a move that is making bank investors nervous, Fed Governor Tarullo (voting) was on the tape saying the Fed should consider the large scale purchasing of MBS in order to drop mortgage rates further.

Small Biz Satisfaction

A recent JD Power survey found small business owners are happier with their banks than they were in 2010, as satisfaction rose in every category except fees. M&I, BB&T, and M&T all ranked high in various categories of major banks. BofA and Wells, ranked last and 2nd to last, respectively, overall. The small-business banking satisfaction study was based on nearly 7k responses from financial decision-makers at small businesses with sales of $100k to $10mm and ranked satisfaction in product offerings, fees, facilities and account management. More details can be found here in case you are interested in using the info for social media or other marketing: http://tiny.cc/PCBBJDPowerBiz

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