HAPPY OR STRESSED WHEN MANAGING CREDIT RISK

by Steve Brown

New research by the American Psychological Association finds the three things that deliver significant stress in people's lives are money (76%), relationships (55%) and job stability (49%). Is it any wonder, psychologically-speaking at least, that everyone is so stressed given the economic backdrop? To change the tone, we focus on another study conducted by psychologists on happiness. It found that people are their happiest when they are optimistic, appreciate what they have, practice acts of kindness, have a good family life, have strong relationships, are focused, take time to enjoy the small moments, take care of themselves and commit to doing whatever it takes to accomplish a goal. We prefer to be positive, so we are going to savor finishing this introduction portion of the publication before we move on to the rest of it. Ahh....we feel better already. Now that we have a positive frame of mind, we focus our energies on better managing credit risk in the loan portfolio and what regulators expect to see when they come in for their next visitation (see, we even picked a happy word here, instead of using 'examination'). To begin, much has been learned and relearned since the Great Recession began and much of that learning centers on the loan portfolio. Credit risk management has risen in importance and become the discipline of managing the entire loan portfolio, not just individual credits. To be truly effective, credit risk management includes focusing on concentrations or groups of loans that can negatively impact performance, even when individual credits within the portfolio are soundly underwritten. The worry is that some concentrations will move together in times of difficulty, causing the scales to tip abruptly to one side, as multiple single loans "clump" together given an economic or financial event. We have learned as an industry that too much of a good thing is simply that, so managing such risks on a portfolio basis is critical to help prevent larger issues from occurring. In practical terms, the first key to getting a handle on this is to figure out which individual transactions may perform similarly or have common sensitivity to an economic or financial event. The goal is to find out how much credit impact the bank might incur, should a given event actually happen. It is much better to do even rudimentary stress testing to take such events out for a test drive to see where difficulties can surface before they happen. Even areas of the portfolio that have not seen any problems as of yet should be tested so they don't become an unexpected problem in the future. In analyzing any potential impact on the bank, it is important to try and capture or think about it in terms of the impact to capital and earnings. For instance, a loss of $1mm under a given scenario might reduce capital ratios by 5bp and take 3 months to earn back. The more you think that could happen, the more you need a plan to prepare, just in case. Having a contingency or action plan related to capital and earnings before such issues arise will not only keep you and the regulators from stressing out, but it will also keep your management team and the board happy because everyone knows what to do. You cannot capture all potential issues that may arise, but understanding where pools of risk are in the loan portfolio and their potential effect on capital, asset quality, earnings and liquidity will help keep you smiling.

BANK NEWS

Closed (3)

After a hiatus, the FDIC closed 3 banks on Friday. Central Florida Bank (9$79mm, FL) was assumed by Center State Bank ($1.9B, FL) under loss share without a premium. The First State Bank ($420mm, GA) was closed with about 78% of the assets assumed by Hamilton State Bank ($921mm, GA) under loss share and a 50bp premium for deposits. American Eagle Savings Bank ($20mm, PA) was closed with the assets and deposits assumed by Capital Bank NA ($325mm, MD) without premium.

FOMC

The Fed set the tone for this week's FOMC meeting, by releasing 2 blank templates of the charts they will use to report projections for the appropriate Fed Funds target rate. One chart will detail the number of participants voting for each rate and the 2nd gives each individual member's rate forecast.

Consolidation

Glacier Bancorp ($7.2B, MT) announced it will consolidate its 11 banks into a single charter in order to reduce expenses. Names of the banks will be retained for branding and as operating divisions.

BofA Mortgage

While rumored for some time, BofA said they will officially end cash-out mortgage refinancing.

Deleveraging

A new survey by CreditKarma.com finds consumers continued to get their house in order in 2011, cutting credit card debt by 11% (the average credit card balance was $6,576, down from $7,404 in 2010), following a 7% decrease in 2010.

Global Engine Sputters

Bloomberg is reporting that a survey of 26 economists predicts China (the world's 2nd largest economy) grew at the slowest pace in 10 quarters in the 4Q of 2011. While still a decent 8.7% level, the slowdown would be the 4th in a row, adding concern the economic expansion worldwide is on tenuous footing.

Hotel Sector

Atlas Hospitality Group reports that foreclosures on CA hotels soared 66% in 2011, as lenders foreclosed on 230 hotels. The good news is that Atlas expects foreclosures will fall up to 20% this year, as the economy slowly recovers.

Risky Security

Experian indicates nearly 67% of internet users rely on the same password for at least two websites.