HAPPY AS A LARK WHEN MANAGING LOAN RISK

by Steve Brown

When asked what best predicts financial satisfaction, more people said having an emergency fund, than said paying off a credit card or owning a home, according to a University of Georgia study. That is important when you consider many people ignore the advice to have an emergency fund of 3 to 6 months. Studies find, in fact, that 43% of households have less than $1,000 in liquid savings and 28% live paycheck to paycheck without any savings at all. Saving can be difficult for many, so be sure to remind customers you have goal- oriented savings accounts for them that do that and just about anything else they can think of to garner new customers and keep existing ones happy as larks. Speaking of being happy as a lark, yesterday we touched on the risk of concentration in the loan portfolio and how it can impact community banks. We received some emails back on the subject (thanks) from bankers seeking further clarification on some items, so we endeavor to do that today, as we conclude our discussion on this important subject. When talking about commercial real estate (CRE) exposures, there are many ways to view concentration risk. Here, bankers can view the sector as an industry and segment it by source of repayment, for example, or using other methods such as by property type, geography, risk rating, debt service coverage, fixed or floating, or tenant concentrations. These can all provide different insight into portfolio risks that may not be obvious, but can provide valuable and actionable information to help protect the bank in the event of unexpected stresses. One way to get started is to use such metrics as those just outlined to begin breaking the loan portfolio into groups or pools that can then be further analyzed. Once you have done that, think about how each one might behave for a given set of circumstances. You might be surprised to find out that some of the smallest pools you have can create the biggest unintended consequences simply because of their inherent volatility or sensitivity to certain events. Just knowing this is quite helpful when you set strategic direction, manage capital or monitor liquidity when conditions shift around. Concentrations with single property types, borrowers or other factors can be unpredictable when stresses occur, leading to a spike in losses. Having a better handle on which pools might cause problems is important when you are trying to manage the overall portfolio risk. Once you have identified these pools, try to "shock" them to see what happens. Do this in specific terms, so you can compare the impact better. Put another way, run a stress scenario on the portfolio and then see how it ripples through each pool in terms of the impact to earnings, loan loss reserves, capital levels, etc. To do this, use historical losses, projections and your own judgment to really test what could happen if a given scenario were to occur. Finally, now that you have the data in hand, consider the impact on the bank for each pool in turn and then in aggregate on basic credit benchmarks. Calculate and work to understand the impact on classified assets, nonaccrual loans, delinquencies, risk grades, probabilities of default and expected/unexpected losses to name a few. One final thing - larks sing a tone that humans find pleasing, so now you know where this phrase originated.

BANK NEWS

Foreclosure Settlement

After protracted negotiations, US State Attorney Generals reached an agreement with Bank of America, JPMorgan Chase, Wells Fargo, Citibank and Ally Financial for payment of $25B to settle allegations of deceptive foreclosure practices and robo-signing for privately held mortgages issued between 2008 and 2011.

BofA

Last week at an employee meeting CEO Moynihan outlined that expense cutting will likely hit $6 to $8B instead of the $5B previously announced. Staff reductions and process improvements in home lending, retail branches, operations and credit cards will bear the brunt of it on top of the cuts in wealth management and trading already announced.

Remittances

The CFPB issued their final rule on fee disclosures for money that fails to arrive on time for remittance transfers. The Dodd-Frank mandated rule goes into effect January of next year and also provides for the user to receive reduced fees or a refund if the transfer is late, as well as forces the bank to investigate the reason for the delay.

Crowdsourced Products

The Commonwealth Bank of Australia is running a social media promotion to solicit ideas for products their customers would like to see. If the idea is used, the submitter will get $10k. Ideas range from a set of "non- automated" bank products targeted at older customers, a new web authentication method, a home mortgage lottery promotion and others.

Home Ownership Training

Research by John Burns Real Estate Consulting projects home ownership levels could drop to levels not seen since the Census began tracking the data in 1963. The company predicts home ownership will continue its decline from the high of 70% hit in 2005 to 62% by 2015. The effect of foreclosures cuts ownership 5.6%; factors such as weak consumer confidence and a weak economy cut it by 3.0% and positive demographic trends only offset it by 0.7%.

Better Loans

Research by the Georgetown Center on Education and the Workforce on college graduates finds that over a lifetime, the earnings of workers who have majored in engineering, computer science or business were as much as 50% higher than the earnings of those who majored in the humanities, arts, education or psychology.