WHAT DID YOU SAY ABOUT CONCENTRATION RISK?

by Steve Brown

Bankers are always trying to fit more hours into the day trying to get more done. Yet, somehow, things occasionally slip through the cracks. To stop that from happening, try tips like: setting a reminder in Outlook (or on your phone); writing the task down on your to-do list; saying "no" every once in awhile instead of "yes;" quickly delegating tasks to someone else, as soon as they hit your desk and finally - staring straight ahead and pretending you cannot hear (the reaction is at least fun to watch). Now that you have more time to get things done, you might have more time to dig into the loan portfolio and evaluate its potential risks. As a community bank, it is difficult to avoid some concentration risks. The area in which most do business is geographically finite and customers are all from the same community. That makes managing concentration risks problematic, but not impossible. To begin managing concentration risk, you might want to consider modifying underwriting standards. This is not to say make them weaker, but rather, take the time to consciously explore which higher quality borrower types you want to have in the book and which group of weaker borrower types you want to reduce. For the lower quality borrowers you want to reduce exposure to, for instance, consider increasing pricing or tightening terms/conditions as quick ways to begin the process. This exercise can be beneficial even if you cannot do all that much about either one, as at a minimum, it will help your team better understand the risks inherent in the existing portfolio as you focus on what tomorrow could bring. Another area to consider when trying toward better managing concentration risk is to focus marketing and sales efforts on generating or otherwise capturing loans that are not likely to perform in the same manner as the existing portfolio. Admittedly, this can be a difficult problem to solve (particularly for a community bank operating in a given geographic area), but that does not mean it should not be an area of focus and effort. Mapping out which loan sectors seem to move in the same direction (albeit not 1 for 1 necessarily) is a good first step. Even if nothing comes of it except conversation, it is a good exercise to periodically discuss the risks in the portfolio as it exists today and areas the management team might see moving the same direction if a given event were to occur. This will put optics on the potential for difficulty before it happens and give your team time to seek out credits that behave differently. A third area that is worthy of consideration is to reduce concentration risk by selling loan participations or conducting whole loan sales. These can reduce risk, but they are difficult because they also serve to remove the customer exposure from the balance sheet (in whole or in part), which can be tricky on the relationship as well. These are very effective tools for community banks, but it is critical to maintain the servicing. That way you can maintain the relationship, even as you reduce concentration risk. Finally, you can just live with the additional concentration risk by maintaining higher levels of capital. Here, you need to run some math to determine the cost of your capital, but then it becomes pretty easy to decide which concentrations you have decided to keep, the risk of doing so and the additional capital you will need to support carrying this additional risk. Regulators do this as well, when they determine a bank is not holding enough loan loss reserves for a given loan or sector of loans, through analysis based on factors such as loss projections and capital levels. Doing so yourself is beneficial as it helps you better understand areas of potential risk. That also frees up more time, allowing you to focus efforts on identifying concentration risks and managing exposures. Reducing concentration risk will protect your bank and enhance opportunities, as you ensure the stability of long-term return.

Related Links:

PCBB 2012 Executive Management Conference

BANK NEWS

Bank Lending

Last week's loan data showed that: 1) C&I loans were down slightly MTD, but should finish up for 1Q. 2) Credit cards volume declined due to cyclicality. 3) Investments (ex unrealized gains/losses) declined despite thrift conversion. 4) SFR mortgages origination increased (due to thrift conversions) and will finish higher for the Qtr. 5) ALLL fell at large banks about 4bp.

Subprime

The FDIC will issue a proposal this week that will redefine the definition of both subprime and leveraged commercial loans for banks. While applicable for banks over $10B, the definition will have an impact industry wide.

Housing

Barron's analyst predict that with improving job data, consumer confidence and low mortgage rates, housing should rebound by spring 2013.

Tech Banking

The head of internet and mobile banking for Citigroup said in a recent interview that Citi sees people using the internet/mobile channel to pay bills primarily, while using the tablet to make some payments, but also read educational content and get more interactive.

Business Checking

As of 3/12, the average number of "free" transactions per cycle for community banks is 195.

Fed Tweet

The Fed initiated their Twitter presence at @federalreserve. However, the Fed did say that they will tweet only after information is posted on their website.

Online Banking Risk

The Financial Services Information Sharing and Analysis Center reports online banking account takeovers are rising at a rate of more than 150% per year.

Credit Cards

The average person has 7.3 credit cards.