HISTORY, EXAMS & CONCENTRATIONS OF CREDIT

by Steve Brown

Way back in the year 1690, the Massachusetts Bay Colony issued the first paper money in the colonies that would later form the United States. A lot happened after that, but by the end of the Civil War in 1865, paper money theft had become so commonplace that between one-third and one-half of all U.S. paper currency in circulation was counterfeit. In 1877, the Department of the Treasury's Bureau of Engraving and Printing began printing all U.S. currency. We give you this historical walk down memory lane because you are a banker and money is in your blood, so you of all people can appreciate it. We have also found it can be nice to recall the history of our currency now and again (this time courtesy of the Federal Reserve historians), as you prepare to get started for the day. Speaking of using history as a guide and getting started on something, banking examinations often are based on historical documents from the bank. This is one reason we were intrigued, when the OCC late last year updated the Comptroller's Handbook on concentrations of credit. Nearly every community bank has some concentration of credit, so an updated document that indicates regulatory expectations in this area is helpful to bank management teams and their boards. To help determine whether your bank is adequately managing credit concentrations, consider some of the areas that will be closely reviewed by exam teams. One such area is a review of work performed by internal and external audit teams and other examiners on related examinations. Here, examiners will take a close look to see how management responded to exam or audit findings and what actions have been taken since. Examiners want to see whether management is responding quickly and has a tracking process in place to ensure all issues are dealt with on a timely basis. A detailed review of documents and discussions with management are usually undertaken to determine this. Another area related to concentrations of credit that will be closely reviewed relates to concentrations themselves and trends in the portfolio. Here, exam teams are looking at growth, delinquency levels, nonperforming loans and losses in the portfolio to see if they got better, worse or remained the same since the last exam or audit cycle. Exam teams want to understand where the bank has been, where it is going and whether that direction is helping or hurting the situation, so trends are important. Understanding this and preparing for the types of questions that are likely to surface will help you get ahead. Next, examiners will be looking at how your bank manages credit concentrations, by thoroughly examining policies and procedures. These are essentially the roadmaps the bank uses detailing how and where it will take risk and how much risk is acceptable. As such, they are nearly always a starting point for exam teams seeking to get a better understanding of where the bank is heading (or at least where it could go) and how it plans to manage risk along the way. In this area, examiners will seek to understand the bank's loan portfolio strategies, risk tolerances, concentrations and limits. Here, exam teams will look for the type of data the bank is capturing on its systems, as well as concentration and exception reports that are passed on to the Board. They will also review what sort of capital planning the bank is performing and whether or not it includes stress testing to better understand the impact of various "what-if" scenarios. Asset classes that have more volatility, mitigation strategies, local market conditions/trends, strategic plans and risk implications are all areas of focus. As you prepare for your next examination, keeping an historical perspective and balancing it with current regulatory expectations and market conditions is a good way to prepare.

Related Links:

PCBB 2012 Executive Management Conference

BANK NEWS

Closed (22)

In the busiest bank closing day of 2012, regulators closed the following 5 banks Ã¢Â€" HarVest Bank of Maryland ($164mm, MD) was closed with assets and deposits assumed by Sonabank ($612mm, VA). Bank of the Eastern Shore ($167mm, MD) was closed and Deposit Insurance National Bank of Eastern Shore was created in its place to house the deposits after no buyers could be found. Plantation Federal Bank ($467mm, SC) was closed with the entity purchased by First Federal Bank (the old First Federal Savings and Loan Association of Charleston) ($3.1B, SC). InterBank FSB ($482mm, MN) was shuttered with both loans and deposits assumed by Great Southern Bank ($3.8B, MO). Palm Desert National Bank ($123mm, CA) was closed with both assets and deposits assumed by Pacific Premier Bank ($957mm, CA).

Branch Closures

First Financial Bancorp ($6.7B, OH) said it will close 10 branches in OH and IN, as it seeks to cut annual overhead by about $2.3mm.

Cancelled

First Banks of Clayton ($6.7B, MO) announced that it stopped its plan to sell its 19 Florida branches to an unnamed bank after a breakdown in negotiations. The terms were for generally a 2.3% premium to be paid.

Delayed

The FHFA postponed their decision on what to do with principal reductions for portfolio-ed Fannie and Freddie distressed mortgages. The decision will now come later in May.

Exam Study

While we question the methodology, the ABA released a 90 bank study that concluded that 73% of the banks believed that exams added value before the crisis, but only 45% of them do after. Further, 34% of banks found the exam counterproductive after the crisis, while only 3% of banks felt that way before the crisis.