EXPANDING & MANAGING RISK POTENTIAL

by Steve Brown

We found it interesting that a new Accenture study showed that 25% of employees worldwide regularly use personal electronic consumer devices and applications for work-related activities. This is despite the potential security risk to the employer. To protect your bank, experts suggest taking such steps as requiring employees to install software that allows the bank to remotely access and wipe devices; limiting the type of accessible information to email and calendars; signing agreements with the employee that cover device inspection upon termination or upon request by the company and not storing company information on the device. We offer this as just a quick tip to keep you moving in this expanding area of employee access and the inherent security risk around it. On another note, speaking of things that could expand and lead to something unexpected, today we focus our efforts on risks bubbling in the commercial real estate sector (CRE). We bring this up because in a speech given yesterday, John Curry, the Comptroller of the Currency, outlined some key issues for community banks that echo previous comments from other regulatory agencies. In his speech, Curry highlighted the fact that national banks and thrifts hold over $700B in CRE loans, or roughly 14% of their aggregate loan portfolios. That sounds fine, but Curry also quickly pointed out that CRE levels are 37% for institutions under its Community Bank Supervision program or about 267% higher. While he indicated that is the nature of community banks in many markets and is not abnormal, he also pointed out that examiners are very focused on how bank management teams are dealing with concentrations and the amount of capital retained as a buffer against losses. Mr. Curry highlighted the fact that concentrations were a key focus for the OCC, because the vast majority of community bank failures over the past 3Ys involved CRE and exposure was the primary reason for failure. In fact, his analysis found that banks above the 100% - 300% threshold levels set in 2006 failed 23% of the time vs. only 0.50% for banks below those levels. The good news is that regulators in general feel community banks are doing a good job managing CRE exposures. The bad news is that the nonperforming rate for CRE was 3.5% for the 1Q of 2012 - about 200% above the prior 10Y average. Beyond the current picture, regulators are also worried about the fact that about 50% of all outstanding CRE loans in the system will have to be rolled over by 2014, many of which were interest only or low amortization structures. Given the softness in the economy, these components have regulators on edge. Areas of particular concern and focus highlighted by Curry include how banks will resolve repayment issues (such as declining net operating income and high loan to value due to lower property valuation); credit concentrations (are they managed and supported appropriately); correlations between concentrated groups of loans (if one area goes bad is it tied to another that also drops); understanding & documenting appraiser competency (certifications, abilities for each assignment); and scenario / stress testing (are they rigorous enough given concentrations, do they consider the effect of multiple variables). A quick perusal of other agency web sites finds most also have common themes and include other areas of focus such as loan loss reserves (should be directionally consistent and any reductions well documented) and property cash flows (have weakened from high vacancies and reduced rents). In short, while positive trends are continuing in CRE, regulators remain worried about the future and as such will be very focused in this area so community banks should remain vigilant. As with the risk of employees bringing in their own technology to the bank, an ounce of prevention is worth a pound of cure.

BANK NEWS

EU

Driven by housing prices that fell by the fastest amount on record and by the fact its banks need another $70B in capital, Moody's slashed ratings of Spain's banks to near-junk.

Unsustainable

American Banker reports reserve releases (the amount by which chargeoffs exceed loss provisions) have accounted for 15% to 30% of quarterly net income since early 2010 (assuming an effective tax rate of 35%).

Foreclosures

RealtyTrac data showed that foreclosure filings rose 9% in May vs. Apr - a rare increase for the past year.

Criminal

The former CEO of Orion Bank (failed, FL) was sentence to 6Ys in prison for lying to regulators in connection with making false real estate loans and then having that money funneled back in to the back as capital. One customer and 2 other executives were also found guilty and jailed.

Student Loans

The CFPB published a notice in the Federal Register and sent a variety of letters to agencies, colleges, lawyers, lenders, etc. for complaint data on private student loans. This is on top of the study that it is about to be completed by the Dept. of Ed where it reviewed some 2k complaints.

Housing

Home prices continue to turn the corner, as the CoreLogic housing index jumped 2.4% in April, following the upwardly revised 1.1% gain in March. This gain was the strongest monthly return since 1976.

Small Biz

A survey by U.S. Bank finds small business owners think the following would be the most beneficial to their companies - lower taxes (20%), less regulation (17%) and dealing with health insurance (15%).