BALANCING RISK AND REWARD

by Steve Brown

We don't know what got into a guy in Vermont, but news reports say a person recently went nuts and drove his tractor over seven police cars. Maybe it was the drought, maybe he thought he was driving a monster truck, maybe he was crazy, or maybe he was just angry about a ticket he received for speeding in his tractor and let the situation get the best of him. We don't know for sure, but we are sure the $250k bill he will reportedly get for his actions won't make his tractor insurance company very happy. Clearly the guy in this story did not balance his risk and reward equation when he decided to do this, while most bankers usually do. That is why we were intrigued by a recent study by Accenture that looked at global risks and what actions bankers may or may not be taking to mitigate them. One area that community bankers can certainly understand that surfaced right away (as part of the survey), was the fact that 62% of financial executives in banking and capital markets businesses said their regulatory risk is increasing significantly. That is nearly double the level of other companies, so bankers are clearly feeling pain. While not much can be done to reduce the regulatory burden, make sure your voice is heard in DC, consider outsourcing non-essential areas so you can lighten the load and focus your energies on more important tasks and stay on top of regulatory proposals to make sure you don't miss deadlines. These things will help, but know that the next 2 to 3Ys will still be heavy, as Dodd Frank is only about 50% done and bankers still have to absorb the impact of Basel III. Hang in there and get regular updates from your risk managers to stay ahead of the curve here. Another area of concern among survey respondents was financial fraud and crime. Here, 93% of company executives said this issue was more challenging to address than just 2Ys ago and a whopping 87% of U.S. companies said they had been affected by fraud. This is one area where community bankers can turn extra attention to avoid potential pitfalls. A few key areas recommended by the AICPA include: setting an ethical tone from the top; having a clearly structured employee manual; checking all employee references and performing comprehensive background checks; securing and monitoring areas of potential risk; reviewing jobs to make sure any sensitive ones have duties that are handled separately; limiting who gets to see sensitive documents; have regular independent reviews of various areas of the organization; hire professionals to review sensitive areas; rotate audited areas and make sure best practices are updated. A third area that surfaced as part of this study related to measuring ongoing risks. Here, 50% of companies said they were not even measuring emerging risks. Our advice is to create at least a rudimentary tracking mechanism to highlight issues that could surface in the next 6 months so your team has time to prepare and respond. As management consultant Peter Drucker once said, "If you can't measure it, you can't manage it." To improve in this area, make sure you track the important things, measure ongoing progress and take action to fix things along the way as needed. Finally, the study surfaces areas that are worthy of ongoing discussion. In this day and age of stronger risk management, many community banks we know are focused on how best to further leverage this unit to enhance the bank. The next time you meet to discuss risk management, consider the study findings that highlighted what specific areas executives said they saw as important. The top 5 were: compliance with regulations (94% of respondents said they saw this as an important area for risk to help); sustainability of future profitability (93%); infusing a risk culture (91%); enabling long term profitable growth (91%); and reduced operational, credit or market losses (89%). These are all worthy aspirations, but they are not easy to achieve, so be sure to give your team realistic timelines to do so. Balancing risk and reward is never as simple as it seems, but at least it beats having to drive your squad car after it has been crushed by a tractor.

BANK NEWS

Major New Competitor

Amazon.com has launched a new business (through its Amazon Capital Services Inc unit), offering small business loans to online sellers.

Fees

A survey by Moebs finds overdraft revenue at financial institutions increased 2.1% for the fiscal year ended June 30, as the median overdraft fee rose to $29 from $28 the prior year.

More Debt

A Pew Research Center study finds a record 19% of U.S. households had student debt in 2010 (up from 9% in 1989), owed an average of $26,682 and the debt load made up 5% of all debts.

Less Free

An annual Bankrate survey finds 39% of noninterest checking accounts are free, down from 45% last year.

Tax Hikes

The French government hiked taxes on businesses and the rich on Friday, as it moved to address the crisis in the Eurozone. Taxes were increased to 75% for those earnings over $1mm euros and businesses saw sharp cuts in the amount of loan interest which is tax-deductible (as well as a capital gains cut). Could this happen in the U.S.?

Job Cuts

Forbes reports that through July, 26,352 employees were laid off in the financial sector. This is the fifth highest on the list of industries with the most job cuts and experts say more cuts are likely as banking and brokerage firms continue to proactively reduce costs amid the ongoing structural changes to the industry and a slow economic environment.