RISK MANAGEMENT AND TAZERS

by Steve Brown

The world we live in can be strange at times. In a sad but true story reported last week by NBC, British police used a stun gun to subdue a blind man. It seems police officers were responding to multiple reports that a man was walking around a small English town with a samurai sword. When police responded, they said they mistook the cane the man was using for the sword in question and when they asked the man to stop and he did not respond (he thought he was about to get mugged), an officer used his Taser. Once they recognized the mistake, police apologized and took the man to a hospital for treatment. We wonder - is it really that difficult to confuse a blind person with a red and white tipped cane as a man carrying a samurai sword? This is a very sad and odd incident indeed. To eliminate this from occurring in the future, perhaps the English police should do a risk assessment on their officers. Many community bankers we know have already been working on risk assessments, as a component part of setting up an overall enterprise risk management (ERM) program. No matter where you are in the risk assessment process, some helpful hints might get you further down the road, so we explore them today. In general, risk assessments should incorporate a systematic approach to identify and assess the possibility that a given event will occur that could adversely affect the bank's ability to achieve its goals and objectives. To fully understand what we are talking about here, let's break this down further. To determine how far the risk assessment needs to go, it is important to understand the bank's objectives and areas of possible risk. To get started, focus on the 80-20 rule and expend efforts on the 20% of objectives that generate 80% of the risk. You can do so by listing risks in the first column of a spreadsheet, then in the next column rating the impact or severity using a number scale and then in the third column rating the likelihood or probability that the event will occur (again using a number scale). Then, using simple math, you can add up or multiply the columns and come up with a "heat map" commonly used to begin the risk assessment process. Once the heat map has been created, you now know where to focus your energy, as you take the next step in this process. Step back, look at the heat map and determine how wiling the bank is to accept each of the risks and what you would do if they were to occur. This information can be invaluable to management teams and boards alike, because it focuses efforts on not only recognizing where risks exist within the bank, but gets both groups thinking about ways to measure, monitor and control those risks. By understanding potentially adverse events, management teams and boards can be more proactive in protecting the bank. The point of assessing risk is to understand where it is coming from and the impact it could have on the bank. The point of having a risk appetite statement is to make sure the bank's acceptable risk levels are understood by all. The point of an enterprise risk management program is to make sure the bank operates within the risk appetite boundaries now and in the future. Managing risk is the responsibility of every business unit, so if you see risk increasing, make sure management is aware New products or services, concentrations, cutting corners, a lack of training, correlations and a host of other factors can all cause or exacerbate risks within the bank, so it is critical to be aware and spread the word when you see an issue surfacing. Banking is a business full of risks and it is management and the board's responsibility to manage those risks. Having a decent risk management framework is also a fundamentally good way to avoid getting tasered by a risk somewhere down the next road.

BANK NEWS

M&A

Pacific Continental ($1.3B, OR) will acquire Century Bank ($87mm, OR) for $13.4mm or about 1.09x tangible book.

Interesting M&A

Talmer Bancorp ($2.2B, MI) will buy First Place Bank ($2.8B, OH) for $45mm. Talmer will recapitalize First Place with $200mm in capital, after First Place exits bankruptcy. Talmer is backed by W.L. Ross & Co.

Operational Risk

Regulators have begun to highlight operational risk as an emerging area of concern. They expect banks to have a code of conduct or ethics policy; risk appetite and tolerance statement; risk management policy; active senior management involvement and a strong business continuity plan. Two key drivers regulators are monitoring closely are the complexity of a bank and the volume of new products.

Mobile Need

A KPMG survey finds 84% of financial institutions and technology providers think mobile banking and mobile payments are important to a bank's business.

Mobile Value

Zions Bank finds customers with both an online and mobile banking relationship generated close to 30% more revenues than an online customer, while having an attrition rate that is about 60% lower.

Channel Costs

Analysis by Fiserv and TowerGroup finds by delivery channel it costs about $4.00 per transaction using a branch channel; $3.75 via call center; $0.85 for an ATM; $0.17 online and $0.08 for mobile.

Less Cost

The FHFA estimates the cost to the government for the bailout of FNMA and FHLMC will cost about $76B by the end of 2015 vs. the current level of $142B.

CU Growth

Analysis finds 1,693 credit unions (about 24%) added at least 1 branch between 2007 and 2012, while the rest either maintained or decreased the size of their branch network.