THANKFULLY SHOPPING FOR LESSONS LEARNED

by Steve Brown

As you prepare to enjoy Thanksgiving with family and friends tomorrow and gear up for Black Thursday / Friday, we leave you with a few more interesting facts to consider. Our recommended strategy to gain maximum attention is to ask for the mashed potatoes to be passed your way and when they reach you, raise the spoon, go in for a big scoop and then clear your throat loudly to draw attention. Once conversation stops around the table, announce to everyone that they might find it interesting there are 46mm frozen turkeys eaten every Thanksgiving, that it takes about 5 days to thaw a 15 pound frozen turkey in the refrigerator and that seven other nations also celebrate an official Thanksgiving Day (Argentina, Brazil, Canada, Japan, Korea, Liberia & Switzerland), albeit not on the same day. Enjoy the fun tomorrow. As you do, consider the lessons you may have learned during this week about Thanksgiving. In a similar fashion, bank regulators apply a specific process to most significant events called "lessons learned." It examines the root causes, looks for commonalities and is designed to be sure bad things don't happen again. Then, regulations, processes and training are updated and depending on the severity of the matter(s), examiners will make it a point to focus on these at upcoming bank examinations. Take for instance some of the lessons we learned over the past few years that are rolling out across the system. One of these relates to paying loan officers commissions based on origination volume. A study by the FRB Chicago and Ohio State University finds commission based loan officers are 19% more likely to accept loan applications, 23% more likely to approve larger loan amounts and that those and other factors result in observable credit quality of loans booked by these loan officers that were 28% more likely to default. In addition, the research found the increase in default occurs mostly for the population of loans that would not have been accepted in the absence of commission based compensation. Simply put, compensation structures tied to short-term revenue generation, rather than long-term profitability over a cycle led banks to take on too much risk because customer facing teams were compensated that way. This is a lesson learned by both bankers and regulators and is one reason why so many banks have instituted claw-back features and made other changes around compensation plans. Another takeaway is how important it is for banks to have a diversified funding strategy and strong risk management to go with it. The FDIC is certainly one agency that looked closely at brokered CD funded growth strategies at failed banks to see if there were any lessons that could be learned. Doing so found that as capital levels deteriorated in a credit crisis environment, banks exposed to higher levels of brokered CDs were not able to roll them over, leading to a liquidity squeeze. It is easy for CD investors to leverage the internet and online services to shop rates and identify the highest yielding deposits. The lesson from that is these customers can be much less stable than a more typical relationship deposit customer. When banks fail or when market conditions change significantly, regulators have seen these customers rapidly transfer funds elsewhere, adding strain to funding sources. As such, focus is heightened on banks that use significant amounts of brokered (or rate sensitive) deposits and examiners will test concentrations, review overall limits, risk management processes and capital structures to ensure adequate safeguards are in place. Banks that lack expertise in wholesale funding; are young; have few relationship deposits; are growing quickly; have inadequate internal audit; have inadequate information systems or controls; have a strategy that does not support using rate sensitive funding; have a management team focused on rates over liquidity; weak liquidity policy limits; or have increased loan delinquencies are all likely to receive particular regulatory attention in this area. Whatever lessons you have learned in your banking career, forget about it all as you enjoy the holiday tomorrow. We will be back on Friday with another edition, to help keep bankers informed and laughing for those who will be in the office.

BANK NEWS

Home Lending

Fed Governor Duke in a speech last week said policymakers should reassess mortgage lending regulations at community banks to reduce the cost and establish a simpler regulatory structure. She said policymakers should "abandon efforts for a one-size-fits-all approach to mortgage lending."

CU Social Media

New research about how credit unions use social media to market (survey) to customers finds: 94% use Facebook; 75% say they track penetration metrics by counting the number of fans they have; 59% measure the number of mentions and 55% track the number of posts. Meanwhile, CU marketing teams said beyond Facebook, in 2013 they plan to leverage social media through mobile applications (74%); Twitter (66%); YouTube (61%); using social media analytics (48%) and LinkedIn (39%).

Improving Productivity

Bankers seeking to improve the business model and boost performance might look inside first, if the results of a Robert Half survey are any indication. It found executives spend about 17% of their time each week overseeing poor performers and 33% said weak employees greatly affect team morale. To improve, management may want to closely review staffing and remove anyone that isn't performing or has a negative attitude.

Spanish Banks

The latest report finds banks in Spain are struggling with bad loans equal to about 10.7% of total loans.