MANAGING RISK IN A CHANGING BANKING INDUSTRY

by Steve Brown

Let's face it - customers get mad when they get poor service. In fact, a study by American Express found people will tell an average of 9 other people when they get good service, while those who get bad service will tell 16 people. To help your bank improve this year, remind customer facing staff to take an appropriate amount of time to service all customers to be sure issues are resolved. Then, remain friendly and work to solve all problems without making excuses. Doing these things can help your bank keep even picky customers happy and get them to see you understand and are trying to help. In like manner, every so often people will approach bankers we know and ask them what they do and how it helps society. For some, the first reaction is to explain they take deposits and make loans, but the problem here is that this does not do justice. As economists have explained, among which we find Professors Gorton, Eichengreen and Woodford, the changes in the banking system from the 1980's have transformed the landscape into what they call the "financial market." Many years before the banking crisis, intermediation played an important role, especially with the removal of fixed fees that were a source of revenue for bankers. This change drove larger banks toward more complex revenue-generating sources that required a different technical expertise. Nonetheless, regulation is only one driver for this change. The sense of wealth created by access to housing and other investment options and the global monetary flows to the U.S. by international players also induced changes in banking relationships. Over time, this shift and more access to information on the internet made customers more sophisticated and increased their expectations when dealing with their bank. To explain all of this when asked the original question, the challenge remains how to explain a market that has achieved a level of complexity beyond what many may be able to grasp. Banks remain in the risk business as they always have, but understanding those risks is difficult to explain. Community bankers can relate to this because it is in front of you every single day. Consider a recent risk management survey by Ernest & Young. It found the banks and insurance companies surveyed are devoting much more attention to risk management these days. In fact, a full 75% said they have implemented new risk stress-testing methodologies in the past 12 months and 70% said the impact of the credit crisis and new regulatory requirements have driven them to do more analysis around how capital is being used and the risks inherent in their enterprise. The key assumption is that banks can only absorb so many risks at any one time to be effective operators. For instance, banks may decrease the risk associated with lending activities by engaging in other transactions or designing a new product unrelated to lending. Current market practices focus on eliminating interest rate risk by transferring them (through swaps), commonly known as "risk transfer." In the end, answering the original question is tough because community bankers wear many hats today. You need not only lending and funding expertise, but also economic, trading, compliance, marketing, technology and legal proficiency. To compete in this changed environment, you need partners that will spread industry know-how into you business units and aid you in gaining the power to compete more effectively. We can help, so give us a call or email if you are struggling with something and we can talk through options that might make sense. Rest assured that nearly all of the technical areas you might need help are readily accessible to you through our team of banking experts. As for the next time someone asks what you do, consider just saying "I manage risk."

BANK NEWS

M&A

Bell State Bank & Trust ($2.4B, ND) will buy The Business Bank ($229mm, MN) for an undisclosed sum. Bell adds the bank, a mortgage origination unit and one branch.

Cyber Source

The NY Times quotes a former official in the State Department who says the U.S. government knows Iran is behind the cyber attacks being waged on large U.S. banks.

Basel Liquidity

Global bank regulators extended for 4Ys and expanded the types of assets eligible under liquidity rules that were set to start soon. Under the old rule, effective Jan. 2015, banks would have been required to hold enough liquid assets to cover 30 day outflows when economies were under stress. The new rule phases in the liquidity requirements through 2019 and expands the types of securities banks can consider liquid.

Stress Testing

Large U.S. banks will have to submit their stress test results to the Fed by Jan 7 (made public by Mar. 31).

Slight Improvement

A 3Q report from the Federal Housing Finance Agency finds the number of home loans backed by FNMA and FHLMC that are seriously delinquent or are in the foreclosure process fell below 1mm for the first time since 2009.

FOMC Clarification

The most recent FOMC minutes made it clear the zero interest rate policy will end once unemployment gets back to 6.5% and inflation reaches 2.5%, but distinctly separated that from their actions related to quantitative easing.

Tough Lending

The latest survey by the National Federation of Independent Businesses finds about 70% of small business owners think now is a bad time to expand.

Worse

The jobless rate in the euro zone climbed to a new high of 11.8% in Nov. vs. 11.7% in Oct. By major country, Spain was the worst at 26.6%; Greece was 26.0%; France was 10.5% and Germany was 5.4%.