Watch for Falling Cows

by Steve Brown

It was hard to not be struck by the oddness of the story of the man killed in bed by a cow that fell through the roof of his house. What?! Yes, it seems this gentleman lived on the side of a steep hill and a cow escaped from a nearby farm. It then wandered from the hillside onto the roof of the house and tumbled through the bedroom ceiling onto the sleeping man. His wife sleeping next to him was unharmed, as was the cow, but the poor man sadly did not make it.

There are very few things that bankers deal with on a day to day basis that are as random as this story. Today we try, by introducing the topic of risk. Certainly, as with the cow example, some risks are obvious and some not. What then can a banker do to avoid the cow-on-the-roof situation and the inevitable spilt milk that follows (you know we had to go there).

A recent report from the OCC's National Risk Committee provides some good insight on their view of the primary sources of risk and therefore where community bankers should focus their efforts. The OCC's summary finds performance of institutions improved across the board in 2012 and profitability has increased to its highest level since 2006. That is good because it adds a foundation of earnings to support capital and performance. Further, asset quality also has improved at institutions both large and small, as problem assets have declined from peaks of early 2010. There are still significant headwinds for banks though.

Key areas of risk highlighted in the report focus on strategic matters, challenges to revenue growth, operational risks centering around cyber threats and expanding reliance on technology.

Strategic risk is worrisome due to sluggish economic growth and persistently low interest rates. Loan growth is also at about 50% of the average pace of the last 25Ys. Finally, while there has been some increase in non-interest income, this has not been enough to overcome the drop in interest income in most institutions. Community banks in particular have had difficulty in generating significant growth in non-interest income.

Yet another risk concern of regulators is that times of little change in interest rates and high liquidity have encouraged some banks to chase yield. This has increased credit or interest rate risk as many banks have sought to boost return. As such, sound corporate and risk governance requires banks to carefully consider these factors and mitigate risk in these areas as a central part of strategy. Annual strategic planning is more of a process now and these risks should be understood.

As if these issues weren't enough for community bankers, revenue growth remains weak. Loan borrowers are infrequent, competition is high and worries are mounting that underwriting standards are slipping. Only time will tell, but expect regulatory scrutiny here to be heightened.

Finally, cyber-threats, greater reliance on technology and increased IT outsourcing are seeing increasing risk. As bank customers rely on technology for more and more interaction with their bank, problems with functionality, a poor provider or a malicious attack can undermine the bank's reputation. For some banks these days, a crashed online banking system could be a cow-on-the-roof moment (unexpected, but not unforeseeable), so take care where you lie down.

For risk managers, building a fence may keep the cow from walking from an adjoining pasture onto the roof and avoid issues. That said we have seen them jump over the moon so anything is possible no matter the risk mitigants. Nonetheless, it is a good practice to check around your bank to see where a garden fence might make a difference.

BANK NEWS

M&A

Wintrust Financial ($17.1B, IL) will acquire Diamond Bank, FSB ($174mm, IL) for an undisclosed sum. The move adds 4 branches.

Changing Customers

n a sign of the times (and one bankers should note), TechCrunch reports Starbucks saw 10% of its sales at US locations done through a mobile device this past quarter.

Outsourcing Trends

Capgemini research finds 77% of banks surveyed outsource today. Tasks most often cited include: IT (58%), back office (58%) and support functions (27%). In the technology area: 39% of banks said they outsourced IT staff and projected that number would grow to 52% in 5Ys. Meanwhile, IT functions banks expected to outsource the most in the next 5Ys were development (68%), maintenance (68%) and technology operations (58%). As for support functions, banks cited the following as most likely to be outsourced in the next 5Ys: HR (58%), property management (47%), procurement (42%), accounts payable (26%), accounts receivable (26%) and treasury functions (16%).

Coin Bite

The SEC has filed a fraud lawsuit against Trendon Shavers, founder and owner of Bitcoin Savings and Trust. The SEC alleges Shavers ran a Ponzi scheme using virtual currency Bitcoin as a vehicle to dupe 66 investors into giving him about $4.5mm.

Cybersecurity

Hackmageddon research finds attempts by hackers to damage or destroy a computer network or system (cyber attacks) climbed 51% in Q1 vs. the prior quarter and financial services companies were targeted 24% of the time.