The 5 Second Rule

by Steve Brown

People all over this country have operated according to the 5 second rule. This rule says that if you drop food on the floor, as long as you grab it within 5 seconds it is ok to eat because that is too fast for germs to attach themselves. You will be happy to note some new research has produced results that agree with this premise, but those results also have turned one of our general perceptions upside down. For example, we always assumed food falling on a hard surface like a tile floor would be cleaner than something that falls on a dirty carpet. Unfortunately for us, a study by microbiology students at Aston University in Birmingham, England came to a different conclusion. It found that E. coli and staph bacteria were less likely to transfer from carpet to food than from tile or laminated surfaces. Maybe there is less actual surface contact due the fuzziness of the carpet or maybe tile is just dirtier. Either way, it just makes sense to move faster.

Speaking of moving faster, there was a recent survey on the cost of compliance in financial institutions by Thomson Reuters. They surveyed 600 banks, brokers, insurers and asset managers worldwide. The data found that while increasing costs and time were not surprising, the level at which compliance officers felt that their personal liability had increased had been rising very fast indeed. In fact, some 53% of respondents felt this was true. This brings to light the difficulty of the job and the personal risk associated with being a senior compliance officer. For banks, that cost has to be factored into increased expense, as evidenced by 66% of respondents expecting an increase in the cost of senior compliance professionals and 64% expecting the total compliance team budget to be larger than it is today.

We don't have to tell community banks how onerous regulations are right now. You fully understand the increased personal responsibility that management and boards carry for the outcomes of their decisions and you live it every day. The part that might not be so obvious, however, is that the compliance function has migrated like other risk management processes toward the anticipation of future problems rather than defensive actions or simply following a set of rules. As such, this function needs to focus on how a business operates as it takes a more outcomes-based approach. Compliance and risk cannot simply function according to pre-set guidelines and try to keep moving because the stakes are too high. This shift also means risk and compliance teams over time will need more training and require a greater degree of sophistication than in the past.

As we wrap up, we note there were a number of other findings of interest in the survey. For instance, in most institutions the compliance function spent little time collaborating with the internal audit function. That is surprising and is likely to also be a cause for concern among regulators. Not surprising, the number of compliance teams spending 10 or more hours per week tracking regulatory developments in the U.S. nearly doubled last year rising from 13% in 2013 to a projected 25% this year. Further, 76% expect the quantity of regulatory information published to be greater than last year and 20% anticipate spending more than 7 hours per week amending policies and procedures to reflect those changes. This means banks will still have plenty to do in the regulatory arena, so be prepared.

While increased costs of compliance are unwelcome in this era of squeezed margins and the difficulty of generating earnings, a strong and effective risk management program is crucial for a bank's wellbeing. Finally, move quickly to enhance your risk program to ensure compliance with the 5 second rule and it will help you also avoid stomach ailments that usually come along with any new rules or regulations.

BANK NEWS

Q1 Earnings

JPMorgan reported Q1 net income fell to $5.3B vs. $6.5B for the same period last year (a 19% drop). On a YOY basis: net revenue fell 8% (fixed income trading tanked 21%); provisions for credit losses increased 38%; ROA was 0.89 (-22%); Return on Common Equity (ROE) was 10% (-23%); assets increased 4%; loans were flat and deposits increased 7%. Wells Fargo reported record Q1 earnings of $5.9B (+14% YOY). Other YOY metrics: ROA was 1.57% (+5%); ROE was 14.35% (+6%); loans (+4%); deposits (+8%); efficiency ratio was 57.9% (-1%); NIM was 3.20% (-29bps or 8%) and non performing assets (-18%).

M&A

Bofi Federal Bank ($3.6B, CA) will acquire certain assets and all of the deposits of H&R Block Bank ($1.4B, MO) for an undisclosed sum. After the deal, Bofi will provide H&R Block branded financial services products through Block retail and digital channels.

M&A

Old Missouri Bank ($167mm, MO) will acquire Bank of Ash Grove ($71mm, MO) for about $8.4mm.

Rate Hikes

JPMorgan points out the FOMC message on rate hike timing is not as controversial as many are making it out to be. They still project stimulus purchases under QE3 will end this year and short term rate hikes will begin in the middle of 2015. JPMorgan expects rate hikes once they begin to be a very slow and drawn out process.

New Regulations

The biggest banks in the U.S. will need to raise about $68B in capital to meet new regulations on leverage capital according to experts. The new rules require the largest banks to hold leverage capital of 5% of total assets at the holding company level and 6% at the subsidiary bank level.