Slipping On A Banana Peel

by Steve Brown

You may wonder how slipping on a banana peel become a standard comedy gag. It is important to note that banana peels got a reputation as a threatening object a long time ago. You see, back in the mid 19th Century, bananas from Panama were first imported to New York City and they quickly became a favorite street food. Sanitation control was less formal in those days and so the strong odor and the sliminess of rotted peels quickly added up to a bad reputation and a public hazard. In the 1880's, Harper's Weekly equated anyone who threw a peel on the ground as being a direct cause of broken limbs and general mayhem. Back then it was also common for wild pigs to roam the streets of cities to clean up rotting organic matter. We can only imagine this created a different set of difficulties.

This brings us to the biannual Banking Banana Skins 2014, a survey of banking risks. This survey is conducted by the Centre of the Study of Financial Innovation (CSFI), a non-profit think tank that measures risks facing the global banking industry. The previous survey 2Ys ago found the greatest concerns were the macroeconomic climate and credit risk was second. There are still macro-economic concerns today, but the specifics are substantially different as the current focus on rising interest rates, potential asset bubbles and weakness in emerging markets are more the norm.

Overall the survey found banks see the financial crisis as finally over so anxiety levels in the industry have eased. Of the 28 banana skins, the top two in this year's survey are over-regulation and political interference. Meanwhile, banks in North America and the Euro-region are most concerned about regulation, but there is also an interesting divergence between the regulatory survey respondents and the bankers. Non-bankers felt there were major vulnerabilities around weak corporate governance and risk management practices, while bankers were less concerned with these areas. Political interference was also closely related to regulation. Respondents felt politically that backlash against banks has been overdone and it is inhibiting their ability to move forward given increased regulation.

Looking further into the report, credit risk declined from #2 to #7, but there is a question of whether it has declined or simply changed. Most banks have dealt with existing problem credits on their balance sheets by now, but in new underwriting, banks say pricing risk is a primary concern. Survey respondents felt that the pressures of competition tend to push them to under price risk and as a result banks are bringing new credit risk onto their balance sheets.

Of interesting note, technology risk vaulted from #18 to the #4 area of concern. Respondents worry about the vulnerability of outdated systems to cybercrime and system outages, including reputational risk arising from outsourced activities. Complexity itself is also seen as a risk.

Finally, respondents were asked how well-prepared banks are to deal with the most important risks identified in the survey. The result on a scale of 5 (well-prepared) was 3.04. This is slightly higher than the result of 2Ys ago but not enough to really get the bell ringing so room for improvement remains.

While this survey is global and includes both large institutions and small, it provides an interesting look at the risks in our industry today and how they have migrated over time. In addition to understanding risk on a larger industry level, it's a good idea to go through the 28 measures and assess their importance within your bank and your market if you get some down-time. Doing so may protect you from both slippery banana peels and wild pigs.

BANK NEWS

Office CRE Lending

A survey of global corporations by CoreNet Global finds the average space per office worker globally was 225 square feet in 2010, but that by 2013 it had declined 33% to only 150 square feet. The survey projected it would decline to about 100 square feet in the next 5Ys.

Insurance

The ABA reports the top insurance policies carried by banks other then financial institution bonds are: workers compensation and employer liability (99%), umbrella and excess liability (99%), automobile (98%), general liability (98%), directors and officers liability (97%), building and contents (96%), employment practices liability (93%), fiduciary liability (92%), safe deposit coverage (89%), kidnap/extortion (89%), foreclosed property (87%), bankers professional liability (87%), mortgage impairment (85%) and cybersecurity (81%).

Debit Fraud

The ABA reports about 96% of banks experienced losses from debit card fraud and 63% had losses from check fraud.

Basel III

The phase in schedule for community bank capital ratios for minimum common equity Tier 1 plus the capital conservation buffer will be 4.500% (as of Jan 1 2015), 5.125% (Jan 2016), 5.750% (Jan 2017), 6.375% (Jan 2018) and 7.000% (Jan 2019).

Funding Costs

As of Q1, the FDIC reports banks with assets <$1B had a cost of funds 31% higher than banks with assets >$1B (0.51% vs. 0.35%). There is still room to reduce funding costs.

Extreme Wealth

The Fed reports the net worth of households and nonprofit organizations (i.e. wealth) climbed 2% in Q1 to an all time high of $81.8T. Rising stock values and real estate (housing) were the catalysts for the increase.

Pay Raises

The Bureau of Labor Statistics reports average weekly pay for U.S. employees climbed 1.3% in 2013.