Upgrading Doesn't Mean Adding Peas

by Steve Brown

Last week was an exciting one for news, with the continuation of the Greek/Euro crisis and numerous important economic reports like June unemployment numbers. That said, the most compelling story of the week was a recipe for Guacamole that included peas that was published by the New York Times. Perhaps we should give them a break in that NYC is not exactly a hotbed of expertise for Southwestern cooking. Nonetheless, it raised eyebrows and hackles, and social media exploded over the controversy.

We give a little leeway for lack of expertise when it comes to recipes, but your regulator is unlikely to give your bank much leeway for unfamiliarity when it comes to modeling the risk in your bank. Risk management is at the heart of banking and every bank has processes in place, both new and old, to assess and manage the risk on its balance sheet. Bankers should note specifically that the expectations of regulators have changed dramatically since the credit crisis and the result is that most bank CFOs are spending more time doing risk analysis than ever before.

For our part in assisting community bankers, PCBB has produced a number of webinars and next week there will be a two part presentation entitled "Next Generation Risk Management: Optimizing Your Processes." The first session will cover Asset Liability Management (ALM) and the second will discuss the Current Expected Credit Loss Model (CECL) which banks will need to adopt for their calculation of the loan loss reserve. Today we will discuss some aspects of ALM and tomorrow's BID will tee up the discussion around CECL.

Best practice ALM models use an integrated approach for modeling risk. If a bank has multiple models that do not use the same assumptions or metrics, then the integration of the results in order to measure risk becomes impossible. Beyond the difficulty in analyzing the backward look, it makes strategic planning for a bank's future very difficult. So what makes up an integrated approach?

First, banks should leverage existing efforts wherever possible to build bank-specific assumptions. Banks should look at a variety of scenarios for a full picture. Static scenarios are required to quantify core risk, but dynamic scenarios are needed to quantify the risk embedded in the operating plan. In addition, what-if scenarios should include sensitivity analysis and integrated stress scenarios. These should analyze combined rate, credit and liquidity events to get a true understanding of the risk.

Reports should also be multi-level to facilitate board and management review. In addition to providing the level of detail that regulators require, this approach helps everyone get a better understanding of the issues from their own perspectives. Board and management committees will appreciate an executive overview that gives a big-picture view. Then, in addition to the primary ALCO package, there should be summaries from individual scenarios plus the detailed model configuration to explain the process. Reports should identify conditions that drive changes in the balance sheet and risk profile, and finally back testing and forward projections should be included.

It is a lot to undertake and for this reason, many banks who have previously taken care of ALM internally are considering outsourcing it. Still other banks who are already outsourcing their ALM process are taking a closer look to determine if the model is just too simplistic to handle dynamic industry and rate changes. PCBB's ALM service is robust and designed to save your staff time and money. Our service also provides the benefit of outside expertise to help you meet the changing regulatory environment and achieve your goals and objectives.

As for the guacamole recipe from NY, the outcome was that the peas acted as a dull filler, making the dish neutral and flavorless. Make sure regulators don't view your ALM process as mostly flavorless filler because it lacks bank-specific data. Sign up for a webinar to learn more about best practices in ALM.

BANK NEWS

Greece

Given everything going on in Greece and its recent no vote, you might find it interesting that the country has about 11mm people. That would squeeze it somewhere between the size of MI and OH if it were a US state, makes it equal to just less than 33% of the population of the state of CA, or about the size of the cities of New York and Los Angeles combined. Greece makes up just 2% of the euro zone's economic output and population.

Mobile Growth

Research by Chase finds 33% more consumers are using their mobile device to access a mobile banking app than did so just 1Y ago, while online banking is also up 35% YOY.

M&A Activity

1) The parent of Citizens Deposit Bank & Trust ($388mm, KY) and Premier Bank, Inc. ($880mm, WV) will acquire First National Bank ($261mm, WV) for $26.5mm in cash and equity.

Branch Activity

1) Americas United Bank ($165mm, CA) will acquire 2 CA branches from Banc of California ($6.1B, CA) for an undisclosed sum. The branches hold $50mm in deposits and $35mm in loans.

ATM Usage

The Minneapolis-St. Paul Business Journal reports that so many people now skip using ATM machines, US Bank says it is losing hundreds of thousands of dollars every year on its 17 ATMs at the Minneapolis-St. Paul International Airport. US pays the airport a $636,000 annual minimum plus 50% of the $3 fee that non-customers pay at the ATMs. US Bank indicates it is losing about $30,000 per machine per year.

Retail Risk

Banks active in retail lending should note American Apparel said it will close an undisclosed number of stores over the next 18 months and lay off employees as it seeks to cut $30mm in costs. The retailer has 239 stores.