

From: "Mark Riley" <mriley@bankresourcesandsolutions.com>

To: lriley@bankresourcesandsolutions.com

the riley report July/August 2009

Common Sense Banking for the 21st Century



Welcome to the July/August Newsletter - Ideas and Strategies to Improve Your Bank's Performance

This newsletter is focused on topics that can affect your income in areas where close scrutiny and having solid advisors makes a world of difference. In no particular order, (except my rant on loan modifications at the bottom of the newsletter), timely topics include: valuation of warrants, executive compensation update, choosing the right compliance consultant, and an update on the Fearless Prediction.

- **David Danielson, Danielson Associates: Valuation of TARP Warrants**
- **Richard Deutsch, Titan Executive Compensation: TARP Update**
- **Ralph Dahm, IT Audit Search: Skimping on Lookbacks - Not a Great Idea**
- **Fearless Prediction Update**
- **Open Letter on Making Loan Modifications Work**

*As always, we appreciate your comments and suggestions.
Mark Riley*

Valuation of TARP Warrants

With the recent movement to repay TARP funds, effectively establishing the appropriate valuation of TARP Warrants is important. David Danielson, President of Danielson Associates, reported his company has expanded its Valuation Services to include TARP Warrants.

Established in 1978, Danielson Associates focuses on helping management and boards of financial institutions adapt to the changes within the financial services industry and determine their future direction. Arnold Danielson, who founded the firm in 1978, remains very involved and is the firm's Chairman.

For the past five years, Danielson Associates has been led by David Danielson who joined the firm in 1998. Since joining, David has provided financial advisory assistance to bank clients in regards to mergers and acquisitions, stock valuations, branching, and strategic planning. He is also deeply involved in assisting organizing groups form new banks by preparing market and feasibility studies, as well as assisting in the preparation of regulatory applications. He served on the board of the Felton Bank in Delaware and is currently serving on the board of a de novo, Community Bank Delaware, based in Lewes.

Danielson Associates ranks perennially among the leading advisors for bank and thrift mergers. Since its inception, the firm has advised on acquisitions of banks, thrifts, insurance agencies, and bank and thrift branches with a combined transaction value in excess of \$4 billion. David Danielson may be reached at 240-207-2306 or dgd@danielsonassociates.com.

TARP From an Executive Compensation

FIRSINC and Your Bank

FIRSINC knows these are challenging times; we are available to assist you in addressing the tough questions, throughout the CAMELS' spectrum. With an extensive track record of turning around community banks, we would enjoy having the opportunity to assist you, your management and Board in making the right decisions for your bank.

For more information, please contact me at mriley@bankresourcesandsolutions.com or 757-642-8353.

Refer a Colleague

We would like to share this information with your colleagues. [Click here to add your colleague to our mailing list.](#)

Fearless Prediction Update

In March, we fearlessly predicted the end of the bear market would occur on December 9, 2009, give or take a month or two. The good news is the FRB Beige Book, June Treasury Economic Report and Newsweek, to cite a few, suggest the recession may reaching its bottom. The Cash For Clunkers program has been a rip roaring success. It will be interesting to see if these were new buyers vs. those that had been planning to purchase a new car and took advantage of the government offer.

Not all is positive, though and while I'm an eternal optimist, there are some disturbing signs.

Perspective

Richard Deutsch, Principal, The Titan Group LLC, provides the following summary:

1. Pay for Performance Act passed by House. Stoked by outrage over perceptions of unreasonable executive compensation, the House in April approved an Act which bars compensation that is "unreasonable or excessive" or is not a result of "performance-based" metrics by any financial institution which has received or will receive a direct capital investment under TARP (or other similar programs). "Longevity bonuses" (undefined by the Act) and restricted stock grants are exempt. The Act leaves much to Treasury to develop implementing rules, **including a possible exemption for "community financial institutions" that receive less than \$250 million.** Potential performance standards may include (i) ability of the institution to repay Treasury, (ii) individual performance, (iii) adherence to risk management requirements, and (iv) other standards designed to promote accountability to shareholders and taxpayers. Severance pay of up to \$250,000 would be permitted in the ordinary course of business to an executive who has five or more years of service with the company. Additional, extensive reporting to Treasury would be required. The restrictions would apply until either Treasury is repaid or a comprehensive repayment agreement has been reached. The Senate appears to be in no hurry to consider this proposal.

2. "Say on Pay" Resolutions. According to a recent article in the Wall Street Journal, confusion and conflict have resulted in early returns of say on pay votes. Large investors tend to rely on guidance from one of three major proxy advisers (including Risk Metrics, formerly Institutional Shareholder Services). These advisers use different criteria and can reach different conclusions as to whether executive pay practices should be approved. Regions Financial Corp., Valley National Bancorp and Lakeland Financial Corp. all have received conflicting evaluations from the proxy advisers and large investors (such as pension funds). In one instance, Risk Metrics objected to "goal-post shifting" (changing the performance metrics after the fact) even though (i) it was done to eliminate factors beyond management's control, (ii) management was underpaid compared with peers, and (iii) performance was better than peers. Undoubtedly we will see more examples of conflicting perspectives as more annual meetings are held.

Conclusion. Despite the public anger over and governmental intervention in the executive compensation issue, the bedrock principles appear to remain. Prudent process is essential—peer analysis as a reference point, compensation philosophy as a guide, and performance-based incentives (that benefit shareholders but do not encourage unnecessary or extreme risk-taking) have not gone out of fashion.

Richard Deutsch has over 20 years of experience in financial analysis and consulting. His areas of focus are nonqualified executive benefit plan consulting and corporate/bank owned life insurance (COLI/BOLI) consulting. In the area of nonqualified executive benefits, his expertise includes plan design, taxation, accounting, funding and related planning issues. Related to COLI/BOLI consulting, his experience extends to insurance product design and pricing, and related financial, tax and accounting implications. He may be contacted at 804-249-6026 or rdeutsch@titanhr.com.

The Implications of Skimping on Lookbacks

Ralph Dahm, President, IT Search, referred the following article from [June 2009 Compliance News](#) and sourced through Fortent Inform.

Cash-strapped banks facing federal mandates to hire outside consultants to improve their compliance programs are increasingly seeking lower bids from anti-money laundering consultants to get the work done cheaply, say compliance professionals. The result is that some consultancies, faced with evaporating budgets, are cutting senior anti-money laundering (AML) professionals and using a higher percentage of lesser-paid, junior investigators on complex remediation assignments, such as transactional reviews to find missed suspicious activity. The potential for a qualitative drop in consultant work has, on at least two occasions, prompted federal regulators to require banks to redo costly look backs with a more experienced team, according to Ralph Dahm, president of Wheaton, III.-based IT Audit Search.

1. Early 2nd quarter operating results in some Financial Institutions, indicate a further worsening in Non Performing Assets. The current results may be the result of Performing Watch list loans deteriorating into a NPA status. However, if we are seeing a ripple effect of the unemployment levels affecting current loans, then the recovery may have begun, but will be a slow rebound.
2. 1.5 million foreclosures through June 2009 will continue to ripple through the economy affecting not only the homeowners involved, but their families, schools, community networks and support agencies. This is one area in which the federal government needs to do more to assist those homeowners that can and should be saved from foreclosure.
3. Perhaps, because it's summer, the media has been fixated on the death of Michael Jackson, the Appalachian Trail to Argentina, Birthers, Deathers and Beer Summits. It seems to me that as long as we have our military in harm's way and a fragile economic recovery, that should be front page news every day.

At December 31, 2009, the Dow Jones Industrial Average (DJIA) closed at 8,776. Since July 22, 2009, the DJIA has exceeded that level and closed on August 13, 2009 at 9,398. The corollary data suggests a continued increase, albeit modestly. On that note, I'll amend my fearless prediction to suggest the bulls have returned earlier than I thought. However, I'm confident that within a few months, there will be those who will opine that the Recession really wasn't all that bad and both administrations overreacted. I'd suggest that whether it's a company, bank or general economy, turnarounds require multiple approaches, aggressive focus and recognition that some actions will work well and others will not. Effective leadership recognizes that and won't let the

In one instance, a federal regulator forced a Florida-based bank in 2007 to drop its AML remediation team because the members had inadequate experience, he said. In another case, a European bank realized midway through a look back that the consultants it had hired didn't have enough background to meet regulatory standards, according to Dahm.

Banks trying to select consultancies according to the lowest bid "is not working and could result in multiple penalties," and with higher costs as the bank is forced to try again, said Dahm. To make up for cost cutting at banks, some consulting firms are using their "top-level, high-grade" consultants for only a few weeks into six-month jobs in an effort to "wow" the bank early on before handing over job responsibilities to lower-level contractors and consultants, said Thomas Flattery, owner of TMF & Associates, an AML consultancy in Hayworth, New Jersey. Those who remain on the job, particularly those with only a few years of on-the-job experience, may "lack specific subject matter skills, which is vital for AML work," said Flattery, a former Federal Reserve Board examiner. "This isn't a curriculum in schools. The only good way to learn is experience." Second tier and smaller consulting firms have sent representatives to banks to perform AML reviews, independent testing and remediation work that "didn't know what to do and what to look for," said a former regulatory examiner, now a Texas-based compliance officer for a large U.S. bank. The consultants would "write these glowing reviews of a bank and we would find problems during a compliance exam," the person said, speaking of what was found during examinations done between 2005 and 2006 at the U.S. Treasury Department's Office of the Comptroller of the Currency. "A bank has to realize if it doesn't contract with people who have the right experience, it's not the consulting firm that will be held accountable by regulators for any missed activity or weak programs. It's the bank," the former examiner said. One current federal bank examiner said that as the economic crisis has deepened over the past two years, regulators have been increasingly critical of banks for choosing less costly consultants that didn't have adequate experience. The consulting firms "didn't cover enough, so we had to note that in the exam," said the examiner, who asked not to be named.

Multiple calls to AML consultancies-including KPMG, PriceWaterhouse Coopers, Ernst & Young, BDO Seidman LLP and IPSA International-were not returned by press time. Michael Zeldin, the global practice leader at Deloitte Financial Advisory Service LLP's AML practice, said in an e-mail that the division had grown over the past year and continued to staff "people appropriate to the task."

Looking Back, With Budget Constraints

A federal mandate to perform a look back or transactional review as part of a compliance enforcement action can be as costly for banks as a civil money penalty, translating into the hiring of dozens, even hundreds, of consultants and leaving a financial institution with a bill that can total millions of dollars per month. Over the past three years, federal regulators have ordered banks to hire independent auditors and consultants for remediation actions dozens of times, usually in an effort to find missed suspicious activity during a particular time frame. But the pace of remediation orders has dropped overall during that period as regulators turned their attention to capital requirements and lending troubles, said Dahm.

Federal regulators and the New York State Banking Department issued 58 percent fewer AML-related penalties overall between 2007 and 2008, according to Fortent Inform data.

For compliance consultants, the drop in the economy has meant a concomitant drop in the number of assignments as banks look to save money on remediation actions, said Dahm. While a year ago some consulting firms had trouble subcontracting seasoned compliance officers, today "hundreds, if not thousands" of AML consultants have found themselves out of work or underworked, he said. As a result, former federal examiners and law enforcement agents who once commanded wages of more than \$100 per hour say that pay rates have dropped as low as \$15 per hour, he said. "While that's better than being out of work, people can't afford to work at that pay level for four months," he said. To save costs and boost profits, some firms have begun letting go of their more costly consultants and replacing them with recent college graduates

'It wasn't that bad' crowd from focusing on the results.

Previous Articles

The following articles have been previously published and are available, in their entirety, on our website:

<http://www.bankresourcesandsolutions.com/>.

- Net Interest Margins Increase!!! - Well, Not Exactly for Every Bank
- The 2008 Financial Services Meltdown and the Federal Government's Response
- Oh Really?... Banks and TARP
- 1stWEST Mergers & Acquisitions LLC
- The Home Equity Conversion Mortgage Product - an Intriguing Product at an Opportune Time
- The SBA and the 2009 Recovery Act - Well Worth Taking a Look At
- CDARS: Bankers' Competitive Edge
- The OCC / OTS Mortgage Metrics 2008 Report and Why We Need to Take Another Look at How We're Assisting Homeowners in Crisis
- Know Your Customer Regulations and Enhanced Due-Diligence in a Difficult Lending Environment
- Hundreds of Community Banks Are Now Offering High Interest Checking Accounts - Are These Guys Nuts or What?
- Insuring to a Better Tomorrow - Utilizing Operational Risk Management to Decrease Costs to Increase Efficiency
- Here's Why It's So Hard to Modify a Mortgage: [MSNBC: The Mortgage Modification Mess](#)
- 2008 Neighborhood Mortgage Stabilization Program Proposal - The Riley Plan

Assisting Upside Down Homeowners and Community Banks - Let's Try This Again

or junior-level employees, according to a Chicago-based AML consultant laid off earlier this year from one of the "Big Four" auditing firms. Such cost-cutting measures may ultimately come back to haunt the firms, the person said. "When you cut straight down the line to meet a budgetary goal, you could lose that key person with the resource knowledge needed," said the person, who asked not to be named. "There is no cause without effect."

For one New York-based AML consultant laid off from a large consulting firm six months ago, having multiple industry certifications and a decade of experience has seemed like a disadvantage in a market where firms are turning to "new, talented graduates" to save money.

KYC Redux

To avoid having a regulator order that a bank restart a mandated look back, financial institutions hiring consultants may want to make an important tweak to their know your customer, or KYC, programs, according to Julia Mold, managing partner of Boca Raton, FL.-based consultancy Clear Sky Compliance Inc. They'll want to know their consultants too, she said. For some banks considering using outside consultants, "cost is the driver of who they accept, not necessarily cost versus experience," said Mold, a former consultant with Deloitte. "Banks need to check résumés of consultants and contractors, one by one." That kind of attention to detail on a sprawling remediation project potentially saved one New York-based former chief compliance officer from being forced to start over, according to the person who was recently hired at a consultancy.

In the project, which involved a large U.S. bank and more than 100 consultants and contractors from several firms, the person "interviewed every one of the junior consultants and I looked at each of their résumés. Anyone I found that was inadequate, I let them go."

About Fortent Inform

This news is taken from Fortent Inform. Access to proprietary Fortent content including Analysis of Legs and Regs and News is restricted to Fortent Inform Subscribers. Find out more about Fortent Inform. Fortent Inform provides access to all key US banking regulatory documents and summaries of all key anti-money laundering documents. As new regulations, legislation, guidance, enforcement actions and other banking regulatory documents are released, they will summarize quickly for your immediate access.

Ralph Dahm's firm, IT Audit Search, has over 30 years of providing exceptional candidates to clients in the financial, regulatory compliance, risk management and technology disciplines.

IT-AUDIT-SEARCH uses a unique search methodology developed and refined through many years of working with clients ranging from Fortune 1000 organizations to government agencies at the State and Federal levels. Ralph may be contacted at 630-517-8824 or rdahm@itauditsearch.com.

**Financial Institutions Resources and Solutions, Inc.
757-642-8353**

**mriley@bankresourcesandsolutions.com
www.BankResourcesandSolutions.com**

With the July 22, 2009 *Washington Post Editorial* regarding rising foreclosures and limited level of success in modifications, I remain convinced the my approach, outlined in the 2008 Neighborhood Mortgage Stabilization Program (aka The Riley Plan) is still a better strategy than current efforts.

I am pleased the Administration has incorporated two elements of my proposal into their efforts: including current homeowners in relief efforts and increasing the LTV to 125% (albeit for only one Government Sponsored Entity-GSE). However, according to the August 13, 2009 RealtyTrac Press Release, 360,149 foreclosure filings occurred in July 2009, up 7% from the previous month and 32% above July 2008.

There are discussions about adding cram downs or initiating other ways to lower the mortgage obligations. However, the majority of the homeowners, that are current on their debt and yet are struggling to stay current, do not want to have any of the debt eliminated as that will adversely affect their credit. I agree the best way to reduce the levels of modification defaults is through lower payments. That's why my approach makes more sense. The other critical differentiation is my proposal pushes the refinance efforts to all of banking, not just the major servicers.

When I originally drafted the proposal, I suggested these loans have a 30 year amortization and 7 year balloon. The traditional 30 year fixed rate mortgage is generally not retained by a community bank as it is difficult to match liability funding to 30 year mortgages. The simple solution, at no cost to the federal government, is to allow banks to make credit worthy 30 year fixed rate mortgages with the provision that if the loans have been paid, as agreed, once every 5 years, the bank may sell those mortgages to a GSE at par.

Here's the real frustration. The GSEs have billions of dollars in loans that would benefit if my proposal was incorporated into the mortgage relief efforts. Continuing on the current path will result in current homeowners falling over the proverbial financial cliff. Please take a look at the proposal

on our website,
www.bankresourcesandsolutions.com. If
you agree or believe there might
be other ways to assist these
homeowners, please let me know
and tell your elected officials.

© 2009 Bank Resources and Solutions - a division of Financial Institutions Resources and Solutions Inc.

This email was sent by Mark Riley, Bank Resources and Solutions - a division of Financial Institutions Resources and Solutions Inc, 14732 Vint Hill Road, Nokesville, Va 20181, using Express Email Marketing. You subscribed to this permission-based list on 12/17/2008.

Express Email Marketing supports permission-based email marketing. You can change your [preferences](#) or [unsubscribe](#) from this mailing list at any time.
