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Common Sense Banking for the 21st Century



Welcome to the September Newsletter - Ideas and Strategies to Improve Your Bank's Performance

This month, we outline vendor evaluation and OREO strategies that will result in savings for your bank, discuss the slight rise in NIM and NII ratios and put in our two cents on Senator Dodd's proposal to combine four agencies (not pleased, to put it mildly).

- **Jim Wilkson: 7 Steps to Effective Vendor Evaluation**
- **RileyREO: Improving the Management Oversight of OREO Properties**
- **Net Interest Margin and Non Interest Income to Earning Asset Ratios Slightly Improve, But No Cause for Celebration**
- **Merging the FRB, OCC, OTS and FDIC - Just Not a Good Idea**

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

Net Interest Margin and Non Interest Income to Earning Asset Ratios Slightly Improve, But No Time to Celebrate

For banks with assets to \$1 billion, the nominal increase in the Net Interest Margin and Non Interest Income to Earning Asset Ratios is tempered by the ratios remaining lower than 2008 levels. The historic low interest rates, non accruing loans, loan and investment options are major components of the Net Interest Margin strain. As the economic recovery continues and loan portfolios are cleaned up, margins should improve. The challenge for bankers is: *What are the best loans and investments to make through 2010 that will be solid credits, provide a reasonable yield and position the bank for an upward tick in interest rates?*

The Non Interest Income component is also hovering below 2008 levels, but may be an easier challenge to overcome. For too many years, the principal theme in marketing has been "Make it Free" and business will flow to the banks. Philosophically speaking, well run financial institutions provide excellent products and services and should be reasonably compensated.

If your bank is running below your Uniform Bank Performance Peer levels, let's take a look and see where there may opportunities to improve your standings.

Source: FDIC June 2009

Net Interest Margin	Less than \$100M	\$100M - \$1 B
2nd Qtr 2009	3.87%	3.65%
1st Qtr 2009	3.83%	3.63%
2008 (full year)	3.95%	3.83%
Inc/Dec 1st Qtr 09 to 2008	-0.12%	-0.20%

Riley REO: Improving Your Bank's Oversight and Disposition of Its OREO Properties

According to the June 2009 FDIC reports, there are \$34 billion in OREO properties and \$332 billion in Non Current Loans on the books of Commercial and Savings Banks. For the past 10 years, the rise in real estate values masked many problem assets. Heck, all a bank had to do was wait long enough and most properties would appreciate their way out of their problems. To make matters worse, the Special Asset specialists who worked during the 1980's banking crisis have retired or moved on. The result is a glut of OREO properties, limited experienced staffing and a whole range of commission based companies all very willing to assist the banks. My concern, though, is bank leadership wants to assert greater control over the process, but is limited by the options in the market.

In creating RileyREO, we focused on developing tools that bank management could use to oversee the expeditious disposal of its OREO properties. These tools include:

- Launching in 4th Quarter 2009, www.RileyREO.com, a website that provides a direct conduit between the bank and its buyers and investors. All requests for information are routed directly to the bank or its designated agent.
- Providing reports that empirically measures buyer contacts for each property <http://us.mc525.m>

Inc/Dec 2nd Qtr 09 to 1st Qtr 09	0.04%	0.02%
Inc/Dec 2nd Qtr 09 to 2008	-0.08%	-0.18%

Non Interest Income to Earning Assets	Less than \$100M	\$100M - \$1 B
2nd Qtr 2009	0.83%	1.10%
1st Qtr 2009	0.79%	1.08%
2008 (full year)	1.01%	1.18%
Inc/Dec 1st Qtr 09 to 2008	-0.22%	-0.10%
Inc/Dec 2nd Qtr 09 to 1st Qtr 09	0.04%	0.02%
Inc/Dec 2nd Qtr 09 to 2008	-0.18%	-0.08%

7 Steps to Effective Vendor Evaluations

Banks are always looking for ways to reduce expenses, and the current economic environment makes reducing expenses especially important. Behind salaries and interest expenses, a bank's third largest expense is typically their data processing costs. Whether your bank processes many of its services in-house or you outsource most of your processing, you may be in a position to reduce many of your costs by undertaking a thorough evaluation of your current solutions and performing an "apples-to-apples" comparison with other service providers.

You owe it to your shareholders to make certain your bank is utilizing the latest technology with the best possible service levels at competitive pricing (notice I didn't say the lowest cost!). How do you get started? Here are **7 Steps to Effective Vendor Evaluations**:

STEP ONE:

Gather contracts from your service providers. Document the expiration date of your current contract for services, the amount of time prior to the contract termination date that your contract will "automatically renew," and the renewal term if contracts were allowed to automatically renew. *(Upon request, BankSmart can provide you a complimentary Excel file to help you with your contract tracking efforts.)*

STEP TWO:

Determine which services are in a position to be evaluated and/or renegotiated. The best time to begin the process is between twelve and twenty-four months prior to the contract expiration. Start by 'politely' notifying your current providers that you do not want your contracts to automatically renew. *(A sample letter is available from BankSmart at no cost.)*

STEP THREE:

Develop a written Request for Proposal (RFP). Craft the RFP to obtain specific information about each prospective provider's ability to meet the bank's operational requirements and detail the fees they charge for their services. This step requires each proposing vendor to provide relevant information in a common format and provides you with documented assurances of vendor capabilities that may be needed if issues occur during or after implementation.

STEP FOUR:

Determine the "short list." Once your bank team has determined the "short list" of vendors that will continue to be evaluated, each vendor should be asked to present their services to the bank, including demonstrations regarding how the bank would utilize the proposed services based on the needs outlined in the RFP. Put together a preliminary agenda of presentation topics and ask the vendors to gear their presentation around these topics.

STEP FIVE:

Develop an "apples-to-apples" pricing comparison between the vendors. Every vendor charges differently for their services. It is important to develop a comprehensive baseline set of processing volumes formulated on estimates of future growth and apply proposed pricing to these projections consistently among vendors. Don't forget monthly base fees and minimum monthly processing fees!

STEP SIX:

- listed on RileyREO.com,
- Marketing the properties, via the internet, to buyers and investors that may not utilize realtor sites. (Note: There is no prohibition to using realtors or other agents.)
- Your management decides the best strategy for the bank. RileyREO.com provides you with a new avenue to market your OREO properties.
- Creating a web link for the banks to market their OREOs on their website that can be automatically updated without charge and,
- Provide an analysis of the marketing efforts of the bank and its agents.

Pricing ranges from from \$50 - \$100 per property slot per month, depending upon the number of property slots utilized by the bank. There are no fees or registration requirements for potential buyers. RileyREO will be launched in the 4th Quarter 2009. We are currently seeking beta banks, who in return for the participation, will receive 90 days of property slots at no charge, an automated link to their website that details their properties and a review of the current OREO marketing efforts.

If you are interested in more information or would like to be a beta bank, please contact us at mriley@bankresourcesandsolutions.com.

Merging the FRB, OCC, OTS and FDIC - Just Not a Good Idea

Senator Dodd's proposal (Washington Post, 09.22.2009) to combine the FRB, OCC, OTS and FDIC into one super agency has met with extensive resistance from the banking lobbies, and properly so. I suppose an intellectual argument can be made to combine the OCC and OTS. After all, they are both agencies of the U.S. Treasury. Senator Dodd commented that combining agencies was "essential to prevent firms from regulatory shopping or regulatory arbitrage." Here's an easier, far

Check vendor references. Develop a standard set of questions to ask each reference. It is important to talk to current users of the solutions you are evaluating to confirm functionality and vendor service levels. Vendors will generally give you several references, which will undoubtedly be good ones, so be sure to check with other bankers you know to get a good cross-section of feedback.

STEP SEVEN:

Select a finalist. Once all presentations, reference calls and pricing comparisons are completed, your Evaluation Team should collectively determine which vendors are finalists based on the relevant criteria established in advance by the team. One team member (or your professional consultant) should be responsible for negotiating pricing and terms with the selected vendor(s) until the team and executive management are prepared to move to final contracts.

The FDIC document titled *Effective Practices for Selecting a Service Provider* suggests that "banks may wish to consider using consultants to provide expertise and assistance throughout the selection process." The BankSmart team of professionals can assist your bank with vendor selection, contract negotiation, implementation assistance and other special projects. Visit www.BankSmartSolutions.com for more information, or contact Jim Wilkson for more details regarding these 7 Steps at JWilkson@BankSmartSolutions.com or **(813) 774-8000**.

more effective way to stop the shopping: require the current and proposed regulatory agencies to perform simultaneous examinations on financial institutions requesting the switch. Prior to approving the switch, all impacted agencies would need to agree on the CAMELS ratings and any CAMELS rating less than '2' would not allow the switch to occur. Further, the Senator's proposal appears to overlook the Federal Financial Institutions Examination Council (FFIEC) whose role as noted on the FFIEC website: "[t]he Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) and to make recommendations to promote uniformity in the supervision of financial institutions." There are a myriad of challenges to be addressed. Consolidating these agencies isn't one of them.

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.

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