

October 2010 - the riley report and RileyREO, Inc

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the riley report common sense banking for the 21st century



Bank Failures, Texas Ratios and 2011 - Not a Pretty Sight

In 2008, I suggested we would see between 400-800 FDIC insured Financial Institutions (FIs) fail before this cycle was over. Since then, there have been 288 FI failures. 67% had assets of \$500 million or less at the time of failure. Here's why I believe my original estimate will bear out: using June 30, 2010 FDIC data, there are 839 FIs with Texas Ratios* of 75% or greater. Within that group, 511 FIs have Texas Ratios of 100% or higher. Moreover, the FDIC has identified 829 Problem FIs as of June 2010. Undoubtedly, there is an overlap. However, this is up from 76 Problem FIs in 2007 and underscores the weakness in many FIs in this economy.

Given all this, I believe regulators and the investment community have recognized the number of FIs will continue to shrink either through failures or consolidations. Bank leadership needs to be brutally honest in its self appraisal and prospects for the future. For those struggling FIs, access to capital, assembling effective management teams, cleaning up loan portfolios, and lowered valuations will remain the topics that keep CEOs and their board awake at night. Another challenge that will grow is shareholder activism in all of its permutations.

For the healthy bank, has management assessed the impact of these failures and consolidations in its respective market? With every crisis, there are opportunities. If we thought this year was exciting, stay tuned for 2011.

www.RileyREO.com

We want your REOs on our website!

Designed by former bankers, www.RileyREO.com provides a low cost, no commission, and direct conduit between banks wanting to expeditiously dispose of their Other Real Estate Owned properties, and buyers or investors. **Launched in late August 2010, www.RileyREO.com has received inquiries from potential buyers from 48 states searching for properties. We are currently looking for more REOs to post on www.RileyREO.com.**

Our new website overcomes the current bank to buyer limitations in getting together. With over \$49 billion in REO properties (June 2010 FDIC), bankers need to utilize every available tool to manage and expedite REO sales. Here's how we fill that niche:

Current Bank Options & Limitations

1. *Sell it yourself* - Limited to bank contacts and local media advertising.
2. *Create a web page* - Buyers need to find the bank's website.
3. *Assign to Realtor* - Realtor sites require their utilization and do not list properties that are for sale directly by the bank.

For the potential buyer, www.RileyREO.com provides access to bank REO properties at no cost or registration requirements. Acting as the conduit, www.RileyREO.com does not get involved in the negotiations or sale of properties. As such, www.RileyREO.com works well with properties listed directly by the bank or through realtors.

Current Buyer Options & Limitations

1. *Contact your bank directly* - Time consuming and usually not productive as buyer must first identify banks in the targeted market, contact the bank and be connected to someone in the ORE area (or leave a message) -- and that's to determine what properties may be available and whether the bank is handling the property or if it's been assigned to a realtor.
2. *Search realtors' MLS* - Limited to realtor listed properties, which has no benefit if the buyer's goal is to buy directly from your bank. Multiple markets require multiple realtors.
3. *Join REO website* - Must register (will personal information held at site), pay monthly fees and most refer properties to realtors.

For participating banks, www.RileyREO.com provides detailed reports of what properties are being reviewed, which buyers are requesting additional information, a link to the bank's website, and assists in preparing property and market information.

The www.RileyREO.com Solution

Benefits for Banks

- Bank controls the sales process using current staff or realtor

*Texas Ratio is defined as: (All loans 30+ days Past Due, Nonaccruing Loans, Other Real Estate Owned)/ (Equity and Loan Loss Provision)

Community Bank Mortgage Lending and Helping Homeowners, without Taxpayer Dollars

Community banks have stayed out of the 30 year fixed rate mortgage market principally due to the ALCO interest rate risk. Why not create a federal program that would permit banks to sell their 30 year fixed rate mortgages every 5 years to a designated GSE, at par, provided the loan has been paying as agreed for the five year period? Currently, 30 year fixed rate mortgages are 4.25% (Bankrate.com.) while the 5 year Daily Treasury Yield Curve is reflecting a 1.23% rate; a 302 BP spread. For bankers, there's a great incentive to create solid loans, improve their Net Interest Margin and assist their customers. For the federal government, the program will stimulate lending and bolster the economic recovery. Homeowners will see more competition for their loans. All in all, a win-win approach for everyone.

FIRSINC - Working with Investors and Banks

Our company provides results proven consulting services to banks and investors. As my own background includes leading the revival of two banks that were operating under regulatory agreements, I understand the various roles of everyone involved and can help guide a bank's Board and management through the myriad of challenges.

For investors, FIRSINC is developing a niche service that provides summary Due Diligence reports for potential investors. The approach focuses on determining the credibility of the management, the financial reports, quality of the assets, and stability of its

- No commission fees
- Institution remains anonymous in market until buyer contact is made
- Individualized web page available with free, automated RileyREO upload
- Extensive professional internet marketing expands universe of buyers
- Detailed management reports

Benefits for Buyers

- Buyers may be individuals, REITS, investment funds, insurance companies or small and large businesses
- No registration required to use RileyREO
- No monthly or hidden fees: completely free to Buyers
- Buyers remain anonymous during search
- Buyers may "bundle" (aggregate and inquire about all properties of interest)

RileyREO Features

- Scalability that allows banks of any size to compete on the same playing field as large banks
- Full integration into the bank's current sales strategy
- Free upload to the bank's website of their REOs
- Detailed empirical feedback about number of hits and inquiries per property posted
- **Low cost** structure (\$50-\$100 per property per month); RileyREO does not share in any commissions paid by the bank

For more information, please contact us at info@RileyREO.com.

Overdraft Programs -- The Next Chapter

Mike Potter, Sr. Vice President - Strunk & Associates LP

The Current Regulatory Issues

Based on my conversations with bankers, association executives, and the content of some recent examinations, I'd like to offer a few comments on the post-Reg E environment for your consideration. For the last five years at least, the regulatory community has promulgated multiple rounds of guidelines and descriptions of best practices that largely focused on more and more disclosure of the nature of overdraft programs so that customers were better prepared to understand them. The underlying premise seemed to be (personal opinion) that customers in general were under-informed, and that if they had better information, such as the Reg DD additions to monthly statements, they would use overdraft services less often.

The Reg E amendments took that idea to a new level by requiring that customers specifically opt-in to having their debit and ATM transactions covered before the bank could charge a fee for providing overdraft services on those transactions ... yet more disclosure.

The simple fact is, however, that none of the enhanced disclosures have resulted in any discernable change in customer behavior. Similarly, my conversations with bankers who have **successfully** completed their Reg E efforts in recent months suggest that the Reg E amendments are having relatively little impact on customer acceptance of well designed overdraft programs other than eliminating the ability to charge fees for those items which the bank is forced to pay if the customer has opted out. That income line item alone amounts to several hundreds of thousands of dollars at some community banks.

All of this suggests that customers do not behave the way they do because they lack information, despite the desire of some industry observers to believe that. Customers behave the way they do because they find strong value in=

liabilities, capital levels, local market pressures and potential for success.

Well run community banks will thrive in the 21st Century. Our singular goal is assisting banks achieve their potential for success.

Thanks for your support and we look forward to your comments.
Mark C. Riley

HUB International Reduces Insurance Costs on NPAs

If your bank hasn't recently conducted a thorough analysis of its insurance programs for Non Performing Assets, including Other Real Estate Owned, contact Chris Riley, Program Manager (christopher.riley@hubinternational.com) for more information, including a no cost analysis. HUB is one of the nation's leading insurance providers of insurance to financial institutions with a focus on collateral protection solutions such as Mortgage Impairment, Lender Placed-REO, CPI and non-real property collateral.

To access previous issues of the riley report, please visit:

www.BankResourcesAndSolutions.com

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the overdraft services offered by the vast majority of community financial institutions.

The focus of the regulatory community seems now to be moving beyond how much information the *customer* has about their overdraft program to assessing how much information the *financial institution* has about their overdraft program. Further, additional focus is being placed on determining if the program is risk managed appropriately, and if there is sufficient disclosure to ensure that it is not potentially in violation of the Federal Trade Commission's definitions of Unfair or Deceptive Acts or Practices (UDAP). This article cannot hope to fully discuss these issues, but all bankers should be aware of some basics, including the recently proposed guidance from the FDIC.

Let's be clear. The vast majority of community banks try very hard to offer services that benefit their customers and the bank, and the regulatory community has been clear about that in several of their writings. No bank can thrive in the long term by mistreating customers, even unintentionally. The vast majority of overdrafts are unintentional, and they tend to occur in amounts that pose no significant risk to the bank to accommodate when the bank exercises the same degree of management attention as in any other customer service or product.

Even though this new FDIC proposed guidance is not yet final, I would offer the thought that community bankers who review the new proposed FDIC guidance on overdraft programs with an eye toward thinking about the design, execution, communication, and daily management of their overdraft programs might find valuable material here. Main Street bankers have already been unjustly tarred with the same brush that should have been exclusively aimed at the instigators of the mortgage market meltdown. Prudent risk management particularly "reputation risk" can help ensure that the egregious behavior of a handful of players don't destroy the perceived value of a service that the vast majority of our customers enjoy.

How Does Your Overdraft Program Compare?

Virtually all banks today have some sort of discretionary overdraft program, either developed internally over the years, or acquired from their core processor or companies like Strunk & Associates. In the light of the most recent regulatory attention, few of them are equipped with the full range of policies, procedures, best practices, and management tools needed to ensure that the best interests of both customers and the bank are protected. In truth, the recent enactment of amendments to Regulation E and the currently proposed FDIC guidelines now present bankers with perhaps the strongest opportunity to date to confidently offer a truly valuable customer service. Through effective and thoughtful program design, bankers can offer a customer-centric overdraft program that creates an optimum balance between fee income enhancement and protecting the customer from the kind of potential abuses caused by some of the more aggressive practices of a handful of larger institutions who have figured prominently in recent regulatory actions and press articles.

In recent years, many bankers have withheld some very valuable benefits from customers by unilaterally deciding to offer only limited overdraft coverage. The much-discussed "\$30 cup of coffee" and stories of large overdraft fees mounting up from small overdrafts have led many bank CEO's to place restrictions on their program, such as refusing to allow overdrafts from ATM or debit card transactions.

In the past, when check transactions constituted the majority of customer transactions, this may have had little impact on our customers, but with debit cards quickly eliminating the traditional check, removing customer choice from the equation has very real negative customer service results. Customers don't think of checks, ACH, debit, or ATM transactions as different kinds of events. They are all equal parts of the customer's convenient access to their accounts. Customers expect to make their own decisions about how they use the bank ... they don't expect the rules to be dictated to them. When a customer reaches for their debit card to pay for groceries or for a meal, they have no reason to suspect that their bank will arbitrarily decide to treat them differently than if they had written a check. The return of a check for insufficient funds and the decline of an authorization for their debit card both present embarrassment and inconvenience.

While the customer assumes that their bank will offer an even-handed approach to their transactions, they should also be able to expect that their bank will not subject them (in either case) to a quickly mounting pile of fees, particularly when caused by single small transactions. It is not a question of

whether the transaction was by check or debit card, it is the design and daily management of the overdraft service that should protect the customer from inordinate expense while also protecting the bank from the potential reputation risk any perceived financial harm.

You can "protect" your customer from the \$30 cup of coffee by refusing to pay their potential debit card overdrafts, but the cost of that "protection" is confusion, embarrassment, and poor customer service. The customer can be genuinely protected from that same \$30 cup of coffee by paying the item (whether check or debit card) and not charging an overdraft fee for items below a dollar threshold that covers such relatively small items. "Runaway" overdraft fees can similarly be prevented by establishing a daily cap on fees, again regardless to the type of transaction, and many community bankers already have such policies in place.

Bankers should also think very deliberately about the disclosure of their programs. Many community banks, regardless of their "rules" about overdrafts, do little or nothing to inform their customers about the program, particularly on an ongoing basis. In many cases, this decision is driven by the fact that there are no consistent rules to disclose. In those situations, how can the customer be anything but ill-informed or confused? I have heard more than a few bankers talk about being at a competitive disadvantage and even losing good customer accounts because the customer moved to a new bank that had a well-disclosed overdraft program. Those customers were lost to the bank because the customer was not even aware that their existing bank had such a program.

A properly designed and well managed overdraft program is a genuine customer service, and it should be communicated just as clearly as any other product the bank has. As in all bank services, the customer is best served when they can make an informed decision about whether any product or service is right for them. As documented by the ABA's annual survey of bank customers on overdrafts, while only 21% of those surveyed paid an overdraft fee in the past year, over two-thirds of respondents said that they were glad that the items were paid.

A Free Compliance Update Webinar for Bankers

As a timely resource for all banks, Strunk conducted a free compliance update on September 22. Audio links to this program will be available for bankers who were unable to attend the webinar: simply email us for the program link.

Mike Potter is Senior Vice President of Houston-based Strunk & Associates, L.P. Strunk's Overdraft PrivilegeSM service is the most frequent choice of bankers around the country. Mike can be reached at mpotter@strunklp.com.

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