

Overdraft Privilege Programs

The Best Noninterest Income Opportunity for Your Bank

By Ken Johnson, Executive Vice President, Strunk and Associates, LP, a BancSource Business Partner

For most banks, 2006 was another record-setting year, or at a minimum another good one. Even so, many Oregon bankers are awake at night thinking about how they're going to continue their bank's favorable financial performance in 2007 and beyond.

Like most bankers across the country, OBA members continue to see their net interest margins decline. Banks in the United States saw their average net interest margins fall to 3.38% (as of 9.30.06) – a 17 year low. Everyone agrees the prospects for improving net interest margins in Oregon or across the country are slim. Fortunately, there is hope beyond net interest margins.

High performance banks are increasingly replacing net interest income with noninterest income. This change in the way banks make money is by no means a recent phenomenon. In the early seventies (before deregulation within the financial services industry) noninterest income made up only about 20% of net operating revenues (net interest income plus noninterest income) for commercial banks. Today, that number is almost 45%, and in most high performance banks it's even higher. The bottom line trend is clear; increasing noninterest income performance should be a key objective going forward.

When you say it fast, it sounds easy. Luckily, increasing noninterest income is easier said than done. This is especially true in Oregon, where the average ratios for noninterest income versus average assets and service charge income versus average assets are significantly less than industry averages throughout the United States. For example, over the past five years, the average ratio of service charge income versus average assets for Oregon banks has been only about half of the average for banks throughout the United States. So, how can Oregon community banks increase noninterest income?

Deregulation and technology have created many new options for generating noninterest income for community banks. Realistically, many of those options don't make sense for many community banks. The question is, "What should community bankers do that will produce the most profit with acceptable risk and be the highest and best use of their time and expertise?" At least for now, the answer leads most bankers back to the basics of banking, i.e. for most community banks, the single largest source of noninterest income is overdraft services. Not surprisingly, that's where most community bankers can make the most difference going forward.

All banks offer overdraft services and almost all of them believe they're doing a good job, but do they really know? Unfortunately, too many banks are not realizing their full potential and are leaving significant income and customer service opportunities on the table. Their feelings of success are based solely on the fact that

current revenues are greater than they were in the past. Without more analysis and information, it's difficult to be sure why there was improvement (it could have been organic growth, improved collections or other reasons that had little to do with their overdraft program). Those bankers don't have a clear view of how they compare to their peers or industry performance benchmarks. And most importantly, those bankers have limited knowledge whether their bank is in full compliance with current industry best practices and regulatory requirements.

Beyond misguided ego, why haven't more bankers adopted current overdraft programs? Many are concerned about regulatory reactions and other related issues. They're asking themselves:

1. How are the regulators going to react?
2. The bank already offers a good overdraft service. How can additional revenue be produced without unacceptable risk?
3. How will my customers react to the program?
4. Should we promote our overdraft program?
5. Is the potential revenue worth the effort and the regulatory scrutiny?

Continued on page 27

West Virginia Becomes 22nd State to Join Fraud-Net



On February 7, the West Virginia Bankers Association's Fraud-Net website officially

went live, joining twenty-one other states participating in the internet-based secure network dedicated to reducing financial crime. The WVBA rolled out Fraud-Net to its membership during the week of March 5, 2007.

The Oregon Bankers Association's Fraud-Net site has been in operation since 2004 and currently boasts participation from 36 law enforcement agencies, 55 financial institutions and over 300 individual users.

Fraud-Net is a free service provided to OBA member banks and law enforcement. If you or your institution are not registered but would like to be, please contact **Andee Rose** with BancSource at (503) 581-3522 or arose@banc-source.com. ■

Organized Business Burglars and Check Cashers Keep Oregon Banks on Alert

If you're a registered Fraud-Net user, then you're already aware of the numerous robberies targeting Oregon businesses in the past several months. The organized burglars have been stealing payroll check stock from businesses, forging signatures and cashing the checks at unsuspecting banks.

The burglars are known to scout out locations and spend considerable time to research and find examples of the check issuers' signature and employee addresses. In four separate instances at construction-related companies in the Salem area, the suspects approached the businesses inquiring about employment opportunities. According to Detective Michael Korcek with the Salem Police Department, businesses should be on the look out for employment or other inquiries from persons with out of state license plates and to look for other suspicious activities such as parking down the street versus using the parking lot.

In November of 2006, the group victimized a Eugene-area business, eventually forging and cashing the stolen payroll checks. A month later, the burglars were seen in California, and on January 19 they returned to Salem to cash more stolen checks. The organized burglars have hit businesses throughout Oregon, including Aumsville, Eugene, Klamath Falls, Oregon City, Salem and Stayton.

The financial loss to Oregon banks as a result of the check forgeries has been significant. Lieutenant Bill Kohlmeyer with the Salem Police Department reports that damages are in excess of \$100,000. Kohlmeyer wants to heighten business owners' awareness to securing their payroll check stock, particularly at locations with no alarm systems.

To help assist you in alerting your business customers, BancSource and the Oregon Bankers Association have created a Fraud Alert flyer to educate them about the burglary and check cashing scheme. We encourage you to post and distribute the flyer at your branches. The flyer can be downloaded at www.fraud-net.com, or you may contact **Andee Rose** with BancSource at (503) 581-3522 or arose@banc-source.com to obtain a copy.

In addition to alerting your business customers, the OBA encourages you to immediately post any information regarding these activities on Fraud-Net – it's a quick and easy way to disseminate important case information to members of the OBA and to law enforcement agencies working throughout the state. ■

Check Program Highlights

Welcome New Participants!

BANCSource CHECK PROGRAM
pb = Participating Banks

Total Coalition
 (as of February 2007)
 209 Participating Banks

Every month BancSource returns rebates exceeding \$600,000 to the banks and state associations participating in our check program.

We are proud to announce that the following banks have recently joined our BancSource check program coalition:

- **Adams Co-operative Bank** •
Adams, Massachusetts
- **Ware Co-operative Bank** •
Ware, Massachusetts
- **University Bank** •
Ann Arbor, Michigan
- **First Capital Bank** •
Glen Allen, Virginia
- **TowneBank** •
Portsmouth, Virginia

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Attention Business Owners

Fraud Alert

A group of organized burglars have been targeting Oregon businesses for the past several months. In each of the incidents, payroll checks were stolen from the businesses and spend considerable time to research and find examples of the check issuers' signature and employee addresses. In four separate instances at construction-related companies in the Salem area, the suspects approached the businesses inquiring about employment opportunities. The suspects have robbed businesses throughout Oregon.

Protect your business with these measures:

- Secure your payroll check stock in a locked safe
- Have employees store their valuables and personal items in a locked and secure place
- Don't leave your workplace unattended when strangers are present
- Password protect your computers and sensitive software programs
- If possible, pay to have an alarm system installed, or at a minimum, add deadbolts to your door locks

Report It!
 Suspicious activity should be reported to local authorities immediately.

Write down any information that may be useful such as license plate numbers, suspect descriptions, etc.

Don't FORGET!

This message provided by the Oregon Bankers Association

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The New Basel Capital Rules for Community Banks

By: Kevin Crowe, Senior Compliance Counsel, Harland Financial Solutions

Until recently, the Basel capital rule proposals have focused on a few large, internationally active banking institutions, most of which have over \$250 billion in assets. The landscape has now changed. The federal regulators recently issued a proposal that will dramatically change the risk-based capital rules that apply to all financial institutions, no matter what size. It is important to understand what these new Basel capital rules might mean.

On December 26, 2006, the federal banking agencies (the FDIC, OCC, OTS and Federal Reserve Board) published a notice of proposed rulemaking (NPR) that solicited comment on various proposed revisions to the existing risk-based capital framework. This NPR is known as "Basel IA." The Basel IA NPR addresses the concern that allowing large banks to obtain lower risk-based capital requirements as a result of the Basel II capital rules would put community and regional institutions at a competitive disadvantage.

The major changes discussed in the Basel IA NPR are:

Increasing the number of risk-weight categories to which credit exposures may be assigned – The agencies' risk-based capital framework currently has five risk-weight categories: zero, 20, 50, 100 and 200 percent. The Basel IA NPR suggests adding three new risk-weight categories: 35, 75 and 150 percent, allowing a more accurate assignment of risk and associated capital requirements.



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Expanding the use of external credit ratings to determine the risk-weighting for externally-rated exposures – The agencies are considering using external credit ratings that are issued by Nationally Recognized Statistical Rating Organizations (NRSROs) (e.g., Moody's or S&P) to assign risk weights to corporate debt and other types of rated exposures.

Expanding the use of externally-rated collateral and guarantors that may qualify an exposure for a lower risk weight – The agencies are considering expanding the list of collateral and guarantors that will permit an exposure to obtain a lower risk weighting, provided that the collateral or the guarantor are externally-rated at least Investment grade by an NRSRO.

Using loan-to-value ratios and private mortgage insurance (PMI) for assigning risk weights to residential mortgages – The agencies are considering changing the risk-based capital requirements for first lien, one-to-four family residential mortgages to more equitably assign risk levels based on property investments. Currently, performing 1-4 family loans receive a 50 percent risk weighting. Under the proposal, only loans with an LTV (after PMI) of greater than 80 percent and less than or equal to 85 percent would have a 50 percent risk weighting. LTVs would be treated as follows:

The Basel IA NPR is only one of a number of recent risk management-related actions that the federal regulators have taken, and it is clear that the regulators are expecting bank management and boards of directors to make risk management a primary goal in 2007.

This article briefly summarizes the Basel IA NPR. Detailed information on the Basel IA and the Basel II proposals can be found at: <http://www.harlandfinancialsolutions.com/NewsAndEvents/WhitePapers.asp?SuiteID=78>.

Additional information on recent trends in credit risk management is available through the following online event: <http://www.harlandfinancialsolutions.com/webinar/#Trends>. ■

LTV for First Lien, 1-4 Family Residential Mortgages	Required Risk Weight
≤60%	20%
>60% but ≤80%	35%
>80% but ≤85%	50%
>85% but ≤90%	75%
>90% but ≤95%	100%
>95%	150%

Kevin Crowe is Senior Compliance Counsel with the Compliance Legal Department at Harland Financial Solutions. He previously served as Senior Vice President & General Counsel of the Federal Home Loan Bank of Seattle and as General Counsel for a multi-billion dollar savings bank. For more information, contact **Kevin Crowe** at (800) 274-7280 ext. 2887 or kevin.crowe@harlandfs.com.