

Currency

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The next chapter: Overcoming challenges for future growth

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In the aftermath of the subprime and credit crises, financial institutions of all sizes are asking the same question: Now what? The majority of bank executives are bracing themselves for a challenging year ahead. In fact, pessimism about the economy was the highest in the history of Grant Thornton's *15th Bank Executive Survey*. Although many executives reported their institutions as having no specific exposure to subprime loans, the aftershocks are now impacting the valuations of assets held by many of these institutions. However, they do not have to wait until the dust settles to begin the cleanup. In fact, addressing the challenges of the climate today can help position financial institutions for growth tomorrow.

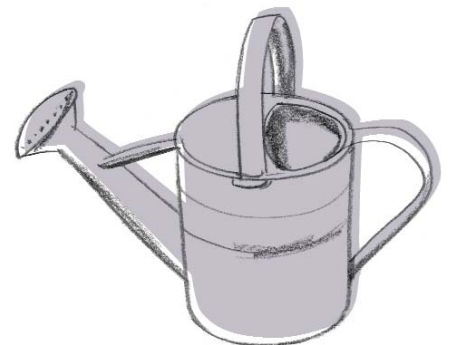
Tightening underwriting

The subprime loan crisis had a domino effect on the financial services industry. The falling real estate market and softening of the market for mortgage-backed securities has led to a tightening of credit and liquidity issues for many entities, which has in turn created problems for municipal insurance companies and holders of auction-rate securities. What are your company and audit committee doing to reduce your risk of the next unknown market crisis? Many institutions are responding by fixing the original problem and tightening underwriting and ensuring they have adequate capital. Nearly half of the survey's respondents have already begun tightening underwriting standards and another 35 percent plan to this year. Executives would benefit from a hard look at underwriting policies.

Building capital

Raising capital is more difficult than years past. Before the crisis, for instance, trust-preferred securities were an easy way to boost capital. Banks would pool trust-preferred securities and enter the market for millions of dollars at a time. Now that market is virtually non-existent — financial institutions looking to go to market with trust-preferred securities have to go to market individually to raise upward of \$15 million at less attractive rates.

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The next chapter: Overcoming challenges for future growth (continued)

Capital is generally more expensive in the current environment. Valuations of financial institutions are low, with many trading at or below book. Although it's not ideal for institutions to sell stock when the price is lower, some institutions may have to in order to maintain adequate levels of capital or to fund future growth.

Customer relationships

Building customer relationships will be vital in any recovery efforts and long-term successes, as well as in combating competition. Community banks pose the most competition for respondents (76 percent), with credit unions presenting the second-highest threat. To compete more effectively, 91 percent of respondents plan to increase cross-selling efforts to gain customers and stimulate growth. New promotions to attract customers to existing products and services will also play a significant role in growth. Market area expansion by opening new branches in new geographic areas is in the plans for 54 percent of respondents.

As the stronghold of Internet banking increases, financial institutions have the opportunity to expand online services. The majority of those surveyed (98 percent) plan to introduce electronic bill payment in the next three years and three-quarters (78 percent) plan to start providing e-mail/wireless banking alerts and online loan applications. Of course, prudent IT security practices go hand-in-hand with Internet banking, and go a long way in reinforcing consumer trust.

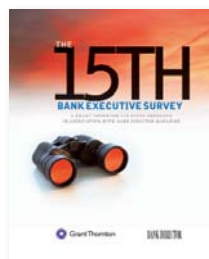
Risk management

One need look no further than the subprime crisis to appreciate the importance of strong corporate governance and risk management. An overwhelming number of respondents (88%) agree that corporate governance is integral to their banks' success, with a top concern for the coming year being regulatory compliance.

As financial institutions face evermore scrutiny, they cannot afford to be lax when it comes to compliance. Evaluating your supervisory controls system on a regular basis and adjusting it as risks change can help identify deficiencies and help prevent costly and reputation-damaging issues in the future.

These fixes will do little for the long term if they are only cosmetic. Financial institutions need to engrain the positive changes that are made, from tighter underwriting standards to greater transparency, in their culture. Those that do can emerge from the crisis and differentiate themselves in the eyes of regulators, shareholders and consumers. More importantly, these prudent practices can help prevent history from repeating. •

For more information, visit www.GrantThornton.com/banksurvey to read the survey and watch a webcast in which Bank Director and Grant Thornton's Financial Institutions Practice group review its results.



About the authors

George Mark is as an Audit partner based in Grant Thornton LLP's New York office and is the Financial Institutions industry leader for the New York metropolitan area.

Mark has more than 25 years experience providing professional services to the financial services industry. Prior to joining Grant Thornton, he was a partner with a major national accounting firm and a large international firm. He also has experience as a chief financial officer for a publicly traded managed-care company and as executive vice president for a diversified publicly traded financial institution. Mark is frequently sought after for his expertise and is routinely quoted in leading financial institutions publications.

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About the newsletter

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