



April 6, 2016

**Weekly Post: Know Your Neighborhood – Beyond Peer Group Comparison**

Dear Clients-

Peer group comparisons are used by ALCO to make ALM decisions, the Board of directors to monitor performance, and regulators to ensure your institution is in line with your peers. But, in my opinion, peer group comparisons have limited applications and can be misleading.

Banks and Credit Unions should learn from market best practices and not from an “average” peer group to attain higher performance. Each institution is unique rendering “peer” an ambiguous term. For example, some managers may have high risk aversion because of the experiences of the S&L crisis while others may take more risk to seek higher returns. Many institutions are subject to special local market conditions.

**Market Wisdom - Art Hilliard\***  
Last week a \$4.5mm scratch and dent pool, 23% government guaranteed loans, sold to multiple bidders at 92.31; 6.224% YTM.

- This was a Geographically diverse pool - 13 loans in 11 states
- A mixture of fixed (77%) and ARMs (23%)
- Good quality loans – WA FICO 741, WA LTV 65% – all performing
- With a WA Rate of 4.309%, these loans were a good buy at this price

**Pool details attached *THC* site *Conf Room***  
<https://www.thcdecisions.com/tro>

By way of contrast, in place of “peer group comparison,” THC uses “Know Your Neighborhood”

**Challenges**

- How should you compare your institution with your competitors?
- How do some institutions in your region outperform you?
- How should you tell the regulators that *their* peer group comparison can be misleading?
- How do you search for loans that are for sale in your region?

**Solution**

THC **Know Your Neighborhood** allows you to

- Select multiple groups of banks for different comparison purposes. The groups can include your peer group, chosen competitors, sector leaders for emulation, and potential partners in loan participation.
- Generate reports including the comparison of 15 unique performance measures of banks in the selected group (as listed below). Also of note, a selected group of banks can be used for your quarterly reports. Separately, you can generate the Directors Dashboard and Management Summary report comparing your institution to the group of competitors that you or your management choose to put in your comparison group.

	Asset (\$000)	Loan (\$000)	Deposit (\$000)	Equity (\$000)	Nil (\$000)	Loan/Asset (%)	Investment/Asset (%)	Loan/Deposit (%)	Borrowing/Deposit (%)	Broker CD/Deposit (%)	ALLL/Loans (%)	Equity Ratio (%)	Margin (%)	ROA (%)	ROE (%)
2015Dec CALL															
<b>Bank</b>	388,951	284,733	311,691	38,591	15,999	73.21	18.55	91.35	9.62	14.72	1.40	9.92	4.09	0.39	3.96
<b>NYC small banks</b>	450,803	294,666	351,877	66,431	12,390	61.76	15.25	74.86	181.77	5.80	1.28	17.85	2.86	0.97	5.93



- Compare yourself with a selected group and then use Trade Simulations and Financial Simulations to pre-test any rebalancing of the balance sheet that these comparisons may suggest. An illustration is provided below with a hypothetical bank. You can select loans available for sale in your region.

**Performances (key ratios)**

Performance	Current	Peer Group*
Earning Asset Yield	4.33%	3.33%
Cost of Funds	0.24%	0.47%
Net Interest Margin	4.09%	2.86%
Equity to Assets	9.92%	17.85%
Noninterest cost(income)/Equity	35.55%	15.97%
Loss Provision/Equity	1.43%	0.60%
Realized GainLoss/Equity	1.37%	0.20%
Tax/Equity	1.89%	1.40%
Return on Average Stockholders' Equity	3.96%	5.93%
Efficiency Ratio	88.56%	76.36%
Loans/Deposits+FHLB	83.33%	71.98%

The above comparison report shows that the bank’s earnings are driven by high margin and a low capital ratio. The high margin, in fact, comes from the long duration of the assets. This results in an EVE duration of 14.79. Clearly this example shows a very liability sensitive balance sheet.

**Numerical Example**

The comparison is not confined to comparing with the FFIEC peer group classification. The comparison can be conducted with the institutions within the same state, banks considered to have best practices, or with your competitors.

To improve the balance sheet performance, the hypothetical bank described above may simulate lowering its short term borrowings and borrowing \$10mm 6 year FHLB advances.

Performance	Base	Pre-Trade	Diff
EVE ratio(%)	14.79	14.79	-
Duration	14.95	14.02	-0.93
% EVE Chg up 400	-58.22	-54.94	3.28
% NII Chg up 400	-5.35	-2.93	2.42
Short Term/Asset(%)	4.31	4.33	0.02
Margin(%)	3.75	3.70	-0.04
NII(\$000)	15,294	15,156	-138
Earning(\$000)	664	571	-93
ROE(%)	1.12	0.96	-0.16

The simulation results show that the duration drops 0.93 at a cost of \$93,000 in annual income. These simulations enable you to analyze the risk and return tradeoffs.

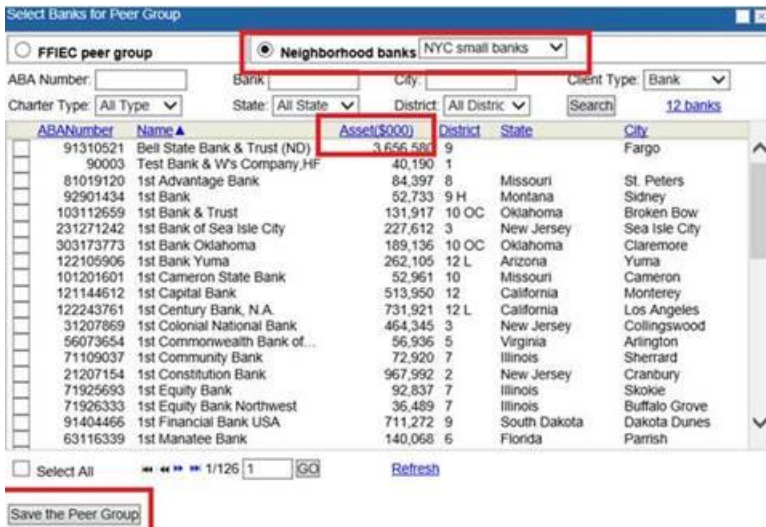


**Conclusions**

I have highlighted the importance of Know Your Neighborhood: This allows you to compare yourself with your competitors, your local peers, or a group of your choice. You can also search for suitable loan availability. This approach goes beyond FFIEC peer group comparison, allowing a comparison which is powerfully useful for regulatory purposes. Furthermore, by knowing your neighborhood, you can use trade simulations to analyze strategies to improve your performance while potentially reducing your risk.

**Appendix: How to Use Know Your Neighborhood**

Step 1. Access “Know Your Neighborhood.” Use the App on the left panel of the homepage or click on the icon on the banner, and you will see the screen below.



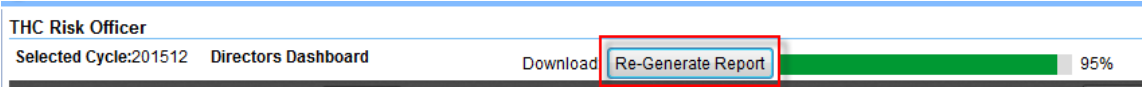
Step 2, Filter the institutions by state, city,.... You can also rank the list by size etc, and then select the institutions for your peer group. Save your Peer Group using your identifier of your choice, e.g. NYC small banks.

Step 3. Generate Reports. You can generate 3 reports after you select your group file to generate reports.

- Know Your Neighborhood report can be generated by clicking on the reporting icon on the Banner.

2015Dec CALL	Asset(\$000)	Loan(\$000)	Deposit(\$000)
Bank	388,951 ↑	284,733 ↑	311,691 ↓
NYC small banks	450,803	294,666	351,877

- Directors’ Dashboard and Management Summary Report can be generated any time by clicking on the “regenerate report” button in the site where you download the respective reports on the left panel of the homepage.



Please don't hesitate to contact me if you have any questions about the "Know Your Neighborhood" feature .



Regards,  
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\*Art Hilliard is the Principal at AHilliard Company assisting banks, credit unions and mortgage companies with mortgage advisory and asset sales and acquisitions.

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