Correspondent Views

BANKERS' BANK OF THE WEST newsletter for community banks

March/April 2015

FROM THE CHIEF FINANCIAL OFFICER

Knowledge, vigilance, adherence to policies fortify cyber defense

Alice M. Voss, EVP & CFO · Bankers' Bank of the West

CYBERSECURITY. Just a few years ago, that word wasn't even part of the community banker's lexicon. Today it's a familiar term that tends to make information technology professionals, senior bank management and boards of directors wince.

Cybersecurity is the process of protecting information by preventing, detecting and responding to attacks. As part of cybersecurity, banks should consider management of internal and external threats and vulnerabilities to protect information assets and the supporting infrastructure from technology-based attacks.

Deflecting these dangers is no small undertaking. We know too well that cyber threats morph, multiply, gather speed, and become more sophisticated by the hour. Given that banks are dependent on technology for critical operations, any decision related to new products and services—along with general technology investment decisions—could expose the bank to vulnerabilities that must be anticipated and managed. We can make at least one safe assumption: Criminals can be counted on to exploit weaknesses to attack financial institutions, exposing them to operational, reputational and financial risks.

The point of this message—drafted at the request of BBW President Bill Mitchell—is not to stir up anxiety but to underscore the importance of cyber risk management and oversight, describe **several cyber-schemes perpetrated recently in BBW's service area**, and offer suggestions for strengthening your defenses. What you see on this page is only a portion of this article. You can **download the complete version** from BBW's home page under the Bulletin Board column.

Let's begin by recognizing that banks have never operated in a zero-risk environment. Two centuries ago, bank robbers escaped by train or on horseback with their plunder. Thieves today can steal more, and more quickly, from halfway across the globe using a laptop. The so-called tools of the criminal's trade have changed. But the challenge for the banker is still to mitigate risk.

Some 21st century threats can gain entry as a result of human error. A bank customer or employee would be quite capable of unwittingly launching a cyber security incident. A hacker who compromises your customer's technology could impersonate that customer using fraudulent emails or Internet banking transactions. By clicking on a link embedded in an email, one of your own employees could unknowingly launch malware programmed to infect your network. To greatly reduce the potential for carelessly caused security issues like these, step up your customer education and employee training efforts. Review and follow your own policies and procedures.

Read the **full article** *at* **www.bbwest.com**.

INSIDE

TAKING NOTE

ASSISTANCE UPON REQUEST

Preparing for an exam or a vendor management review normally involves a good deal of information gathering in the form of reports, certificates and other records.

To obtain documentation you need on services provided to your bank by Bankers' Bank of the West, please email **Debbie Wendt** at **ops@bbwest.com**. In the body of the email, be sure to specify which information you need. Keep in mind it usually takes some time to gather all the information—so for peace of mind, please make your request as far in advance as you can.

SKILL-BUILDING FOR BUSINESS LENDERS

Attention, loan officers with portfolio, underwriting or calling responsibilities: The highly rated skills-oriented seminar **Loan Officer Financial Management Training** will return to Denver on **October 22 and 23**.

Created for experienced commercial lenders seeking to build long-term relationships with their business customers, this program stresses practical tools, techniques and strategies needed to bank today's businesses.

The course, taught by its co-creator, **Kyle Enger**, has been sponsored annually by Bankers' Bank of the West since 2008. Class size is limited to allow for individual attention and discussion, so early registrations are recommended. Download the brochure at **Newsroom** (Events) at **www.bbwest.com**.

GOT MEETING?

Customer banks needing space for a larger meeting, training session or other business function are welcome to request complimentary use of the multipurpose room at BBW's headquarters in downtown Denver. The room, which holds up to 40 people, can be reserved on a space-available basis. To inquire, email **jsvitak@bbwest.com**.

ABOUT

Correspondent Views is published by Bankers' Bank of the West for independent community banks in our service area. Online versions are posted to our website.

If you'd rather receive newsletters by email, send your request to **webmaster@bbwest.com.**

Headquarters location:

Bankers' Bank of the West
1099 18th St., Ste. 2700
Denver, Colorado 80202
303-291-3700 | 800-873-4722

ADVOCACY FOR BUSINESS CUSTOMERS

Next station on the journey to EMV? Education and preparation

Bankers' Bank of the West Bank Card Division

Several community banks in BBW's service area are finding some of their commercial customers have been misinformed by representatives of independent sales organizations that unless they upgrade to EMV-ready equipment by October 1 of this year, they will be unable to process payments.

This message is beyond alarming: It's false. And it's already pressured some merchants to make hasty decisions that might not be in their best interests.

Proactive financial education is among the most important value-added benefits you can provide for your customers, as it equips them to make informed decisions. We recommend that you share the following key points with your merchant customers:

An EMV/chip card is a credit/debit card with an encrypted microchip embedded in the plastic. Within the chip is a number that changes after each card-present transaction. This enhancement helps combat fraud such as card counterfeiting, commonly known as "skimming," using a stolen magnetic stripe. While cards will still have a magnetic stripe on the back after full migration to EMV, the embedded chip will bolster security.

A customer with an EMV chip card will insert her card into an EMV-ready point-of-service (POS) terminal. She will either sign the receipt or enter her PIN before removing the card from the reader. Data will be transmitted from the chip to the financial institution for authentication—a process that takes a few seconds longer than a magnetic stripe swipe.

A liability shift will occur on October 1, 2015. Some outcomes will be unaffected: For example, if the merchant is presented with a fraudulent **magnetic stripe-only card**, the loss will go to the card-issuing bank, as it does today. However, from October 1 on, if a merchant is presented with a **chip card** and has the capability to swipe the magnetic stripe–but is unable to process the chip–the merchant will be liable for the fraud loss if the card happens to be fraudulent.

Upgrading to EMV-ready equipment by October 1, 2015 is not a mandate. Instead, merchants who choose to upgrade to EMV-ready equipment by that time will limit their potential losses due to fraudulent chip cards. This provides an incentive (**not** a requirement) to become EMV-compliant sooner rather than later.

Your customers also need to know that the difference between a world-class merchant service provider and one with a short track record can be huge. Community banks deploying BBW's merchant services program have the latest technology at the point of sale. Our merchant banks are solidly supported with personalized training and the assurance that BBW adheres to the strictest security standards in the industry. Other built-in program benefits are three decades of merchant processing experience, a responsive team of professionals, and competitive pricing.

Certainly the EMV chip is not a silver bullet that will end all fraud. But studies have shown that fraud in Europe has declined about 64% since the adoption of EMV. Full adoption of EMV in the United States could take seven to ten years—and we're ready to support both your bank and your merchant customers through the transition and beyond. To learn more about any of our bank card services, email **bankcards@bbwest.com**.

CULTIVATING LONG-TERM STRENGTH

Risk management – are you zigging when you should be zagging?

Bank Strategies LLC

As the unpleasant memories of the Great Recession of the latter part of the last decade fade farther into the rear view mirror, and the health of the banking industry is gradually restored, it may be time to remind ourselves something we all intuitively know—banking is cyclical, and storm clouds will return.

Clearly, there are many reasons why the lessons learned from hard times need to be "relearned" repeatedly as history unfolds: Memories fade, wounds heal, trouble takes a different path, the industry changes, and seasoned management retires, replaced by leadership without the perspective of their predecessors. Plus, it's probably human nature—after coming through a period when stress levels were elevated and firefighting a daily exercise—to want to focus on the more enjoyable aspects of banking, such as growing balance sheets and improving profits.

That said, there is probably no better time than the present to ensure your leadership is being proactive in assessing the adequacy of its risk management efforts, and taking steps to address areas of weakness. This is intuitive, right? It may seem so, but we sometimes see bankers' actions as counter to what they need to be doing at that point in time. It's like doubling down on your stock market strategy after a period of good returns instead of looking to diversify and lock in your gains.

One example of this is loan review. During the last downturn, we saw a number of institutions that initiated loan review activities, or increased the scope of the function after their portfolios showed signs of stress. By that point, everyone's radar—lending staff, management, directors, and regulators—was heightened, and decisions and practices were being scrutinized internally and externally. In many cases, it almost appeared the loan review functions were focused on addressing the severity of symptoms, not preventing problems.

We would argue the time to increase scrutiny of your credit practices and loan portfolio is when you think you least need it. After all, it will be the loans you put on during the good times, when you're most confident, that likely will (or will not) carry your bank through the *next* downturn. A sound loan review function can help ensure your bank is being as proactive as possible in evaluating and addressing credit risk exposures before the weaknesses manifest as credit losses or become magnified by external factors. Furthermore, the loan review can more than pay for itself if it helps prevent or reduce the loss exposure on even one loan.

The people at Bank Strategies LLC, also doing business as BBW Consulting Solutions, have extensive experience in conducting external loan reviews for community banks. We welcome the opportunity to visit with you about how we can help your bank. Call us at **303-903-9469**.

Dave Nowling to present at May 12 Operations Conference

Leading the two-hour session ***Crucial Conversations—Stop Avoiding and Start Engaging*** at BBW's Bank Operations Conference in Denver will be **Dave Nowling**, a member of the Bank Strategies LLC team, a former Federal Reserve Bank manager, and popular 14-year faculty member of the Graduate School of Banking at Colorado.

To **download the program description** and registration form for the operations-focused conference, visit **www.bbwest.com**.

BUZZ ON BIDS—Bankers Internet Data System

More daylight for seasonal work — and spring training

Debbie Wendt, Vice President—Operations
Bankers' Bank of the West

Leaving winter behind, we're seeing longer stretches of sunshine, which (scientists say) gives us more energy for a typically heavy load of spring projects.

LendingTools.com has given BIDS users a head start by implementing software releases to accommodate NACHA Operating Rules updates that went into effect March 20.

PPD-to-WEB template conversion.

Updated person-to-person rules could affect transactions that had been done as a prearranged payment and deposit (PPD) entry. The ACH Origination portion of BIDS now has an option to convert existing ACH origination templates from PPD to WEB Standard Entry Class (SEC) transactions. Users should check the payment code—which defaults to "R"—on all templates they create and make changes if needed.

Code changes.

Also in accordance with the NACHA Rules updates, two new return reason codes have been added to BIDS:

R62–Return of erroneous or reversing debit.
R77–Non-acceptance of R62 dishonored return.

In addition, the Notice of Change (NOC) code C0-4 (incorrect individual name/receiving company name) has been removed.

A few words about spring training— *on BIDS, that is: The first BBW-led webinar training session, an overview of system capabilities, was held March 24. Kudos to the many BIDS users—115 and counting—who signed up. We welcome your feedback, questions, and ideas for future topics. Please send related suggestions to* **mbrown@bbwest.com**.

SECURITIES SAFEKEEPING

Enhancements shine a year after system modernization

Since the rollout of new safekeeping software on May 1 of last year, our customers have enjoyed convenient access to receipts and user-friendly reports on BIDS. All activity, with the exception of call notifications, is accessible on BIDS for download at your convenience. Following is a summary of what is available along with projected posting times (Mountain Standard).

- **SK Payments.** Provides payment detail for a specific date; usually available by 7 am.
- **Projected Maturity Notices**. Generates report of maturing securities ten days out, and shows if security is pledged. Available by 7:30 am.
- **Account Activity**. Trade receipts (buy/sale) and pledge/release receipts; available after 2 pm.
- **Holdings Report.** Available on the last business day of the month after 2 pm, or upon request.
- **Pledged Report.** Available on the last business day of the month after 2 pm, or upon request.

BBW's **Safekeeping Department** currently serves 101 customer banks with a total par value of $4.9 billion and approximately 9,700 securities. Our clients receive outstanding personal service and support at highly competitive prices. To learn more about our safekeeping capabilities, call Vice President **Sandy Gerk** **303-313-8102**, or email **sgerk@bbwest.com**.

2015 TRAINING BY WESPAY

Payments-focused WesPay courses for BBW customers begin in May

In keeping with their common goal of making high-quality, job-specific education accessible to community financial institutions, Bankers' Bank of the West and the WesPay payments association have scheduled a series of webinars open exclusively to BBW customers.

Session dates and topics are given below to allow you to plan ahead; all listed webinars will start at 1 pm Mountain time. Specifics including course presenters and descriptions, session length, and a registration form will be distributed to BIDS administrators soon. You may also contact your BBW cash management officer to request a complete 2015 schedule.

May 5	*Tuesday*	**ACH Regulations and Government Payments**
June 2	*Tuesday*	**Green Book 101**
July 7	*Tuesday*	**ACH Operations for the RDFI**
August 4	*Tuesday*	**ACH Operations for the ODFI**
September 2	*Wednesday*	**ACH Risk for RDFIs**
October 5	*Monday*	**ACH Risk for ODFIs**
December 8	*Tuesday*	**Check Fraud Risk and Mitigation**

WesPay Vice President, Education **Chuck Floyd** will present at BBW's May 12 **Bank Operations Conference** in Denver, where he'll discuss the impacts of proposed and approved 2016 Same-Day ACH rule changes. Download the conference information at **www.bbwest.com**, and register today!

1099 18th Street · Suite 2700
Denver, Colorado 80202
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TRANSWESTERN FEATURE

"Will she or won't she?"

Kendrik de Koning, Senior Managing Director
TransWestern Capital Advisors, LLC

Persistently low interest rates continue to frustrate the traditional community banking business model, whatever their source. There are some fundamental lessons to be recalled that might help going forward.

Lately, the front page of the **Wall Street Journal** seems to contain a daily discussion of "*Will She or Won't She?*"—a reference to whether Fed Chairman Janet Yellen and her colleagues on the FOMC will finally start to raise the overnight target Fed Funds rate sometime in 2015.

On one hand, it would seem that the employment target of 6.5% as announced by the Fed has been met for several months now. In addition, while not at an exact 2%, the inflation figure most often cited by the Fed, the PCE (Personal Consumption Expenditure) measurement, is currently at 1.30%, certainly not evidence of deflation. And with the Federal Reserve seemingly without many tools left at its disposal to fight the next unforeseen crisis, it would seem that those counting on a 0.25% hike in the overnight rate in June or September of this year might be right.

On the other hand, headwinds facing our economy include forces like a soaring dollar (see index below) hampering manufacturers and exporters, swelling ranks of *under*-employed, an aversion to lending (as a result of regulatory backlash) that is much greater than any previous modern economic expansion, increased savings rates that are husbanding the otherwise lavish refund afforded the American consumer by lower gasoline prices, worse economic conditions in Europe, as well as less-developed regions (populated with consumers) around the globe. These must give the Fed reason for caution.

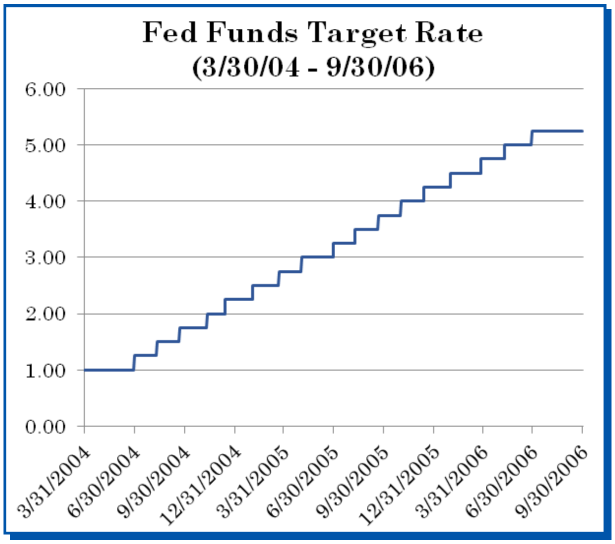
Whenever the Fed decides to start raising rates, it is our view at TransWestern Capital that it will be a good thing—probably long overdue—for community banks. Of course, there is no way to tell for sure how new assets will get booked with the competitive landscape having changed significantly since the last tightening cycle began—over 10 year ago (see below for a picture of what it was like, way back when).

And the same can be said for the deposit side of the balance sheet, although if that money was going to leave for the stock market, one would have thought that would've happened by now. (Moreover, with banks like JPMorgan purposely running more than $200 billion out of their banks, there is likely plenty of cheap funding in the system.) But higher rates, or in any case more "natural" (market) rates, can only lead to more willing buyers meeting more willing sellers. Or, more willing lenders and more willing borrowers. Operating in the synthetic environment of QE 1, 2, 3, Operation Twist, Cash-for-Clunkers, Too-Big-to-Fail, etc., etc., is not good for the economy, and certainly not good for community banking.

Continued on the reverse.

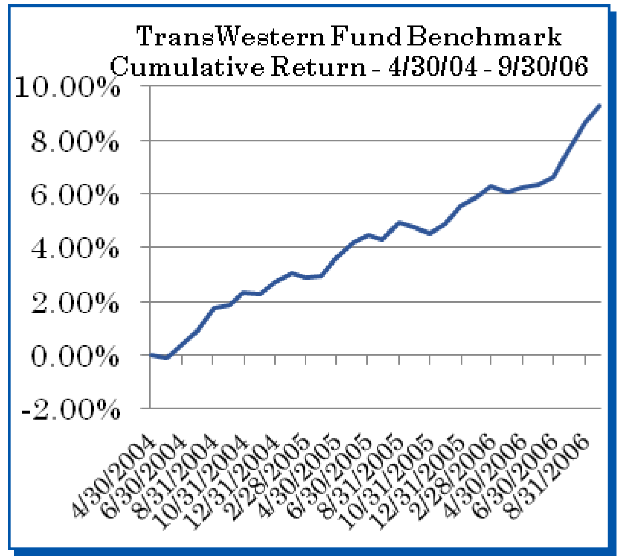
Continued from reverse

Regardless, where higher rates are concerned, to quote the godfather of government expansion, the 32nd President of the United States: "The only thing we have to fear, is fear itself."



Transmuted for our purposes, the community banking model historically thrived on gathering deposits and making loans—or buying bonds. The pervasive reluctance to deploy excess funds into long-term fixed rate loans, or bonds, or even to bonds at all, has empirically and irrefutably been an expensive exercise. This aversion is shared by many who think of themselves as "conservative," and who will do anything to avoid owning an under-market (or water) asset coupon. The problem lies in the fact that foregone income is foregone earnings, and, ultimately (after Uncle Sam gets his) foregone capital. What could possibly be more conservative—or prudent—than having more capital? The short term consequences, history has shown again and again, are mere noise in the long term earnings impact of income.

Those in search of more inspiration might recall the impact of the last tightening cycle on the yield curve. In a word: *flattening*. As you can see, the yield curve at the end of the 2004-2006 hikes is significantly flatter, and only slighter higher in aggregate yield. This was a good time to be in short duration assets, one year, three years, it didn't matter much, but certainly off the sidelines.



As witnessed by the simple index that we use as a benchmark for our short duration government bond fund, the effect of income during that time frame outweighed the impact of any market losses by more than 8% on a cumulative basis during that exact same period. Were prices down? *Yes.* Was significant income generated that 2-1/2 year period that outweighed price changes by more than 8%? *Yes.* It's nothing fancier than blocking and tackling, but you've got to get onto the field if you want to play.

Call TransWestern Capital Advisors, LLC at **800-997-0718** to discuss the particulars of your institution, or visit our website at **TransWesternFunds.com** for more information and recent returns on the TWSGX fund.