



2014 Annual Convention

The New Normal Is Anything but Normal

Presented by:

Jack R. Salvetti, President

S.R. Snodgrass, P.C.



Enterprise Risk Management

The First Rule of Enterprise Risk Management is:

“It’s NOT just about Risk”

Enterprise Risk Management

Managing risk is not just about identifying, assessing, and monitoring all the things that could go wrong. It is also about understanding all the things that need to go right for a bank to achieve its mission and objective of safely and profitably serving its customers and communities.

Carolyn G. DuChene, Deputy Comptroller Operational Risk, OCC

ERM RISKS – Business Risks

The risk to earnings or capital arising from:

<i>Risks</i>	<i>Definitions</i>
Credit Risk	An obligor's (e.g., borrower or counterparty) failure to meet the terms of any contract or otherwise fail to perform as agreed.
Market Risk	Movements in interest rates (repricing risk; basis risk; yield curve risk; options risk). Changes in the value of <u>traded</u> portfolios of financial instruments.
Liquidity Risk	The inability to meet obligations when they come due without incurring unacceptable losses. Changes in funding sources or market values.
Operational Risk	Inadequate or failed internal processes, people, systems, or external events.
Compliance & Legal Risk	Violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards.
Reputational Risk	Negative public opinion.
Strategic Risk	Adverse business decisions, improperly implemented business decisions, or lack of responsiveness to industry changes.

Strategic and Reputational Risks
are at **Elevated Levels!**

What Financial Firms Can Learn from Target's Crisis Response

American Banker – May 9, 2014

Gregg Steinhafel's tenure as chief executive of Target came to an unfortunate conclusion this week when the retail chain announced that its leader was stepping down. Steinhafel's demise as CEO was not a direct result of the data breach that compromised the data of 110 million customers last December. Rather, it was the company's response to the data breach that likely created new questions about its leadership.

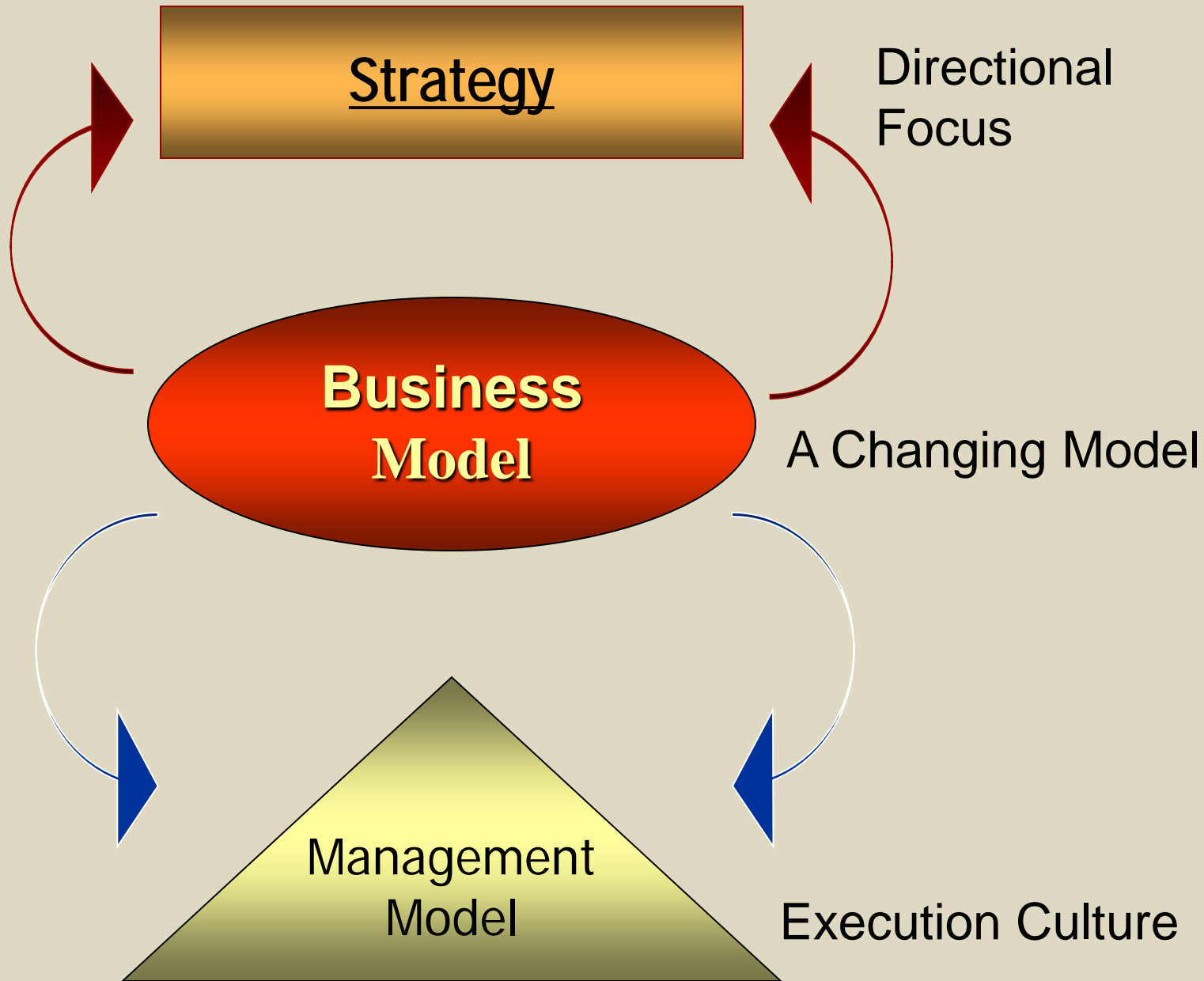
Michael F. Clement
American Banker, May 9, 2014

Reputation Risk: The Effects of Negative Public Opinion –

- Not Just Security Breaches
- Industry / Institution Level
- Customers
- Shareholders
- CFPB provides protection from harm
- Recruiting Future Leaders

Strategic Risk: The Effects of Adverse Business Decisions; Improperly Implemented Business Decisions; Lack of Responsiveness to Industry Changes

“Performance Follows Focus”



Hudson Valley Looks at Putting Its Stockpile of Cash to Work

American Banker – May 6, 2014

Hudson Valley Holding (HVB) is eager to reinvent itself seven months after being freed from a regulatory order. Fortunately, the Yonkers, N.Y., company has plenty of cash to pull off the transformation.

The key for the \$2.9 billion-asset company, given its historic focus on commercial real estate, has been diversification. It launched an asset-based lending unit in November and in March created an equipment-lending arm.

The goal is to “win business away from some of the largest and most-sophisticated banks” while converting “excess cash into earning assets,” Stephen Brown, Hudson Valley’s president and chief executive, said during a conference call last week to discuss quarterly results.

Diversification also represents a shift for Hudson Valley, which had been the “poster child” for New York City commercial real estate lending since its founding in the early 1970s.

Hudson Valley Looks at Putting Its Stockpile of Cash to Work

American Banker – May 6, 2014

Management largely credits regulatory intervention for the strategic shift. The Office of the Comptroller of the Currency entered into a small written agreement with Hudson Valley in 2012 that required the bank to reduce its commercial real estate concentration and build better internal processes to manage risk tied to such loans.

The order forced Hudson Valley to diversify its skill set and change its **focus**, Brown told attendees at a conference last year. (Brown was promoted to CEO in 2012 with a mandate from the company to diversify.)

The OCC's move was preemptive and designed to stay ahead of potential loan problems before they start, making a slightly unusual decision for **regulators**, analysts say. Hudson Valley had not suffered high losses or reported serious credit problems in its commercial real estate book.

Hudson Valley Looks at Putting Its Stockpile of Cash to Work

American Banker – May 6, 2014

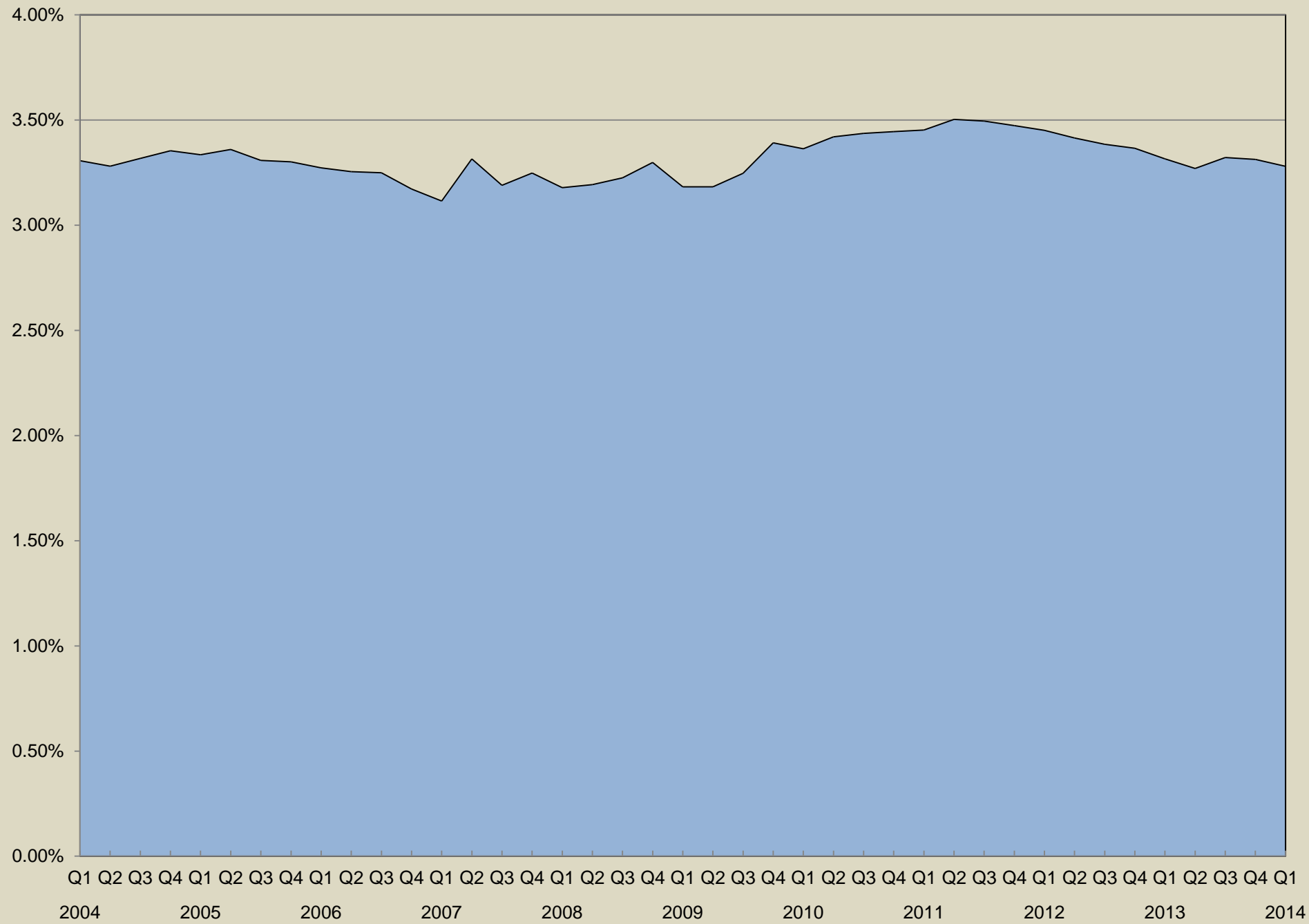
The order “**forced Hudson Valley to change their whole corporate strategy and their lending strategy.**” The company’s concentration of commercial real estate loans has fallen to about 35% of total loans, compared to 44% in mid-2011.

The order indirectly led Hudson Valley down a path where it began to invest in itself. Management sold \$474 million of commercial real estate loans after the **OCC’s intervention**, adding to already strong cash reserves.

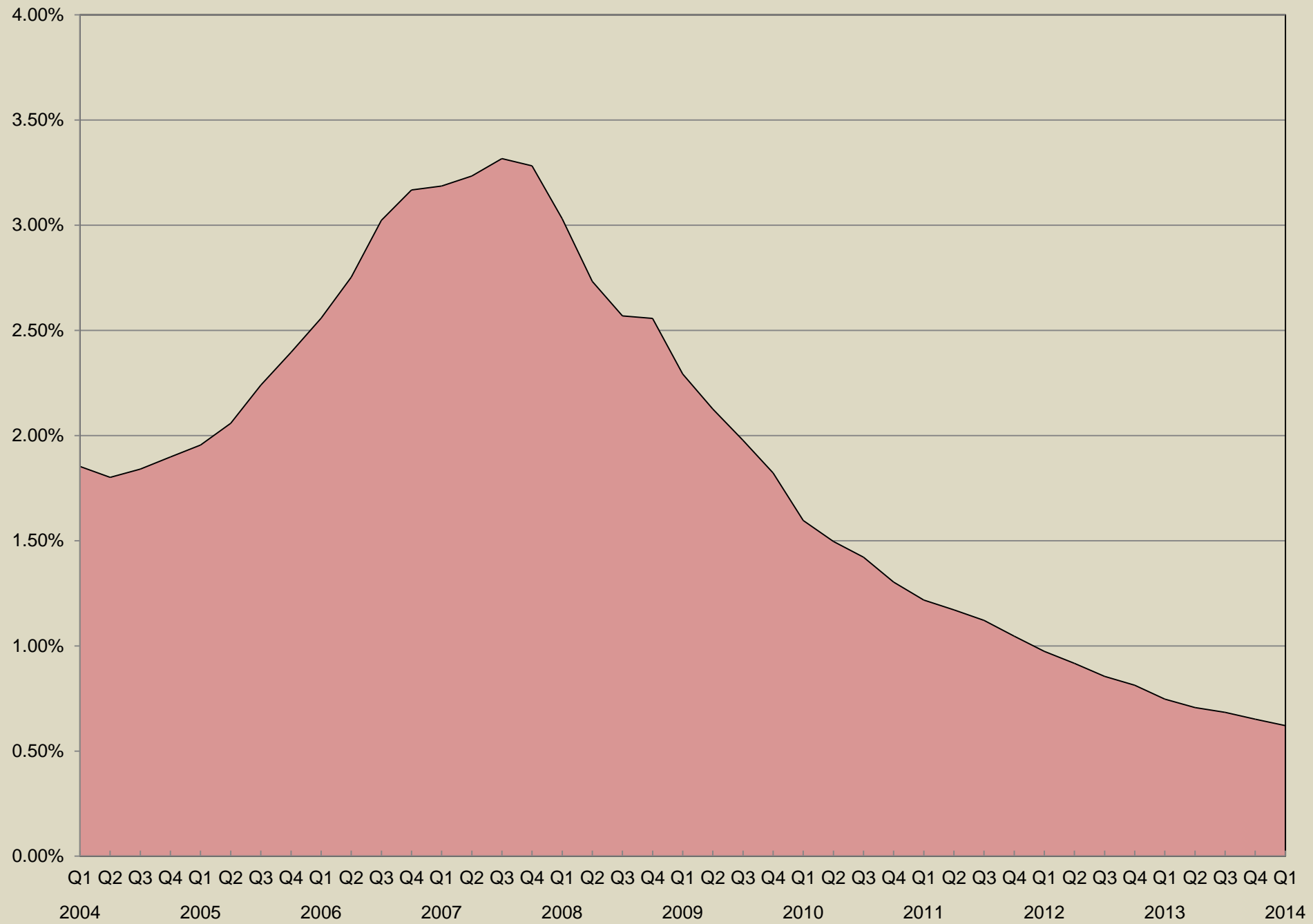
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Chris Cumming
American Banker, May 6, 2014

Pennsylvania Banks: Net Interest Margin



Pennsylvania Banks: Deposit Cost

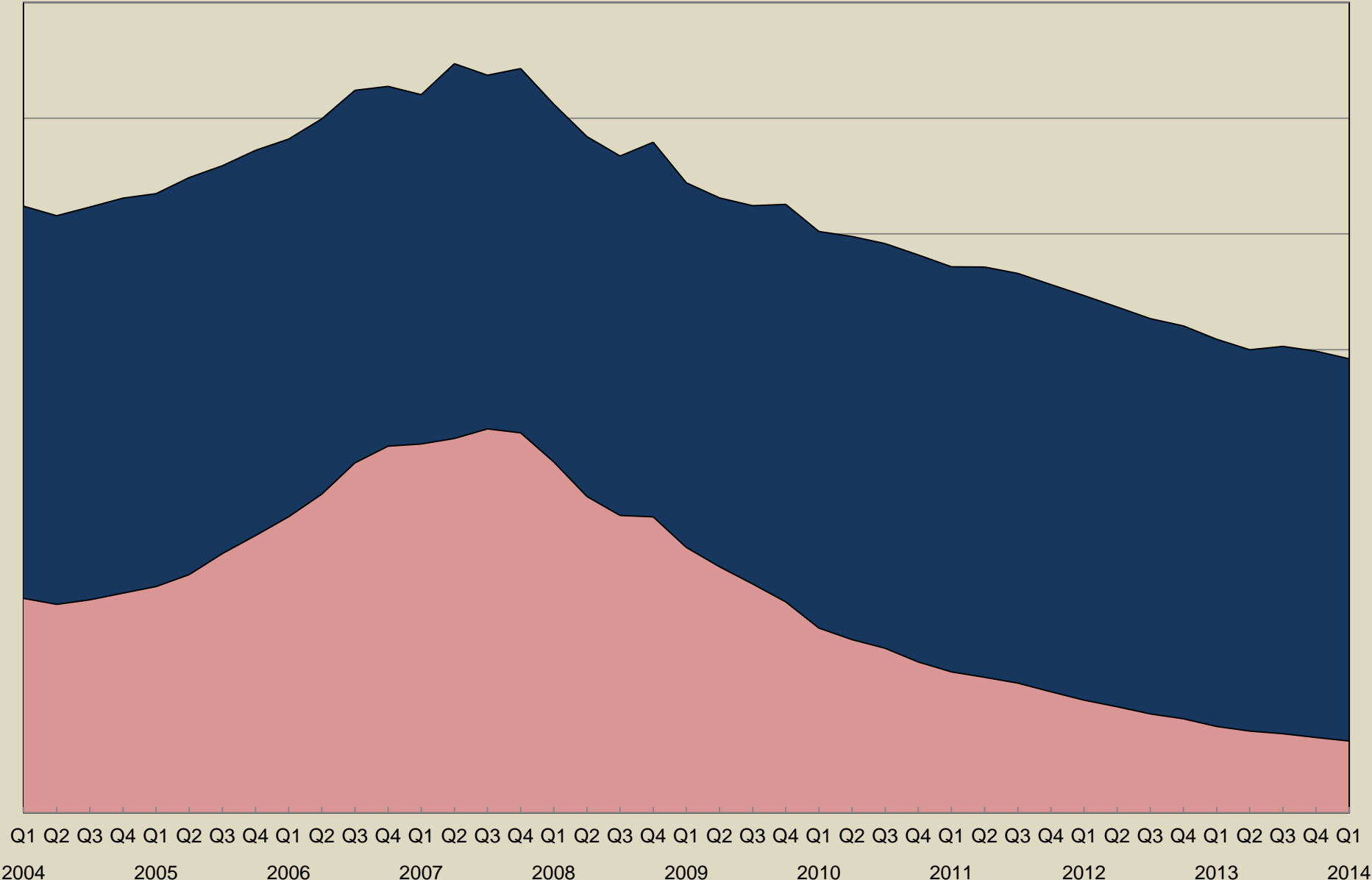


The Deposit Customer is “Rate Weary”

- At or near the bottom
- 2008 “Flight to safety” buying FDIC Insurance
- The objective was wealth preservation
- Today a balance of wealth preservation and creation
- Trend in transferring retirement assets back to equities
- The Biggest Banks are reacting to the Basel III liquidity requirements (liquidity coverage ratio)
- Loan demand is beginning to improve
- Funding Strategic Risk - “Money Desk”, “Customer” or “Vendor”
- Impacts Reputation Risk

Pennsylvania Banks: Yield on Earning Assets to Deposit Cost Comparison

■ Yield on Earning Assets ■ Deposit Cost



Doldrums in Housing Market Worry Fed Official

The Wall Street Journal – May 8, 2014

Many investors expect the Fed to wait until the middle of 2015 before it starts raising interest rates. Ms. Yellen offered a broad assurance of continued low rates, while avoiding specifics on when exactly the Fed might start to tighten credit.

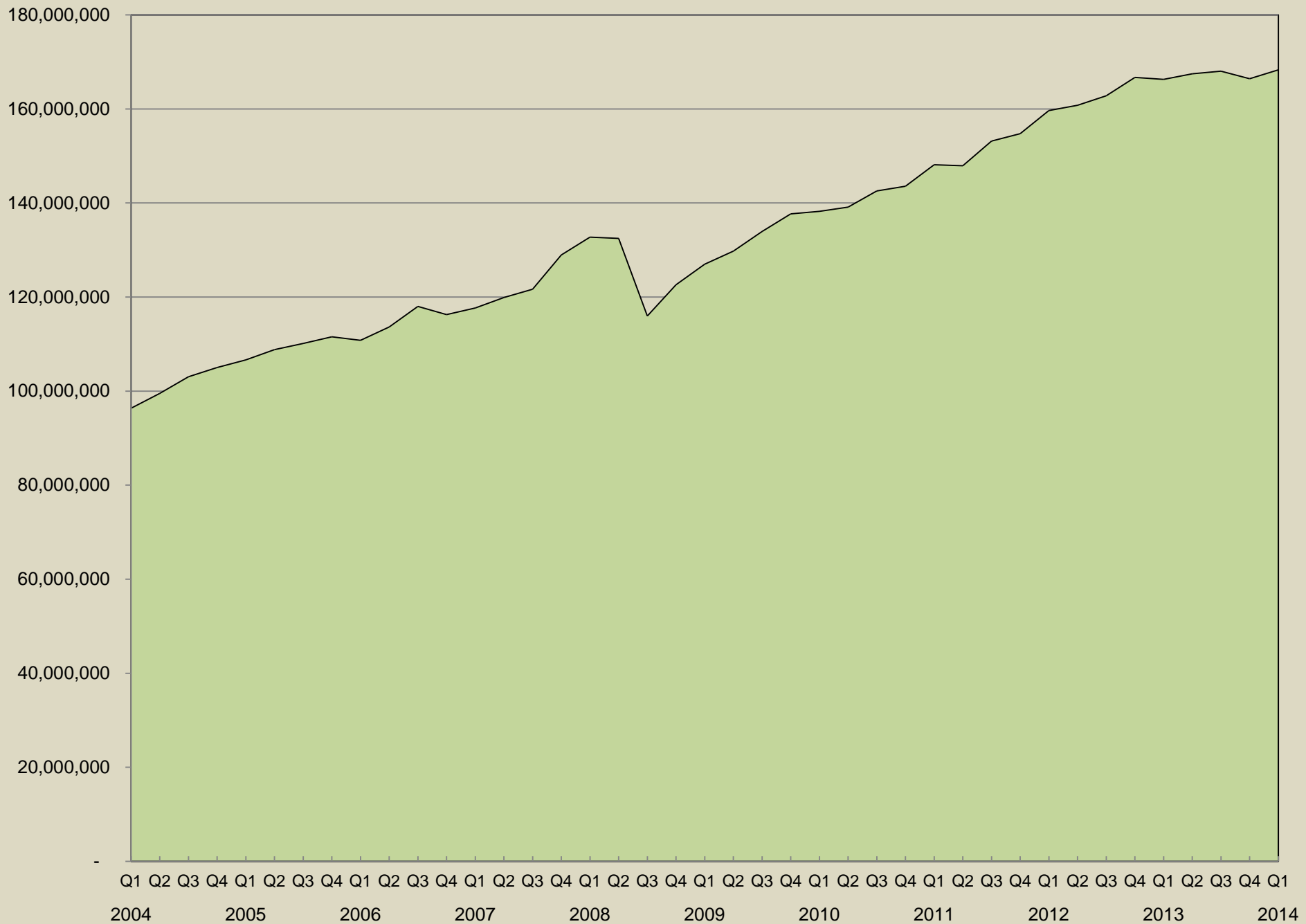
Doldrums in Housing Market Worry Fed Official

The Wall Street Journal – May 8, 2014

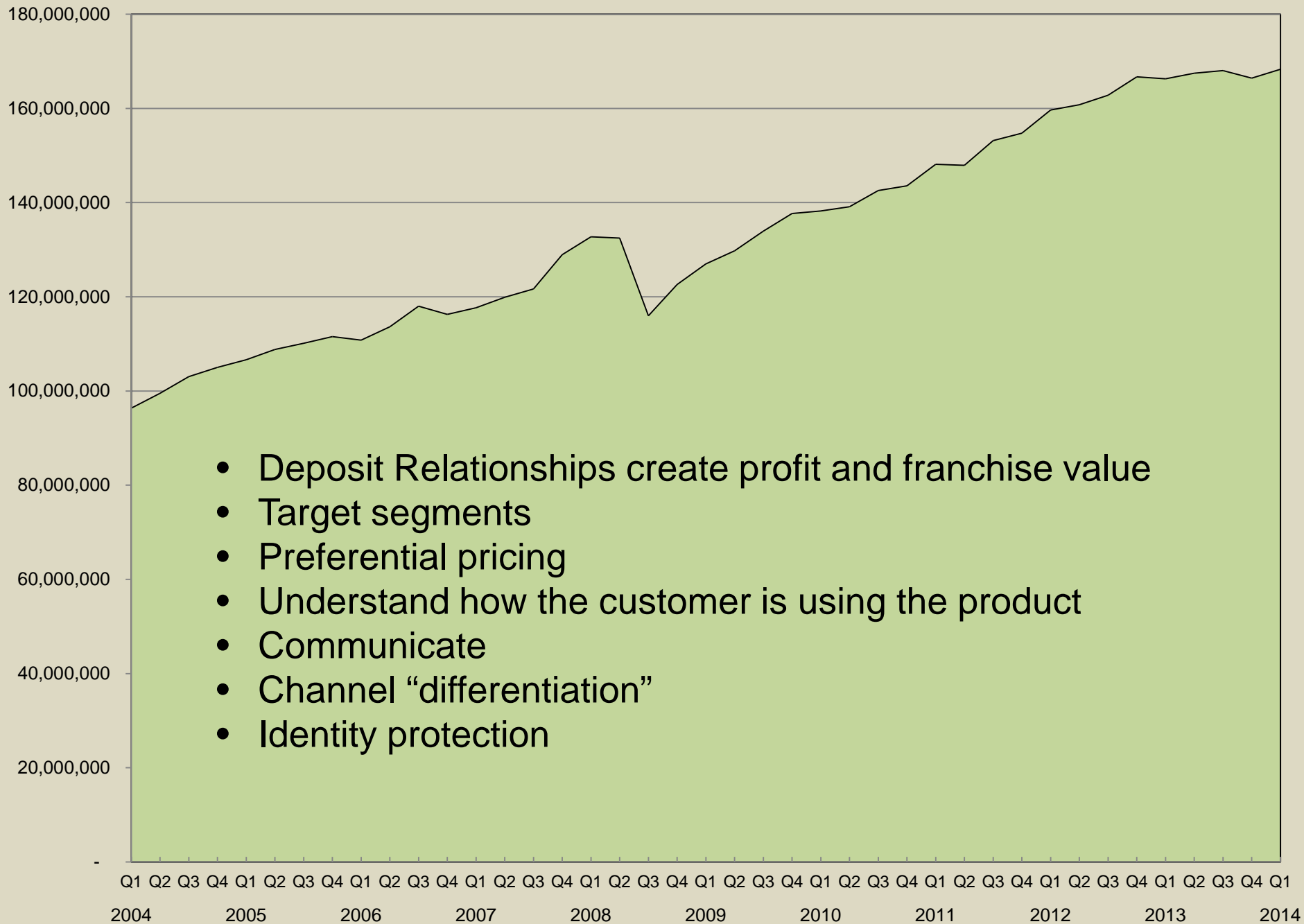
If housing fails to revive as expected and holds back the broader recovery, Fed officials could decide to take even more time on an already slow path to eventual interest rate increases.

Jon Hilsenrath & Nick Timiraos
The Wall Street Journal Print Edition
May 8, 2014

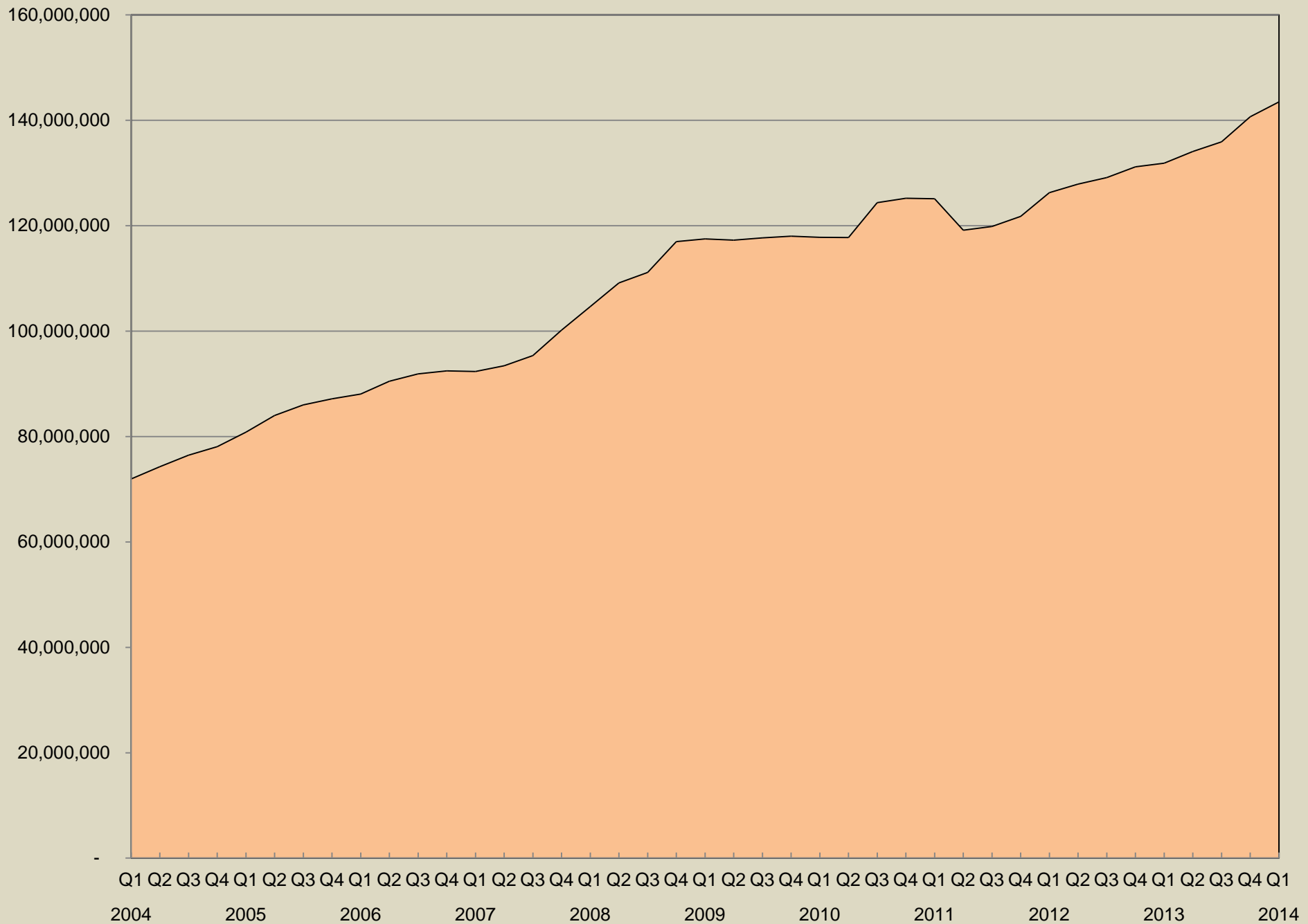
Pennsylvania Banks: Total Deposits



Pennsylvania Banks: Total Deposits

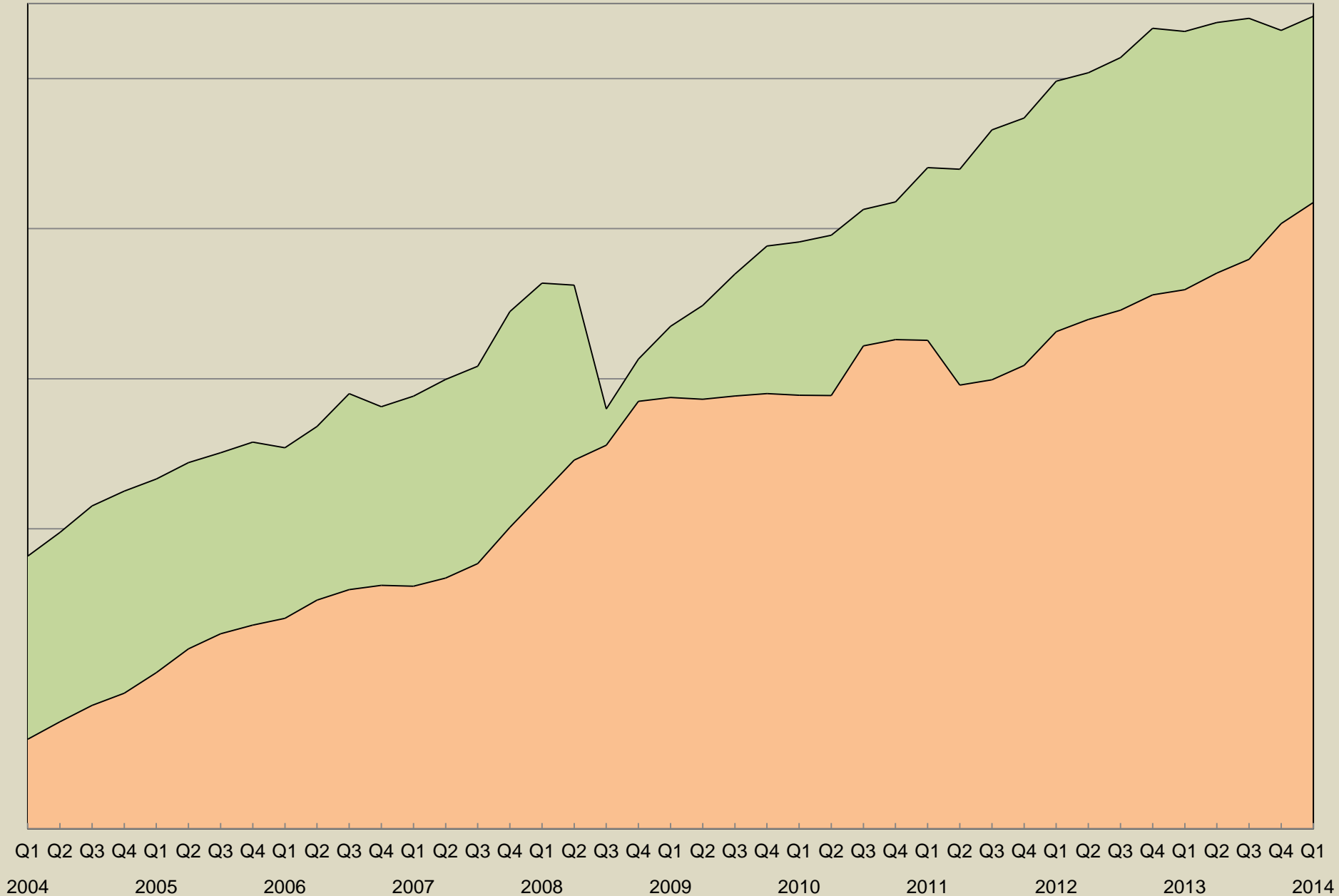


Pennsylvania Banks: Total Loans



Pennsylvania Banks: Total Deposits to Total Loans Comparison

□ Total Deposits: □ Total Loans:



The Customer Value Equation

The **Results** Produced
for the Customer + Service
Quality

Price to the Customer + **Costs** of Acquiring
the Service

The Service Profit Chain :
Heskett, Sasser & Schlesinger

The Customer Value Equation

Customers buy **Results** not products or services + The **Way** in which a product or service is delivered

Price to the Customer + **Costs** of Acquiring the Service

The Service Profit Chain :
Heskett, Sasser & Schlesinger

The Fundamental Strategic Choice....

Which approach will create greater shareholder value?

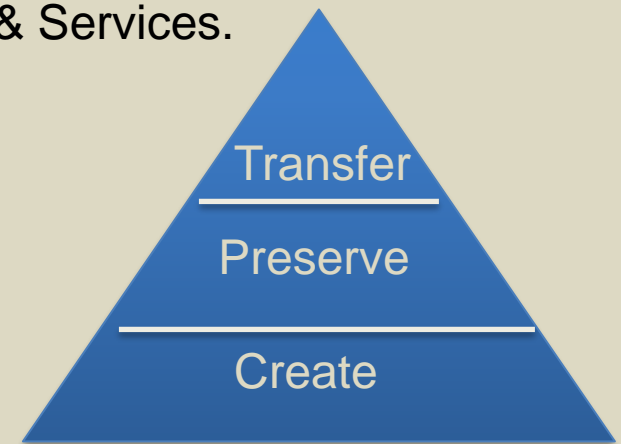
Product Orientation

Design, Produce And Deliver Quality Products That Have Attractive FEATURES.....

- ◆ Simplicity
- ◆ Flexibility
- ◆ Optionality
- ◆ Convenience
- ◆ Price

Relationship Driven

Utilize market segmentation to recruit customers who will use a number of Products & Services and value Advice and Assistance in managing their FINANCIAL AFFAIRS. Seek to understand how customers use the products & Services.



Reputation Risk: The Effects of Negative Public Opinion

Strategic Risk: the Effects of Adverse Business Decisions; Improperly Implemented Business Decisions; or Lack of Responsiveness to Industry Changes

OUTSOURCING
ENTERPRISE RISK MANAGEMENT
CONSULTING AUDITING
TECHNOLOGY SERVICES
TAX SERVICES



Jack R. Salvetti, CPA—President
S.R. Snodgrass, P.C.



Jack is the President of S.R. Snodgrass, a regional accounting and consulting firm specializing in service to financial institutions. As a consultant to the financial services industry, Jack has led management and director teams in the achievement of high performance in the areas of strategy, enterprise risk management, process improvement and earnings growth. Jack has gained a national industry perspective assisting hundreds of organizations located throughout the country. He combines his background as a CPA with business experiences gained over a career serving the financial institution industry. Jack is recognized nationally as an expert to the industry, participates on the faculties of a number of banking schools, has authored several articles on bank performance-related topics, and is a frequent speaker at financial management conferences.

SRSNODGRASS.COM 800.580.7738