

# In Touch

July 2011

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Community Bankers Association of Kansas

## CLOUD COMPUTING & SERVER VIRTUALIZATION

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## • Announcements •

TCK — The Trust Company of Kansas is pleased to announce the addition of **Kathy Ewing**, who will be handling client distributions and mutual fund trading.

Ewing comes to TCK with more than 25 years of experience in the financial industry. She holds a BA in history from Wichita State University.



Ewing

## • Anniversaries •

Congratulations to the banks celebrating July anniversaries as chartered institutions!

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**125 years**

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**117 years**

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**109 years**

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**105 years**

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# Director Profile

• Jon Ott •



**HOMETOWN** Kiowa, Kan. • **BACKGROUND** I grew up on a family farming operation located on the Kansas/Oklahoma border, which also included stocker cattle and a cow-calf operation. We were very involved in showing cattle. The county fair was always the highlight of the summer, so we always looked forward to it; however, it meant the end of summer was right around the corner. Most of my teenage summers were spent sitting on a tractor. • **EDUCATION** I graduated from Kiowa High School and attended Hutchinson Community College. I earned my bachelor's and master's degrees from Kansas State University. Graduating from the Graduate School of Banking at Colorado enhanced my banking knowledge. • **JOBS PRIOR TO BANKING** After college, I worked for Farmland Industries as a livestock production specialist in Lawrence, Kan., and worked for the Kansas Livestock Association as the director of the purebred division. • **FAMILY** My wife, Konnie, runs our registered Angus cow herd and maintains herd records for another Angus breeder. We have two sons: Luke is majoring in geology at Kansas State University in Manhattan; and Stewart is majoring in zoology and playing football at Coffeyville Community College, in Coffeyville, Kan.

by Alex Peak,  
Assistant Editor,  
BankNews Media

**Jon Ott** is branch president of Bank of Kansas in Anthony, Kan.

## Q What is your background in banking and with the Bank of Kansas?

I have worked in rural banks in south central Kansas throughout my entire career, primarily in Barber, Harper and Sumner counties. In October 2010, I was fortunate in being able to join the Bank of Kansas as president of the Anthony, Harper and Mayfield branches.

We at Bank of Kansas believe in being a partner in our customers' business and their community. The communities we serve are not just a place to build our banking establishment, but a place where we integrate into the community. Bank of Kansas' commitment to our communities fits nicely into my beliefs of what being a community banker means. I have always felt that not only do I help my customers with their business decisions regarding financing, but I become a part of their business with the goal for them to succeed and make money. I'm with them every step of the way.

## Q What do you like about being a community banker?

Something different is always going on, as it seems like no two days are alike. I really like having an opportunity to see a variety of both personal and business proposals. I am very interested in what makes a business successful. It is challenging to use your experience and resources to determine what may work for the bank and the customer. I think being a community bank lender is a great job that can be very rewarding.

At Bank of Kansas and throughout my banking career, I have maintained the attribute of ensuring my customers are using the best products and services for their lifestyles and goals. The beauty of being a community banker, and one with Bank of Kansas, is being able to help any type of customer with his or her financial options. My goal is to make sure our customers succeed in choosing financial solutions that makes sense for them.

## Q What favorable qualities do you look for in an employee?

I love working with energetic people who are passionate about what they do every day. Having a good attitude is so very important, as well as having a strong work ethic. Work doesn't have to be work — it can be fun. I try my best to create an atmosphere that is enjoyable at the bank, because I believe it transfers over to our customers.

Great service is what keeps customers coming back. The referrals grow our business. In community banking, you don't refer your close friends and neighbors to someone

you can't trust. Good employees understand the community banking concept. Quality employees deserve to be rewarded with recognition and a fun, friendly atmosphere to work in.

## Q What are some of the things that it takes to be a successful community bank?

I believe very strongly that it is a total team effort, and everyone should be an ambassador for the bank. A lot of front-line people who meet the public every day do not get the credit they deserve. They are extremely important to the overall bank. If a customer's initial impression is favorable, then they will more likely make that next step in moving forward with a deposit or loan product.

Trust, loyalty and commitment to our communities are traits any community bank should possess. All employees, not just the bank's officers, make the bank. Involvement in the community should come natural and not be a forced requirement of employees. I see success come when employees who truly enjoy being in the community

atmosphere are a part of the bank. Again, employees who portray positive attitudes are going to succeed and, thus, in turn help the bank succeed. A successful bank is one that gets to know its customers. It may not always sell on price, but it has the best interest of the customer at heart.

## Q How have your responsibilities changed since being with the bank?

As a past president/CEO of other banks, one of the monthly routines is getting ready for board meetings. It seems like you just get one over with and you are already starting on the next month. Even though I am president of three branches and am on the board of directors for Bank of Kansas, someone else prepares the monthly materials for the meetings. I can honestly say that is something I don't miss doing. Another big area is compliance. I have been the compliance officer at my prior banks for as long as I can remember. At Bank of Kansas, someone else handles that, which frees me up to spend more time on the important things — my customers.

I continue to be excited and look forward to each new day. There is much that I have to be thankful for! •

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# CLOUD COMPUTING & SERVER VIRTUALIZATION

BY ROBERT MENDEZ



**A** ccording to a nationally recognized bank consulting firm, within five years, community banks will no longer install servers. Instead, they will utilize cloud technology and virtual servers to reduce costs, enabling them to focus on the core business of banking. Large banks have already taken this approach because they know it reduces their per-employee IT support costs and enhances their capabilities.

For many of us, “cloud computing” and “virtualization” are terms we hear but may not fully understand. Grasping the basics of cloud computing and virtualization, as well as what they can offer your institution, can mean the difference between business as usual and business that is faster and more efficient.

## What is cloud computing?

So what is cloud computing? Simply put, it is a way for businesses to use software applications without spending money to purchase the hardware and to manage the hardware and software on an ongoing basis. A third party hosts and manages the resources (servers, software updates, backups, redundancy, etc.), and you pay a fee for access to the cloud.

The benefits result because the firm providing the cloud service for you also provides it to many other clients. With

economies of scale, you receive a higher level of security, reliability and support, and at a better price than any single community bank can achieve internally.

For example, some cloud-based services are staffed 24/7, providing around-the-clock network security and monitoring of system availability. Others also offer 24/7 support, which is important if you are trying to complete a call report or other critical item late one evening. Individually, community banks cannot afford (and would not have) technical staff that is available 24/7/365 to provide network security, monitoring and support. With cloud computing, resources such as these — previously available only to the largest banks — are now available to community banks.

### What is server virtualization?

How about server virtualization? This involves taking one physical server and using specialized software to make that one physical machine act as multiple servers. The benefit, once again, is a reduction in both the hardware costs and the management costs related to the hardware. (Most cloud services use virtualization technology to reduce hardware costs and increase efficiency.)

Additionally, virtualization has some disaster-recovery benefits, in contrast to traditional backups. Historically, when you made a backup of a server, you probably used a tape, tape drive and tape drive software. Due to storage tape limitations, as well as the amount of time the backup took and the cost, a tape usually backed up only the database, but not the software programs or the operating system on the machine. As a result, when you had to recover from a backup tape, the re-installation process could take 24-48 hours — even if everything went well and extra hardware was readily available. With virtualization, a snapshot is made of each virtualized machine that includes the database, programs and operating system, allowing for recovery in minutes. And virtualization allows you additional recovery options. You no longer have to install a new server where the old one was: You can simply apply the snapshot to a server in a data center that can host it. If broadband Internet access is available, you can easily get access to your server, the programs and the data.

### Are cloud computing and server virtualization right for me?

Most community banks desire the benefits of added

security, increased reliability, improved disaster recovery and knowledgeable technical support. The challenge comes in selecting a vendor partner that can provide the technical solution, while also meeting requirements unique to the banking industry.

More cloud computing and virtualization vendors are appearing all the time, but few of them specialize in financial institutions. Before choosing a cloud service or virtualization vendor, check the following:

- **Regulatory and Audit** — Is the vendor regulated by banking authorities and does it have audits, such as SAS70 Type IIs?
- **Experience** — Does the vendor have experience not only with the technology but also with your specific banking applications? Many banking applications require specific knowledge to make them work correctly in virtualized environments.
- **Redundancy** — Does the vendor have appropriate redundancy built into the systems to support the requirements of financial institutions?
- **24/7/365** — Does the vendor have around-the-clock support to ensure that your servers, backups, and networks are ready and available?
- **Security** — Does the vendor have appropriate safeguards to protect your client data, such as employee background checks, internal monitoring and appropriate GLBA assurances?
- **Financial Stability** — Is the vendor financially stable? A company you entrust with hosting your bank's data should have a history of profitability, minimal debt and preferably no venture capital investments.
- **References** — Ask for and check the vendor's references.

Best of all, you don't have to be an IT expert to enjoy the benefits that cloud computing and server virtualization can provide: You simply have to perform appropriate due diligence to find the best fit for your bank. •

#### • ABOUT THE AUTHOR • • • • •



Robert Mendez is executive vice president at BankOnIT. A former banker with 25 years of experience, he works with community banks to make IT easy.



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# AN INVESTOR'S GUIDE TO FEDSPEAK

## HOW THE BOND MARKET REACTED IN 2004

BY JIM REBER



It's hard to believe, but as of this writing, it has now been seven full years since the Federal Reserve's Federal Open Market Committee last voted to raise interest rates. The date was June 30, 2004, and it was both the culmination of a year's worth of speculation as to be first move, and the beginning of an extended period of actual rate hikes.

• ABOUT THE AUTHOR •



Jim Reber is president/CEO of ICBA Securities and can be reached at 800-422-6442 or [jreber@icbasecurities.com](mailto:jreber@icbasecurities.com).



could also be helpful to your investing strategies as we approach the inevitable tightening cycle.

### Top O' the Market

On June 30, 2003, if you were a portfolio manager, you had both a lot of unrealized gains in your portfolio and low available yields. The two-year Treasury note yielded 1.30 percent, and one had to go out to five years to get to a 2.50 percent yield. Our senses have been numbed by the past two years, but the yields mentioned above were the lowest the bond market had seen in at least 50 years.

The FOMC's statements that accompanied their meetings were of the "downside risks outweigh the probability of sustained growth" variety. GDP growth was positive, and we clearly weren't in a recession, but inflation was hovering around 2 percent and falling.

By the end of 2003, economic growth was improving, but not yet to the FOMC's satisfaction. Inflation was beginning to show signs of returning, however, so the Fed's statements were essentially unchanged for the rest of the year. The bond market sensed a shift was approaching, and the two-year Treasury's yield had risen 52 basis points to 1.82 percent by Dec. 31.

### Change in Tenor

About this time, the FOMC's statements shifted to subtle warnings. The March 31, 2004, release stated "...upside and downside risks...are roughly equal" but it "...can be patient in removing its policy accommodation." By the May 4, 2004, meeting, the language was less ambiguous. It read, in part, "the Committee believes that policy accommodation [read: low rates] can be removed at a pace that is likely to be measured."

The bond market was battered as investors began building in full expectations for rate hikes sooner than later. The two-year's yield rose to 2.20 percent, even though Fed Funds was still anchored at 1 percent. This is an enormous difference between the two, which is normally about 45 basis points.

### Flattening of the Curve

The first shoe fell on June 30, 2004. Fed Funds rose to 1.25 percent after the FOMC's statement that repeated the "likely to be measured" phrase from May, and added the sentence "The Committee will respond to changes...to fulfill its obligation to maintain price stability."

By the close on June 30, the two-year had risen all the way to 2.68 percent. Clearly, the short end of the market was many meetings ahead of the Fed. As is typical in a rising rate environment, yields on the longer end rose much less. The final accounting is that for the 12-month period ending June 30, 2004, the two- to 10-year curve

flattened by 31 basis points. And that was followed by additional flattening through 2006.

### Conclusions

These should be pretty obvious. One, when this FOMC's language removes the "for an extended period" language to their press releases, it will be a clear signal to the market that rate hikes are coming sooner than later. For another, the steepness of today's curve will certainly begin to undo itself.

Less subtle are the effects on your portfolio. Normally, as rates rise, yield spreads tighten, and durations extend. The drop in market prices is often as pronounced on short (e.g., two year maturities) as they are on longer ones, compliments of the flattening curve.

The recommendations, therefore, are to stay attuned to the Fed's statements as they are released, as they have become less opaque under the Bernanke regime. And continue to monitor your portfolio's price volatility, especially in the "rates up" scenarios. •

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# PUTTING A KICKSTAND ON A HORSE

BY BILL WYCKOFF

I've just returned from the Labette County Jail. I, along with other bank lenders, was escorted through the jail maze — past the laundry with the orange clothing and flip-flops to a work area in front of the holding and detox cells — and awaited my turn to be fingerprinted.

of the Federal Fannie Mae and Freddie Mac meltdown — which was caused by abuses from mortgage brokers, not bankers. This is about as practical as requiring a kickstand on a horse. These government entities either didn't check the loans they purchased or didn't care that the loans they bought were bad. Rather than going after the guilty parties, Congress decided that everyone who makes real estate loans should pay the price, even lenders like us who keep virtually all the loans we make in house.

Our Congress and president determined that thousands of community bankers all over the country were a potential risk to the well-being and financial security of the United States of America (since these bankers make home loans). Therefore, it was decreed, each banker must be fingerprinted and receive an FBI criminal background check before they can make any more real estate loans. Maybe at Mega Bank in New York they have a specialized mortgage loan department, but out here in the heartland of our great country, almost every lender at a community bank is bound by the new law. So at Labette Bank, 22 lenders with a combined total of 435 years of lending experience are forced to follow a stupid law hastily passed because

Community banks didn't cause this problem, but since the bad guys already took the last train out of Dodge, we are the only people left to tend the horses. It would be like you sitting at home, minding your own business and then getting a speeding ticket because an out-of-state driver was caught speeding through town. The government would just say, "You own a car, don't you?" Even though we get regular federal, state, external CPA and Federal Reserve examinations, we are now mandated to be fingerprinted — actually palm printed, too — along with local sticky fingers who were just hauled to jail in the back of a squad car. If anyone wants to know why it is more expensive and more difficult to get a home loan, just thank Congress for the additional red tape. To quote Forrest Gump: "Stupid is as stupid does." Who knows, maybe that is

#### • ABOUT THE AUTHOR •

Kansas Liberty columnist Bill Wyckoff is president of Labette Bank, a community bank with locations throughout southeast Kansas, and an occasional contributor to *The Wall Street Journal* and Fox Business News. He lives on a farm outside Altamont, Kan. E-mail him at [bwycckoff@labettebank.com](mailto:bwycckoff@labettebank.com).

the double-secret, special password used in Washington these days?

Aside from the stupidity of this law, another major concern is the apparent lack of anything resembling privacy or data security with this process. Fieldprint, Inc., is the private company contracted with the NMLS (National Mortgage Licensing System) to get the prints and check all of us dastardly community bankers. Upon receiving my registration packet, I was more than surprised at the listing for the first three preferred personal information collection sites: the UPS Store in Tulsa, Okla.; the PostNet store in Rogers, Ark.; or the Mailbox It store in Springfield, Mo. Each of these seemed to be less than a secure place to gather, hold and distribute sensitive information — not to mention they are each more than a hundred miles from my bank location in Kansas. Since these sites are so out of the ordinary for such an important task of gathering and transmitting personal information from a group of bankers, I may be wrong, but it is my understanding that money usually changes hands in order to be placed at the top of most selection or search lists. As a prudent banker, I can't justify a government-required field trip for the staff, so my loan officers got the pleasure of traveling to a more trusted location, the local county jail.

Already one of our loan officers has noticed that the sidebar ads on his Facebook page suddenly changed after he registered with the NMLS, showing mortgage loan information and training sites being advertised where before it had only been his preferred hunting and fishing stuff. Obviously, someone collecting this data leaked or sold his personal information. Banks have to be tested and enforce rigid privacy and security policies and procedures. Violations result in severe penalties. The government must not have such a requirement? If our own government can't ensure that contractors honor basic privacy rights and policies



for honest working people, how can we be confident it can do something as complicated as ensuring the integrity of the private lending system?

P.S. I must also include my registration number from NMLS (#409159) on my business cards to protect the public; I feel this is a little too close to what is required of the people with numbers on them at the county jail. Forrest Gump had it right about stupidity. •

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# CHALLENGES IN THE ESTIMATION OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES



BY MIKE LUBANSKY

The estimation of the allowance for loan and lease losses has been a part of the financial institution's accounting processes for years, but it has taken on increased importance throughout the last several years.

Between increased regulatory scrutiny and the challenges of documenting and defending the allowance estimation to multiple constituencies including the regulators, external auditors and the board, many financial institutions find themselves overwhelmed with the process of estimating and documenting the ALLL on a monthly or quarterly basis. The ALLL estimation is significant in that regulators are vigilant about ensuring financial institutions have enough in their reserves, but the ALLL estimation is also significant in its impact on an institution's earnings and capital.

One of the defining regulatory statements on the ALLL, the 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses, states:

*The ALLL represents one of the most significant estimates in an institution's financial statements and regulatory reports...each institution has a responsibility for developing,*

*maintaining, and documenting a comprehensive, systematic, and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses.*

Tom Ryan of Turner and Associates, Inc., a bank consulting firm serving clients in the Midwest, sees this in practice, noting: “Estimating the allowance for loan and lease losses is one of the most important challenges bankers face today, though often the least understood. Bankers can minimize the inherent imperfections of this estimate by adopting a supportable and consistently applied methodology and providing verifiable documentation of their findings.”

Some of the general overarching challenges that financial institutions face with regards to employing this type of comprehensive, systematic, and consistently applied process to their ALLL estimation include:

1. The manual, time-intensive nature of the process each month or quarter. For many financial institutions, the process can take several days if not more per month for several of the institution’s finance, credit and/ or lending staff. Some of the individuals involved in the estimation are high-level executives whose time is at a premium, so the greater amount of time directed toward the ALLL can be a burden. This process is labor intensive, manual and often prone to error, through the usage of an assortment of Excel spreadsheets, which lend themselves to version control issues and formula errors, among other potential issues.
2. Keeping up with new accounting standards and regulatory demands placed on the institution. The financial institution must stay current not only with the published regulatory guidance, but also with new accounting standards issued from FASB, as well as the regulatory demands from the institution’s specific regulators, which may or may not coincide precisely with the two aforementioned sets of standards.
3. Additional reporting and disclosure requirements, as well as increased scrutiny on the assumptions, used to determine the ASC 450-20 (FAS 5) reserves. In recent years, FASB has continued to issue new requirements through its Accounting Standards Updates. Although this often consists of simple reports and aggregation of data that is already being used, it can be time-consuming and places additional strain on limited resources.
4. Increased scrutiny on the assumptions used to determine the ASC 450-20 (FAS 5) reserves. This can include questions around the how-to appropriately segment

the ASC 450-20 (FAS 5) pools, assumptions used for the number of periods of historical data to include for establishment of the Historical Loss Reserve portion of the ASC 450-20 (FAS 5) reserves, and the judgment and defense of qualitative factor adjustments in the assessment of the ASC 450-20 reserves.

Increased scrutiny around the ASC 310-10-35 (FAS 114) reserves. This includes the appropriate determination of which loans need to be evaluated for impairment under ASC 310-10-35 (FAS 114), determination of whether the loan should be considered “collateral-dependent” and evaluated under the “Fair Market Value of Collateral” method or under the “Present Value of Future Cash Flows” method if the borrower is still expected to make repayments on the loan, the correct assumptions to employ in either method, as well as additional considerations that have been expanded upon by FASB as pertains to Troubled Debt Restructure (TDR) loans that have been modified or restructured.

Nelson Reeves from Reeves Risk Management, a firm serving financial institutions in the Southeastern U.S., sums up these challenges by stating: “Overall, one of the most significant challenges is arriving at an amount in the allowance which both adheres to the accounting and regulatory requirements and satisfies the regulators as to its adequacy.”

Given the above list of conflicting demands pertaining to the ALLL being placed on financial institutions taken in context with increased regulatory demands in other areas of their operations, it is easy to see how many financial institutions are struggling to put together a comprehensive, systematic and consistent estimation of their allowance for loan and lease losses and to meet the demands of the various constituencies that scrutinize this calculation. Approaching such challenges requires a systematic approach in which the institution carefully examines the effect of their loan policies, and implements a structured approach to evaluating the losses inherent in their portfolio. Current spreadsheets and policies may or may not be adequate to meet these demands. Any efforts to streamline the process and better document the financial institution’s assumptions are beneficial in defending the estimation of the allowance in a comprehensive manner. •

• ABOUT THE AUTHOR • • • • •

Mike Lubansky is a senior financial analyst and product manager at Sageworks, where he oversees product development, market research and implementation in the financial institutions market. Lubansky has a background in both the financial and consumer industries.

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