# MITIGATING POTENTIAL CREDIT RISK

by Steve Brown

The Banc Investment Group ("BIG") is part of a bankers' bank. As such, our main goal is to provide wholesale products and services that allow independent banks to better manage risk and increase performance. One of our current concerns is loan performance. For those becoming worried along with us, we have an extensive suite of products to help protect banks. For starters, our Loan Pricing Model is one of the only risk-adjusted capital applications available that incorporates the latest in credit, interest rate and prepayment data. This tool permits lending officers to price and set reserves on all varieties of loan credits with increased granularity based on risk. With pricing covered, our Credit Stress Analyzer tips banks off to how much credit risk is embodied in their current portfolio. Concentration issues, reserves, earnings volatility and capital impact are all stressed against a series of possible downturns. This model answers the question whether a bank has the right mix, risk profile and capitalization. Banks seeking to change mix or diversify risk can take advantage of BIG's loan trading desk. This group stands ready to purchase, sell or participate loans to change concentration levels. As an added benefit, the group can purchase loans that are both performing and sub-performing. For banks where earnings are more important than growth, selling concentrations mitigates risk, increases ROE and demonstrates liquidity to the regulators. Banks seeking to restructure risk can swap construction loan concentrations for C&I in order to increase risk-adjusted earnings and dramatically lower risk. If growth is the main driver, then we can look at a variety of 1st loss/subordinated pieces, or credit insurance, to bolster the quality of an existing portfolio. Finally, we stand at the ready with a variety of capital alternatives. For banks happy with loan mix and reserves, increasing capital may be a prudent move to guard against a potential downturn. Our bankers' bank did this as part of a risk mitigation strategy recently, recognizing that the credit market appears poised to deteriorate. BIG can arrange trust preferreds, perpetual preffereds, holding company loans, lines of credit and common equity. Currently, a popular product bundle is a holding company loan and revolving line of credit (to solve short-term funding needs 4Ys and in) and trust preferreds to boost long-term capital. Prices range from Libor + 1.50% to 1.90% depending on credit and amount. All of our capital alternatives provide a flexible way to handle a variety of opportunities or credit shocks. BIG, in conjunction with our bankers' bank, has designed a complimentary product set to identify, prevent, validate and mitigate credit risk in a lending portfolio. Banks worried about a potential credit downturn, or focused on improving their risk/reward profile, should contact us toda. The time to mitigate potential risk is now, when banks can negotiate the best pricing and keep the greatest number of options open.

## BANK NEWS

**M&A**

Dutch giant Rabobank NA will acquire Mid-State Bank & Trust ($2.4B, CA) for $851mm, or about 3.3x book.

**M&A**

New York Community Bancorp ($29.6B, NY) will acquire the holding company of Penn Federal Savings Bank ($2.3B, NJ) for $260mm in stock, or about 1.54x book.

**M&A**

First Citizens Bank ($206mm, KY) will acquire the Military Allotment operation of PNC Bank. The group specializes in processing data associated with military allotments and federal benefits.

**FDIC**

The agency has informed banks that insurance will be twice as high as requested, as the regulator seeks to build a stockpile of cash. The FDIC said the requirement will amount to 5 to 7 cents per $100 of a bank's deposits. By risk class assessment, 3,605 banks will pay 5bp; 4,300 will pay 5bp to 7bp; 53 will pay 28bp; 416 will pay 10bp; 413 will pay 7bp and 2 will pay 43bp. The agency also said it would collect assessments after each quarter end in 2007, to allow for more current information to be collected. Invoices for the 1Q will be due June 30.

**Interesting Tactic**

A handful of banks in slow-growth states have invested in de-novo banks in other states, as they seek to increase assets through overlines.

**CRE Lending**

As a final ruling on CRE lending exposures winds its way through the regulatory labyrinth, it is interesting to note that as of the end of 2005, banks held $1.3T in CRE loans, a 16% increase from the prior year. In a recent speech to OCC regulated banks, the Comptroller said it was ok for banks to have concentrations in CRE loans as long as they had "appropriate risk management and capital to address the increased risk."