BANKING UPDATE FOR THE 3Q

by Steve Brown

The FDIC finalized 3Q call report data and finally released the information for general consumption. Among some of the highlights, earnings fell 1% in the 3Q (compared to the 2Q), as banks increased loan loss reserves, while trading revenue and servicing income slipped. NIM Â– A flat yield curve and heavy competition pushed NIM to its lowest level in 17 years. This is probably going to be the most topical discussion item as banks make the rounds at coffee houses. At just 3.38%, average industry NIM was the lowest since the 3Q of 1989. In addition, the decline in NIM was the 5th in the past 6 quarters, highlighting the shift toward more interest sensitive funding sources and tremendous competition for loans. ROA - Average ROA slipped 4% to 1.29% and only 54.4% of banks could muster an ROA above 1.00%. ROE - Average ROE also inched lower, slipping from 12.99% in the 2Q to 12.76% in the 3Q, a drop of 23bp or about 2%. Credit - On the credit front, the amount of loans 90 days or more past due increased nearly 7% during the quarter, the 2nd quarterly increase and the largest increase in 5 years. By type, construction and development loans past due soared 33%, while C&I climbed nearly 7%. In total, nearly 90% of all banks added assets to nonaccrual status during the quarter. On the charge-off side of the ledger, the 3Q brought a 34% increase in C&I loans and a whopping 119% jump in real estate construction and development loans. The silver lining is that despite the increase, loss rates overall remain near cyclical lows. Reserves Â– In the 3Q, banks reserved ever so slightly more, pushing total reserves up 0.04%. Despite the small increase, however, the industry's ratio of reserves to total loans slipped to 1.09% during the quarter, reaching its lowest level in more than 21 years. Assets Â– Banks were able to increase total assets during the quarter by 2% and loans by 9.8% on an annualized basis. Interestingly, with softness in single family residential, roughly 67% of overall loan growth came from real estate construction and development (up 5.3%), C&I (up 2.1%) and real estate loans secured by nonfarm nonresidential properties (up 2.6%). Funding Â– The worst news about the 3Q probably came on the funding side. Proving things are very tough out there, core deposits fell for the 1st time in 3 years, driven primarily by a 3.5% drop in noninterest bearing deposits. Federal Funds purchased jumped 18.5% during the quarter. Time deposits also increased 3.8%, as banks struggled to fill the void left through loan growth. Time deposits have risen nearly 19% over the past 12 months. In total, deposits now fund roughly 64.5% of assets, the lowest level in history. Finally, banks shifted borrowing to other sources as well, pushing "other borrowing" up 11%, FHLB Advances up nearly 7% and subordinated debt by 17%. Efficiency Â– Perhaps marking the end of a long period of squeezing more out of less, banks reported their efficiency ratio increased from 56.00 to 56.65. Hedging Â– Derivatives usage increased 6% during the quarter, but more interesting, the mad scramble to hedge interest rate risk pushed to total number above the 1,000 barrier for the first time in history (to 1,011). Other Â– A few last interesting tidbits from the 3Q included the formation of 47 new banks and 83 mergers.

BANK NEWS

Local Preemption

The Ohio Supreme Court ruled that local municipalities may not adopt predatory lending statutes that conflict with state law.

CRA

The OTS proposed restoring the investment and service CRA test for large thrifts $1B or over. After doing away with this requirement last year, there were too many problems associated with regulating thrifts differently than banks.

Fedwire

The Fed has extended the comment period for banks that have an opinion on the operational risks of using Fedwire, especially as it relates to late-day transfers. The new comment period will close March 15th.

M&A

Acquisition activity appears poised to easily break the all-time record set in 2000. As of last Thursday, prior to some large announcements, the total value worldwide had reached $3.37T. The U.S. accounted for 36% of all activity.

Clients

Banks may want to pass along this tax information to their small business clients. The IRS reports audits of tax filers making more than $1mm are up 33% over the prior year, while those with incomes above $100k are up 18%. The IRS also reported it increased audits of Sub S corporations (up 34%).

Healthcare

A recent study finds about 1,100 banks now offer HSA accounts to their clients (about 13%). Meanwhile, about 125 credit unions, as of the end of 2005, offered HSA's.

Employees

Studies show 90% of employees that work with low performing peers have thought about leaving their company. Keeping low performers around can hurt.

Referrals

Studies show over 90% of women will tell someone when they have a good experience with a business. This compares to only about 10% for men.

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