GOT THE TIME

by Steve Brown

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Market research finds that in 2006 consumers spent 17% less on watches than they did just 5Y earlier. Analysts say an overabundance of cell phones, Blackberry's and iPods has helped push the ubiquitous wristwatch toward extinction. We point this out because whenever we speak about concepts related to asset liability management (ALM), most people immediately check their watch, mumble something under their breath about being late for something and run toward the exit doors. After all Â– ALM theory can require some deep thinking and it is particularly grating on the human psyche (some would say these concepts may even cause irreparable brain injury). We say bankers have an insatiable appetite for information and are always interested in learning more. We begin with the obvious Â– the yield curve is flat. Technical types will tell you the term structure of interest rates refers to the relationship between interest rates and the time to maturity. The yield curve is nothing more than a graph of the term structure. So, a flat yield curve is a picture telling us interest rates are the same over a long time to maturity. When people talk about the yield curve in the U.S., they often mean Treasury securities (to eliminate the impact of credit risk on the term structure). If however, people are talking about the yield curve related to lending, funding or structuring, they are nearly always referring to the Libor or Swap curve. National banks use the swap curve every morning to set the base rates they will pay on domestic deposits for that day. While risk in ALM varies from moment to moment, critical risk concepts bankers should understand relate to repricing, yield curve, basis, and options risk. In banks, repricing risk occurs due to differences in the maturity or timing of coupon adjustments of bank assets and liabilities. This is also referred to as maturity mismatch risk. Consider a bank with 6 month funding that is originating 10Y fixed rate loans. If short-term rates rise significantly and long-term rates do not, funding costs can rise above the asset coupon, squeezing margin. Even if rates don't rise that much, shifts in the short-end of the curve can cause problems, due to the maturity mismatch and timing. Another risk banks must address in ALM relates to yield curve risk. This occurs when rates shift in a non-parallel manner. For instance, consider the impact on a bank if the Fed Funds rate drops 75bp, while the 10Y Treasury rate rises by 136bp. The third risk to understand is basis risk. This occurs when one instrument's value fluctuates at a different rate than another instrument. An example of this could be a bank's MMDA account which moves more like the 3Y Treasury rate vs. a 3 month CD rate, which moves more like 3M Libor. The final risk we are going to introduce is options risk, which occurs when options are embedded in either assets or liabilities. When interest rates shift, cashflows in either liabilities or assets can also change, resulting in faster or slower repayment. The best example of this is a loan prepayment, which occurs when a change in interest rates prompts the borrower (option holder) to prepay their loan (exercise the option). We see people checking their iPods now, so we will call it quits for this morning. Understanding these key risk management concepts is a critical first step for banks interested in comparing between and calculating profitability among liabilities, assets and customers.

BANK NEWS

M&A

BOK Financial Corp. ($18.1B, OK) will acquire Worth Bancorporation, inc. ($390.3mm, TX) for an undisclosed sum.

Overhaul

A bill has been introduced in Congress that would overhaul regulatory oversight of FNMA, FHLMC and the FHLB system by creating a new regulator and requiring a fund be created for affordable housing. The bill has bipartisan support.

Construction

Lennar Corp., one of the largest homebuilders in the country, is reportedly asking contractors to cut their unpaid invoices by 20%, or be barred from bidding on new projects for at least 6 months.

Unusual

Banks should take note that a teller who was robbed at gunpoint 3x is now suing her previous employer, claiming management failed to bring in guards and enhance security at the branch despite the fact it was robbed 4x in 4Y.

CRE Losses

The FDIC is reporting that CRE loan chargeoffs soared to 18% of overall chargeoffs in 2006, a 300% increase over 2005.

Turnover

A study by RHR International finds 40%-60% of high-level execs brought into a company from the outside will fail inside of 2 years.

Industry

A study by Grant Thornton of community bank executives finds the top 5 challenges expected this year are retaining deposits (94%), attracting new business customers (94%), developing new sources of revenue (87%), using technology to improve productivity (84%), and finding adequate funding sources (77%).