FRIDAY THE 13TH, BLACK CATS & FAS 159

by Steve Brown

In our culture, superstitious people will tell you to avoid black cats and Friday the 13th. While both are in play today, in other cultures such things can bring good luck. In similar fashion, many bankers are wondering whether early adoption of FAS 159 is good luck or bad. In an effort to clarify mounting industry confusion and our position on this matter, we pick up on our discussion from yesterday. To be clear, as we have been saying for years, we wholeheartedly support marking the entire bank balance sheet to market. Unfortunately, early adoption of FAS 159 doesn't go far enough. Given this fact, while FAS 159 does take steps down this path, it could also expose unprepared banks to a quagmire of bad juju. This pronouncement further changes accounting from a "rules-based" approach (following a rule book that attempted address as many potential contingencies as possible) to "principles-based" (key objectives of good reporting and guidance are provided along with an explanation of the objective). This is a new area for many and a key reason why both bankers and accountants are struggling to find definitive answers. To assist bankers, here are some of our additional thoughts. Investments: Banks already thinking of restructuring their investment portfolio may see early adoption of FAS 159 as a good opportunity to do so. While we don't recommend trading securities simply to take advantage of an accounting rule, early adoption could be considered on certain instruments. Bankers should take care if they decide to adopt and also sell, as potential transaction costs stand to wipe out economic advantages. Banks choosing early adoption may want to look at securities with duration of 1.0 or less, in an effort to limit volatility going forward. TRUPs: In similar fashion, bankers may want to consider early adoption for higher cost trust preferred securities. This can make sense particularly if the TRUPs are callable in 2008 or earlier AND the bank was already intending to call them (even without FAS 159). TRUPs callable longer than that are subject to market volatility, so are probably not viable. FHLB: Banks that had utilized long-term fixed rate Advances and were hoping an opportunity would arise where they could refinance the borrowing may want to review early adoption of FAS 159 for this group of liabilities as well. If loans that were being funded have refinanced, or the bank's strategy has shifted, there may be an opportunity to choose early adoption or even prepay this debt. Banks could borrow to a different duration, or shift into brokered CDs to address liquidity, collateral or other constraints that may have arisen since the debt was first borrowed. Other: Finally, banks may have an opportunity to early adopt as a result of certain special situations. These could include premiums paid on certain liabilities related to a merger, CD investment ladders with prepayment penalties, callable CDs, subordinated debt, BHC loans, underperforming loans and many other possibilities. As bankers ponder whether early adoption of FAS 159 is good luck or bad for them, industry discussions are moving along at a rapid pace. Bankers should get up to speed quickly on both FAS 159 and 157, analyze the opportunity contract by contract, model the impact of any change before it occurs, review financial statement disclosures, get professional accounting advice and ensure board discussions have been free flowing and loaded with content on the subject. Good luck and don't hesitate to contact us if you would like some assistance deciding whether early adoption of FAS 159 makes sense for your bank.

BANK NEWS

M&A

Randolph Bank & Trust ($279mm, NC) will be acquired by Bank of the Carolinas ($4.5B, NC) for about $36.95mm or 1.65x book.

Subprime Refi

BofA and Citi are funding part of the $1B Neighborhood Assistance Corp of America fund (a non-profit group) that will seek to refinance 7k to 10k subprime mortgages at 30-year fixed rates with no down payment and no fees. The move not only has a good public relations tint to it, but allows banks to move sub and non-performing loans off the balance sheet, but still capture some upside.

CRE Lending

Spreads for "BBB-" rated bonds backed by commercial real estate loans have risen from 95bp in January to 160bp most recently. The increase in credit premium is due to a slowdown in demand associated with concern over subprime defaults and overall weakening of underwriting standards. Commercial mortgage backed securities usually lead independent loan pricing trends (but to a more muted extent) by 6 to 12 weeks.

Lenders

Headhunters indicate demand has pushed salaries for commercial lenders in certain regions up by 20% over the past 3Y. Meanwhile, a survey of independent bank CEOs finds 92% say finding commercial lenders in their market is becoming more difficult.