PUSHING FORWARD

by Steve Brown

Kids love to be pushed in a swing, but as they get older they begin to lose interest. That is too bad, because everyone needs to feel the wind whistling in their hair and the swish-swish feeling you get as the swing goes back and forth. As we fondly remember childhood, we also recall the way banking used to be - simple, profitable and fun. These days, however, things have aggressively changed and community bankers are scrambling to adapt. In preparation for 2008, we outline some things community bankers should know and expect to see in the upcoming year:

Regulators will be closely looking at the loan portfolio and how banks are managing risk. A clear alarm bell has been sounded around liquidity and credit this year and bankers should take heed. Banks with concentrations of any type should ensure they have policies and procedures in place to manage the associated risk arising from such concentrations. It is important that bankers take the time now (before examiners show up at the door), to ensure adequate risk management is in place to identify, monitor and manage credit concentrations and to have an established set of robust and adequate concentration limits.

As a result of the turn in the credit cycle, expect to beef up monitoring efforts on loans as they slip into past due status. Banks should be very proactive, monitor and regularly update appraisals and immediately seek out customers that seem to be having difficulty to see what can be done. While not all problems will be easily solved, jumping on issues quickly can help avoid a much bigger mess down the road.

Competition for small business customers will remain blistering hot. Large banks have found they can capture these customers with RDC, upgraded ATMs and online cash management services. They have boosted calling efforts, enhanced credit card penetration and improved marketing efforts. Community banks should have a plan in place to combat these product offerings.

Since asset growth will be harder to come by this year, bankers should focus on increasing revenue with a greater emphasis on expanding business with current customers. These are the most likely to do business with the bank, so bringing tools on board to boost cross-selling efforts, enhance technology and focus on differentiation will help.

The subprime mortgage mess and credit crunch are expected to flow deep into the year. While the FRB works to boost liquidity, bankers should expect fallout and loan losses to rise. Construction and land exposures should be closely monitored.

Things are tough and many banks are realizing it. As a result, look for boards of directors to increase pressure on management or seek out merger and acquisition opportunities. While sellers still seek 2x book, expect rising credit losses to push that number back down closer to 1.5x by the end of the year.

Community bankers will finally embrace derivatives. Bankers are beginning to realize that interest rate swaps can help them better manage risk, capture new customers and better retaining existing ones. Low interest rates that are heading lower, stressed borrowers and heavy small business customer competition will continue to push bankers to seek solutions. Interest rate swaps give community bankers another tool in the toolbox to increase profitability and customer acquisition opportunities.

Giveaways and marketing will increase. Bankers vying for customers will find the field crowded, with an average of 6 to 10 other firms seeking the same business customer. Differentiation is difficult in such an environment, so look for community bankers to ramp up marketing efforts and customer perks. Concierge services, RDC, personal banking and more frequent face to face visits are likely to accelerate.

As with childhood, the fun only lasts so long. This year is shaping up to be one of the roughest in many bankersÃ¢Â€Â™ careers, so now is the time to get prepared.

BANK NEWS

M&A

West Suburban Bancorp ($1.9B, IL) will purchase National Bank of Grand Ridge ($28mm, IL) for $5.7mm, or about 1.66x book.

Citigroup

The Bank posted a huge $18B subprime related loss, the biggest in its 196Y history. Citi also slashed its dividend by 41% and said it would cut 4k jobs (with more likely). Citi also reported it obtained $14B in capital from investors including the government of Singapore and UBS.

Merrill Lynch

Continuing the foreign money theme, Merrill raised $6.6B in preferred capital from the Kuwaiti government and JapanÃ¢Â€Â™s Mizuho Financial.

Housing Pain

The CEO of FNMA said he expects the housing sector to continue to weaken through 2009, with a turnaround not likely until 2010.