ROLLING UP YOUR SLEEVES TO INCREASE LIQUIDITY

by Steve Brown

Let's say that that one day, for some crazy reason, you need liquidity like Senator Dodd needs press coverage. Maybe you lose access to the brokered CD market, maybe a large depositor gets acquired and moves balances to another bank or maybe there is a small run on deposits (if there is such a thing as a "small run"). Whatever the reason, if you need immediate liquidity, where do you go?

While we have already discussed what a liquidity plan should contain, today our point is the importance of being able to work with both the FHLB and the Fed to achieve funding. If there are "best practices," then there must be "worst practices" and one of the worst practices a bank can exhibit is not having capacity at both the FHLB and FRB.

Smart banks lay the ground work well ahead of time. It is always a bad practice in banking to say "nice to meet you," immediately followed by "can I borrow $30mm?" To prevent this, make sure you already have the introductions out of the way, have filed an application to borrow from both the FHLB and FRB Discount Window and have the myriad of agreements in place. This process can take 30+ days, so planning ahead is critical.

Speaking of planning, a common problem we see are banks with a blanket lien from the FHLB that try to borrow from the Discount Window. While some FHLBs have a master subordination agreement in place (such as FHLB Seattle) that allows collateral to be shared with the FRB, most need to be negotiated on a case-by-case basis (as an inter-creditor agreement). This agreement takes an average of 2 weeks to put in place, so get this done before you need it.

While we are on the topic of collateral, banks should also understand the format a collateral list should be submitted (and that your servicing system can handle it). While securities are straightforward, loans become more detailed and things like LTV, payment status and loan type often trip up banks seeking to quickly pledge a group of loans. Both the FHLB and Fed must be provided a loan schedule, determine if the collateral is eligible and then make a determination on the lending margin. Having your FHLB conduct a collateral review ahead of time can speed up this process and often result in higher lending amounts (thereby giving your bank more liquidity).

Speaking of liquidity, most banks should also get access to the Fed's Term Auction Facility ("TAF"). This acts essentially like a 28-day repo and gives banks yet another avenue to borrow funds (currently at a 2.30% rate). Like other facilities, the TAF program has its particulars, so banks get comfortable with them now.

Finally, let's talk about the "stigma" of borrowing from the Fed. Times have changed and like tattoos, working the Blackberry in a meeting or showing your belly button, it is now acceptable behavior. In fact, like the aforementioned activities, it is downright trendy to borrow from the Fed. Everyone is doing it, from community banks to multinationals. Heck, broker-dealers and the GSEs are now into the act. The fact is that if you treat the Fed as the lender of last resort, then you get the stigma of borrowing from a lender of last resort. If, however, you make it a point to borrow a couple of times a year, then borrowing from the Fed is no big deal.

If you are looking for liquidity best practices, utilizing both the FHLB and Fed should be high on any list. While many banks are well versed with the FHLB, for more information on the Fed (and to get the agreements) go to http://www.frbdiscountwindow.org/ Better yet, attend the "Call the Fed" meeting on this very topic - http://www.frbsf.org/banking/events/index.html. Unfortunately, since it is a conference call, no one will get to see your cool banker tattoo of that pile of money.

BANK NEWS

2Q Earnings: Wells Fargo

reported earnings above expectations (53 cents per share vs. 50 cents expected), however 2Q profit fell 23% as it increased loan loss provisions (boosted $1.5B to $3B). Wells earned $1.75B during the 2Q, compared to $2.28B during the same period last year.

US Bank

The 6th largest bank in the US reported a larger-than-expected 18% decline in 2Q profit, as it struggled with rising credit losses. The bank said it expected bad loan numbers to continue to rise in coming quarters. The bank tripled its loan loss reserve from the same period last year and saw net charge offs and nonperforming assets double over the same period.

First Horizon

The bank reported a $19mm loss in the 2Q and has reported losses in 3 of the previous 4 quarters. The bank took a $220mm loan loss provision (about 500% more than last year), booked net charge-offs 600% more than the same quarter last year and said losses were rising on its C&I and CRE portfolios. The bank also replaced its cash dividend with stock.