MORE DATA GOING THROUGH THE GRINDER

by Steve Brown

Regulators have decided they need more information, so they are modifying the Call Report. The changes kick in under a phased-in approach beginning in March of 2009. Calling the current situation "the most turbulent banking environment in more than a decade," regulators said the new revisions focus on areas where the industry faces "heightened risk."

To assist you, we started by breaking out the changes that would take effect as of March 31, which include capturing information on held-for-investment loans and leases acquired in business combinations; reporting on non-controlling (minority) interests in consolidated subsidiaries; clarifying the definition of the term ''loan secured by real estate;'' instructions for reporting unused commitments; exempting certain items for banks with less than $1B in assets; providing guidance on quantifying misstatements; and eliminating confidential treatment for data collected on fiduciary income and expenses.

Since so many community banks have loans secured by real estate, we underlined it above, because we begin our conversation there. In general, regulators say they are providing this clarification because they have found banks are not reporting such data consistently. As such, regulators have chosen to clarify the definition. In short, the estimated value of the real estate collateral must be greater than 50% of the principal amount of the loan (at origination), in order for the loan to be considered "secured by real estate." Regulators also say that while banks should apply this clarified definition prospectively (e.g. into the future), banks do not need to reevaluate or recategorize loans (currently reported as loans secured by real estate) into other loan categories on the Call Report.

To assist further, here is the more detailed explanation directly from the regulators regarding loans secured by real estate. "A loan secured by real estate is a loan secured wholly or substantially by a lien or liens on real property for which the lien or liens are central to the extension of the creditÃ¢Â€"that is, the borrower would not have been extended credit in the same amount or on terms as favorable without the lien or liens on real property. To be considered wholly or substantially secured by a lien or liens on real property, the estimated value of the real estate collateral (after deducting any more senior liens) must be greater than 50 percent of the principal amount of the loan at origination. A loan satisfying the criteria above, except a loan to a state or political subdivisions in the U.S., is to be reported as a loan secured by real estate in the Reports of Condition and Income, (1) regardless of whether the loan is secured by a first or a junior lien; (2) regardless of the department within the bank or bank subsidiary that made the loan; (3) regardless of how the loan is categorized in the bank's records; (4) and regardless of the purpose of the financing. Only in a transaction where a lien or liens on real property (with an estimated collateral value greater than 50 percent of the loan's principal amount at origination) have been taken as collateral solely through an abundance of caution and where the loan terms as a consequence have not been made more favorable than they would have been in the absence of the lien or liens, would the loan not be considered a loan secured by real estate for purposes of the Reports of Condition and Income. In addition, when a loan is partially secured by a lien or liens on real property, but the estimated value of the real estate collateral (after deducting any more senior liens) is 50% or less of the principal amount of the loan at origination, the loan should not be categorized as a loan secured by real estate. Instead, the loan should be reported in one of the other loan categories based on the purpose of the loan."

There are many more changes to the Call Report expected throughout 2009 (and regulators have already said the Rescue Plan if it passes could require even more), so be prepared to provide more data into the grinder going forward. The positive side of this is that financial information will become more transparent and homogeneous, thereby eventually driving down the cost of capital.

BANK NEWS

Rescue Plan Update

The Senate will take up where the House failed and try to pass a Plan tonight. The modified proposal is expected to include an increase in the cap on FDIC deposit insurance from $100k to $250k; extend tax breaks for 2Ys for individuals and corporations; add $17B in tax credits for development of renewable energy; spare 24mm households from a $62B AMT tax that would otherwise take effect this year. Assuming it passes, it then goes to the House on Thursday, where stronger protections for homeowners facing foreclosure and modifying mark-to-market rules are favorites to be incorporated before it too finally passes the bill.

FAS 157 Reversal

The SEC and FASB clarified that banks do not need to write down the value of troubled assets to the lowest price, if the price is not the result of an orderly transaction between buyer and seller. The move gives banks more flexibility when valuing assets, allows executives to use their own financial models and judgment if no market exists or if assets are only being sold at fire-sale prices.

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