CUTTING EDGE FINANCIAL COMMUNICATION

by Steve Brown

Last night, both Presidential candidates sounded antiquated talking about tax cuts/hikes, the need to control the deficit, the evils of Chinese Treasury investment and the repurchase of mortgages. Those ideas are so last week. This week, the deficit is not even close to the main concern and we are happy if anyone buys Treasuries. In their defense, the world is making this rescue up as it goes along and each day brings a new chapter in financial market management. Today, we have a never-before seen coordinated rate cut and the announcement that, for the first time since the Depression, the Fed will skip over banks and lend directly to US corporations in the commercial paper ("CP") market.

In terms of the 50bp emergency rate cut, something had to be done after the wholesale rout of Asian markets overnight. As we have seen in the US, a rate cut in a stressed credit situation does little (particularly in light of the fact that Libor is so high). Due to the rate cut, Libor has reset down by 20bp, which is about the responsiveness that we have seen (given the last 5 downward rate moves). Fed Funds are already low, due to all the liquidity and past rate cuts that heretofore have had little stimulative effect. As we saw in the 1990's, the impact of rate cuts in a stressed credit environment is often delayed an extended period before its benefit is felt.

This coordinated move brings immediate relief to floating rate commercial borrowers, as well as most home equity credit users. In addition, the move has a huge psychological impact. Considering, the speed of the Rescue Plan (remember it took 3Ys to think through the RTC) and the fact that, as late as August, some Fed members were still talking more about inflation than growth; confidence is in short supply (as evidenced by equities). Little has been done so far to stimulate job growth, which is really where we need to focus next.

The Fed's move to lend directly to non-financial corporations is an interesting one and extraordinary in its breadth. While the details are not yet known, it appears the Fed will make available short-term facilities to replace/purchase CP liquidity (that has dried up in recent weeks) and provide major US corporations with operating cashflow. This is surgical in its delivery and will go far to prevent a greater panic (by getting short-term markets restored and credit moving again). For banks, this is a wholly-positive development. Many large banks have refused to increase short-term credit lines (and many have cut) so the Fed's injection won't displace business. For community banks, the benefit will be indirect, but no less important. The success of major corporations has downstream effects on almost every local market.

There are still a whole lot of tricks up the Fed's sleeve, including making credit facilities available to non-banks, cutting rates further, a UK-style bank recapitalization (our favorite) and lending to municipalities. Hopefully, we won't have to resort to these, but the trend is not pointing in that direction.

Right now, the best thing community banks can do is to increase communication and take a higher profile financial leadership position within the community. This means daily training phone calls with all staff, weekly letters to shareholders and constant communication with customers. Helping Main St. understand how the latest Fed moves affect their daily lives is the most important thing banks can do right now. We make our writings in this publication and our monthly updates available to any community bank that wants to use our work free for the asking (but please let us know). In return, if any bank is particularly proud of their communication and would like to share it with banks outside of their area, we would love to see the work.

BANK NEWS

UK Rescue Package

The British gov't said it would invest up to 50B pounds ($87B) in exchange for preference shares in 8 of the country's largest banks (Abbey National, Barclays, HBOS, HSBC, Lloyds, Nationwide Building, Royal Bank of Scotland and Standard Chartered). Any investment will come with strings including control over dividend policies, executive compensation and a commitment by each bank to support lending to home buyers and small businesses. The government also flooded the system with 200B pounds ($350B) in 3M loans (a move to get Libor to drop) and provided 250B pounds ($438B) of loan guarantees to help banks roll over existing debt.

FDIC Premium Increase

The FDIC is proposing doubling to 13.5bp (from a current 6.5bp) average banks would pay for insurance beginning January 1. In addition, starting in April, a risk-based program would kick in that reduce assessments for banks taking actions that would lower the cost of a bailout (high capital ratios, more subordinated debt) and raise assessments on banks that are doing things the FDIC feels would raise the cost of a bailout (brokered deposit + FHLB Advances > 15% of deposits). The FDIC is taking the action, given projected losses over the next 5Ys of $40B.

Regulatory Capital Change

Regulatory agencies have proposed lowering the regulatory capital risk weight of FNMA, FHLMC and FHLB debt to 10% from its current 20% level given new Treasury backing of the entities. The change could be applied to credit exposures on the books (excluding preferred stock) or purchased after September 7, would not affect the calculation of the leverage ratio and is elective (if not selected, the risk weight stays at 20%).