MAGNIFYING THE NEW FDIC GUARANTEE PROGRAM

by Steve Brown

The trouble with government bailouts is that they can be arcane, difficult to understand and lacking in details. Yesterday's announcements by the Treasury and the FDIC were no exception, so this morning we put a magnifying glass on the major aspects of each. As always, we focus in on them with an eye toward what they mean specifically for community bankers.

First, let's cover the FDIC guarantee as it relates to noninterest bearing deposit accounts. For the next 30 days (thru Nov. 14), all banks in the country (as well as other financial institutions) automatically have full deposit insurance coverage on an unlimited amount of noninterest bearing transactional deposits. Fees for the coverage are also waived during this initial 30D period, after which (if a bank remains in the program and does not "opt out"), a 10bp surcharge will be applied to the portion of deposits not already covered under the existing insurance limitation of $250k. The good part - for community banks, this is an inexpensive way to keep small business customers and attract new ones. In addition, a 10bp charge on the overage amount on a noninterest bearing account is an inexpensive price to pay to keep small business payroll deposits and good client relationships. We would expect virtually all community banks to remain in this portion of the program through its expiration on 12/31/09. The catch - banks that stay in the program will be subject to enhanced supervisory oversight to prevent rapid growth and excessive risk taking. While these remain undefined, some of the hot points we would expect (given recent regulatory directives) could include banks growing above average, using wholesale funding sources or with higher than average construction or CRE exposures.

Next, we look to the senior debt guarantee portion as it relates to Federal Funds ("FF"). For the next 30 days, FF are guaranteed, however it appears that may be the case only up to a specific level. The literature and discussions we have had with various experts seem to indicate FF would be covered up to 125% of the debt outstanding of the purchasing bank, as of 9/30/08 (not yet reported) and scheduled to mature before 6/30/09. The guarantee lasts until 6/30/12 (again, assuming the bank does not "opt out") and the FDIC fee for the guarantee is 75bp x any amount covered under the program.

This one is a bit harder to understand, but let's take a look. First, we assume markets are normalized, with a 1.50% Target FF rate, 1.75% FRB Discount Window rate and a 0.75% FRB Interest on Excess Reserves. The last two represent the corridor recently set by the FRB. On the borrowing side of the coin, we note that the FRB is also a "risk-free" investor. Therefore, we would expect banks that stay in the program and carry the FDIC guarantee (risk-free) should also be theoretically able to borrow close to the risk-free rate. Despite that, we still expect some tiering will occur in the market and that the actual rate borrowing banks will pay will be slightly higher (required by the market to incorporate the additional hassle, etc.) than the FRB rate of 0.75%. We estimate that premium will probably be about 15bp. That means, banks that stay in the FDIC guarantee program should theoretically be able to buy FF at around 75bp+15bp or about 90bp. Meanwhile, it is expected large national banks would be able to buy FF on an unguaranteed basis at the Target rate of 1.50% for "normal" bank risk.

We would not expect the larger national banks to stay in the guarantee program, but we would expect community banks to do so. While the cost of borrowing is pricey at 75bp, this squeezes out the arbitrage. In short, community banks would theoretically borrow under the guarantee program at about 5bp to 10bp less than the Discount Window rate when all is said and done (0.75% risk free rate + 0.15% market premium + 0.75% FDIC fee). Again, the good part about this is that it should allow community banks to open up more funding options closer to the FRB Discount Window rate.

There is much more to cover and to discuss, but unfortunately we are out of room. Rest assured, we continue to talk to bankers, solicit regulatory feedback and plan to magnify the details of these new programs in coming editions of the BID. Tomorrow, we focus on the new recapitalization program. While complexities exist (requires modification of current benefit plans, compensation caps for top executives and shareholder approval), we believe the recapitalization plan will have a big impact on community banking, so stay tuned.

BANK NEWS

OTTI

The SEC asked FASB to quickly address issues related to the "other than temporarily impaired" rule. Of particular interest is clarification about perpetual preferred securities.

Bony

The Bank was named custodian for the Troubled Asset Relief Program. The gig is for 3Ys and starts immediately.

JPMorgan

Posted 3Q profit of $527mm, down 84% from the prior period. A $5.8B writedown was taken associated with lower asset prices, increased reserves and various purchases (Wamu and Bear Stearns).