LIQUID COURAGE AND THE GOV'T PROGRAM DEADLINES

by Steve Brown

If bars were open at this hour, we would need a shot of Gentleman Jack to get us through the next couple of days. Since that is not an option for another 4 hours, we will take a stab at helping bankers make some tough decision about the future of their bank.

Tomorrow is the deadline to opt-in for private-bank capital under TARP ("CPP"), the Transaction Guarantee Program ("TGP") and the Temporary Liquidity Guarantee ("TLGP") Program. If all those acronyms make you want to throw back a belt, just know that there have been 12 other government programs that have been created in the last 2 months - enough to throw the average banker into a stupor. The question is what to do with the 3 programs since you need to make a decision.

The CPP is straightforward and we have been strong in our recommendation that 80% of banks out there should apply. While CPP is a source of cheap capital, it is not free. If you truly have no need for capital in the next 3Ys, have stress tested your portfolio and conclude you will still be above well-capitalized should commercial property cash flow levels drop 35%, then opt out. Other than that, take the capital.

Of the 2 additional FDIC coverage programs, the easiest to decide on is the TGP. Almost all community banks will opt-in for this program and pay the 10bp to cover transactional accounts (for accounts earning 50bp or less). If you haven't done so already, bankers need to get moving on a marketing program to exploit the unlimited FDIC coverage and gain a first mover advantage. The key point here is that with a 50bp limit on what accounts can be covered, given low rates in the market, this guarantee can be utilized to cover a variety of accounts (not just checking). Packaging these unlimited guaranteed accounts in a "safety" bundle for consumers and an "elite" package for business customers will work wonders. Using this guaranteed account to go after investment balances of corporations will be the fastest way to build low cost balances. Banks should prepare a series of different messages under the theme - "the safest place to keep your money is still the bank" - ready to go out when upcoming negative headlines hit. In other words, the future holds many opportunities to market, so banks should think in terms of a multi-piece campaign instead of a 1 shot marketing effort. Again, our advice is to opt-in.

The Debt Guarantee is a little more problematic as in some respects the 50bp, 75bp or 100bp FDIC fee seems cost prohibitive. That said, since most community banks don't issue senior unsecured debt in the normal course of business the guarantee is a free option (you only pay when you use it). This is a good option to have in case funding opportunities arise or problems occur and banks need liquidity. While some banks have been confused over the 37.5bp non-refundable fee (thinking it is an upfront payment), this only pertains to banks that want to issue non-guaranteed debt at some point in the future. Funding opportunities include either putting 3Y notes in the marketplace (similar to what Goldman and BofA have been doing) or using it for rolling 31+ days of funding in case times get tough. Since the economy continues to deteriorate sharply, we urge bankers to keep all options open and opt-in.

We have looked into the possibility of more regulatory scrutiny if you take the guarantee and have concluded that is highly unlikely. There will be more regulatory oversight in the next couple of years, but it will happen with our without the guarantee. Assuming we are right, there is very little reason not to opt-in for each of these programs. Hopefully, our viewpoint today will give you a little more liquid-ity courage to make these irrevocable choices.

BANK NEWS

M&A

Capital One ($154.8B, VA) will purchase Chevy Chase Bank ($11.8B, MD) for $520mm in cash and stock.

M&A and More

Ocwen Financial Corp. ($2.3B, FL), a loan servicer, has applied to become a bank holding company and purchase Kent County State Bank ($15.1mm, TX).

Global Rate Cuts

The European Central Bank cut interest rates by an unexpected 75bp to the lowest level in 10Ys. Meanwhile, the Bank of England cut its key rate by 100bp. Central banks around the world continue to cut rates in an effort to stimulate their economies.

Lower Mortgage Rates

In an effort to jumpstart the housing market, the Treasury is reportedly strongly considering stepping in and purchasing mortgage-backed securities from Fannie Mae and Freddie Mac in an attempt to lower the rate on a 30-year mortgage to 4.50% (about 100bp below current market levels).

Corporate Stress

A new study by S&P finds 75 companies have defaulted on their debt this year through mid-October, more than 300% higher than last year and double the number of 2006. Meanwhile, another study finds 38 large companies have had to renegotiate their debt terms through October 30, well over the 18 who did so during the same period last year.

Customer Concern

The percentage of companies using business credit cards has increased from 34% in 1998 to 48% as of the last count. Meanwhile, it is estimated that 30% of all small businesses carry credit card balances.