HAPPY BROCCOLI BIRTHDAY - WHO NEEDS CAKE

by Steve Brown

Have you ever been to a birthday party where someone substituted vegetables for cake? It may sound crazy, but the other day we wandered into the lunch room and someone was doing just that. Sometimes actions can go too far. Here are three such issues bankers are facing that might push some to eat broccoli cake.

Crazy Item #1: Cash. Federal funds have been experiencing a quantitative easing (occurs when more funds than banks need are injected into the market). The FOMC meeting isn't until Dec. 15 & 16, but the flood of excess funds have led large banks (biggest buyers of daily Fed Funds) to act as if a rate cut had already occurred. The effective trading rate (average for all trades on the day) on Fed Funds has fallen from around 50bp during the first couple of days of the month, to about 13bp as the month has progressed. That pressure, however, does not mean community bankers have to eat broccoli cake with their cash. Consider, for instance, that the PCBB "As Agent" Fed Funds pool gross rate has outperformed the market by nearly 400% this month! It hasn't been easy, but hard work and market savvy have helped community bankers in the pool achieve superior results. We don't know if the FOMC will cut rates by 25bp, 50bp, or 75bp at the upcoming meeting, but whatever they do, know that we will continue to work aggressively on your behalf.

Crazy Item #2: Failure. Already, 23 banks have failed so far this year and more are expected today (Friday is the typical day the FDIC announces bank failures). To get a handle on this issue, we analyzed 3Q FDIC data based on banks nationwide ranked by 90+ day delinquent + nonaccrual + OREO (excluding real estate ventures) as a percentage of the loan portfolio. By the time we were done, we found 176 banks were above 11% (vs. an average of 2.59% for the industry) and 43 banks were above 20%. While no one knows how banks get on the FDIC's "Problem" institutions list, if a good chunk of the portfolio is having difficulty, it is probably an indicator. After all, is it just coincidence that the FDIC lists 171 problem banks and our list had 176 (well, yes it is, but you get the picture). As for our Top 10 list, 3 banks are in GA, 2 are in NY and there are 1 each in UT, MD, SD, WI and WA. By the way, the average for this group is a whopping 43% of the loan portfolio. Unfortunately for this group, it looks like a slice of broccoli cake may be on the way.

Crazy Item #3: Fraud. Finally, we focus in on major news of the day related to investment manager Bernard Madoff. This 70Y old guy reportedly bilked wealthy individuals, hedge funds and pension funds from $50B dollars in what even he has called "one big lie." If true, this fraud would also be the biggest Ponzi scheme in history. While the size pales in comparison, given extreme personal stresses on everyone, bankers are reminded that most fraud is from employees. Studies find that most bank fraud goes undiscovered for 18 months before it is uncovered. In addition, 18% of fraud is committed by senior executives and the average loss on all bank fraud is about $260k per event. To avoid broccoli cake in this area, we suggest banks periodically run background checks on employees with an eye toward large debts (may add pressure to steal), a lavish lifestyle or addictions (such as drugs, alcohol or gambling). The upcoming year will be a doozy, but common sense, hard work and avoiding vegetable cake whenever it is served should help see you through.

BANK NEWS

TLGP

The FDIC published the list of banks that opted out. A higher than expected 3,100 banks opted out of the free option to have their term debt guaranteed. As we work on funding programs to bring banks additional and emergency funding utilizing this guarantee we remain puzzled why some would pass up the option. While the expected number of banks also opted out for the transactional guarantee), we wonder how they know for sure that it won't be needed in the future.

Updated Call Reports

The FFIEC issued revised Call Reports for year-end to take into account TLGP additions.

Bank of America

The Bank announced it will cut 11% of its workforce (approximately 35k jobs) over the next 3Ys as the bank absorbs Merrill Lynch.

Commercial Sector

Experts predict commercial real estate will soften through 2010, as prices drop 20% from the peak reached in 2007. Meanwhile, commercial property sales have already fallen to levels last seen in 2003. On the good news front, commercial property LTVs are running 50% to 55% now, given bank requirements for additional up front borrower cash.

SBA

The agency is betting on two changes to bring life back into its loan programs. Lenders may now price variable rate loans at 300bps above LIBOR rather than Prime and loans with different rates can be pooled into packages for investors.