NEW YEAR LIQUIDITY

by Steve Brown

If you are like us, you have probably waited until this weekend to get most of your holiday shopping done. Face it. You have had other responsibilities like procrastinating putting the holiday lights up or watching college football. The reality is most of us will continue this attitude right through the weekend to the 23rd, at which time we will panic. This is were the practice of giving coupons for back rubs, wrapping batteries separately to make it look like you are giving more gifts than you actually are and giving kitchen appliances reaches an art form. Hopefully, the extra time you save wondering aimlessly around shopping malls this season can be better spent on managing liquidity for 2009.

On that topic, we wanted to check your interest in either issuing or investing in FDIC insured guarantee liquidity obligations under the Temporary Liquidity Guarantee Program ('TLGP"). We have been hard at work on this for the past month and are close to bringing the product to market, but we could use some help to better understand both supply and demand. Since this is a new market, we are in unchartered territory and so we seek information in order to better meet bank's needs.

Banks will be able to take advantage of this program in two ways. Some banks will issue to raise funds, some will invest and many will do both at different times. Here is a quick recap of each position:

Issuing: Banks that are looking to fund themselves can do so under this program. Utilizing the guarantee, banks can have access to funds, at prices that would not normally be available. While these are considered wholesale funds, they will help diversify liabilities and give banks another tool to structure different maturities. Issuing under this program will keep FHLB lines available, will not use up precious collateral and will provide a new source of funds. It should be noted that while Bank of America and others have issued at levels of 85bp above the swaps curve, community banks will have to pay more for two reasons. One, Bank of America issued $6B, providing global investors with suitable liquidity. The second reason is that while the obligation is the same general risk (because of the guarantee), there are differences. Should a bank fail, there is an associated delay in getting principal and interest repaid. In addition, there is a period of time when interest stops accruing at the time of bank failure. While this is minimal, investors do take this into account when pricing. Because of this fact, pricing in the 2Y and 3Y area is approximately 30bp to 45bp more than where a large national bank has issued.

Investment: The instrument offers an excellent way to add low risk investments to the balance sheet that are 20% risk weighted. These obligations will all be bullet maturities so they present an excellent alternative for use in a leverage program. For reasons mentioned above, pricing on community bank guaranteed obligations are slightly higher than national bank issuance. While the difference is a little more liquidity risk, banks that plan to hold the investment to maturity, can garner additional earnings.

These obligations can be structured as a loan, security, deposit or one of many other structures in order to help meet 2009 asset/liability goals. To see specific proposed terms and to get a glimmer of what we have in store, if you are a bank that has opted in for the TLGP Guarantee Program, click below to take a quick survey and register your interest (in either issuing or investing). In this manner, unlike the recipients on our holiday gift list this year, we will be able to better deliver something that you need. To see more, go to:

http://www.zoomerang.com/Survey/?p=WEB228MXGW5DKJ

BANK NEWS

M&A

Chemung Financial ($864mm, NY), the holding company of Chemung Canal Trust Co., has entered a deal to acquire Canton Bancorp ($80mm, PA) for $7.7mm, or roughly book price. Chemung will assume $62mm in loans, $70mm in deposits and 3 branches.

M&A

BB&T Insurance Services will purchase J. Rolfe Davis Insurance in Florida. J. Rolfe has 130 employees and 5 insurance groups including employee benefits, personal lines, commercial property and casualty, financial services and retirement plans. For BB&T Insurance, this marks the 100th insurance agency it owns around the Southeast.

M&A Canceled

An acquisition deal between Summit Financial Group ($1.6B, VA) and Greater Atlantic Financial ($205mm, VA) has been called off again; this time due to a steep drop in deposits at Greater Atlantic. Summit first entered a deal to purchase Greater Atlantic in 2007, which was called off a year later.

Negative Equity

Roughly 1 in 7 homeowners are now underwater on their home, owing more than the home is worth. That equates to a whopping total of 12mm nationwide and is about 2x the level from the end of 2007. If home prices fall another 10%, the total would rise to nearly 15mm.

Modifications

According to the Association of Consumer Bankruptcy Attorneys, nearly 50% of loan modifications in November raised monthly payments and increased interest and unpaid fees (raising mortgage balances an average of nearly $11k). Only 33% of loans modified saw reduced monthly payments.