A FLOOD OF REGULATORY INFORMATION

by Steve Brown

We don't know about you, but it has become harder than ever to keep up with the constant flow of regulatory updates, rulings and requirements. Heck, in the past 2 weeks alone, various regulators have informed bankers about these items:

The Temporary Liquidity Guarantee Program ("TLGP") was extended from 6/30/09 to 10/31/09 and that an additional surcharge would be imposed on debt issued with a maturity of 1Y or more. The catch is that all banks or holding companies must have issued before 4/1/09 to qualify. Those who have not done so must apply to the FDIC by 6/30/09 and may or may not be allowed to issue. Not much impact for most community banks.

Industry performance was worse than originally reported in the 4Q and for all of 2008. So many institutions filed amended financial statements that the impact significantly changed earlier reported earnings and performance. Overall, sharply higher charges for goodwill impairment widened the industry's 4Q loss to $31.1B (an increase of 23% over the earlier report). In addition, net income for the industry for the entire year fell to $10.2B, a decrease of 58% from the prior report. When all was said and done, industry ROA for the year fell to 0.08% (0.41% for banks < $1B in assets), while ROE came in at 0.79% (0.31% for banks < $1B in assets). OTTI killed industry earnings.

Regulators have been giving testimony to Congress and banks are being reminded that risk management is critical. Regulators also indicate: they will be tightening things up further; even the best policy manuals/risk models are not a substitute for strong governance; and a risk-focused tone must be set at the top & instilled throughout the company. Look for future emphasis to focus on underwriting standards; risk concentrations across product and business lines; liquidity; infrastructure; capital levels and more capital planning. Expect more regulation.

Regulatory reform is coming, so bankers should prepare. There will be a systemic risk regulator, which probably will be the Federal Reserve Board. There will be an insurance and wind-down specialist, which will likely be the FDIC. The OCC and OTS will probably combine, as will the SEC and CFTC. We'll have to wait and see how Congress puts its stamp on things, but change is clearly in the wind. This should create more consistency.

In an effort to preserve capital in the banking system, the FRB delayed until 2011 rules that would have restricted certain elements from Tier 1 capital (such as TRUPs and cumulative perpetual preferred stock). This helps at the margin.

In an effort to restore liquidity and free up bank balance sheets, the FRB expanded collateral it would accept under TALF. It will now take securities backed by biz equipment, vehicle fleet leases, floor-plan loans and mortgage servicing advances extended to cover payments missed by homeowners. Already included were auto loans, credit cards, student loans and SBA guaranteed loans. System liquidity continues to increase.

To reduce long-term yields and allow mortgage borrowers to refinance, the FRB began purchasing $750B of agency MBS (pushing total purchases to $1.25T or about 25% of all agency MBS) and said it would buy $300B of long-term Treasuries over the next 6 months. It is working.

To help small biz lending, Treasury will buy $15B of SBA 7(a) and 504 securities starting no later than May. In addition the Treasury temporarily raised SBA 7(a) guarantee to 90%; eliminated borrower and lender fees on 504 loans; eliminated up-front fees on 7(a) loans; rebated fees paid since 2/17/09 to borrowers or lenders that were charged; will turn around applications in as little as 2 days and will have the IRS issue guidance to allow small businesses to "carry back" losses for up to 5Ys. Good for small business customers.

Floods are never helpful and are often quite destructive, so we'll continue to keep you informed as conditions change (in order to help you manage the deluge).

BANK NEWS

Credit Union Update

We reported that the NCUA had placed corporate credit unions (the backbone of the credit union system) USCCU and WesCorp ("CCUs") into conservatorship. This was due to losses in their securities portfolios, which had eroded value. As with the FDIC, the NCUA is backed by the full faith and credit of the US Gov't and it operates the National Credit Union Share Insurance Fund (NCUSIF). NCUA said it took the action in order to protect the fund and is now in daily control of these CCUs (which it indicates are operating normally). The size of these CCUs ($57B) and the unprecedented action are amazing, but the NCUA also indicates since both entities participated in the Guarantee Share Program (similar to TLGP, but also covers Fed Funds) that funds eligible under the guarantee are fully protected.

Lending

Commercial loan volume may have dropped in 2008, but banks accounted for 51% of the market vs. 43% in 2007.

TLGP Reporting

FIL 15-2009 was issued that allows banks that have been approved for TLGP debt, but have not issued, to stop filing the monthly reports.

IT Risk

Studies finds that in 2008 only 2.4% of data breaches involved encrypted data. To reduce the risk of theft, community banks should evaluate what data is encrypted and what is not to be sure this loop is closed. Meanwhile, electronic data is about 5x more likely to be stolen than paper.