HEARD AROUND BANKING

by Steve Brown

We exchange email with and speak to lots of bankers and regulators around the country. We are also ferocious readers and as strange as this may sound to some, actually enjoy reading financial periodicals, newspapers and books. Doing so, we believe, allows us to stay on top of all things community banking and gives us plenty of information to spread around. Here are some things we have read or heard recently that we think you might find interesting.

If you are wondering when the FRB will raise rates and pull out all the liquidity they have been adding to the system, the most likely scenario is that they won't raise rates until GDP begins to stabilize and the unemployment rate flattens.

Regulators are very focused on interest reserves of any kind (even customer provided reserves paid in cash); unfunded commitments (cut them back, document and report trend); liquidity (focused on wholesale funding usage; general liquidity analysis must include dynamic stressing); risk management (needs to be improved, focus is on governance and board reporting); capital (new well capitalized level is now 12% and it must be incorporated into annual planning process); ALLL (must be robust and qualifiers should be regularly updated); contingency planning (must be formal, go beyond BCP, incorporate liquidity/capital) and appraisals (should be actively reviewed when they arrive and downgrades should occur promptly if needed).

Deleveraging is underway with a vengeance in the industry right now. Banks are focused on reducing risk, working on loan problems, shedding wholesale funding and trying to get capital percentages back in line. Look for ROEs to suffer as capital requirements rise and industry returns drop.

Job of risk manager is gaining in prominence. Position focused on setting company risk appetite; developing policies/procedures; assisting in capital allocation to business lines; monitoring data/trends; working with business managers to control risk.

In an effort to stay on top of things, some banks are running ALLL analysis monthly. Meanwhile, we hear more banks are also having weekly meetings to discuss past due loans, what actions need to be taken and analyze contingencies.

According to regulators, loans are collateral dependent if repayment is expected to come solely from the underlying collateral. If a loan is collateral dependent, expect to charge it down to fair value of the collateral less costs to sell regardless of whether foreclosure is probable.

Community banks are hanging in there, with about 60% telling us they have seen an increase in deposits (as large banks have reported weak earnings) and nearly 50% say they have been able to capture more business customers.

The credit crisis has wiped out $8T in stock market holdings and $12T in net worth from US households. Meanwhile, home equity as percentage of home value has fallen to 43%. The good news for banks is that all this volatility and fear helped drive up total bank deposits by 5% in 2008.

Banks looking to sell construction portfolios should know that we see current bid levels of around 20 to 30 cents on the dollar in the open market. That isn't surprising when you consider the overhang; lack of capital and the fact that 11.4% of construction loans are currently delinquent (the highest level since 1993).

As of the end of 2008, 163 banks had more troubled loans than capital (up from only 13 in 2007). That is about 2% of all banks in the country.

Studies find about 75% of people now say they mistrust financial institutions in general, but an amazing 80% say they trust their own primary bank.

The latest surveys project the recession that officially began in Dec. 2007 will slowly begin to improve in 2010; unemployment will remain in double digits through 2010 and the CRE sector will slowly start to rebound in early 2011.

As you digest these items this morning, know that we will keep our ears open so we can periodically report back.

BANK NEWS

Take Action #1

Bankers have until Apr. 1 to file OTTI comment letters. Under the FASB proposal, "other than temporary impairment" markdowns would be recorded on securities, unless there was no intent to sell. In that case, only the credit portion of the loss would be recorded in earnings and the non-credit portion would be recorded in other comprehensive income.

Take Action #2

Community bankers are reminded they have until Apr. 2 to send comments to the FDIC on the proposed 20bp assessment. You can e-mail comments to comments@fdic.gov and the reference line should be "Assessments, RIN 3064-AD35".

CU Premiums

The NCUA is raising insurance premiums by about 100bps to cover the est. $6B cost of Friday's takeover of US Central Federal and Western Corporate Federal. The agency had set aside only $4.7B to cover CU losses.