WATERPROOF NOTEPADS WITH A COOL LIGHT

by Steve Brown

Bankers are always trying to figure out new things to give away to capture new customers and we have come up with a sure winner. Give away a waterproof pad of paper and pen with a small reading light attached to it. We say this because a new survey of small business owners finds 58% forget to write down creative ideas that would help their company succeed, 44% find inspiration about their company while taking a shower and 25% work late into the night to inspire creativity. Our waterproof, take anywhere, light-enhanced notepad handles all of that.

As you ponder where you can order one of these, we thought we would take a moment to zero in on 5 things regulators are focused on right now, as lessons learned from the crisis are absorbed and the industry continues to work through a period of unprecedented challenges.

1. Stricter Guidance. For years, regulatory agencies have issued "guidance" to help bankers understand where regulators are coming from on various issues. While guidance has not meant direct "regulation" in the past, things have morphed as a result of the crisis and the lines have blurred (consider CRE guidance issued in late 2006 regarding concentrations in construction, land and development loans). A future focus of regulators will be to reexamine where the informal and formal worlds collide and for guidance to move ever closer to more definitive regulation. In short, expect more specific requirements and increased communication of regulatory expectations.

2. Letter & Spirit. The crisis has shown how some adhered to the letter of the law, while others followed both the letter and the spirit of the law. Since laws cannot keep up with changes in the industry, bankers should expect regulators to focus more on not only the actual laws, but also the intent. For example, expect regulatory scrutiny to increase on consumer protection in both spirit and letter of the law, look for more development of regulatory "red flags" to identify diverging areas and expect to see more focused examination teams.

3. Capital Adequacy. Is any amount of capital "adequate" in the eyes of regulators these days? Given industry stresses, expect regulators to zero in on the amount of leverage a bank is taking in comparison to its capital and the overall risk inherent in the assets. Current risk-based capital rules will get an overhaul and bankers should prepare to hold more capital as a cushion for future events. Banking supervisors worldwide (through Basel) are already working on this issue, so expect to hear more by the end of this year or early next year.

4. Liquidity. Along with capital adequacy, liquidity risk has surged into one of the top areas of concern for regulators. One of the lessons learned from the crisis is that some banks have not held enough liquid assets, did not robustly analyze potential future cashflow needs, had employed limited stress testing, had low levels of backup funding available, relied on volatile funding sources, relied on concentrated funding sources and had weak contingency planning processes. Understanding that this will be an area of heightened regulatory scrutiny, embracing the concept and increasing your attention on assessing liquidity risk will be important for any upcoming examination. Don't wait to hear from the regulators that this is important because in their minds they have been broadcasting this to bankers for years. Take steps now to devote more attention to liquidity risk management and get ahead of the curve.

5. Diversification. One of the most basic elements of any strong risk management system is diversification. Whether talking about loan borrowers, investment securities or counterparties, having significant concentrations of any of these can impact performance or even survival. Banks have re-learned this lesson recently in FN/FH equity preferreds, the failure of Lehman and the collapse of certain large developers within specific geographic regions. Expect regulators to spend more time examining risk concentrations of all types and don't be surprised to see additions to regulatory requirements in this area.

Now, if only we could figure out how to deliver this publication in waterproof form, with a backlight, we would really be on to something nifty.

BANK NEWS

M&A

Danvers Bancorp ($1.7B, MA) acquires Beverly National ($485mm, MA) for $60.4mm or 1.44x book. Beverly has 10 branches and produced an 8.9% ROE last year

Overhaul

The Administration released a financial markets overhaul in hopes that Congress can turn it into legislation by year-end. The plan would eliminate the OTS; make the Fed the consolidated supervisor for large banks (as well as more responsibility for payment/clearing activities at financial firms); bring oversight to hedge funds; create an agency with powers over consumer lending; require mortgage originators to retain a risk share in sold loans; create a formal exchange for derivatives; establish a "Systemic Risk Council"; leave the rating agencies largely untouched; and, push companies to give shareholders a greater say on executive compensation. While it is too early to handicap this horse, the plan is less painful to community banks than originally feared. Look for more analysis in the future as discussion swirls.

Bank M&A

The average non-FDIC assisted bank acquisition through May was at a 1.57x multiple of book, 1.65x of tangible book and 22.6x of earnings.