BANKING TAX = UPSET STOMACHS

by Steve Brown

Did you know studies show 75% of people experience symptoms like headaches or upset stomachs due to stress? If you are a banker, no one has to tell you that. Before the stress kicks in today, we take a moment to discuss something that might at least delay that inevitable queasy feeling that has become banking these days.

Banks will soon have to cough up a chunk of change in order to pay for the FDIC special assessment as a way to rebuild the Deposit Insurance Fund. The assessment of 5bp on bank assets minus Tier 1 capital (as of Jun 30) is due Sep 30 (but banks have to accrue it now, so the impact is already being felt). This asset-based change on the assessment shifts the cost more toward banks that rely on non-deposit funding and those with larger asset bases. Despite the change in calculation methodology by the FDIC, the overall assessment maximum is also capped at 10bp of domestic deposits. Although this is a charge that all bankers will have to bear in a difficult environment, the shift in calculation methodology is generally less than prior for most community banks.

This "banking tax" will have to be paid but many community banks have limited ways to do so. Income is precious and the result of this assessment is that many bankers will end up taking a hit to capital at the very worst economic time. That is a very tough pill to swallow, but since leverage is "out," cranking up the loan to deposit ratio is not a viable option. That leaves bankers with limited alternatives to pay for all of this.

What if you let the cause of all this extra cost pay for itself? By knocking 5bp to 50bp off your current posted deposit rates, banks could go a long way toward taking some of the sting out of the assessment. We know reducing deposit rates is very disconcerting to many, but it may not lead to the massive runoff a bank may be worrying about. Keep in mind that banks everywhere are deleveraging at the same time customers are seeking safety over return. If banks don't need to grow deposits to support growing loans, then paying lower rates is a strategy worthy of consideration.

Take a poll of the market and see where your rates fall in to the stack. If you are in the top 50%, consider cutting back and tracking any outflows. If runoff becomes too much, you can always inch the rate higher, but right now if we had to guess, customers care about safety over rate by a factor of probably 10 to 1. Give the customers what they want and help the bank at the same time. Continue to emphasize the safety of banking and deemphasize rate.

If the bank is in a stressed area of the country, things are looking up on the funding side. That is because the new FDIC rule on interest rate restrictions limits the rate a strained bank can pay to 75bp over the prevailing national rate. While the rule doesn't officially take effect until Jan. 2010, bankers paying rates above that level can expect a not-so-friendly letter from the FDIC and the primary regulator "reminding" the bank they are above the threshold and indicating which rates the bank should reduce. This makes sure banks are not paying exorbitant rates in any region and lowers deposit pressure. For banks raising deposits outside the market (such as internet deposits), the rule limits the rate to 120% of the current yield on similar maturity Treasuries. Using the grid below for example, banks posting rates on the internet above 0.20% for 3M, 0.38% for 6M or 0.59% for 1Y maturities can expect a friendly little reminder from their regulator urging the bank to reduce rates.

No matter what, any additional fees, costs or taxes levied on community banks really hurt during these trying times. While little can be done about this banking tax at this point, going to the spot (deposits) that is causing the pain and extracting the money to pay the tax may at least help reduce the stomach ache.

BANK NEWS

Libor Restructure

The British Bankers Assoc. said it will look to add banks to its survey (only 16 participate now) in order to more accurately calculate Libor. In addition, it will look to go to a 2x per day calculation instead of the traditional 1x.

CRE

The MBA projects CRE prices will rebound in 2010 at the earliest. In the 1Q, industry defaults rose to 2.3%, the highest level in 15Ys and up from 1.6% the prior quarter.

Retirement WIll Wait

According to a survey by Watson Wyatt, 34% of Americans have pushed back retirement dates within the past year compared to just short of 50% for those over 50. The top three reasons cited were declining 401ks, rising healthcare fees and higher consumer prices.

CEO Turnover

With the financial sector topping the list, May saw a 47% increase from the previous month in CEO turnovers. Nationwide, 115 CEOs departed their post in May, according to Challenger Gray & Christmas Inc., an outplacement consultancy firm. If you're in the banking industry, don't worry too much: CEOs in the healthcare sector have the highest YTD leave rate.