A LIQUID CUP OF JOE FOR BANKERS

by Steve Brown

Given that we begin writing this around 4am PT each morning, we have become accustomed to downing multiple cups of coffee. For whatever reason, if you enjoy a cup of Joe now and again, you may be interested to find that studies show drinking coffee may reduce your risk of diabetes, Parkinson's, liver cancer, ovarian cancer and colon cancer. As if that weren't enough to get one awake this morning, consider that coffee has also been shown to improve one's mood, reduce the effects of asthma, treat some headaches and even lower the risk of having cavities. We feel better just knowing all of that as we top off yet another cup.

Speaking of the value of liquids this morning, we focus our energies on some principles of sound liquidity risk management. Regulators have been increasing their focus on what community bankers are doing when it comes to managing liquidity risk and are hammering home the idea that community banks should have in place strategies, updated policies, monitoring processes and other factors related to managing liquidity under adverse and varied conditions. In fact, in June, the regulatory agencies issued proposed guidance on this very subject.

Since no one wants to read 51 pages of anything, let alone a regulatory "summary" that consolidates principles of sound liquidity risk management, ties into international guidance from Basel and incorporates recent market events. The good news for our readers this morning is that our coffee has begun to kick in, so since you will have to know this stuff anyway, we will take a shot at trying to summarize the summary to help drive home some of the salient points.

Before delving into the guidance, however, we stop to emphasize that bankers should be doing the basics. Believe it or not, we still come across banks that have not yet filled out the paperwork to borrow from the FRB Discount Window. Bankers that don't do so can expect not only increased regulatory scrutiny, but are also putting their institutions at heightened risk of problems should a liquidity event occur at some point in the future. We highly encourage every community bank to get signed up to borrow at the Discount Window as soon as practicable - even if you never use it (at least you have the option available and it can take as long as 90 to 180 days to gain access for the first time).

Focusing on the guidance, bankers should know that one of the most critical takeaways is that regulators believe bankers should be doing a better job in boosting liquidity and managing its risks. Areas where regulators think banks could improve include holding sufficient amounts of liquid assets, not funding assets with volatile short-term liabilities, creating meaningful cashflow projections and having stronger liquidity contingency plans.

In addition, the proposal emphasizes that banks should be utilizing more cashflow projections, diversifying funding sources, incorporating stress testing, carry a cushion of liquid assets and be sure to have in place a well-developed and board approved contingency funding plan.

Since we have just scratched the surface of this important topic and given how difficult it is to distill 51 pages down to a space this small, we'll pick things back up tomorrow as we continue to focus on this important subject.

Until then, take a moment to think about bank liquidity, as you enjoy your own liquid refreshment this morning of your favorite black coffee, espresso, cappuccino, lattÃƒÂ© or frappe macchiato upside down quad half-caf.

BANK NEWS

Lending Survey

The trend towards tighter credit is subsiding, as only 30% of banks reported tighter standards in July (down from 85% back in Nov., according to the Fed's Senior Loan Officer Survey). CRE lending is still undergoing change, however, with 45% of banks tightening.

Credit Card

The new credit card legislation goes into effect this week. The law requires greater disclosures, more notification time and longer pay cycles.

More TALF

The Term Asset-Backed Securities Loan Facility was extended from 12/31/09 to 3/31/10 for existing ABS and CMBS and to 6/30/2010 for new CMBS.

Back to School

With the important back to school season half over, retail sales are down 5%. Analysts predict the season will be down 3% overall, the first drop in more than 10Ys.

FDIC Coverage

The 102 banks that have failed in the past 2Ys have resulted in an average hit to the FDIC Insurance Fund of 25% of assets of each failed bank. This is up from 19% for closures between 1989 and 1995.

Distressed Deals

M&A related to bankruptcies and restructurings have increased to $84.4B YTD, more than 4x the $20B of 2008. In contrast, bank M&A deals total a meager $822mm for the 1H of this year, compared to $7B a year prior.

Nonperforming

Preliminary 2Q data shows nearly 300 banks held 3% or more nonperforming loans and over 150 had 5%+.