DATA AND THE FRB DISCOUNT WINDOW

by Steve Brown

We really like to dig into data because it provides insight that may not be immediately obvious at first pass. For instance, did you know that data shows only 3% of people over 16Ys of age are paid the minimum wage or that people hit the "Del" and "Esc" keys on their keyboards more than any other key (700x per week)? Data can be fascinating, which is why we decided to dig further when the FRB announced they were making changes to collateral pledged at the Discount Window effective October 19.

As the story goes, the changes reflect the results of a broad-based review of methodology and data sources as part of the FRB's normal risk management practices. The modifications have nothing to do with current market conditions, but they have been modified in this latest version to be more granular and to increase transparency. For community banks, we zero in on some of the changes we think you might want to know about.

One change is that the FRB will now assign an internally modeled price for any eligible securities where a vendor price cannot be obtained and apply the ">10 duration bucket" margin for these less-liquid securities across the board. This eliminates a whole series of unique margins and simplifies things.

For securities commonly held by community banks, borrowing capacity expanded for: Treasury securities (0-5 duration went from 98% to 99% and >10 went from 93% to 96%); agency securities (0-5 duration went from 98% to 99% and >10 went from 93% to 96%); AAA-rated corporate securities (duration >10 went from 93% to 94%); Municipal securities (0-5 duration went from 97% to 98%, >5 to 10 went from 95% to 96% and >10 went from 92% to 95%).

The FRB added the category of acceptable corporate securities by adding those rated BBB to AA (0-5 duration is 95%, >5 to 10 is 93% and >10 is 92%).

Mortgage-backed securities that used to be combined (both agency and private label) have been broken out separately now. As a result, agency MBS improved slightly (duration >10 went from 93% to 95%); agency CMOs were mixed depending on duration (0-5 duration went from 97% to 98%, >5 to 10 went from 95% to 96% and >10 went from 92% to 90%) and private-label CMOs got worse (0-5 duration went from 97% to 90%, >5 to 10 went from 95% to 84% and >10 went from 92% to 83%).

Government sponsored enterprise stock (FNMA, FHLMC, FHLB) dropped sharply, going from an 87% borrowing capacity to 65%.

The biggest changes came in the loan categories, where things get more complicated (now based on maturity, risk grade, type and coupon). Overall, the FRB moved from blunt buckets by high-level types to more refined groupings broken down by minimal risk (rating 1 or 2) or normal risk (rating 3, 4 or 5 regulatory pass credit). Then, within those two categories, loans were categorized as before between individually deposited loans (only through Automated Loan Deposit System) and group deposited loans (more typical for community banks). It should be noted that while the individually deposited loans have a range of margins that can be applied, that is determined by maturity and coupon of the loan. The good news is that the FRB provided expanded tables so banks can figure things out.

On group-deposited loans, banks used to borrow based on lendable value (a percentage of the outstanding loan balance adjusted for market value) but that has now been changed to a simpler format of just a margin times the outstanding balance (no fair value adjustment).

One key thing to point out is that for securities the margins are based on duration, while for loans it is based on loan maturity.

In closing, while we enjoy crunching the data now and again, there is simply too much data to cram it all into this space. Therefore, interested bankers may want to check out this link to see what exactly the impact might be on your own bank when the new rules kick in on October 19:

http://www.frbdiscountwindow.org/20090819margins_announcement.cfm?hdrID=21

BANK NEWS

FDIC Non-Interest Guarantee

The FDIC board meeting Mon. will decide the fate over whether the blanket guarantee of non-interest checking accounts will extend past the end of the year.

Private Equity

Next week, the FDIC is expected to loosen requirements for private equity firms to invest in troubled banks. Look for the relaxing of capital maintenance targets below 15%, as well as a hold period shorter than 3Ys.

Cash For Clunkers

The simulative program will end Monday. What will happen with sales after that?

Lehman, The Movie

The BBC will produce a TV movie about the demise of Lehman Brothers. Look for it this fall.

Deposits

As consumers tightened purse strings, banks gathered $500B in deposits, reaching a record $7.5T as of 1Q. Interestingly, the data also shows depositor behavior has shifted and only about 33% of deposits are now kept at consumer's primary bank, as opposed to 44% in 2008.

CRE Values

According to Investment Property Databank, property values dropped over 15% in the first 2 quarters of this year, already topping the 12% decline for all of 2008. Over the 2Q, values fell 6.9% on average with office properties experiencing the largest declines, dropping 7.8% followed by industrials, down 7.5%.