THE IMPACT OF FIL 50-2009

by Steve Brown

Late last week the FDIC came out with their controversial Financial Institutions Letter 50-2009 (FIL 50-2009) that extends the de novo period for state chartered, non-member banks from 3Ys to 7Ys. Prior to this regulation, banks less than 3Ys old were subject to higher capital requirements, greater regulatory oversight (including more frequent examinations) and fairly strict adherence to their business plans. The regulatory view was that new banks require greater supervision.

Now it is the FDIC's belief that "Recent experience demonstrates that newly insured institutions pose an elevated risk to the Deposit Insurance Fund." The FDIC goes on to claim, "Depository institutions insured less than seven years are over represented on the list of institutions that failed during 2008 and 2009, with most of those failures occurring between the fourth and seventh years of operation." Because of this belief, the FDIC extended its de novo supervision from 3Ys to 7Ys.

For starters, we question the FDIC's cause and effect, as failure has more to do with asset composition, state of domicile and operating expenses than age of origination. For every bank that was more than 3Ys old (but less that 7Ys) that grew too fast (from 2005 thru 2007 and ran into trouble), you can most likely find a bank in the same age range (that grew fast from 2000 thru 2002), that produced above average returns. Our point is that the conclusion is derived from the period one chooses to measure. As such it seems the FDIC is fighting the last crisis, but it is too late for that argument.

Extending the de novo supervisory period from 3Ys to 7Ys affects about 250 institutions directly and everyone else indirectly. For clarity, the logic of not including OCC banks (43 banks that would be affected), Fed-member banks (22), OTS savings banks (27) and FDIC savings banks (6) in the ruling escapes us, but we will chalk that up to politics. Regardless, for the approximate 250 institutions that it does affect, the value of those institutions has dramatically dropped because of this ruling. The greater regulatory scrutiny and loss of flexibility not only adds an estimated $30k to the expense side of the balance sheet, but it makes potential investment in start up banks less interesting. While little data is available, it takes the potential price down an estimated 15%, as a charter less than 3Ys old now has added cost and lower flexibility for new investors (existing banks purchasing new charters will not be impacted).

Next to existing banks less than 3Ys old, the next group that this ruling impacts are those hearty private investors looking to start a bank in the next couple of years. Very few banks are getting approved now and FIL 50-2009 adds an additional layer of expense and risk to new investors that makes the economics even less compelling.

For banks older than 3Ys that are not directly affected by this policy change, the ruling is a good thing. FIL 50-2009 makes existing charters over 3Ys more valuable and we would expect to see more interest in young, troubled banks that can be consolidated.

We do feel for those banks that were just approaching their 3rd birthday and were looking forward to normalized regulatory oversight. Unfortunately, this will be just the first of many new rulings over the next 2Ys that will keep our industry in a state of flux.

BANK NEWS

Negative Rates

The Swedish Central Bank has become the first central bank to introduce negative interest rates on balances left with it by banks. It is believed negative rates will force banks to lend again instead of leaving excess cash on balance with the government. The Bank of England is reportedly considering a similar move.

CU Closed

Kaiser Lakeside Credit Union ($24mm, CA) was shut down with SafeAmerica Credit Union ($392mm, CA) agreeing to assume some assets and liabilities.

Bailout Bucks

The US Gov't pulled in a $4B profit from the 8 largest banks' TARP repayments. An additional $35mm in earnings also came from the other 14 banks that have repaid TARP.

Default

According to Real Estate Econometrics, commercial mortgages in non-accrual rose to 2.88% (or $27.8B) in the 2Q, more than double the 1.18% at the same time last year and 31% higher than the 1Q.

Warn Your Customers

An industry group that keeps tabs on crimes against the financial sector warns cyber attacks are increasing against small and mid-sized businesses. Thieves will usually send a targeted email to the company controller and include a virus or link that installs malicious software to steal passwords.

Credit

Credit card companies are reducing credit lines, increasing rates and shutting off inactive accounts. Analysts estimate credit card lines have already been cut by 20% to 45% as of July.