HALLOWEEN AND SCARY BANKING

by Steve Brown

Halloween is officially behind us, but the ghosts, goblins and ghouls that knocked on our door seeking treats remain fresh in our memories. On Friday, regulators released a Policy Statement on Prudent Commercial Real Estate (CRE) Workouts. Long rumored to be boiling in the cauldron, this concoction certainly shocked community bankers that had time to skim it before heading home to don a costume.

For the past 2Ys, the relationship between community banker and regulator has been about as strained as we have seen in decades. Gone are the days of discussing loan downgrades and action taken by management from the last examination, replaced with more of an authoritative structure community bankers have called unyielding. That has been a primary driver why so many banks we talked to just ceased making loans and moved to forcefully shrink their balance sheets to preserve capital. That is why we were perplexed by the seemingly positive tone taken by the policy statement given what banks have been experiencing as of late during examinations.

Right in the opening paragraph, regulatory agencies say they support prudent CRE loan workouts and "recognize that financial institutions face significant challenges when working with commercial real estate borrowers that are experiencing diminished operating cash flows, depreciated collateral values, or prolonged sales and rental absorption periods."

Regulators then go on to say that "while CRE borrowers may experience deterioration in their financial condition, many continue to be creditworthy customers who have the willingness and capacity to repay their debts. In such cases, financial institutions and borrowers may find it mutually beneficial to work constructively together." Finally, regulators indicate they "have found that prudent CRE loan workouts are often in the best interest of the financial institution and the borrower."

If you have been through a recent examination, this sounds like some sort of trick. After all, aren't these the same regulatory agencies that have been seemingly looking at banks as goblins, forcing downgrades, hammering home troubled debt restructurings (TDRs) as all nonperforming/nonaccrual and forcing chargeoffs that deplete capital? Is it possible things are slowly changing and regulators are beginning to realize all bankers aren't dressed up as evil-doers?

Given the importance of CRE lending to the strength of our economy and concentration levels already in place at so many community banks, over the next few days, we will be dissecting this 33 page guidance to help community bankers figure it all out.

At a basic level, the guidance indicates regulatory agencies devised this updated proposal in order to enhance and replace existing supervisory guidance. In particular, the guidance is designed to assist examiners in evaluating bank efforts to renew or restructure loans to creditworthy CRE borrowers. In short, the new guidance indicates banks that are prudent in doing loan workouts (that include a comprehensive review of borrower financial condition) will not be subject to criticism - even if the restructured loans have weaknesses that result in adverse credit classification. As long as the loans are to borrowers that have the ability to repay their debts (and documented appropriately) according to reasonable modified terms, the new loan will not be subject to adverse classification solely because the value of the underlying collateral has declined to an amount that is less than the loan balance.

There is so much more to cover on the new guidance that we cannot fit it all in today. We will work through the details in coming issues as we try to surface whether this is truly a trick or a treat for community banks. Our early read is that this is indeed a treat as the policy statement is a good first step toward a more normalized lending environment that we sincerely hope finds support throughout the industry and the regulatory community.

BANK NEWS

Numbers 106 to 115

The FDIC closed the 9 banks; all were owned by FBOP ($19B, IL). The associated banks include: Bank USA ($214mm, AZ); California National Bank ($7.8B, CA); San Diego National Bank ($3.6B, CA); Pacific National Bank ($2.3B, CA); Park National Bank ($4.7B, IL); Community Bank of Lemont ($82mm, IL); North Houston Bank ($326mm, TX); Madisonville State Bank ($257mm, TX); and Citizens National Bank ($118mm, TX). US Bank will assume the majority of the deposits, 153 branches and 80% of the assets under a loss share. The cost to the FDIC insurance fund is estimated at $2.5B.

CIT

The $71B finance company files for a prepackaged bankruptcy, despite taking $2.3B of TARP funds. This is the 5th largest bankruptcy in the US and was a result of credit losses in their small and middle size business lending.

FRB & CEOs

The Fed has called a meeting with the CEOs of the 28 largest US banks to discuss compensation practices.

Capital Stress

Analysis shows mortgage related losses have wiped out $500B of the US banking system's capital base.

Small Business

A new survey finds 60% of small businesses have used a credit card in the past year to provide business capital. That compares to only 45% that had a bank loan.

NCUA

The Agency has decided to charge CUs a 15bp special assessment on insured shares to pay back the $310mm borrowed from the Treasury and boost the SIF.