A THIN SLICE OF THE BANKING INDUSTRY

by Steve Brown

If you have ever worked as a cook or in a deli you have probably used a Hobart slicer. This gizmo takes a hunk of meat and slices it paper thin if you want or as thick as an elephant's hide if that is more your style. The flexibility of the Hobart slicer is world renowned and it remains a workhorse of any good restaurant kitchen. No matter how you slice or dice the industry these days, stress can be found in about as many different forms as there are types of meat.

Formal or Informal: For instance, as of the end of 2009, there were 8,012 financial institutions insured by the FDIC. A recent article in an affiliate publication of American Banker, indicated that data provided to AB found just over 14% of all institutions (1,143) were under formal (made public) enforcement actions, while slightly less than 14% (1,099) were under informal (not public) actions. That means a whopping 28% of all financial institutions in the country were either under a formal or informal enforcement action as of the end of the year - that is a new record for the country and more than double 2008 levels.

Problems: Meanwhile, 702 institutions were deemed "problem" by the FDIC or about 61% of those under a formal enforcement action (it is assumed all institutions labeled "problem" would be under a formal action, but that is not really known as the definition is not publically disclosed).

Texas: Everything is big in Texas, which is maybe why some 603 financial institutions had a Texas Ratio of 100% or greater (or have failed) at the end of the year. Recall that a ratio in excess of 100% significantly increases the likelihood that a bank will be closed by regulators, so 603 is a lot of institutions in that strained category.

Efficiency: This ratio is either loved or hated because, like most ratios, it is a blunt measurement stick. In short, the ratio tries to calculate how much cost is expended to generate a dollar of revenue. The cost side includes salaries, technology, buildings, administrative expenses, etc.; while revenue includes net interest income and fee income. While a low efficiency ratio is generally admired (below 50%), this is not a great measurement stick since a bank that is retail focused will run a higher ratio, while a more wholesale or business bank will have a lower ratio. Suffice it to say when discussing efficiency, things become very inefficient very quickly. Right now, legal (and other) expenses are higher (due to loan workouts), provisions are higher and more loans are on nonaccrual. That is why, over the past 2Ys, the average efficiency ratio (for institutions with assets under $1B) has jumped 10% to 74.24%. As if that weren't brutal enough, when compared to banks > $1B in assets, community banks are nearly 39% less efficient - a distinct competitive disadvantage.

Reserves: From 2008 to 2009, banks dumped buckets of profitability into the loan allowance. You may not have been keeping that close an eye on things, but if you had, you would know the average allowance to loans & leases increased for the industry by 41% (from 2.21% to 3.12%) over this period. This will eventually stop and bank profitability will return, but through 2010, look for earnings to remain pressured.

As can be seen from all of this data and more, no matter how you slice and dice things, the blade is still spinning so care must be taken. Economic recovery is underway, but bankers should be prepared to make lots of sandwiches before things return to normal once again in the industry.

BANK NEWS

Consumer loan delinquencies

The ABA reports 8 of 11 categories of consumer loans saw delinquencies fall in 4Q including credit cards (down 8% to 4.39%) and home equity lines (down 5% to 2.04%).

Retail Growth

Citibank's West Coast regional president reported "double-digit" growth in retail loans and deposits over the past year. Citi attributed this growth to longer branch hours, a "commitment to communities" and a focus on financial planning for customers.

Notes from VA Lending

Though most military borrowers are of high credit quality, the performance of these loans is tied to underwriting quality as well. Of 1.3mm such loans outstanding, 5% are at least 90 days past due, 1.6% less than prime mortgage delinquencies. When the worst lenders are taken into account however, defaults have risen to over 15%.

New Technology

In sticking with our goal oriented savings account theme that we have been reporting on, Regions Bank launched their "Savings Goal Tracker" that can be found at www.savewithregions.com.

FDIC Assisted Assist

: For 2009, the average boost in stock price for public banks that did an FDIC assisted deal is approximately 23% (if you take the price prior to announcement through the end of Jan 2010).

Extended Period

: In the FOMC minutes released yesterday, the Fed clarified that their pledge to keep interest rates exceptionally low for an "extended period" is based on the performance of the economy, not the calendar. They also reiterated this would not limit their ability to tighten monetary policy or lengthen the extended period, as may be warranted by economic performance.