RELAX - WE'VE GOT YOUR BACK

by Steve Brown

On April 30th, banking regulators released new guidance covering correspondent concentration risks. In it, regulators indicated that banks should take additional measures beyond those already put in place by Regulation F to identify, monitor and manage concentration risks between other banks and specifically, correspondent banks. We explore the guidance here, but before we do, know that Pacific Coast Bankers' Bank already has your back. We have a robust program to help your bank track, manage and automatically adjust to such exposures as part of a comprehensive support package. The program gives clients enhanced monthly reporting, a calculator to allow for on-the-fly exposure monitoring, limit setting capabilities, sample documentation and customized assistance to help you as you develop plans and internal limits.

Now back to the guidance. First, it does not eliminate Regulation F, but rather adds additional standards that banks must now follow. Specifically, the new guidance focuses in on two main areas - credit and funding concentrations. A credit concentration is defined as having a credit exposure to your correspondent bank that is more than 25% of your Total Risk-Based Capital. A funding concentration means that you get 5% or more of your funding (defined as low as 5% of your total liabilities) from your correspondent bank. Of note and also indicated within the new guidance, regulators realize some concentrations may be needed because banks sometimes maintain large "due from" balances to facilitate clearing activities with their correspondents. As such, the guidance does not establish strict concentration thresholds, but rather, it requires banks to have robust risk management practices including the updating of strategic plans and setting internal limits to manage such risk on both a bank and consolidated basis.

Now that the basics are out there, let's focus in on the first area of credit risk. To calculate your exposure (examples have been provided by the regulatory agencies in the new guidance as appendices), here is the math: 1) Begin with any DDA balances you have sitting at the correspondent bank or CDs you are holding that are issued by the correspondent bank. 2) Then add in any DDA or CDs held from any affiliates of the correspondent (very few banks will have any of this type of exposure, so probably $0 for most). 3) Then add any Fed Funds sold to the correspondent "As Principal" (note that "As Agent" Fed Funds programs are excluded from this calculation except for the portion of funds you may be selling on any given day to the correspondent). 4) Then add in any under-collateralized portion of any reverse repurchase agreements (here again, most banks will not have any of this exposure). 5) Then add in the net credit exposure on derivatives contracts (here again, most banks will not have any of this exposure). 6) Then add in any unrealized gains you have on unsettled securities transactions (again, most banks will not have any of this exposure). 7) Then add in any loans you may have that are outstanding to the correspondent, its affiliates or its holding company (only a small group of banks are likely to have this sort of exposure). 8) To that total, add in any stock you hold (would also include trust preferred securities and subordinated debt) in the correspondent, its holding company or its affiliates (many community banks will have this exposure, but for most, it is also probably a small amount in total). Once you have all of that added up, take the total and divide it by your Total Risk-Based Capital to calculate the exposure ratio. If the number is larger than 25% (here again, nearly all banks currently doing business with PCBB are not even close to this threshold), you would need to bring this to the attention of your board or the appropriate management committee. In addition, banks will have to develop plans to manage this risk (including contingency plans) if the correspondent's financial condition deteriorates.

Before you start to panic and think about all the extra work this will entail, think about one of the easiest ways to automatically reduce your concentrations. One of the easiest "blunt force" ways to accomplish this quickly is to simply adjust your target DDA balance with PCBB and then have everything else automatically swept over to the Federal Reserve into the Excess Balance Account (as most banks are already doing). If you need help with this, give us a call and we would be happy to assist, and we'll cover more of this tomorrow as we explore the rest of this new guidance to help you along.

BANK NEWS

M&A

TD Bank Financial ($567B, CAN) has entered a deal to purchase The South Financial Group ($12B, SC) for $192mm.

Collins Amendment

Senator Susan Collins got her amendment to the regulatory reform bill passed in the Senate that would establish lower leverage at banks and would exclude trust preferred securities from Tier 1 capital. The amendment would also terminate the small bank holding company provision that exempts holding companies less than $500mm from consolidated capital requirements. If passed, the legislation would require some 640 community banks to raise more capital.