FEELING LIKE A MONDAY DRUID - REFORM UPDATE:

by Steve Brown

If this day seems to drag on, it is because we are in the near middle of the longest day of the year. While summer solstice always makes us feel like we should be conducting some Pagan ritual, we will settle for feeling like a Druid - as soon as we figure out what a Druid is. Honestly, we are not sure, but given the fact that is also a Monday, if there was ever a time to do a Druid impression, it is on a solstice Monday.

Speaking of dragging on and being anti-Druid, financial reform isn't helping. As we get down to the final week of reconciliation, Congress has a whole lot of ground to cover. In fact, we are doubtful that Congress can meet the goal of having the reform bill on the President's desk before the July 4th recess. Today, we offer a recap of where we stand, since the outcome could dramatically alter the banking landscape.

For community banks, the largest potential hurtful open item to be decided this week is the Collins amendment. This provision would tighten capital standards by either eliminating or phasing out the inclusion of trust preferreds (TPS) on Tier 1 capital. While we were really hoping this would be removed, given the needed Republican support for the bill, our take is that some form of future TPS elimination stays. We are keeping our fingers crossed that existing TPS gets grandfathered, unless Congress wants to risk a whole other set of economic problems by drying up capital and ultimately credit.

Next to the Collins amendment, another major open issues is whether Congress will levy some additional fee on banks in order to generate the $20B of revenue needed to help cover the cost of implementing the reform bill (or the $150B liquidation fund that is said to be needed to clean up future banking problems, including those institutions that are too big to fail). This is oxymoronic, or just plain moronic, when you think that in the next 48 hours, our best political minds will be debating how the industry is going to be charged for regulation that it doesn't want, that will create more risk, not less (and in turn, will likely further increase the probability of having to use such a fund). The whole thing just makes us want to crawl back to winter.

In addition to greater fees, banks will be faced with smaller revenue streams. The Durbin amendment needs to be decided this week. It would allow the Fed to determine "reasonable and proportional" fees charged to retailers, when customers pay for purchases with debit cards. While this provision will likely be watered down, under almost any scenario we can think of, earnings will be hurt by at least 1% and possibly as much as 5%.

Following in order other issues that look ugly, the derivatives issue is up for debate, but its fate appears to be largely sealed at this point. Neither of the conference committee's two leaders -Barney Frank (D, MA) or Chris Dodd (D, CT) has given any indication that they plan to change Blanche Lincoln's (D, AK) tough language on derivatives. This is despite continued opposition from Treasury, the Fed, FDIC and every major banking trade group. Look for this legislation to largely stay intact and major bank activity in speculative derivatives trading to be largely curtailed.

By the same token, look for the Volcker-rule (the elimination of proprietary trading within banks) to be instituted largely as is. While this may be watered down to allow only customer trading to occur at banks, it is clear that banks will not be able to directly risk their capital in the markets on speculative (and historically largely lucrative) market positions.

We will do another recap once the legislation is complete to discuss how banks will need to change their strategy to take advantage of some of these changes (or shift tactics to dampen the impact). Until then, keep the pressure on the lobbying effort and break out whatever Druidian ritual you can think of to help give our paid representatives some summer wisdom.

BANK NEWS

Closed (83 YTD)

The FDIC closed Nevada Security Bank ($480mm, NV) and sold it to Umpqua Bank ($10.5B, OR). Umpqua gets 5 branches, all deposits (no premium) and all assets ($368mm under loss share). Of note, the 83 closures so far this year is more than double the pace for all of 2009. For more information, go the bottom right of here.

Insurance

The FDIC Board meets on Tuesday to discuss a final rule on the Temporary Liquidity Guarantee Program (TLGP) and losses to the Deposit Insurance Fund (DIF).

More Reform

In a speech given before the Wharton School (PA) late last week, FDIC Chair Shelia Bair said an overhaul of FNMA and FHLMC "should rise to the top of the agenda," immediately following FinReg legislation.

Banker Optimism

A Grant Thornton survey finds 33% of bankers expect their local economy to improve in the next 6 months, up from 22% who thought so in Dec. Meanwhile, 25% said they expected their bank to hire new employees within 6 months, up from 18% who said so in Dec.

SFR Repos

As repos rose 44% YoY to an all time high in May, distressed properties piled up. Banks' repossession process are now taking the well over 425 days for loans in foreclosure and over 375 days for loans 90 days past due