FINANCIAL REGULATORY REFORM - FINAL OUTCOME

by Steve Brown

You would have to run a full triathlon AND watch the entire Lord of the Rings trilogy before you approached the time-stretched heroics of the Isner-Mahut 11-hour, marathon tennis match at Wimbledon. While we were impressed, we are equally impressed (although not as happy about the outcome) that while we were home sleeping, our Congressional leaders burned the midnight oil to finish of the 2,000 page financial regulatory reform bill at approximately 5:30am ET this morning (after a rare 20-hour session). Legislators normally don't work that hard unless they are campaigning, so we appreciate the effort. Since the Bill has made it out of Committee and now goes to the floor of both the House and the Senate where it is expected to pass, little further change is anticipated. As such, we wanted to give a brief update of where key banking law is expected to change, as it should be signed into law by next week.

The provisions with the largest impact on community banks follow in order - Trust Preferreds (TPS): For banks below $500mm in total assets there will be no change. For banks under $15B, TPS will grandfathered so their status as Tier 1 capital does not change, however going forward TPS will be disallowed. For banks above $15B, they will have 5Ys to replace the capital plus a 3Y phase out period. Deposit insurance: FDIC insurance coverage is made permanent at the $250k level retroactive to 1/1/08 (IndyMac depositors are happy) and TAG is extended through the end of 2012. Business checking: Banks can pay interest on commercial checking accounts starting in 1Y. Derivatives: Banks can use derivatives to hedge their own risk without an issue, but will not be able to make a market as a line of business unless the business is in a separately capitalized subsidiary of the holding company. Interchange: The Fed will be in charge of setting appropriate fees and caps. Preemption: OCC will continue to be able to preempt state banking and consumer protection laws if these laws "prevent or significantly" interfere with the business of banking.

In addition, some important provisions will have indirect impact on community banking and will change certain aspects of our industry - Prop Trading: The "Volcker Rule" will now restrict or ban specific proprietary trading activities at large banks in addition to limiting the investment in private equity/hedge funds to 3% of tangible capital. Securitizations: Banks must hold 5% of securitized loans/receivables sold with a limited safe harbor provision for mortgage loan sales. Bank Tax: Banks over $50B and hedge funds over $10B will get hit with a special FDIC assessment fee over the next 5Ys. TBTF Dissolution: A line of credit by the Treasury to the FDIC will be establish to help in the orderly wind down of failed large banks.

Finally, there are a host of minor changes that will have an impact on our industry - The OTS charter is preserved; banks with less than $75mm in market cap will be exempt from SOX 404(b) auditor attestation provisions; there will be a 3Y moratorium on new ILC charters while the charter type will be studied; bank accounting oversight will fall to the Systemic Risk Oversight Council created by the Bill; and, the Fed's exam authority over state-chartered community banks is maintained.

We are still working through the various provisions as we read the fine print in this voluminous Bill to see if anything turns up as there is no telling what could happen at 1am in the morning in committee.

As usual there are most likely loopholes, oversights and undersights that will be uncovered that will have an impact on community banking. Look for further updates in the future that will hopefully save you the time and effort of a marathon session.

BANK NEWS

M&A

WSFS ($3.8B, DE), the parent company of WSFS Bank, has entered a deal to purchase Christiana Bank & Trust Co. ($202mm, DE) for $34.5mm. WSFS will receive $161mm in deposits, $115mm in loans and $6B in rust assets.

Loyalty

JD Power's annual retail banking survey finds customer satisfaction has reached a plateau, while loyalty and brand image has dropped for the 4th consecutive time. 66% of customers are considering a bank switch, up from 54% in 2007. Poor customer service was noted as the #1 reason for defection (37%). Perceptions do fair better at community banks, as 41% of are set on staying while only 32% have decided so for the big banks.

Free!

This word likely caught your attention and not too surprisingly given a recent study that big banks were able to win over 70% of potential customers compared to 59% at regional banks in the last 12 months. The difference may largely be due to larger banks offering promotional gifts and competitive short-term rates. At national banks, 24% of new accounts cited these offerings as a primary reason for joining compared to only 13% at regional banks. To note, these types of customers carry a higher tendency towards defection, with nearly 25% stating they certainly or likely will switch banks again in within the next year.