A BANKING BED OF ROSES

by Steve Brown

Way back in the 1500's, English poet Christopher Marlowe penned the phrase "bed of roses." Since real roses have thorns, it would hurt very much to sleep in a bed made of roses. It might smell nice, but the pain would probably make sleeping difficult. Interestingly, since that time, the phrase has morphed and come to be used figuratively to refer to any easy or pleasant situation. Whatever you may think about the banking industry as of late, we tend to believe the older version is probably more apropos right now than the latter, given significant changes, regulatory pressures and everything else going on right now.

In just a few days, the first half of the year will be behind us and we will all be staring into the next 6 months. We wonder what changes will come, how we will react and what banking will look like when we reach the end of that short road. While many bankers are beginning to feel better about things, the second half of the year will certainly deliver its share of challenges.

To begin, the biggest financial regulation overhaul since the 1930's is now receiving final tweaks. Once that is completed, the bill will be delivered to President Obama for signature into law, just in time for July fireworks. The new law will curb some risk taking and increase capital buffers, but it does not appear as though fundamental reshaping of the industry is in the offing. Good or bad, much of the law will still need to be interpreted by regulatory agencies in the coming years, so while the basic framework is there, interpretation and enforcement will be where things could get thorny. We'll have to wait and see how it all plays out.

One of the biggest gripes of the new financial regulation is that it really did nothing to prevent too big to fail or much of the kinds of excesses that led to the financial crisis in the first place. Perhaps that was just too much to deal with, or perhaps Congress is leaving that to the regulatory agencies to handle. No matter the reason, the Bill leaves key issues unresolved and nothing in the Bill will prevent another crisis, so vigilance and strong risk management will be primary drivers embedded within the industry going forward.

As the analysis and interpretation swirls this morning, some early points coming out of the new financial regulation are interesting to note.

First, estimates project the changes will hit large bank earnings in particular by 15% to 20% overall. It is still too early to tell whether this is good or bad for community banks, but expect higher fees to be one strategy that likely gains traction, as banks seek to recoup profitability given this impact.

Next, no matter when the Bill is signed into law, the process from there will take years to work through the regulatory agencies. Analysis will be forthcoming, rules will be put in place and then teams of examiners will come into the field with new manuals to follow as enforcement kicks into high gear. Once word around that process spreads throughout the industry, banks that have not yet been examined will slow down as they prepare for their own upcoming examination. We see a general fear of the unknown taking hold until clarity is provided, so look for community banks to keep things simple over the medium term.

Finally, while interest rate hedging and foreign exchange will be allowed to stay inside banks; commodities, equity and credit default swap instruments will be forced to move into a separately capitalized subsidiary. Moving these latter pieces will pull capital out of banks, so look for some consolidation in this area as smaller players move to spin nascent business lines off to avoid having to set aside additional capital.

As the financial regulation process continues, we ponder whether Marlowe or the figurative interpretation will be more accurate for community bankers in the years to come.

BANK NEWS

Closed (89 YTD)

On Friday, the FDIC closed: 1) Peninsula Bank ($644mm, FL) and sold it to Premier American Bank ($1.1mm, FL). Premier purchased all deposits (no premium) and essentially all assets, with $438mm under a loss share. 2) First National Bank ($253mm, GA) was sold to Savannah Bank ($769mm, GA). Savannah assumed all deposits for a 0.11% premium and some assets. 3) High Desert State Bank ($80mm, NM) was sold to First American Bank ($621mm, NM). First American acquired all deposits for no premium and nearly all assets (with $68mm under a loss share). For more analysis, go to: https://biganalytics.bancinvestment.com/

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The summit largely focused on national debt reduction. For the biggest banks, the new capital rules under Basel III Accords will be phased in, with a soft deadline of 2012. The focus of the next summit in Nov. will be on the details.

Failure Projection

The FDIC is projecting losses to the insurance fund will reach roughly $100B from 2009 through 2013 and that losses from 2010 through 2014 will be about $60B. Past 5Ys the FDIC said it expects bank failures to return to very low levels that preceded the financial crisis. Chairperson Bair commented that the FDIC still expects "bank failures to peak this year and begin to taper off next year as the banking industry continues to heal and recover."