# BANK AND CUSTOMER REPO

by Steve Brown

Last week the FDIC released a proposed rule for public comment that clarifies depositors or "lenders" position when it comes to a repurchase transaction (repo) with a financial institution. By our estimation, based on Call Report data and a sampling of banks, about 10% of community banks conduct borrowing or lending on a wholesale basis and almost 35% of community banks have a repo-type arrangement set up with depositors whereby they pledge loans or securities to guarantee any depository amount over the FDIC insured $250k limit. While the number of banks in this latter structure has fallen from 2009 because of bank failures and the Transaction Account Guarantee, the mechanism is still prevalent.

The good news is that for banks utilizing repo, the new FDIC rule validated the orderly liquidation process when the FDIC is appointed the receiver of a bank. While this was always assumed to be the case, there has been some doubt recently over the enforceability of certain deposit structures. Now the rule states that the FDIC acknowledges that repo is a secured claim and will be paid to the full extent of the underlying collateral. Any amount in excess of that collateral will become an unsecured claim with the FDIC. The rule goes on to discuss how a lender/depositor would submit a claim on the cash and how the FDIC, if unable to satisfy the claim, would provide the assets that were used to secure the claim in lieu of cash.

So far so good, however, the FDIC goes on to make an important distinction that should cause many banks to take another look at their repo activity. Specifically, the FDIC makes the distinction that Treasury and government securities are calculated at their par face amount.

This delineation is important for two reasons. One, the wording now calls into question the common bank practice of giving a collateral value amount in excess of par, due to mark-to-market implications. That is, if the securities are trading at a premium in the open market, an amount above par might be pledged. It is unclear if the choice of wording was intended or not, but this is one point where banks should watch for future clarification, as it could reduce the amount of collateral available by some 5%.

More importantly, this proposed rule calls into question the even more common practice of utilizing non-government securities for repo, such as municipal or corporate securities. Here, the market value of the securities will be taken into account upon liquidation valuation, but it is currently unclear if this takes place the day of receivership or some point in the future, that may or may not be advantageous for secured creditors.

Finally, the rule reminds banks that have still not cleaned up their collateral sweep programs to do so now, as the question of "perfection" or ownership of repo collateral is even more significant. Because an on-balance sheet sweep adds another layer of complexity (due to the frequent movement of funds and reassigning of collateral), customers that are active in a repo sweep-style mechanism are at a heightened position of risk, so clarity of ownership and proper disclosures must be given.

Repo as a mechanism for deposit products has been clarified which will help most banks utilizing these products. Now, it is recommended that banks take another look at their structure to ensure that they comply with the latest proposed guidance to see what changes need to be made going forward.

# BANK NEWS

### M&A

Community Bank System Inc. ($5.5B, NY) has agreed to pay $101.8mm in cash and stock to acquire Wilber Corp ($930mm, NY). The deal adds 22 branches to Community's existing footprint of 150.

### Banks Closed (139 YTD)

1) First Bank of Jacksonville ($81mm, FL) was sold to Ameris Bank ($2.4B, GA). Ameris assumes 2 branches, all deposits (no premium) and assets (74% under loss share). 2) Progress Bank of Florida ($111mm, FL) was sold to Bay Cities Bank ($523mm, FL). Bay Cities assumes 2 branches, all deposits (no premium) and assets (75% under loss share). 3) The Gordon Bank ($29mm, GA) was sold to Morris Bank ($335mm, GA). Morris assumes 1 branch, all deposits (0.5% premium) and cash assets only. 4) First National Bank of Barnesville ($131mm, GA) was sold to United Bank ($943mm, GA). United assumes 2 branches, all deposits (no premium) and assets (82% under loss share). 5) First Suburban National Bank ($149mm, IL) was sold to Seaway Bank and Trust Co ($415mm, IL). Seaway assumes 4 branches, all deposits (no premium) and assets (78% under loss share). 6) Hillcrest Bank ($1.65B, KS) was sold to Hillcrest Bank, NA, a freshly charted subsidiary of NBH Holdings Corp (MA). Hillcrest Bank, NA assumes 41 branches, all deposits (no premium) and assets (70% under loss share). 7) First Arizona Savings ($272mm, AZ) was closed and approved for insured deposit payout as the FDIC was unable to find a buyer.

### QE2

Goldman projects the Fed may purchase up to $2T worth of Treasuries to help stimulate the economy, beginning with a $500B program.

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