SPYING ON THE REGULATORS (WELL SORT OF)

by Steve Brown

We sent our spies over the wall with fake IDs, beards, sunglasses and wigs to find out exactly what regulatory agencies might be thinking and where they might be cracking down next. While we were eventually thrown out of a meeting when our beard glue melted and we couldn't answer a question about where money comes from (trees is not correct by the way); we hurriedly collected our

photography and recording equipment and left in a pretend huff (you have to work hard to throw people off your trail in these situations). Anyway, here are some of the areas community banks should be prepared for in 2011 that we uncovered as a result of all of our clandestine (gathering-and-representing-public- information) efforts. Shhhh....

Loan Loss Reserves: Regulators are likely to ask for more information and disclosure if your bank doesn't provide enough to explain circumstances related to a fluctuating ratio of allowance to total loans; a fluctuating ratio of allowance to non performing loans (NPAs); large unallocated allowances and changes in methodologies or charge-off policies. Banks can also expect regulators to look at fluctuations in the different components of the allowance to the total allowance; review regulatory agreements; check to ensure appraisals are being updated in a timely manner when loans are measured for impairment based on collateral value; zero in on geographic or higher-risk loan type concentrations; check charge-off policies for each type of loan and review non accrual policies for each type of loan. While not a complete list, focusing efforts to ensure compliance with all of these is a great starting point to pass any test.

CRE Loans: Here, regulators will want to see enhanced disclosures if your trend of charge offs has been increasing, impacted or is expected to impact the allowance (such as triggering events, circumstances that impact the timing of an allowance, how increasing level of charge offs are factored into the different components of the allowance, how you define the level of your allowance based on charge off history). In addition, expect more information to be requested around large fluctuations in charge offs, non performing CRE loans, indications that workout programs do not explain the types of programs or adequately quantify modified loans and indications that CRE loans are being extended at or near original maturity but not considered impaired (because of guarantees). Bankers should also be prepared to explain whether large increases in NPAs is due to a few large credits or large numbers of small credits; whether the allowance proportionally follows the levels of NPAs and any steps you are taking to monitor and evaluate collateral values of NPAs.

Troubled Debt Restructures: Regulators will be looking closely at the amount of loans that have been restructured; what type of workout strategy is being employed; the benefits of the strategy (including impact on interest income and classification); general terms of the new loans (and how the A and B notes are different); whether the A note is underwritten in accordance with your customary underwriting standards and at current market rates; charge off policies for A and B note structures; and whether A and B notes are placed on non accrual status and included in impaired loans.

Loan Extensions: Regulators will be looking for increases in construction or commercial loans extended at maturity (particularly if not deemed impaired due to guarantees); types of extensions made; loan term modifications from original note; whether loans are considered collateral dependent;

how the guarantor is assessed; type of financial information reviewed, frequency, objectivity and how often that occurs. In addition, expect focus on how many times you have sought performance under the guarantee and the extent of any successes; how you evaluate and determine the realizable value of the guarantee; and the bank's willingness to enforce the guarantee.

We'll cover more sections tomorrow, as soon as we connect with Agent 99.

BANK NEWS

Small Biz

The Treasury has lined out terms for participating in the $30B Small Business Lending Fund for banks with less than $10B in assets. The bank will pay a 5% dividend on funds at start and for every 2.5% rise in small biz lending the dividend will drop by 1 percentage point until the dividend hits a floor of 1%. After the initial 2Y, if lending has not grown, the dividend will rise to 7%. If this persists for another 2.5Y, the rate will jump to 9% (if the fund has not yet been repaid).

Worst Unemployment ERates

The BLS indicates the 10 worst metropolitan areas in the country with at least 1mm or more people unemployed right now are Riverside-San Bernardino- Ontario, CA (14.2%) Las Vegas-Paradise, NV (14.1%) Detroit- Warren-Livonia, MI (13.3%) Sacramento--Arden-Arcade-- Roseville, CA (12.1%) Tampa-St. Petersburg-Clearwater, FL (11.8%) Miami-Fort Lauderdale-Pompano Beach, FL (11.8%) Los Angeles-Long Beach-Santa Ana, CA (11.7%) Orlando- Kissimmee-Sanford, FL (11.2%) Providence-Fall River- Warwick, RI-MA (11.0%) Jacksonville, FL (10.9%).

Small Biz Health

A Kaiser Family Foundation study finds employees at 25% of small companies are uninsured, compared to about half that level for larger companies.