# SPYING PART DEUX

by Steve Brown

Yesterday, in order to keep you informed, we covered key areas regulators have indicated they will review frequently when visiting banks. Our data comes from clandestine spying efforts (or perhaps just public information and speeches), so we share our nearly top secret information

again today. It is important to note that this information may or may not be all-inclusive (see disclaimer potentially hidden or not hidden in this document under a black light).

Concentrated Credit Risk: If a small group of loans make up the majority of the non-accrual loans, be prepared to provide more information about the borrower; type of collateral; amount of credit exposure; amount of allowance; any special circumstances around the loan (out of market, participation, etc.).

Interest Reserves: If you have a material amount of construction loans with interest reserves, expect more focus on how you recognize interest income on these loans; monitor projects to ensure appropriateness of continuing to capitalize interest; extensions, renewals or restructured terms (and reasons for any changes); underwriting process for the loans; specific differences in how you underwrite such loans and whether any loans with interest reserves are currently non-performing.

Non-TDR Loan Modifications: Banks should understand that material amounts of loans that have been modified, but not accounted for as TDRs, will draw inquiry as to triggers/factors used to identify these loans for modification. Key features of the modification program; a description of significant terms modified and length of the modification; success rates of such loans; quantification of the amounts of loans modified by type and strategy in each period presented are important to memo. In addition, bankers should expect to be asked to provide analysis supporting conclusions that the modifications are not TDRs; how loans are classified; whether they accrue interest; the impact of modifications on past due statistics; the extent the modification is short-term; whether such modifications result in more permanent or longer term modifications in the future and how the impairment analysis works for these loans.

Non-Impaired Loans: Expect questions around the allowance allocation in this area such as how these loans are grouped for purposes of deriving historic loss rates; periods used to determine loss rates; any changes made during the current period and why; any portion of the allowance for such loans not calculated based on applying loss rates to the outstanding balance (how calculated, what portion, etc.).

OREO: Regulators will look for banks to provide a breakout of OREO by category (lot loans, CRE, residential, etc.); roll forward of OREO (beginning balance, additions, adjustments, dispositions, ending balance); actual prices received upon sale versus amount recorded; income statement line item where gains or losses are recorded; and typical foreclosure decision making processes (significant concentrations, timelines, processes, etc.).

Liquidity Management: Regulators will be looking for more information on liquidity trends, demands, commitments or uncertainties that could result in liquidity increasing or decreasing in a material way; the types of risks faced by the bank and how those risks are being mitigated; a clear picture of the bank's ability to generate cash and meet existing known, or reasonably likely, future cash requirements; an evaluation of the amount and uncertainties of cash flows; whether there has been any material variability of historical cash flows; and the types of financing that are reasonably likely to be available in times of stress.

Don't worry though if you aren't doing all of these yet or if you are still concerned about what will be required in 2011 - to assist, we will keep our eyes open, listening bugs turned on and our satellite imagery sharply focused, in order to help keep you up to date as things change.

## BANK NEWS

### Mergers

Raymond James will acquire Howe Barnes Hoefer & Arnett for an undisclosed sum in order to bolster its middle market capabilities, particularly around community banking.

### Foreclosures

The OCC and OTS released their Q3 foreclosure report and the number of homes entering foreclosure rose 31% Q/Q and +3.7% Y/Y. The worsening foreclosure picture says housing will continue to face challenges in 2011. Peter Schiff, a noted hedge fund manager, opined in the WSJ today that housing prices still have another 20% to adjust.

### Jobs Picture

A new Gallup poll finds 29% of companies are hiring, while 19% are firing staff. Over the past 6 months, the percentage hiring has held roughly constant, while the percentage laid off has drifted about 2% lower. By company size, large companies with 1,000 or more employees have been hiring the most (42% hiring vs. 22% firing), while those with less than 10 employees have been cutting jobs the most (9% hiring vs. 16% firing).

### CFO Survey

A new Bank of America Merrill Lynch survey of CFOs finds 47% expect to add employees next year and 64% expect higher revenues. The survey also found the items CFOs say will have the biggest impact on the economy next year will be health care reform (54%), budget deficit (5%) and the housing market (43%).