NIM AND A FALSE SENSE OF SECURITY

by Steve Brown

Ahh, the fresh air, the open spaces,the wonderful mountains....the suicides - You wouldn't expect such idyllic conditions to be correlated, but they may be according to a new study by the University of Utah. The study looked at a 20Y period for all 50

states and points out that altitude, more than gun ownership, unemployment or a host of other factors; has the largest correlation to suicide. While the thought is that lower oxygen levels are more likely to bring on depression, the exact cause has yet to be determined. As the study points out, things are not always what you would expect.

While not nearly as sad a situation as suicide, uncorrelated things also hold true for a bank's net interest margin. Put another way, a high NIM may actually be a low NIM in disguise. Take for instance a loan we saw recently on an owner occupied industrial space. The loan was $1.5mm in size, had a 7Y maturity, a 20Y amortization and carried a 6.0% fixed rate. The write-up indicated the bank expected to receive a 4.90% NIM on the loan. The problem is that things are not always so idyllic. The bank in question, like many community banks, has a funding base that is highly correlated to Libor. As a result, over the course of the 7Y loan, Libor is expected to increase - taking this bank's cost of funds with it. As such, according to the forward curve, that loan will actually generate a lifetime NIM more along the line of probably 2.55% on an unadjusted basis. If you go another step and add risk into the equation, the NIM drops to 2.14%, as the expected loss comes out to an annualized 41bp per year (more in the earlier years, less in the later years). As you can see, 2.14% is a far cry from the 4.90% NIM projected.

It doesn't have to be like this. At the risk of tooting our own horn, we have a variety of tools to help prevent banks from making loans with lower than expected margins. Our Liability Coach service, at a minimum, is designed to help you increase the duration and convexity of your liabilities, so that more fixed rate loans can be made. Our Asset Liability Management service is dynamic so it helps you better determine how to manage overall credit and interest rate risk of the bank. Our BIGProfit relationship profitability system is designed to not only give you a loan pricing model to help structure more profitable loans (excellent for looking at a risk-adjusted ROE), but also gives you real-time analytics to help structure more profitable relationships overall. Finally, our BLP program is designed to help you originate fixed rate loans to customers, but convert them back to a floating rate to better match your funding sources and interest rate risk - without the accounting or risk management hassles (in the example above, this bank could receive Libor + 3.19% fully converted and lock in NIM for the life of the loan).

As you begin 2011, consider these tools and others that we offer exclusively to community banks. By pricing according to risk, improving funding and better managing interest rate risk, you can thrive. Contact us soon to find out how to capture a 15% ROE. This is particularly true for banks at higher elevations, as the last thing you want is a low NIM and thin oxygen levels.

BANK NEWS

First Clawback Ever

The WSJ is reporting that Wilmington Trust, CEO Donald Foley returned more than $1.8mm in compensation in order to be in full compliance with regulations covering compensation under TARP. The rescinded pay included a $1.75mm cash signing bonus and restricted stock. In a small concession, the Board did raised Mr. Foley's base salary from $1.2mm to $1.5mm. Wilmington had received $300mm in TARP funds.

Lawsuit Wave

The FDIC said yesterday that it has approved professional liability lawsuits targeting 109 former directors and officers of failed banks (not named by the FDIC) in actions that seek $2.49B in damages. The FDIC is already suing 4 former executives of IndyMac Bancorp (CA) for $300mm and 11 former directors and officers of Heritage Community Bank (IL) for $20mm in damages.

Regulation

The FDIC indicated yesterday that the Mortgage Loan Originators Registry will open on about Jan. 31. As a reminder, bankers should know that all mortgage loan originators are required by law to register with the Nationwide Mortgage Licensing System and Registry within 180 days of the date the registry begins accepting federal registrations.

Rising Fees

Changes as a result of Dodd Frank have pushed banks to impose new fees on customers to make up for lost revenues. These include $25 annual fees on debit cards; limiting the amount of purchases per month; limiting the size of transactions; and charging fees on checking accounts.

Restructuring

A report by the OCC finds 88% of home mortgage modifications implemented during 3Q decreased monthly P&I (54% reduced payments by 20% or more).