VISUALLY PRESENTED SO YOU CAN ADDRESS IT

by Steve Brown

According to research conducted by the Department of Labor (of all places), it is estimated that 80% of comprehension for people occurs through visual input. The research also found that people will retain 6.5x more information when visual aids are used to complement verbal interaction. In short, if you are trying to get a point across, make sure you have plenty of visual support to go along with it. To help you prepare visual aids for your next regulatory examination, today we cover key areas regulators have indicated they will be reviewing closely when visiting banks. The information has been picked up from regulatory speeches and presentations, as well as discussions with our community bank customers.

Banks with a material level of impaired loans that are based on collateral value should expect more scrutiny. Specifically, regulators will review the following: how appraisals are obtained and how that impacts the amount and timing of recording loan loss provisions and charge-offs; any adjustments to appraisals will be evaluated and questioned; whether appraisals are "as-is" or based on another value; how you classify and account for loans that are partially charged off, subsequent to receiving an updated appraisal (and whether the loans are returned to performing status or remain as nonperforming). Other points of scrutiny will be how charged off amounts are determined, whether external appraisals are used (and if not how was the amount derived) and formal calculations on how charge offs impact the coverage ratio (allowance / non performing loans).

Given the upsurge over the past 12 to 18 months, it also shouldn't surprise anyone that regulators are taking a closer look into troubled debt restructurings (TDRs). Specifically, they are focused on explanations of the types of workout programs and quantification of modified loans. They also want to understand why any modified loans are not accounted for as TDRs and the nonaccrual policy for restructured loans. For banks that have a material amount of TDRs, expectations increase in this area and regulators want to see such information as a description of key features of loan modifications, significant terms modified and whether modifications are short or long term. They will also want loans to be broken down by type (residential, commercial, etc.) and classified and quantified separately (as accrual or nonaccrual). Policies will also be reviewed to determine how many payments a borrower needs to make on a restructured loan before it is returned to accrual (6 months minimum is expected). Loan modification write-ups will also be reviewed to determine adequacy of quantification of types of concessions made (such as a reduction in interest rate, payment extensions, forgiveness of principal, etc.). Finally, banks should be prepared to discuss in detail the factors considered when a loan is restructured and success levels with different types of concessions.

We will have more information to present to you as the year continues to unfold, but for now we simply report that you should expect examinations to remain extremely detailed (so preparing in advance should help the process along).

BANK NEWS

Banks Closed (1 & 2)

The first closings of the year are in. The First Commercial Bank of Florida (598mm, FL) was closed and First Southern Bank ($568mm, FL) assumed all deposits (without premium) and about 81% of the assets under a loss share agreement. Legacy Bank ($150mm, AZ) was also shut and Enterprise Bank & Trust ($2.5B, MO) assumed all deposits (1% premium) and about 80% of assets under a loss share.

Stress Test

Rumors are making the rounds that the Fed is looking at 4Q numbers to determine if the largest banks should face another credit stress test. Unlike the past, speculation is that test won't be a "pass/fail" but will be scored (in order to possibly do it on an ongoing basis). One point of concern for the Fed is that large banks may attempt to pay dividends and conduct share repurchases prematurely.

Foreclosure Risk

On Fri, the MA Supreme Court ruled against US Bank and Wells Fargo, upholding the opinion of the lower court that 2 SFR foreclosures were invalid because the banks (acting on behalf of securitization trusts), didn't prove they owned the mortgages. While the ruling is another slowdown in an attempt to clean up delinquent mortgages, it shouldn't have a major impact in the long run.

Eco Outlook

Speaking before the Senate Budget Committee, Bernanke said he expects a "moderately stronger" economy in 2011 and expects a slow and steady march to an 8% unemployment rate by 2013.

Country Default Risk

Analysis by credit default swap data provider CMA finds the top 10 countries expected to default on their debt at the end of the year in order were Greece; Venezuela; Ireland; Portugal; Argentina; Ukraine; Spain; Dubai; Hungary and Iraq. By contrast, the 5 countries found least likely to default in order were Norway; Finland; Sweden; Switzerland and the US.