GREGORIAN, JULIAN AND LESSONS LEARNED

by Steve Brown

We are fascinated by the unusual, which is why a fact about the calendar caught our eye this morning. You may not have known it, but the days between the 2nd and 14th of Sep back in 1752 did not exist. That was the year the calendar changed from Julian (Julius Caesar) to Gregorian (Pope Gregory XIII). The problem was that the Julian calendar did not have leap years, so "calendarians" (made up word) had to chop out the dates to make everything work under the Gregorian structure. During that month, the days went 1, 2 and then 14 through 30. If you were around back then, you only had to work 19 days that month to get paid for 30 - not bad. We recently sat in on a regulatory presentation on lessons learned, so to save you a few days off your calendar we provide a summary below. Characteristics: Regulators on the call highlighted some key characteristics they frequently find in problem banks, which include: strong growth; concentrations of credit (particularly CRE and construction/development; out of area lending; dominant management; failure of board oversight; heavy reliance on wholesale funding; minimal balance sheet liquidity; and, lack of knowledge of complex investments. Bankers were urged on the call to focus on sustainable growth, supported by core deposits. Funding: When it comes to wholesale deposits, regulators said they look closely at the percentage a bank uses to support its assets, in particular. They have seen high levels of brokered deposits in some failed banks and as the bank lost its ability to issue brokered; it could not meet its cash flow needs which compounded problems. Brokered CDs and FHLB Advances have been used to grow assets in the past, but a hiccup on the asset side can lead the dominoes to fall quickly, so the mix of funding a bank uses to support assets is important. There is no rule of thumb on the amount of brokered a bank can use, as it depends on the balance sheet, but a reliance on wholesale funding raises many red flags. Lending: On the loan side, banks that ballooned CRE to 6x capital, focused on speculative construction loans and did subdivision development with little equity were the most at risk. On the appraisal front, low cap rates, conflicts of interest with the appraiser; using comparables that were not really comparable (100 miles away, using a farm vs. a subdivision lot, etc) and using potential value on a construction loan all surfaced as issues seen in failed banks. Regulators said it was important for banks to monitor loans actively (annual or semi annually for stable deals, monthly or quarterly for newer ones) to stay on top of potential problems and address them quickly. Regulators indicated they had seen instances where loans were being refunded with cash-out every 12 to 18 months and warned banks against doing so. Finally, regulators said any concentration in any loan sector is a potential problem that needs to be proactively managed and could need additional capital. To reduce the chances of failure, regulators said banks should certainly develop a capital plan before it is needed. Simply saying the bank will raise capital, without having already identified an investment banker or potential price, isn't a robust enough plan. Take the time to lock down the subcomponents of a plan to be sure action can be taken immediately if needed. Other action steps included fully understanding risks in the investment portfolio; having a growth plan; developing and testing a liquidity plan and maintaining internal controls (cutting expenses too far can lead to sharp increase in fraud and weaken controls).

Whether you are Julian or Gregorian, just knowing what the regulators are looking for and putting it on your calendar to follow up, will help you avoid potential problems in the months to come.

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Treasury FAQ

BANK NEWS

SBLF

The Treasury's FAQs have been updated and can be found by following the "Treasury FAQ" link in the related links section of this page.

Card Act

The Fed approved a final rule modifying the Card Act which does not exclude promotional programs where interest charges get waived for a period of time or programs where the card applicant is required to pay fees upfront before card account opening. The new rule also clarifies that card applications should ask for individual income/salary and not "household income," as the latter encompasses more than the credit decision can take into account.

Competition

Bank of America is reporting its customers can now view both bank accounts and Merrill Lynch investment accounts online and through ATMs

More Competition

Charles Schwab will expand its investment advisor branch network nationwide through a program allowing independent offices to be run by managers who aren't employees of the company but can sell all the same products and services that Schwab's existing branches offer. Schwab said the goal is to significantly expand its existing 305 branch network into communities it does not yet serve.