FOLLOWING THE SIGNS IN BANKING

by Steve Brown

Driving into work the other day it dawned on us how much help people need to stay on track. As we passed by road sign after road sign, we pondered why people need so much help to get to the right place or avoid doing something they shouldn't do. States and cities have found that posting signs is an effective way to get people to do something or avoid something and the same can be seen in banking - although the signs are not always posted clearly or quite as obvious, perhaps.

That is why we begin today's discussion with the topic of when the Fed will raise interest rates. At this point, even the so-called man-on-the-street knows the next rate move will be higher, but timing remains uncertain. That is because the answer isn't as straightforward as many want to believe and significant complexities have to be considered.

We are still slowly coming out of a major recession and history tells us when that happens, recovery timelines extend. We still have very high unemployment and while jobs are slowly coming online, the steps forward have been small ones. In every recession over the last 30Ys, small businesses have driven job growth and pulled the country out of recession, but this time is different as they too have been reluctant to expand. It is going to take us several years before we recover all the jobs lost in the past 3Ys since the recession reached its depths and since consumer spending drives our economy and business hiring, the signs point to a process that will take more time. We have added back 1.5mm of 9mm jobs lost, so we are 17% of the way there.

In addition to the jobs situation, state and local governments are burdened with high pension costs and the high cost of programs. That will add pressure until the economy finds enough footing to generate sufficient tax revenue to solve the problem. As if that weren't enough, housing remains a problem, as prices continue to fall and foreclosures remain high. Given that is the single largest asset people have, working out of that problem will also take time to correct.

There are also issues globally that are buffeting our economy and increasing uncertainty. In addition to major problems still hanging around from the financial crisis, Japan faces the aftermath of a devastating earthquake, tsunami and radiation leak; the Middle East is dealing with significant political turmoil that seems to have no end; European countries are fighting a debt crisis that is threatening its structural fabric and commodities prices are launching into the stratosphere. Is it any wonder that pundits, experts and the Fed are having difficulty in clearing the economic cars away so they can clean the street?

As with the Fed, however, bankers cannot wait for rates to rise before preparations begin. Signs clearly indicate inflation is rising and unless it abates, the Fed will almost certainly have to take action and raise rates, so the question is more about "when."

To prepare, bankers should make sure their ALM systems are robust enough to handle things, have a firm grasp on the impact of rising rates on the balance sheet and ensure contingency plans are dusted off just in case rates rise faster than expected.

There is no doubt that community banks will be challenged in the next few years by the shifting regulatory landscape. The Dodd Frank Act, Basel III and other regulatory changes are just beginning to roll through the system. Caution signs are flashing everywhere and community bankers are doing their best to avoid the potholes in the road. As you drive toward your ultimate destination and try not to knock out your alignment, consider the potential timing of interest rate hikes as yet another pothole along that heavily damaged road.

BANK NEWS

Call Report Changes

Banks should be aware that changes due for the 1Q Call report include providing additional data on TDRs; certain deposits with a remaining maturity of 1Y or less; holdings of CMBS; loans and OREO covered by FDIC loss-sharing agreements; BOLI; consumer automobile loans; non-brokered deposits obtained through deposit listing services; consolidated variable interest entities; and captive insurance / reinsurance subsidiaries. The report also has new instructional revisions pertaining to construction loans and residential mortgage banking activities.

Reg Q

As part of Dodd-Frank, the Fed proposed a new rule that would officially nix Reg Q, starting July 21 and allow the payment of interest on all DDAs. Are you ready for interest bearing biz checking?

OD FAQ

Following up on their webinar, the FDIC issued a FAQ set that further clarified how banks should implement and maintain oversight of automated overdrafts. While there is nothing new here, the FAQs elaborate on how and when banks should counsel chronic users of ODs, as well as making sure banks set some minimum OD where they are not assessed a fee. Of particular note is that banks will be required to have a documented system to monitor whether the OD fee is reasonable relative to the OD amount.