FINDING REGULATORY FOCUS

by Steve Brown

A survey by home and office product company Brother International recently pointed out that employees lose an estimated 38 hours per year looking for misplaced items in the office. We all lose things now and again, so reducing the number of times you have to go looking for something by improving organizational skills is a worthy endeavor. In a similar way, we have some thoughts this morning to help you stay organized when it comes to your next safety and soundness examination. To do that, we reviewed speeches and comments from regulatory higher-ups; explored recent regulatory research; consolidated our notes from discussions with bank executives and analyzed information from other banking industry experts to uncover a few areas regulators could be focused on the next time they wander into your bank.

Regulators across the board are now worried about municipal exposures and the noise level has been increasing in this area. As of Mar 31, banks with assets between $100mm and $1B held 25% of all investments in municipals, compared to only 4% for banks with assets above $10B. Meanwhile, over the prior 3Y period, the smaller asset sized group had increased its municipal exposure from 22%, while the larger group had decreased it from 5%. This has all occurred against a backdrop of increasing concern around municipal default risk, due to ongoing economic weakness and lower tax revenues. As such, examiners are looking closer at bank holdings for concentrations, exposures and overall risk management processes in this area. It is becoming more common for examiners to ask bankers to demonstrate analysis has been performed showing the potential for default of specific holdings, the credit capacity of the municipality to repay, general financial performance and other factors (such as projected tax collections). This is being driven mostly by a lack of current financials on many of these bonds, new regulation under Dodd Frank that disallows the sole use of credit ratings to determine risk in assets; concern over concentrations (some 20% or so of banks have total municipal exposure equal to 100% of their capital base) and a lack of current financials on many bonds.

Another area of regulatory concern is around commercial real estate (CRE) exposures. These loans take a long time to workout and that puts pressure on earnings over a longer period of time (particularly for banks with concentrations). The 100% and 300% of capital concentration limits everyone is keenly aware of for CRE are truly guidance, but banks above these levels should expect more regulatory scrutiny, higher capital requirements and higher liquidity limits if these concentrations are maintained. This also means concentrated banks will need to have a greater level of risk management. One of the areas of particular interest are the expected rise in loss rates on CRE loans as they mature, given 33% of all CRE loans in the country mature in the next 2Ys. Regulators worry that borrowers may not be in a position to increase equity to cover the decline in value of real estate collateral or service their loan at market interest rates due to the declining cash flows from rising vacancies and/or declining rents. Monitor concentrations by borrower, type, etc. and have a good handle on maturities over the next 5Ys so you can get ahead of the curve.

Getting more organized is an important skill set for community bankers these days, as the regulatory flow remains high. To improve, try cutting down on distractions, reducing the data flow wherever possible so you can concentrate and revisiting your filing system to reduce the likelihood of misplacing something. No process is perfect, but Dodd Frank alone demands bankers do a better job of managing information to stay on top of things.

BANK NEWS

M&A

Washington Federal ($13.4B, WA) will purchase 6 branches in NM from Charter Bank ($770mm, NM - but taken over by Beal Bank (TX, $3.6B)) totaling $253mm in deposits for an undisclosed sum.

Expanded Scope

The Fed said it will require all banks with assets of $50B or more (35 institutions) to conduct annual exams to "ensure that institutions have robust, forward-looking capital planning processes that account for their unique risks and that permit continued operations during times of economic and financial stress." This essentially expands the SCAP test from the 19 original banks deemed TBTF to all banks with assets above $50B.

New FDIC Head

The White House will nominate FDIC Vice Chairman Marty Gruenberg to replace Chair Bair at the end of her term on July 8th. Gruenberg was an aide to Senator Paul Sarbanes (D, MD), a former FDIC Chair and has served as Vice-Chair under Bair since 2005.

Lower Lending

FDIC data shows that since June 2008, the volume of loans outstanding has fallen in 10 of 11 quarters. Of note, the only reason it grew during the first quarter last year was due to an accounting change. In total, lending has fallen about 9% in aggregate during this period. In the past 3Ys, loans to businesses are down 18.5%.