BEANS OR STEAK

by Steve Brown

Money magazine points out that in the supermarket business, the shorter the shelf life of a given food the higher the markup. That is why the markup on meat is about 60%, while it is only about 26% on canned goods. Prices vary by store obviously, but the next time you are eating a can of beans, consider you paid about one third the markup of a filet you ate only the night before.

Speaking of interesting facts, after seeing heavy volatility in banking company shares overseas, France, Spain, Italy and Belgium banned short selling of major bank stocks in their respective countries. Given the volatility we have seen this week in the banking names and the fact that the cause of the "flash crash" still seems to be a mystery, maybe we should take a breather and do the same here. It would allow Citibank, Bank of America, Goldman Sachs and other large bank's share prices to calm down and give investors time to understand these entities have tons of liquidity, higher capital and better reserves than during the crisis of 2008. The market is swinging back and forth wildly like a drunken chimp on a rope and no one wants to see a repeat in any way of 2008. We are barely coming out of the crisis and given the malaise, it looks like it will take another 3Ys to 5Ys to work through the more than enough issues we have on our collective plates. The extra gas the beans of shorting are causing on these banks in our own equity market is getting uncomfortable enough to call for a cooling off period perhaps.

Another interesting area for discussion this morning relates to credit ratings. After the downgrade of the USA by S&P, we dove into the regulatory literature to see what banks might have to deal with if things got out of control. The good news is that in a short period of time, the Dodd Frank Act triggers each federal agency, to review regulations that require the use of and any references to credit ratings. This use must be removed and reliance on credit ratings must be substituted by alternative standards of creditworthiness deemed appropriate. Banking regulators are struggling with this for obvious reasons (we have built capital ratios around these ratings over the years, for instance), but some of the early work is interesting. For instance, a simple approach could just be to require banks to assign all loan or investment security types of a certain variety, sector, etc. the same risk weight, regardless of the variation in risks that exist across individual exposures. Another more complex method could be to require banks to assign their own risk weights to individual credit exposures using specific qualitative and quantitative risk measurement standards that could be established for various categories based on broad metrics. To keep things simple for community banks, some academics are reportedly even pitching using bond spreads as a starting point. This process has a ways to go yet, so stay tuned but stay aware because the impact on banking could be profound depending on how everything eventually concludes.

Finally, because we get asked so many times by so many bankers, we offer a few tips for the next examination process to help you pass with flying colors. Any examination will begin by assessing whether your bank has adequate systems to identify, measure, monitor, and control the amount of credit risk in the loan portfolio. Next, examiners will try to assess whether the bank's financial statements accurately reflect the condition of the loan portfolio and conform to GAAP. A particular emphasis is placed on loan loss reserves, the accrual of interest income and the reporting of TDRs. Finally, examiners will assess whether your bank has an adequate capital cushion to support the bank's lending activities and credit risk exposures. While all of this includes a lot of subjectivity, just knowing the overall playbook and approach, as you create presentations and analysis to help raise awareness can get you further down the aisle so you can keep on shopping without interruption.

BANK NEWS

Mortgage Settlement

There was much talk in banking circles that a mortgage settlement with the collective states attorney generals is falling apart, as major banks want only limited future liability once a settlement figure is reached. Since talks have been stalled for the last month, we see the possibility of groups of states getting together to negotiate separate agreements.

Recession Fears

Last week's WSJ survey showed 13% of respondents think the US is already in double dipped recession while another 29% think a recession is coming. The later number is up from 17% 1 month ago. Interesting to note, the forward equity, bond and credit markets have about a 60% chance priced in.

Mobile Bank Apps

In a test by viaForensics, 25% of bank mobile phone applications failed basic security tests. The storing of unencrypted passwords and the recovery of cached transaction data were the largest failure points.