SMELLS AND THE 2Q INDUSTRY DATA

by Steve Brown

What is with the 1 in 100 people who literally seem to bathe in perfume or cologne? There you are, just wandering out to get a sandwich at lunch and one of these sorts of people walks by. Suddenly, you grab your throat, as this tornado of olfactory disturbance knocks you to the ground. As your watery eyes blur your vision, you pass out, only to eventually wake up wondering what happened. This happened to us recently and we just thought that since all community bankers eventually face a customer with defective olfactory glands sporting an abundance of perfume/cologne, we would share the wealth just for fun. Speaking of fun and the banking industry, the FDIC released the 2Q banking profile and some interesting information surfaced. At a high level, it would appear that banks are doing much better, with insured institutions reporting net income of $28.8B in 2Q, a YOY increase of nearly 38% (the 8th straight quarterly increase). That is a great high-level story, until you realize that the main driver was a sharp reduction in loan loss provisions, which were down 53% YOY. The other good news is that only about 15% of institutions reported a net loss in 2Q, the smallest percentage since 1Q 2008 (however institutions with assets < $100mm were the highest category at nearly 18%). Also during the 2Q there were two new banks formed (to buy failed banks), 22 banks failed and there were 39 mergers. Meanwhile, institutions < $1B had a NIM of 3.85%; ROA of 0.56%; ROE of 5.14%; leverage capital of 10.6%; Tier 1 RBC of 16.4%; Total RBC of 17.5% and a loan to deposit ratio of 75.2%. It is clear from the data that loan quality is improving, which is a good thing for the industry, since that has been the single biggest drag on performance. Overall, loan chargeoffs fell 42% YOY in 2Q, marking the 4th straight quarter of improvement. Things improved the most in credit cards (where charge offs fell 52% YOY), followed by construction (down 55% YOY) and C&I (down 51%). Improving conditions also helped banks reduce noncurrent loans by 6.5% from the 1Q, marking the 5th consecutive quarter in which noncurrent loan balances have fallen. Improving credit conditions also led banks to reduce their loan loss reserves, which fell 5% in the 2Q from the 1Q. Of note, 70% of the largest 100 banks reduced their reserve balances in 2Q, while only 37% of the rest of the industry did so. By asset size, institutions < $100mm reported a loss allowance to loans of 1.76%; those with assets $100mm to $1B were at 1.93% and those above these levels were about 2.62% on average. At the end of 2Q, there were 7,513 FDIC institutions in the industry (down 4% from the 1Q), of which, 6,413 were banks and 1,100 were thrifts. Of the total, 865 were identified as "Problem Institutions" or about 11.5%. This is number is down from 888, the first decrease since 2008. During the 2Q as well, banks were able to increase assets by 3% over the 1Q, but that was driven primarily by increased investment purchases (+7.7%). Total loans and leases, meanwhile, fell 1.1% from the 1Q with the only bright spots in C&I (+6.4%) and other (+22%). All other loan sectors contracted, including real estate (-5%); consumer (-4%); and farm (-1%). When it came to liabilities, the flood of funds continued, as institutions reported more deposits (+6.8%) in the 2Q vs. 1Q and much lower wholesale borrowing (-16.3%). A few other interesting facts as we wrap things up this morning include: 1) A low interest rate environment and customer demand for longer-term fixed rate lending drove an 11% increase in derivatives outstanding and led about 1 in 9 institutions to report swaps on the books at the end of the quarter; 2) the number of banks with construction loan concentrations dipped to 617 (a 16% drop from 1Q and 46% lower YOY). 3) The efficiency ratio for institutions < $1B was 71.9%, which was better than the 1Q, but well above the larger banks at 60.6%. 4) Smaller institutions also paid a lot more for funding than larger banks. While the cost of funds has improved steadily since the 1Q of 2008, institutions < $1B are paying 1.06% or about 30% higher than the larger banks. 5) Another area where institutions < $1B are struggling is in generating noninterest income. At the end of 2Q, smaller banks were at 21% (as a percentage of net operating revenue), while larger banks still held an edge at 37%. As the 2Q industry data is reported, depending on how you read it, you may find some areas still smell about as strongly as people you may bump into that have bathed in cologne/perfume.

BANK NEWS

Social Media

According to research firm Corporate Insight, Twitter is now a more widely used social media channel than Facebook by financial services firms. As of the start of the month, 67% of large banks used Twitter vs. 59% for Facebook.

Google+

Already the fastest growing social media, Google+ plans to be open to public businesses by the end of the year with functionality designed for small and medium sized businesses. Banks that have beta tested the application have said this will be their main social media channel going forward.

Reg Burden

The White House released final plans to reduce 500 regulatory requirements across all federal agencies. This "Buffet Reduction," so named after the suggestion of Warren, unfortunately didn't include banking, as the industry falls outside a cabinet level position that was responsible for the regulatory reduction. The one item that did make it in was the possible elimination of an FHA requirement for a full audit for small bank lenders. They could have done so much more.

This Explains It

After going through education and work experience, TheHill.com found 80% of Congress has no background in business or economics.

Loan Losses

CoreLogic reports that in the first half of 2010, about 1 in 52 short sales were deemed suspicious.