BANK REGULATORY UPDATE

by Steve Brown

Recently, we had an opportunity to hear from the regulators on some of their key areas of focus. We were pleased to hear right out of the gates that to an agency, they did not feel there was a minimum level of assets community banks would or should have in order to survive in this brave new world. As some may know, there had been rumors floating around the conference circuit that regulators felt community banks should either be $500mm in assets or find a merger partner. We were very happy when they all put that issue to rest and unequivocally stated that simply wasn't true. Another area that captured our interest was the better tone overall that each regulator had. Judging by bank and asset performance, it does appear we are past the worst of this economic shock and barring another jolt, we should be looking at a slow but steady recovery. There is still plenty of pain around the industry and the business model has changed, but a reduction of capacity and real estate inventory, combined with less uncertainty, should get the economic engine roaring back to life once again. The good news here is that the regulators acknowledged they are seeing nascent signs of recovery, there are fewer CAMELS downgrades and some profitability has even begun to return. These are all happening at a very low level, but they are happening nonetheless. A third area of interest to us was the continuing concern about loan loss reserves. Given that 90% of industry profits in 2010 came from banks reducing reserves, that makes sense. Concerns are still running high that we are not entirely out of the woods, so while credit quality is improving, examination teams will be looking closely at documentation and justification for drawing down reserves. Those that are not directionally consistent with delinquencies and chargeoff trends, or are supporting sectors where additional strains could appear are likely to get more scrutiny. Commercial real estate (CRE) is one sector that still flashes prominently on the regulatory warning light panel. The simple fact is that 67% of all CRE in the country matures in the next 5Ys and the economic recovery has been weak, so prices on these properties are lower. The economy just isn't doing very much to help this sector. In addition to the soft economy, net charge-offs reached a 20Y high in some areas of the country in 2010 and they have only recently started to decrease. As such, expect examination teams to take a close look at these exposures, particularly when the properties have weak cashflows, high vacancies, low rents or rising loan to values. Bankers should be careful when and how extensions are granted on maturing loans that have some or all of these characteristics. Finally, many bankers we talk to are currently experimenting with their business model, as they try to find the magic elixir that will return them to robust profitability. It is certainly elusive, but experimenting with new products or services can make sense, as you begin the search. Here, regulators expect banks to involve all relevant departments early on, so the risks of any new product or service have been fully explored and understood. Technology, risk, finance, operations, credit and other units all play a critical role and each come with their own perspective. In so doing, banks that have conducted a thorough risk analysis and coupled that with experienced staff have gone a long way towards addressing potential issues before they surface. Through the eons, bankers and regulators have had a deeply intertwined relationship. We hope today's piece provides a little more insight into areas of potential regulatory concern.

BANK NEWS

Closed (88)

Community Bank of Rockmart ($62mm, GA) was closed by the State and acquired by Century Bank of Georgia ($115mm, GA). Century acquired approximately 65% of assets under loss share and most of the deposits without premium.

M&A Recap

First Guaranty Bank ($394mm, FL) will sell 7 branches, $96mm in performing loans and $211mm in deposits to CertusBank ($1.8B, SC) for an undisclosed sum. First Guaranty will keep one branch, some deposits and all of its nonperforming and criticized assets, as it recapitalizes the remaining bank.

Bank Stress Test

The Fed's Vice Chair Janet Yellen (voter) announced that a 4th round of US big bank stress test will be required in the next couple of weeks.

Dodd Frank

Yellen's speech on Friday also implied that the long awaited Section 165 details (was due in Sept. and the section that deals with capital and liquidity requirements amongst other important items) should be out at the end of the month or start of Dec.

Buyback

US Companies have increased their stock buyback activities. As of the end of Oct., buybacks totaled $453B, the 3rd highest on record.

Bank Trasfer Day

While in question from bankers, the NCUA claims (from gathering data from multiple surveys) credit unions picked up 650k customers for $4.5B of deposits from large banks because of this campaign.

Multifamily

Rents appear up and vacancies down for furnished apartments on short-term leases compared to the general multifamily market.

More Shopping

A survey by Money finds 85% of people spend more time shopping for deals before they buy a luxury item and 83% say they expect to remain frugal in the future.