FIND YOUR CHUCKLE

by Steve Brown

Extending our theme from yesterday on smiling, we take things one level further by sharing this fact with you - studies find that on average, children laugh about 400 times per day, while adults laugh only 15 times per day. As we get older we lose our sense of fun at some level, so given the holiday season is upon us, we suggest you try to find it again. Try starting with fake but very decent belly laughs that build up and can be belted out randomly. At the very least you will startle coworkers, while others will probably wonder what you had for lunch. Enjoy the reaction and over time, you may even find yourself finding true laughter once again, similar to the level you had as a child. While many may not equate laughter and banking these days (given all that is going on), we focus on directors from a regulatory perspective (from published materials), nonetheless. We think that given so many banks are finalizing plans for 2012; you will find it interesting nonetheless. Directors in banking play a very important role. They are responsible for establishing the risk appetite of the bank and for making sure safeguards are in place and being followed by management. That is important, but the primary fact that makes banking different from the rest of the corporate world is the deposit insurance. From a regulatory perspective, the money that is being loaned out comes primarily from depositors, so bank directors (and management) are expected to act responsibly to protect the insurance fund, the taxpayer and make sure all regulations are followed. This is the lynchpin of regulation and while it isn't funny, it is pretty straightforward. The business of banking also revolves around leverage. Banks use deposits to make loans, some of which will not be repaid in their entirety. That makes credit risk the biggest risk in the balance sheet, which is why in a significant recession; regulators tend to get antsy and really dig into the loan files. In addition to credit risk, interest rate and other risks can also cause damage to the franchise, so at varying times they can also be a concern. To protect against all of this, regulators will often look at capital and loan loss reserves as primary lines of defense. From a regulatory position, the more capital and reserves you have, the more likely your bank is to survive financial problems that inevitably surface. Because lending is the backbone of banking, regulatory scrutiny often follows this area. Here, directors play a key role in determining the risks that will be deemed acceptable to the bank. As part of that process, banks are expected to conduct a thorough financial analysis of each credit, with documentation reflecting the borrower's cash flow position and ability to repay the loan in question. Regulators tend to get more agitated when they see banks base credit decisions on management experience with a given borrower and reliance on collateral values, rather than delving deeply into both project and global cashflow analysis. Knowing borrowers is critical to community banking, but proper financial analysis is just as critical to a strong underwriting process and one directors should expect to see. Another area where directors could see additional regulatory scrutiny right now is in the technology area. That may sound a bit odd, but when you consider how important it is to have good reports and information, so the board and management can make sound decisions, this makes more sense. Systems and processes need to be strong enough to make sure the data is good enough and available when needed to make sound decisions and ensure regulations are followed. More and more we are hearing from banks that tended to ignore this area, but are now seeing increased regulatory focus. There are plenty of areas where directors can add value to a banking franchise and in these volatile times, it is important to talk to management to find out more specifics. Understanding how and where you can help and offering assistance when needed will certainly lift burden from the shoulders of the management team and leave them laughing more often. That is a good thing, because laughter not only lifts spirits and makes us feel happy, but it may even heal. In fact, medical studies have found laughter helps reduce pain, decreases stress hormones and even boosts the immune system. That is probably not a bad thing either, when you consider the industry.

BANK NEWS

M&A

NBT Bancorp ($5.5B, NY) will buy Hampshire First Bank ($273mm, NH) for $45mm in cash and stock.

Harp 2.0

The details of HARP 2 were released and it looks better than expected for both borrowers and banks. While we will have further analysis on its impact on mortgage investment next week, the new program greatly reduces or eliminates the risk-based fees Fannie and Freddie charge on many loans. It also virtually eliminates the chance that lenders will have to pay for losses on loans that go into default if they made underwriting mistakes and streamlines the process.

Mortgage Scams

The TARP special inspector general worked with Google to shut down more than 500 mortgage refinancing scams focused on troubled homeowners.

Not Moving

Blame the housing crisis or the economy, as the government reports only 11.6% of the US population changed locations between 2010 and 2011. This is lowest percentage since the government began tracking the data in 1948.

Regulation

The Basel Committee has indicated it will send regulators out across the world next year to be sure banks are implementing new Basel III capital rules properly.