FRIDAY THE 13TH IN BANKING

by Steve Brown

Stories abound, but superstition has held (reportedly since ancient times) that Friday the 13th is a day of bad luck. There are three such occurrences this year, today, April (ok, that one makes sense given you have to pay taxes) and July. Before you shrug this off as jovial fantasy, consider that medical professionals say as many as 8% of Americans worry about the day and take precautions to protect themselves. The number 13 in fact, is deeply embedded into our history as a bad thing, so people worry about it. Consider for instance that there are 13 witches in a coven; many cities do not have a 13th Street or Avenue; many buildings don't have a 13th floor on the elevator bank; and legend has it that if 13 people sit down to dinner together, one will die within the year (rumor has it that one could refers to the Last Super, where 13 were present). That is all pretty creepy stuff and if you are in the 8% that worries about such things, we say we hope you enjoy reading this on Monday the 16th and that you had a great weekend hunkered down in your underground shelter. Now that our superstitious discussion is out of the way, we can get down to the business of banking. As you head into a long weekend, we give you some things to think about, as you continue to refine strategy this year and execute on your plan. At a high level, credit trends are improving. While quality is still strained, the trend is definitely our friend, as steady improvement can be seen. In fact, the latest Federal Reserve analysis from the Beige Book (a beige-colored book that reviews conditions in each of the 12 Fed Districts) indicates economic activity expanded at a modest to moderate pace, suggesting ongoing improvement in economic conditions in recent months. That is cautiously better news, so things are looking up some in economic terms at least. Loan growth remains difficult, but some opportunity is surfacing. Overall, GDP is expected to be 1% to 2% this year, so that means banks can expect loan origination to be roughly that percentage. Since community bank loan growth is low, paying off higher cost liabilities and better managing that side of the equation becomes a key ongoing strategy. Given how spread dependent community banks are and against this backdrop of weak loan demand, margin compression is expected to continue for some time. That points to a tough operating environment that will require banks to maintain a laser focus on exploring ways to improve profitability. Given the difficulty the industry has already been through and against rough operating conditions, some banks will seek M&A as a way to either boost performance or just cash out. Capital levels are high, so opportunity is there, but some will wait for profits to rebound before making any moves. Given the costs to meet regulatory requirements, it makes sense that banks will seek out partners to reach enough scale to absorb costs. Accounting issues and uncertainty sill make M&A difficult, but look for an increase nonetheless in coming quarters. Further, expect banks to do stock buybacks, pay periodic dividends and shrink the balance sheet in order to boost equity value and maintain flexibility. No matter your superstitious tendencies or beliefs, it could be a few years yet for a decent economy to provide support to the banking industry, so in the meantime, bankers will spend that time refining the business model.

Related Links:

FFIEC Interest Rate Risk FAQ

BANK NEWS

Earnings

JPMorgan is the first major bank to release 4Q earnings and said profit fell 23% (in line with expectations) due to lower corporate underwriting. ROE fell from 11% last year to 8%, despite an improvement in credit quality. The performance partially confirms recent speculation that Wells Fargo is now the most profitable large bank, a fact reflected in Wells' surpassing JP Morgan this week in total market capitalization.

Consolidation

The White House will ask Congress for authority to consolidate a handful of major government agencies as a way to save money. The SBA, EXIM Bank and GNMA are likely to be part of the plan. The proposal is thought to save $3B and result in 2k less jobs.

Interest Rate Risk

The FFIEC released an FAQ around the 1/10 interagency advisory on interest-rate risk management. While there is nothing new here, this is a must read for risk practitioners as it clarifies interest rate measurement, using 3rd party vendors, assumption formation, reporting, modeling, validation and stress testing. The release can be found by following the link in the Related Links section below.

Mortgage Rates

Home mortgages, for those that can qualify, hit another record lowing falling to 3.89% for 30Y product, 3.16% on 15Y and 3.16% for a 5x1 hybrid ARM. These rates are down about 65bp from last year.

BofA

The WSJ Bank discussed a contingency plan with regulators yesterday that would include reducing its footprint in certain regions of the country in order to cut costs and raise capital. While specific geography wasn't named, the plan likely includes a reduction in presence in large towns and small cities, a move that would benefit many community banks.

Citi

Unable to get the price it wants, the Bank has decided to keep its consumer finance unit, now called OneMain.

Foreclosures

According to RealtyTrac, filings were reported on 205k properties in Dec., down 9% from Nov. and down 20% from same period last year.

Annuities

The latest data (3Q) shows banks recorded a record $2.3B in commissions and fees from selling annuities, almost a 23% increase over 2010. It should be noted that 95% of the annuity revenue stream (75% in terms of the number of offering banks) comes from banks over $10B in total assets.