AS CLEAR AS MUD

by Steve Brown

We were asked the other day by an astute banker to clarify the origin and meaning of using "k" or "m" for thousand and "M" or "mm" for million. To begin, "k" (lowercase) is not a Roman numeral but is actually shorthand for "kilo," which represents the 1,000 multiple of a given unit. Meanwhile, "K" (uppercase) over the years has become slang for $1,000. As such, "$1k" is more proper than "$1K," but both are commonly used to represent $1,000. When it comes to using "M" or "m" for thousand, on the other hand, things get really weird. Here, the Greek's used "M" to mean "mega" or 1,000,000. On the other hand, the Romans used "M" to mean 1,000. Over the years this has only added to the confusion as people have used "M" or "MM" to mean one million more typically, so using it to mean 1,000 is confusing. As if that weren't enough to rattle your brain, consider that while it is accurate to use the Roman numeral "M" for 1,000 "MM" actually represents 2,000 and not 1 million in Roman numerals. Back then, 1,000,000 would be represented by an M with a horizontal line drawn above it (indicating the reader should multiply the number by 1,000). Finally, somewhere along the line as empires crumbled and we al got bored, we generally switched to using "mm" to mean million (vs. the older style "M"). Therefore, while variety is the spice of life, to avoid confusion our recommendation is to use $1k (lowercase) to represent $1,000 and use $1mm (also lowercase) to represent $1,000,000. Clear as mud? We know bankers can also sometimes see things as clear as mud, when trying to guess where regulators are concerned and where they are cracking down. To help, we outline some key areas of regulatory focus splashing around in their own publications and speeches out there. Regulators remain worried about core bank earnings, given low interest rates and weak loan demand. While C&I and multifamily have seen some growth, outside of those sectors, banks are struggling to find strong borrowers. Weak lending, combined with persistently low interest rates, are hurting margins. Those same factors are also driving banks to compete aggressively, so underwriting practices are definitely one area getting focus. Funding is a concern despite the flood sitting in the bank lobby right now. Low interest rates have driven huge growth in non- maturity business deposits, which is a good thing. Regulators are concerned, however, that these deposits are vulnerable to run-off and significant upward repricing once businesses start redeploying funds or if interest rates rise. That could strain funding costs and limit upside growth in margin despite stronger economic growth. While this is a lower risk right now, have a plan to keep both borrowers and depositors locked in for the longest terms possible whenever you can do so. Focus is also heightened on reduced loss provisions. Doing so has helped industry ROA recover over the past 18 months, but the trend cannot continue for much longer. Expect scrutiny here, so have well-documented justification and be sure ALLL levels are directionally consistent with asset quality trends. Examiners are also looking at the bank's risk appetite and loan growth. Home equity lending has surfaced as a significant risk. Over the next few years, large volumes of these loans will reach the end of their draw periods. In fact, about 58% of all HELOC balances will start amortizing between 2014 and 2017. As these loans move from interest only to fully amortizing and given such a precipitous drop in home prices, payment shock and refinancing risk respectively are in play. Regulatory scrutiny here is high. Income producing CRE portfolios also remain an area of focus for regulators. Concentrations, high vacancy rates and concern over current and future operating income and borrower performance mean this will remain an area of focus. Massive industry changes have many rethinking their business models. It is critical to evaluate your bank's current situation and have a strong strategic plan given the evolving environment. While certainly not an all-inclusive list, we hope our update this morning helps your bank prepare for the next exam. At a minimum, it should at least assist in washing away some of the mud, so you can discuss emerging industry risks with clarity.

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BANK NEWS

M&A

Opus Bank ($2.5B, CA) will buy 10 branches from the parent company of Pacific Western Bank ($5.4B, CA) for a reported blended deposit premium of 2.5%. Opus gains $145mm in deposits, while PacWest improves efficiency, profitability and books $2mm in after-tax cost savings.

Stop Now

The FDIC is warning banks not to tell customers they are charging them an "FDIC Fee," "FDIC Assessment," FDIC Insurance Premium," "FDIC Insurance Charge," or similarly described fees for deposit insurance. The regulator indicated that while banks can pass along the cost of deposit insurance, specifically designating a fee is for insurance is discouraged (as it can reveal information used to determine the bank's confidential supervisory ratings or mislead customers).

SBLF

The Treasury released updated information that loans made in 1Q increased by $433mm over 4Q, a 9% increase. Community banks accounted for 98% of the increase. While the average bank in the program has increased their lending to small business by about 10%, the average SBLF bank has increased small business lending by 22% versus a 2% decrease for non-SBLF banks.

CFPB

The Bureau issued a 1,097-page proposed rule and 2 proposed forms that combines disclosures under RESPA and TILA. One material change is a new 3-page sheet that consumers are required to receive within 3 days of application that includes the mortgage's cost, major terms and risk. To read the rule, the forms and see a comparison follow the Consumer Finance 'Know Before You Owe' link in our related links section below.