THE WINDING ROAD OF DEPOSITS

by Steve Brown

There are lots of winding roads in the U.S. and we have one of them in San Francisco. That street is known as Lombard (that is not it in the picture) and it has the distinction of being considered by many to be the most winding street in the world. Lombard was built in 1922 to handle a 27% grade and older pictures even show horses drawing buggy's sliding down the hill on their stomachs on wetter foggy days. As with banking of late, many things seem to wind around and around before they eventually settle down. That is our subject today, which is all about the expiration of the Transaction Guarantee Program ("TAG") at the end of this year. Recall that TAG provides unlimited FDIC insurance on noninterest bearing accounts and it supports about $1.6T currently. For us, we sincerely hope Congress figures out how important TAG is to community banks and extends it. Let's discuss why this is so important. First, consider the potential impact of some portion of the $1.6T moving out of community banks and into larger banks deemed too big to fail (TBTF). That could be very impactful, even while banks are awash with funding in such a low rate environment. Simply put, businesses, municipalities, etc. are not going to take risk right now given the uncertainty of the fiscal cliff, Europe, etc. so they will take steps to protect themselves. Moving their money from an uninsured status into a bank seen as TBTF is a risk. Next, failing to extend TAG is likely to disrupt the banking system at a critical juncture given everything going on. This could reduce the ability of small businesses, municipalities, hospitals and other entities to meet payroll and operational expenses, or have to move their accounts to do so. Third, some community banks with concentrated deposits on their balance sheets could see substantial disruption or even outright failure. If large funding sources decide the risk is too great to leave funds on deposit given market volatility. Further, worried small business owners are expected to pull funding and move it to TBTF banks or into government money market mutual funds (deemed "safe" due to their holdings, stable NAV and size). This could reduce funding, reducing localized lending and hampering local economic growth. In addition, the Fed itself indicates "TAG was originally designed as an opt-in program when the FDIC introduced it in October 2008. Participating banks paid premiums to help support the program, which was intended to provide liquidity support and stability for banks as well as to help protect the deposits of small businesses and municipal governments." That hasn't changed one iota and is needed now more than ever given ongoing market uncertainty. Next, community banks have been making business loans and that is good. However, if deposits are withdrawn for any reason in large amounts, it negatively impacts the amount that can be loaned out. While community banks make up less than 10% of the total assets of the financial industry, they pump out about 40% of small business loans under $1mm, so anything that could disrupt that just doesn't make sense right now. It is important to note that so far, some 80 state banking and community banking associations have called for Congress to temporarily extend TAG. Congress may or may not be listening, but let's hope they are. European markets are in turmoil and risk is high, so the last thing we need right now is more uncertainty and more concern in any market sector - particularly community banking. The fiscal cliff looms large and is likely to lead to even more uncertainty after the elections. The last thing we need is community banks or small businesses having to deal with even more uncertainty at year-end. The economic recovery remains fragile and GDP is last at 1.3%, with some economists now projecting future quarters dipping lower. That could push us into recession, lead to dislocations and without TAG, further concentrate fearful depositors to flee into the arms of the largest U.S. banks. Deposits are strong in community banks right now because of the actions of the Fed to flood the market with funding. That could change quickly though if a disruption in the system spooks already-hurting small businesses. Certainty is critical right now. Let's hope Congress takes action and avoids driving small business customers of community banks off the winding road.

BANK NEWS

Closed (46 YTD)

Regulators closed: Excel Bank ($201mm, MO) and sold it to Simmons First National Bank ($1.8B, AR). Simmons gets 4 branches, all deposits and entered into a loss share on $126.6mm of assets. First East Side Savings Bank ($67mm, FL), and sold it to Stearns Bank ($1.3B, MN). Stearns captures 1 branch, all deposits and essentially all of the assets (no loss share). GulfSouth Private Bank ($159mm, FL) and sold it to SmartBank ($332mm, TN). SmartBank gets 4 branches, all deposits and essentially all of the assets (no loss share).

Competition

Mobile payment service Isis, backed by mobile phone companies, launched as a competitor to Google Wallet.

Global Slowdown

The IMF released new projections showing world GDP will grow 3.3% in 2012, the weakest since the 2009 recession and below the 3.5% projection of July. The IMF also said it saw "alarmingly high" risks of a deeper economic slowdown as countries struggle to boost their economies.

Expensive Deal

Analysis by the WSJ finds Countrywide has cost Bank of America about $40B since the deal was closed.

Libor Market

Studies indicate Libor is the primary benchmark for about $350 trillion of financial products worldwide.

Housing

The latest data from the Census Bureau finds homeownership fell to 64.6%, the lowest in 7Ys.