AN EARTHLY BODY OF EVIDENCE

by Steve Brown

A team of Harvard scientists has a new theory about the formation of the Moon. The scientists say the Moon was once part of the Earth and it spun off after the Earth had a giant collision with another body. The theory explains why the Earth and Moon have similar composition and chemistry and is reportedly plausible, as a giant impact could have spun enough of Earth's material off to form a moon. As you ponder that, consider the current leading theory is that the Moon was created from material that spun off from a giant body that hit the Earth (not from the Earth itself). You may think this is splitting hairs and wonder whether you really need to go to Harvard to simply state the opposite of a current theory, but despite the fact we are not scientists, we know there is much more to it than that (probably a whole bunch of math and science stuff). Anyway, we may never know for sure, but it is interesting to think about when you next stare at the night sky - which came first, the Earth or the giant body? Now that we have that out of the way, let's consider how banking regulation has broken off and spun into the industry since colliding with the credit crisis. As we have discussed the past two days in this publication, risk management is now a key area of focus for the industry. That makes sense when you consider regulatory agencies have focused tremendous amounts of resources on better understanding where future risks might emerge in the industry, mitigating factors that create systemic risks, limiting the risk of contagion, raising capital levels to help insulate the industry against unforeseen issues, reducing leverage and enhancing industry-wide risk analysis processes. At a high level, regulators have approached this restructuring effort via two main channels - microprudential regulation and macroprudential regulation. Microprudential regulation is a fancy way of indicating how regulators are dealing with individual banking institutions, while macroprudential regulation expands that to address the potential risks of the industry in its entirety. Throughout the crisis, regulatory agencies have applied a process of "lessons learned" to identify specific areas that require more scrutiny and attention. For instance, once regulatory agencies saw the high level of losses experienced on construction and land development projects and the number of failed banks with high concentrations of this type of lending, they took action. Banks were pushed to reduce lending activities in the sector and they moved to adapt. Most banks even adopted the 100% threshold for construction lending as a hard cap and worked diligently to get below it. In fact, as of 2Q 2012, the number of banks where construction loans exceed 100% of capital had fallen to 370 from 2,344 just 4Ys earlier. This is but one example of how "lessons learned" may be applied to future areas of regulatory focus. Another example comes in the area of better identifying risks before they become too large for the bank or industry to handle. Fundamental to this process is an effort to collect and utilize better data. Areas of focus here include lending and deposit risk concentrations, counterparty risks, liquidity sufficiency and correlation analysis. Not only is capturing initial data crucial to a robust process, but so too is frequency of capture and the analysis that is applied (stress and scenario testing). It is no onger a good practice to keep data solely in physical folders where it cannot be subsequently captured, measured and tested. Risks are everywhere and both banks and regulators are adapting to the ever-changing environment. We will probably never know exactly how the Moon was formed, but we feel confident the industry has certainly been forever changed since colliding with the credit crisis.

BANK NEWS

M&A

First National Bank in Ord ($99mm, NE) will buy City National Bancshares ($20mm, NE) for an undisclosed sum. City National is the holding company for CNB Community Bank.

M&A

CertusBank ($1.8B, SC) entered into a definitive agreement to buy SBA lender Quadrant Financial (GA) for an undisclosed sum. Quadrant is a subsidiary of First Chatham Bank ($502mm, GA) and has offices in 8 states and loan originations in excess of $750mm.

Hurricane Sandy

It is interesting to note that insurers won't have to pay the bulk of losses since many policies don't cover flood damage and infrastructure repairs will be done by state and local governments.

Home Default

Research by the Fed finds only about 10% of mortgage borrowers with a prior serious delinquency regain access to the market within 10Ys of their default, while those who terminate mortgages for reasons other than default return to the market about 2.5x times faster.

Affluent Value

Forrester research defines the mass affluent as the 40mm people in the U.S. who have assets between $100k and $1mm (not including the value of their home). This group holds 33% of all retail investment assets and 90% of the 20 largest banks say targeting this group is on their top 10 list. Other research by Pinnacle Financial Strategies found (after sifting through a large bank's data), that the bank was earning $1,193 from a typical mass affluent household vs. $630 from a mass market household in general.