PLAYING THROUGH LESSONS LEARNED

by Steve Brown

If you are unfortunate enough to be working today, you are no doubt looking forward to those Thanksgiving leftovers you will have for lunch that are sitting in the break room refrigerator. As you fondly recall stuffing yourself more than the bird just hours earlier, you might be interested to know there is a golf course in UT called the Golf Club at Thanksgiving Point that you might want to play sometime. Speaking of Thanksgiving, as we close out our fun facts on this subject for the week, know that History.com reports Americans eat about 690mm pounds of turkey on Thanksgiving Day, the largest pumpkin pie ever baked weighed 2,020 pounds and the first Macy's Thanksgiving Day Parade took place in 1924 (3mm people now attend the parade and about 44mm watch it on TV).

As you think about the coming year, one area of focus certainly will be regulatory pressure. As we touched on before in this publication, regulators and bankers alike have learned lessons from the credit crisis and those lessons have changed the industry landscape going forward. We outline some of those areas this morning to assist you in your efforts for 2013.

One regulatory focal point for sure will be on liquidity and on capital. The lesson learned here is that when banks have enough of these two items, they rarely fail and they have plenty of time to ride out significant financial storms. The key from a regulatory perspective is to make sure measurement methods are consistent and that adequate levels of both are maintained. While this is a difficult task, one way regulators are moving forward here is to require banks to create "buffers" on both leverage (through capital surcharges) and liquidity. The more your business model will be concentrated in risky assets, the more capital and liquidity you will be required to hold. The old regulatory capital ratios are out the window as a result and now the focus is more on bank specifics, strength of management and the processes and procedures around these two areas. Get a jump on things by stress testing what you have now and see what sort of impact it might have on liquidity and capital. Then, document and communicate that to the board and if the levels are outside risk tolerances, take action to mitigate.

Another area of regulatory focus is that of procyclicality. Simply put, the banking industry structure and financial services offered worldwide have increased the momentum of economic cycles, which can lead to extreme swings in economic activity and a breakdown in the system. The entire financial system has become procyclical or highly correlated, which amplifies the impact to the underlying economy. This has ramped up regulatory pressure for bankers to get a better handle on risk management, heightened concerns about capital leverage and broadened perspective to the underlying business cycle. For instance, when the economy is strong, deposit premiums tend to be low, but when the economy is weak premiums increase and further weaken the banking system. One lesson learned from this is that loan loss reserves are important all the time and just because the prior few years don't show losses doesn't mean an upsurge cannot happen in the next few years. Here again, stress testing to understand the impact of paying dividends (reducing capital), reversing out loan loss reserves (reducing cushion) and other factors are all critical to understanding risk and managing through potentially impactful business conditions down the road.

If you plan to shop this weekend we suggest you bring along a roll out putting green to calm your nerves as you wait in long lines at the stores. As you do, think about this as a real life example of how bad things can get when everyone does the same thing at roughly the same time (highly correlated) and what lessons can be learned from the experience to improve for the future. Enjoy.

BANK NEWS

M&A

Northwest Bancshares ($8B, PA) has signed a definitive agreement to acquire The Bert Insurance Group for an undisclosed sum. Bert offers P&C, group, life, disability and other insurance services.

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The Alabama Bankers Association and the Community Bankers Association of Alabama have merged their operations, as the banking associations seek to improve efficiencies and consolidate efforts for member banks.

M&A

Ally Financial has agreed to sell its international operations to General Motors for $4.2B, as it seeks to raise money to pay back government bailouts. The Treasury currently owns about 74% of Ally, which is likely to be reduced to a large extent with this sale.

Branch Purchase

First State Community Bank ($1.3B, MO) said it will acquire 9 Bank of America branches for an undisclosed sum. All 55 employees of the branches will become employees of First State.

Branch Activity

SNL is reporting that during the 3Q, JPMorgan Chase opened the most branches nationwide (35), while Bank of America closed the most (43). Overall, financial institutions nationwide closed 352 branches during the 3Q (vs. 700 in 2Q) and opened 241 (vs. 299 in 2Q).

Capital Rules Delayed

In June of this year, banking regulators issued three notices that would replace current capital rules and would be effective Jan. 1, 2013. Given the volume of comments received, concerns about implementation time and a lack of time to understand the rules, regulators indicate they "do not expect that any of the proposed rules would become effective on January 1, 2013."

Debt to GDP

Fed SF President John Williams indicated publicly held debt as a percentage of GDP is projected to reach 73% this year, the highest level since 1951 and about double the level of 2007. This is simply not sustainable.