SPEAKING THE LANGUAGE OF CAPITAL CHANGES

by Steve Brown

Community banks are always trying to capture new small business customers, as they keep existing ones happy. That is one reason we were intrigued by research from IDC that finds people are 4x's more likely to purchase something from a company that communicates on its website and online in their own language. As you seek out new customers and look to better serve existing ones, depending on the community you serve, perhaps providing multiple language communication options for customers might help you differentiate your brand further in 2013.

As you consider that, we shift gears to another significant issue that will require your consideration next year. This one relates to the rules and regulations around bank capital and the enormous changes that are rolling out in this area. While rules are currently delayed, that logjam will break next year so we take a look at this issue from a high level to help you get a better handle on it and the impact to your bank.

There are basically four major components to the new rules on bank capital. These are Basel III, the Regulatory Capital notice of proposed rulemaking (NPR), the Standardized Approach NPR and the Advanced Approach NPR.

Basel III applies to all banks and it is the international standard. It is a direct result of the crisis; restricts regulatory capital definitions; requires more capital and more liquidity. It also reduces leverage (and thereby your ability to earn profit) and creates new "countercyclical buffers" designed to protect the system (by increasing the cushion of available capital).

The Regulatory Capital NPR also applies to all banks, but is a U.S. refinement. It redefines "core capital" by limiting what you can count and its structure. The rule also changes minimum capital ratios, establishes a capital conservation buffer and modifies prompt corrective action (PCA) rules for better regulatory alignment. As structured, it would also require gains and losses on available for sale (AFS) securities to flow through Tier 1 capital (which adds volatility and could lead banks to shorten investment portfolio duration to avoid such swings).

The Standardized NPR also applies to all banks and it combines with Regulatory Capital NPR (sets a floor on capital requirements). It seeks to address asset quality problems uncovered during the crisis, by changing risk weighted assets and underlying methodologies around them. It specifically discourages lending to sectors that were deemed to have caused much of the crisis and is applied to some loan categories and not others. It focuses on the concept of risk-sensitive capital by replacing and recalibrating risk based capital rules.

The Advanced NPR applies to the largest banks ($250B or larger) and is designed to tighten up counterparty risk, remove credit rating references, modify securitization processes and incorporate a market risk capital rule (to capture trading risk).

Overall, as you can see from the design of the rules, regulators are applying "lessons learned" during the crisis to capital levels and structure for the industry. At a high level, the 1,000+ pages of rules seek to increase the resiliency of the system; ensure banks maintain strong capital levels; enable banks to keep lending even during severe economic downturns; improve the quality and quantity of capital; enhance risk sensitivity; address weaknesses in current structure and incorporate Dodd Frank requirements.

For community bankers, these significant changes to capital will likely have a profound impact on how you conduct your business. While the rules are on hold right now, we expect they will roll out in the middle to later part of next year. That should give you some time to analyze the impact and modify your business as necessary. No matter what your plans for 2013, this is one language where you will need to be fluent.

BANK NEWS

TAG

A Congressional procedural vote has officially defeated a proposed 2Y extension of unlimited insurance on noninterest bearing accounts. Recall that TAG was originally launched during the financial crisis and extended by Dodd Frank, in an effort to support liquidity and stability for banks and protect the deposits of small businesses and municipalities. It is also an extremely popular program, accounting for 20% of all U.S. bank deposits. By group, community banks, municipal and small business associations had pushed for the 2Y extension; while large banks, mutual funds, sweep companies and credit unions had all worked hard to kill it. While there is still time to extend TAG, the impact of this vote lowers the odds to near zero.

No More Bank

MetLife said the OCC has given conditional approval for the company to sell $6.5B in deposits to GE Capital Retail Bank. MetLife has been trying to get out of banking for more than a year, as it seeks to avoid the increased costs and requirements of industry regulations.

ATM Regulation

The Senate unanimously passed a bill that eliminates external fee notice requirements that made ATM operators post a fee notice on or near machines that a fee could be charged. The requirement is being eliminated because operators already disclose fees on ATM screens and consumers have the right to decline transactions without charge if they so choose.

Cyber Attacks

JPMorgan Chase, PNC Bank and U.S. Bank had their websites go down yesterday, as they were likely victims of a hacker group that has launched a new round of cyber attacks designed to deny service to bank customers.

Truly Mobile

Gartner projects that in 4Ys (2016), 67% of all internet traffic will be viewed on mobile devices.