AVOIDING INVESTMENT INJURY

by Steve Brown

The Center for Disease Control (CDC) does interesting work on what people were doing and where they were when they become injured. The most likely activities that result in injury include: leisure activities (27%); sports & exercise (16%); working around the house or yard (15%); working at a paid job (13%); driving or riding in a motor vehicle (8%) or attending school (3%). By age, young people (15-24) were most likely to be injured playing (non-sports leisure activity); adults (25-64) were most likely to be injured while working at a paid job and those 65Ys+ were most likely to be hurt working around the house or yard or doing non- sports leisure activities. About 50% of all injuries occur at home for all ages, followed by the street (14%); a recreation area (14%); a commercial area (8%) or a school/child care center (7%). Have fun, but be aware of your surroundings and your age, to help stack the odds in your favor and avoid injury. To avoid injury in banking, know that effective Jan 1 of this year, bankers are required to do more due diligence around investment securities. This is a direct result of the problems around the rating agencies during the credit crisis, so now every bank has to individually determine whether an investment security they are about to buy qualifies for investment and is determined to be "investment grade" and "not predominantly speculative in nature." To qualify as investment grade, the issuer of the security must have an adequate capacity to meet its financial commitments. To do that, the risk of default must be low and the full and timely repayment of principal and interest must be expected. This gets more difficult to do when structure enters into the mix, but we will cover that in a moment. Overall, there are basically two main parts to these regulations, one of which is based on credit and one based on structure. For the fist piece, credit, government obligations are not subject to the investment grade criteria to determine purchasing eligibility. These securities include Treasuries, agencies and municipal general obligations. However, it is important to note that while Treasuries and agencies do not require an individual credit analysis, they must fit into the overall plan and concentration limitations for the investment policy. For all other securities, including municipal, individual credit assessments must be made prior to purchase and then periodically on an ongoing basis. The second piece, structure, appears in many securities and in many different ways. Here, regulations require banks to understand the cash flows, quality of the underlying collateral and the structure of the security itself. Banks must also know and be able to demonstrate how the credit of the security will perform in different default environments. Expect your due diligence packages to grow sizably to deal with this and document everything thoroughly. The key to this whole regulation is about due diligence. This is to say that regulators now expect banks to conduct due diligence on all securities and know what they are buying before a purchase is made, even when the credit quality is seen as very high. Due diligence must also be expanded depending on the security's credit quality, structure complexity and size of the investment, so beware. he analysis will vary depending on your bank and its situation, but some of the factors to consider will be the spread to Treasuries, financial performance, trends, existing debt profile, local economics, source and strength of revenue, annual debt service, credit enhancements, definition of default, etc. It is good the Fed is buying so many bonds right now, because the community bankers we know are likely to hunker down and just buy vanilla Treasuries or agencies until things develop further (and regulators come through for an examination or two). Take steps now to avoid investing injury.

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BANK NEWS

M&A

Wintrust Financial ($17.2B, IL) will buy First Lansing Bancorp ($371mm, IL) for $38.5mm (60% stock and 40% cash).

Originator Pay

The Consumer Financial Protection Bureau (CFPB) issued its final loan originator compensation rule, which among other things prohibits paying lenders compensation that varies with loan terms. Originators also cannot be paid more if the consumer agrees to buy more services from affiliates.

Job Cuts

State Street Bank & Trust ($200B, MA) follows similar announcements at other large banks, saying it will cut 2% of its workforce in an effort to reduce expenses.

Cyber Attacks

Research by Distributed Denial of Service (DDoS) technology firm Prolexic finds attacks on financial and other companies jumped nearly 28% in number vs. the prior quarter and the average time of each attack climbed 67% to 32.2 hours.

Geithner

As he exits the Treasury, Secretary Geithner told the WSJ that if the recovery were a game of basketball, the U.S. would be early in the 4Q, while Europe is just beginning the 2Q.

Phishing Attacks

Computer security firm RSA reports the number of phishing attacks in 2012 jumped 59% vs. 2011. The total cost of this fraud is an estimated $1.5B globally, about 22% higher than 2011.

Selling

The Treasury said it will sell of the remaining 19% stake in GM that it owns by early next year. Analysts predict it will generate a loss of about $12B.

Economic Projection

The ABA economic advisory committee predicts GDP will be less than 2.0% in 1Q and rise to 2.6% by 4Q. Meanwhile, the unemployment rate is expected to slowly decline through the year, eventually reaching 7.4%.