LOOKING AT EMOTICONS AND LENDING

by Steve Brown

Emoticons are ASCII symbols designed to show an emotional state. Some people overuse them, but we rarely see emoticons in banking correspondence and we think that's a shame. We propose a branch can be represented as; _^ ^_, an ATM as /*, a wise banker as (^~_~^), a banker after seeing his paycheck as ;-|, and a banker exiting a regulatory exam as :-((. We don't have an emoticon for the yield curve, but it is designed to show interest rates across different contract or maturity lengths. The curve shows the relationship between the level of interest rates (cost or yield) and the time to maturity (or term). The term structure of interest rates shows expectations of investors about future levels of interest rates for a spectrum of maturities. The reason the term structure of interest rates is important for community bankers, especially today, is because the short end of the curve is so low. This makes short term asset yield prohibitively unprofitable, so bankers are drawn to longer maturities (terms) as they seek out higher yielding assets. Unfortunately, going too far exposes banks to interest rate risk. It would be great if bankers could choose their desired duration within each asset category. Then the bank could be on the desired term structure, with the appropriate duration, given the liability mix for that bank. This is in fact theoretically possible with securities. For loans, however, it is difficult to sell that which is not in demand from customers. Here borrowers dictate loan duration and right now given such low rates, they want loans that are 5 to 20 year maturities. Bankers should not feel they are stuck with the term structure in demand from borrowers. In today's banking environment, lenders can convert any fixed rate loan to a floating rate and eliminate interest rate risk. This can be done immediately, or after an initial term (say 2 years). In this case, the yield to the bank is initially higher, but the future interest rate risk is eliminated with a floating structure that starts 2Ys from now (but is locked in now at a given spread). If that still isn't fancy enough for you, consider offering a fixed rate to the borrower that converts to a floating rate in the future that is then converted back to a fixed rate to the bank. This option could be used if the bank does not believe that the borrower will keep the loan for the entire duration and wants to increase the floating rate yield by hedging only the middle portion of the loan. Finally, income can also be pushed forward without an out-of- pocket expense to the borrower. Here, we pay you a fee that can add up to 1.5% of the loan amount that might be considered noninterest income. For many banks, a loan fee recognized in the first period can be quite :-)).

In closing, we remind all the bankers that in the Chinese calendar this is the year of the ~>')~~~~~~, so enjoy it. As for banks that would like to better understand how the options above are being used, sign up to any of the three webinars listed in our Related Links section on the bottom right and we will show you.

BANK NEWS

M&A

Centennial Bank ($77mm, NE) will merge with Omaha State Bank ($272mm, NE), as the family controlling both banks consolidates operations and other activities. MORE M&A: KeyCorp ($85B, OH) will sell its broker dealer affiliate (Victory Capital Advisors) to a private equity fund for $246mm in cash and debt. Key is taking the action as it divests non-core business lines and refocuses on businesses that leverage its core banking model.

For Sale

Bloomberg reports OneWest Bank ($25.8B, CA) held informal sales talks with UnionBanCal ($87.6B, CA) and U.S. Bancorp ($348B, MN) in the past few weeks, as private equity investors that own it (including billionaires George Soros and John Paulson) begin exploring ways to exit their investment.

Sequester Impact

Experts say the automatic spending cuts forced by sequester will reduce GDP by 0.6% this year, cost 700,000 jobs by the end of 2014 and raise the jobless rate by 0.25% by the end of 2014.

Opportunity

The Fed estimates $2.0T to 2.5T in mortgages should still refinance based on the current level of interest rates. ???Customers: A Deloitte survey finds 40% of bank customers would prefer reduced fees for a limited level of in-person services (shows electronic banking preferences are increasing).

Jail Time

The last two defendants tied to the $7.2B Stanford Ponzi scheme have been sentenced to 20Ys in prison for their roles. The trial showed the former chief accounting officer and controller both knew Stanford misused bank assets, helped him hide it and helped deceive customers.

Housing

The latest data from the MBA finds the delinquency rate for mortgage loans has fallen to 7.09% as of the end of 2012, the lowest level since 2008 and a 49bp decrease from the prior year-end (nearly 7% better).