Top of the World

by Steve Brown

Roughly 60Ys ago on May 29, the first successful ascent and descent of Mt Everest was accomplished by mountaineers Sir Edmund Hillary and Tenseng Norgay. Mt. Everest is the point at which the earth's surface reaches the greatest distance above sea level at 29,029 feet. The first attempts to reach the top of Everest were in the 1920s, where George Mallory and Andrew Irvine certainly got very close and maybe even reached the top in 1924, but perished on the descent. Climbers who attempt Everest spend substantial time in the so-called "death zone" - altitudes above 26,246 feet - and though many mountaineers have reached the top since the first ascent, there are still many deaths on the mountain due to lack of oxygen, exhaustion, extreme cold and climbing hazards.

Speaking of exhaustion and the death zone, lenders may be feeling that way when it comes to the compliance requirements related to flood insurance. There have been regulations surrounding flood insurance for some time, but after Hurricane Katrina the regulatory agencies got very serious and really started cracking down to make sure banks were following all of the regulations. Banks have to make sure loans secured by a building, either residential or non-residential or even a mobile home if it's permanently placed, must have flood insurance. To determine whether flood insurance is needed, bankers begin by checking to see whether the structure is located in Special Flood Hazard Area (SFHA), for which flood insurance in available under the National Flood Insurance Program (NFIP). Banks must ascertain that sufficient flood insurance is in place for the duration of the loan and are required to force place flood insurance if the borrower does not obtain it within a time window.

However, given regulatory updates and most recently the Biggert-Waters Flood Insurance Reform Act of 2012, there are a lot of uncertainties as to exactly what the regulations require and even which policy documents should be followed.

Let's look at some of the most problematic issues. To begin, flood zones have expanded in an effort to cover all possible risk areas and consideration must be given to a 500Y flood. This effort has caused many areas perceived to be very low risk to require insurance. Any loan secured with a property in a flood zone is subject to the requirement, so that could include a home equity loan or a line of credit, an individual condominium unit in a multi-story building, or even a commercial loan to a car wash (although the level of water damage to such a structure could be debated). SBA loans could also require flood insurance for inventory or equipment. The rules are complex and civil penalties are at stake for even minor errors, so bankers are on edge.

There is also the larger question of banks being required to police one specific kind of insurance coverage for collateral property. Wouldn't it be more logical to have flood insurance as a part of overall hazard insurance? The insurance industry with its experience and expertise has better tools to determine where flood insurance is necessary and where it isn't. Banks could be required to ascertain borrowers have hazard insurance, but not to determine exactly which hazard perhaps. After all, whether it is the danger of forest fires or drought or floods, all could have the same impact on the building in question. As things stand now and as with Mt. Everest, the climb is leading many to exhaustion.

BANK NEWS

2 Closures (16 YTD)

Regulators closed another of Capitol Bancorp's banks on Thursday, shuttering 1st Commerce Bank ($20.2mm, NV) and sold it to Plaza Bank ($438mm, CA). Plaza gets 1 branch, assumed all deposits and entered into a loss- share transaction on $12.2mm of assets. Regulators also closed Mountain National Bank ($437mm, TN) on Friday and sold it to First Tennessee Bank ($25B, TN). First Tennessee gets 12 branches, assumed all deposits except brokered and bought most assets at a discount without a loss share.

M&A

Texas Regional Bank ($165mm, TX) will acquire the Border Capital Bank ($162mm, TX) for an undisclosed sum.

Cyber Coordination

Bank regulators announced they have formed a working group that will coordinate cyber security efforts across state and federal agencies in an effort to strengthen coordination.

Investment Requirements

Bank regulators now require banks to look deeper when evaluating the credit of any investment security before purchase. As a result, bankers can expect examiners to focus more on the pre-purchase analysis and how the bank evaluates credit and monitors investment quality once purchased. One exemption to the rule requiring securities are "investment grade" is provided for obligations of the U.S. government or its agencies (Treasuries, GNMA, FNMA, FHLMC, etc.), general obligations of states and political subdivisions and revenue bonds held by well-capitalized banks. Investment securities are deemed "investment grade" if they have a low risk of default and expect full/timely payment of principal/interest at purchase (not based on credit rating).

Tapering

Community bankers will be interested to know (because it could raise long-term interest rates and negatively impact the mark to market on investment portfolios) that a Bloomberg survey finds large investors expect the Fed will make a tapering announcement at the Oct 30 meeting to start tapering back on QE. The investors expect the first reduction to be from $85B down to $65B.

Data Theft

A new report by Javelin Strategy & Research finds over 50% of identity theft victims also had data breached. Javelin indicates there were 1,611 breaches in 2012, a 48% jump vs. the prior year.