Gains & Losses

by Steve Brown

Research on how office life can expand one's waistline found that most people (55%) consider themselves overweight. In addition, most people attribute their job to be a major factor in their weight gain. For some it is the work itself, as 56% say sitting all day is the major contributing factor. Still others consider the time spent at work as the primary culprit, because of food

???in the office and/or going out to lunch. Many people are also trying to lose weight right now, with 40% saying they exercise regularly, others exercising occasionally and only 10% saying they never exercise at all. Health perks such as workout facilities or workout passes exist at 31% of employers, but in companies that did provide such benefits, interesting that only 10% of employees took advantage of them.

In the last few months, banks have experienced gain and loss volatility as well. Record low interest rates have been around for a long time, but lately, both securities and loan portfolios have been whipsawed with Chairman Bernanke's comments and the market volatility that has followed.

Even before that, beginning in the month of May and then accelerating in June, interest rates have climbed rapidly. The 10Y Treasury jumped 95bps in less than two months. Securities portfolios are marked to market and most will show a loss of market value from Q1 to Q2. Oh well, at least bankers don't have to mark the loan portfolio to market, right?

We wouldn't ask this rhetorical question if we didn't have a ready answer. Let's take a look at what the impact would be if the loan portfolio were marked to market. Assume a bank originated a $1mm dollar fixed rate loan in early May. That loan would now be worth $934,960 (or a 6.5% loss). One key problem with fixed rate loans in a rising interest rate environment is that NIM contracts. Customers want long term fixed rate loans right now because rates are still low historically speaking. However, community banks should be careful when originating them, because there is a great deal of interest rate risk embedded in these structures as seen above. The volatility is a good real life example of what happens when rates begin to move upward. Debt service coverage on the loan declines and banks can now originate higher coupons on new loans, so existing ones with lower coupons lose value. The key to protect your customer credit quality and reduce the mark to market due to this rate movement is to hedge the loan by changing the coupon on your books to floating.

Hedging is not a technique bankers need to use for every loan, because conditions change, rates move around and customer activity shifts as well over time. However, certain credits such as customers who want a long-term fixed rate loan (that doesn't fit your natural funding base) can be good candidates to hedge. Another could be a larger loan with a high quality borrower or when you are competing for the business trying to win the deal. Initially the NIM will be less of course when you hedge the loan (given the yield curve), but doing so will allow the loan to have an expanding NIM in a rising interest rate environment. Large banks do this frequently and we can help you.

Many banks already have some loans in the portfolio where the NIM is contracting just given this market movement. To protect the future, consider booking some with an expanding NIM as well, as you help your customers lock in longer-term rates. Our hedging program can ensure you don't get weighed down when rates rise, so give us a call to get more information.

BANK NEWS

M&A

Grandpoint Bank ($1.2B, CA) will acquire Gilmore Bank ($177mm, CA) for an undisclosed sum.

Basel III

The Fed approved Basel III rules and now they await approval by the FDIC and OCC next week to close off US participation in the international banking capital agreement. Once approved, banks will be required to hold more and higher quality capital and modify risk calculations on certain assets. Under the revised rules, community banks (under $15B) can still count existing trust preferred securities as capital and can choose whether or not to count unrecognized gains/losses on AFS securities.

Extension

Citing feedback from businesses about the complexity of compliance, the Obama Administration has extended the mandate for employers with 50 or more workers to comply with the Affordable Care Act another year until 2015.

Online Advertising

The latest Advertising Age spend report finds the top 5 financial institutions were: JPMorgan $2.1B (of which, 2.1% was online); American Express $2.1B (5.7% online); Bank of America $1.6B (6.9% online); Capital One $1.3B (8.5% online) and Citibank $930mm (8.7% online).

Settlement

Citigroup has agreed to pay FNMA $968mm to settle repurchase claims related to violations of representations and warranties on 3.7mm residential first mortgage loans originated between 2000 and 2012.

Insider Statistics

Analysis by Bloomberg finds individuals sued by the SEC or charged by prosecutors for insider trading were 125 (in 2012), 104 (2011), 67 (2010), 96 (2009) and 56 (2008).

Daily Life

The Property Casualty Insurance Association of America reports 24 states now allow drivers to show electronic proof of insurance coverage during a traffic stop (so you can just hand the police officer your smartphone).