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Issues Facing the FDIC Advisory Committee on Community Banking

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&

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Not All Banks are the Same

- ❖ **Too Big to Fail (TBTF) Banks:** the largest financial institutions whose primary business may be lending, investment banking (securities underwriting, asset management and proprietary trading) or insurance.
- ❖ **Large Regional Banks:** large financial institutions that operate in limited geographic markets and offer fewer banking services than TBTF Banks; Banking services include deposits, loans, leases, credit cards, securities underwriting and brokerage, market making, asset management and insurance sales.
- ❖ **Community Banks:** the smallest commercial banking organizations that typically operate within a relatively small trade area, offer banking services that emphasize loans and deposits, generate the bulk of earnings from net interest income and emphasize personal relationships between customers, stockholders and managers.

❖ **Shadow Banks:** non-commercial bank financial institutions that were actively involved in financial intermediation by which funds were transferred from investors to borrowers. They might originate loans but did not want to hold the loans in portfolios. They might securitize loans and place them with investors. They may be insurance companies, pension funds, hedge funds, money market funds, mortgage banks or off-balance sheet entities with names like ‘structured-investment vehicles (SIVs)’.

FDIC Advisory Committee Meeting

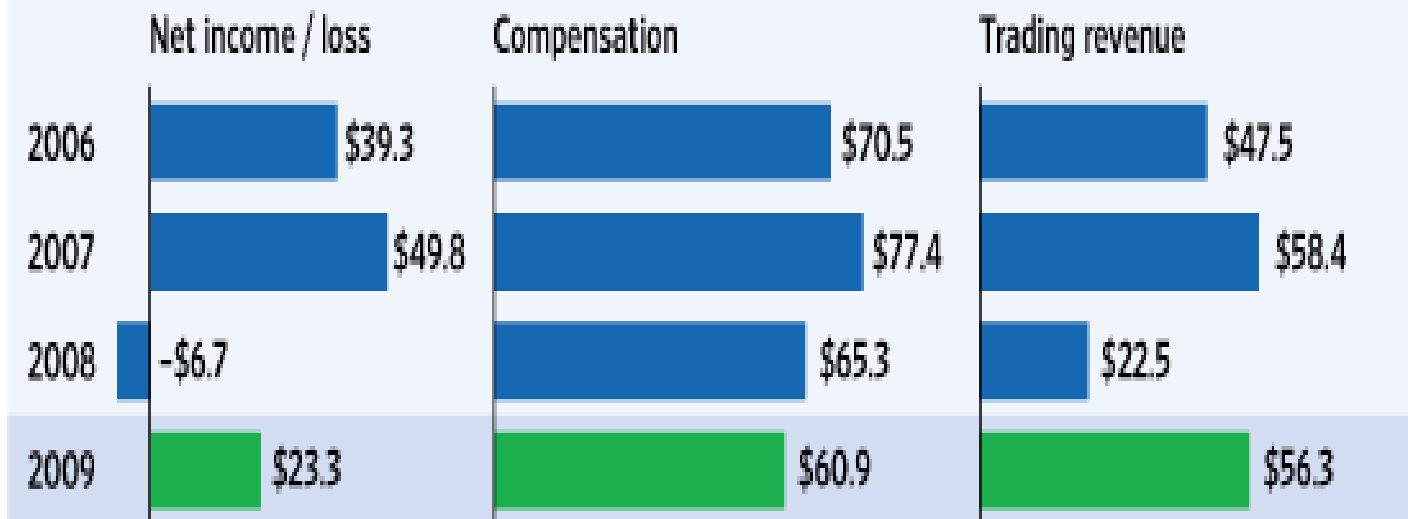
- Loans are being classified due to depreciating collateral values even when the cash flow support is strong; examiners appear to weight the secondary source of repayment (collateral) more than the primary source of repayment (cash flow)
- An FHLB haircut in the event of a bank failure will sharply increase the cost of credit
- There is a need for a federal program for capital infusion in community banks whether they need it (are not viable without it) or not (are viable without it)

- The assessment to replenish the DIF should be based on assets and not insured deposits
- Forbearance is the new 'F' word.
- Bank customers do not need to be protected from community banks under a CFPB
- The use of non-core liabilities is not the problem; the problem is how the funds are invested
- Jumbo CDs should be those with balances in excess of \$250,000
- The method used to auction failed bank assets is flawed and damages the market for loan participations

- There is a serious disconnect between what field examiners see and communicate to management and directors and what directives ultimately come down from the regulators' regional office or Washington
- The dual banking system has worked well historically and should not be replaced; a single regulator is a bad idea

Bouncing Back | The state of recovery for major U.S. banks

Financial metrics for top five Wall Street banks – Bank of America, Citigroup, Goldman Sachs, J.P. Morgan and Morgan Stanley – for the first six months of 2006 through 2009. All figures in billions



Note: For 2006-08, net income and total compensation includes the top five firms as well as the four financial institutions they've acquired (Merrill Lynch, Bear Stearns, Washington Mutual and Countrywide). For trading revenue, 2006-08 includes contributions of Bear Stearns and Merrill Lynch.

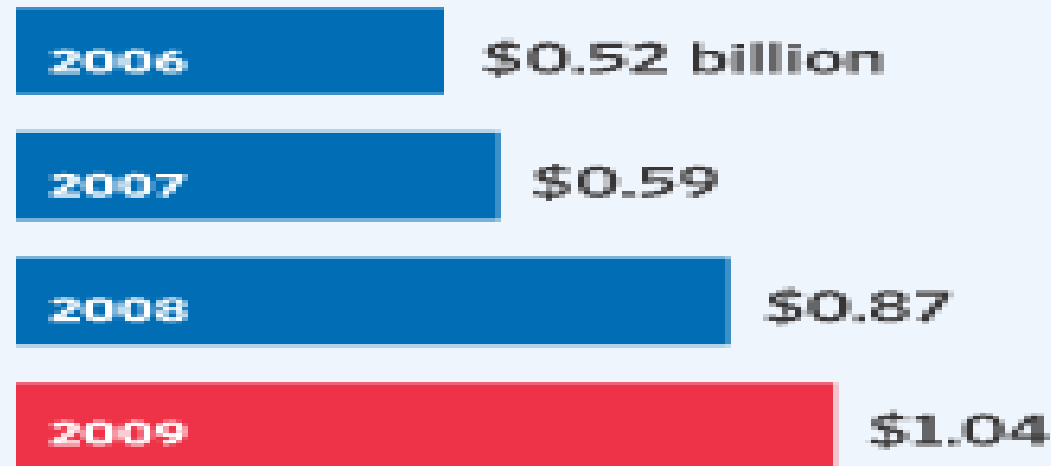
Source: Bank regulatory filings

Enrich & Paletta, op cit.

Have We Learned Our Lesson?

Still Betting Big

Potential daily trading losses at major firms, second quarter



Average "Value at risk" is an estimate of the total amount a bank stands to lose on an average day if its trading bets sour.

Source: Bank regulatory filings

Enrich & Paletta, "Finance Reform Falters as Shock of '08 Fades," WSJ, September 9, 2009

Critical Issues Facing Community Banks

- ❖ When do we get a floor on housing and other real estate values?
- ❖ How will commercial real estate be treated as loans come due in the next 6 months to 2 years? Will we have a CRE credit crunch?
- ❖ Will deposit insurance premiums wipe-out bank earnings?
- ❖ Where do we get capital?
- ❖ How do we improve our liquidity position and not kill earnings?
- ❖ How do we best work with the regulators?

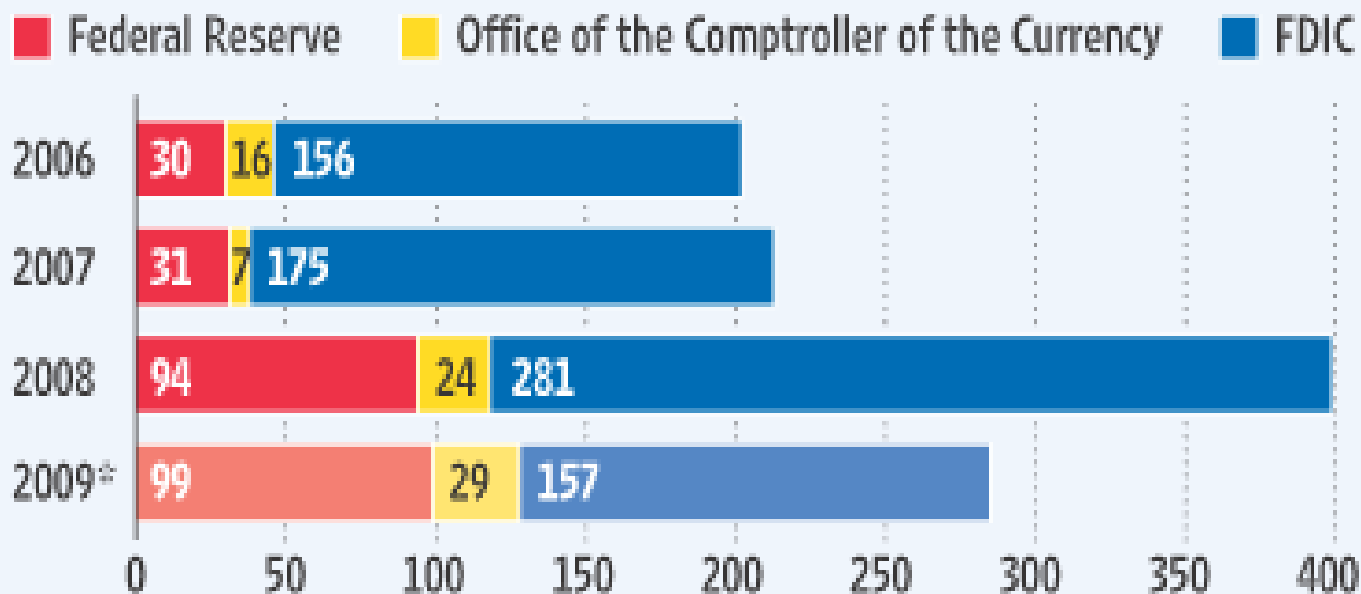
Recent Regulatory Directives

- FDIC will not release information on unsuccessful bids for failed banks; will not release information on TARP bids not closed
- Reserves in the DIF amount to 0.22% of insured deposits (statutory minimum is 1.15%); proposal to prepay \$45 billion in premiums for next 3 years
- FDIC announces more intensive supervision and higher capital requirements for newly chartered banks for up to 7 years (state chartered, non-member banks)
- FDIC now discloses formal ‘notices of charges’ when a bank’s management dissents from signing a Cease & Desist order
- Systemic risk regulation may involve a Financial Services Oversight Council with the Fed as primary systemic-risk regulator.

Trends in Enforcement Actions

On Probation

Number of banks hit with memorandums of understanding, by regulator. **The 2009 crackdowns are on pace to exceed 2008.**



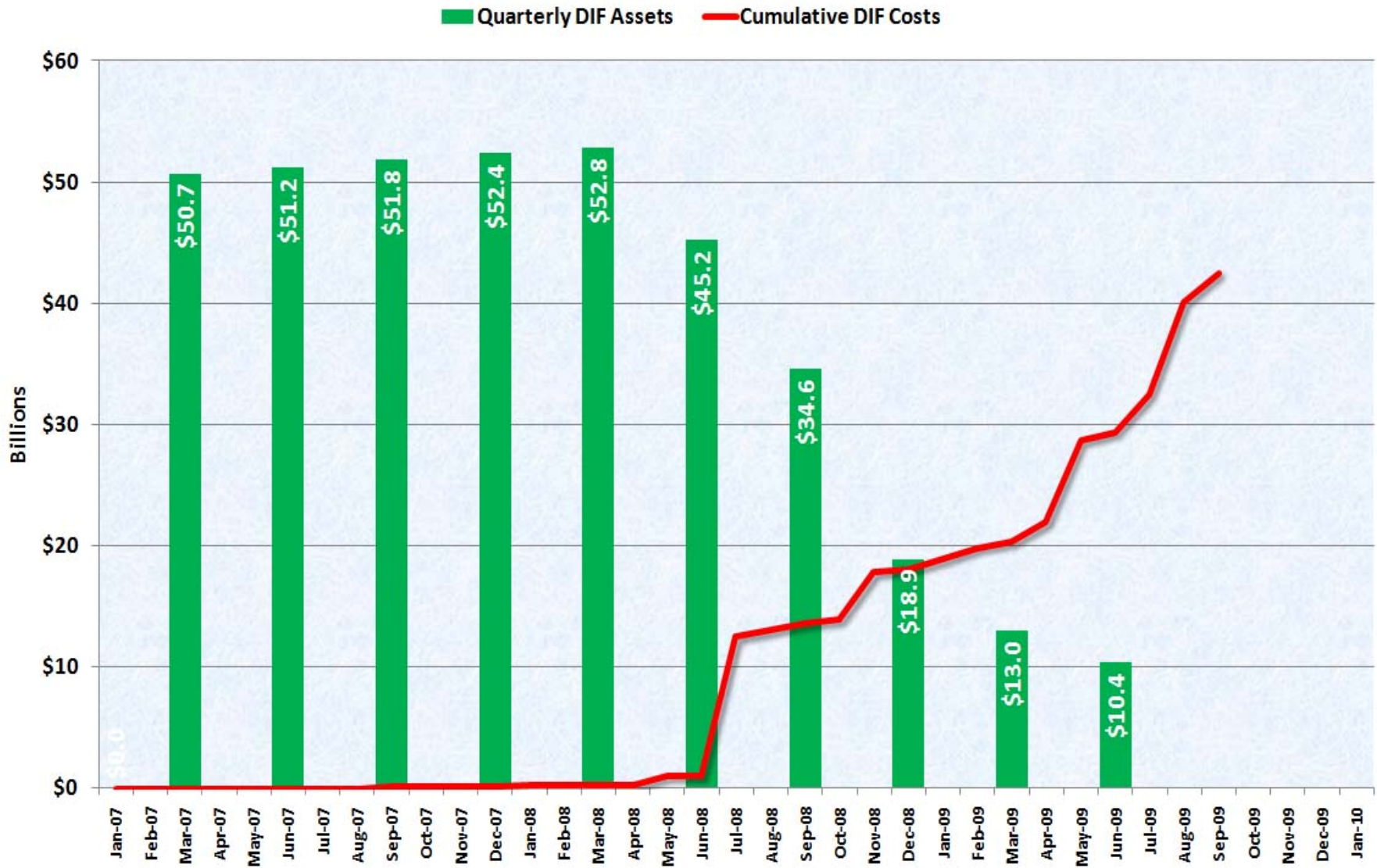
*For 2009, Fed figures are as of June 30, OCC as of July 27 and FDIC as of June 1
Sources: FDIC, Federal Reserve and OCC

Paletta & Fitzpatrick, "Regulators Are Getting Tougher on Banks," WSJ, July 31, 2009

New Liquidity Realities

- Deposit insurance premiums are rising (and will continue to increase)
- Must pay penalty premiums for ‘excessive’ brokered deposit financing and FHLB financing
- Collateral requirements are rising
- Government liquidity programs will eventually go away
- As rates increase, core deposits (especially non-interest bearing DDA) will be harder to get

FDIC Deposit Insurance Fund, Assets and Estimated Costs



<http://www.calculatedriskblog.com/>

How Are Deposit Premiums Determined?

Deposit insurance premiums are determined by a combination of the following:

- Bank's capital ratios
- Supervisory Group ratings (A, B or C)
- Additional risk adjustments based largely on
 - amount of unsecured debt used in financing (- 5 basis pts)
 - amount of secured liabilities in excess of 25% of domestic deposits (base assessment rate may be raised up to 50%)
 - amount of brokered deposits in excess of 10% of domestic deposits (increase up to 10%) – this does not apply to Risk Category I institutions

Capital Category

Supervisory Group

	A	B	C
	Risk Cat. I	Risk Cat. II	Risk Cat. III
1. Well capitalized	12 - 16	22	32
	Risk Cat. II		
2. Adequately capitalized	22		
		Risk Cat. III	Risk Cat. IV
3. Undercapitalized		32	45

Supervisory A Group: CAMELS 1 or 2

Supervisory B Group: CAMELS 3

Supervisory C Group: CAMELS 4 or 5

Total Base Assessment Rates (Annual Basis Points)

	Risk Category			
	I	II	III	IV
Initial base assessment	12-16	22	32	45
Unsecured debt adj.	-5 – 0	-5 – 0	-5 – 0	-5 – 0
Secured liability adj.	0 – 8	0 – 11	0 – 16	0 – 22.5
Brokered deposit adj.	-	0 – 10	0 – 10	0 – 10
Total base assessment rate	7 – 24	17 – 43	27 – 58	40 – 77.5

Each institution is assigned a risk-based rate for a quarterly assessment period. Supervisory rating changes are effective for assessment purposes as of the examination transmittal date.

A Critique of Prepaid Deposit Insurance

- Why use insured deposits and not assets minus tangible equity as the base for assessments?
- With many banks being criticized for inadequate liquidity (consider non-core funding dependence), doesn't prepayment seriously reduce liquidity?
- Doesn't prepayment of 13 quarters of premiums reduce the ability of banks to lend?
- Prepaying deposit insurance is an interest-free loan from banks to the FDIC.
- Banks with liquidity problems may be exempt upon appeal. Will the names of exempt banks be revealed?

Bank Accountability and Risk Assessment Act – H.R. 2897

Permanent funding for FDIC (regular deposit insurance premiums) would be based on total assets minus Tier 1 capital

New Liquidity Realities, cont.

- Will publicity regarding overdraft fees help or hurt community banks?
 - clarify what fees you charge and when (no fees if overdraft is $< \$5$?; limit number of charges per day?)
- How do you offset the increased cost of deposit insurance?
 - monthly account maintenance fee?
 - required minimum balance for checking?
 - move customers to debit cards?
 - move customers to online banking?

Net Non-core Funding Dependence

$$\text{NCFD} = \frac{\text{Non-core liabilities} - \text{ST investments}}{\text{Long-term Assets}}$$

What is a non-core liability?

- \$2 million CD owned by a director and held at the bank for the past 4 years?
- \$50,000 time deposit with a 7-mth maturity paying an above market rate – held by a rate shopper?

Funding Options

- No Collateral Needed
 - Federal Funds
 - Rate Board – www.qwickrate.com
 - Brokered Deposits
 - CDARS – www.promnetwork.com
 - IDC Deposits – www.idcdeposits.com

Sample Rate Board Information

View Rates [A](#) [B](#) [C](#) [D](#) [E](#) [F](#) [G](#) [H](#) [I](#) [J](#) [K](#) [L](#) [M](#) [N](#) [O](#) [P](#) [Q](#) [R](#) [S](#) [T](#) [U](#) [V](#) [W](#) [X](#) [Y](#) [Z](#) [All](#)

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Posting: 353

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Show All Terms:

| [Merge Letters](#)

#		Institution	State	270 Dys	↓ 1Yr	1.5 Yrs	2 Yrs	2.5 Yrs	3 Yrs	7 Dys - 180 Dys
1	<input checked="" type="checkbox"/>	Georgian Bank (57151) ^{SP}	GA	2.151	2.502	2.756	2.761	2.771	3.051	270 Dys - 3 Yrs
2	<input checked="" type="checkbox"/>	Community Bank of Nevada (34043)	NV	2.050	2.501	2.600	2.760	2.710	3.010	3.5 Yrs - SP Term
3	<input checked="" type="checkbox"/>	Meridian Bank, NA/dba Margbank (22644)	AZ	2.150	2.500	2.550	2.730	2.730		
4	<input checked="" type="checkbox"/>	Community Bank of West Georgia (57436)	GA	1.000	2.370	2.440	2.720			
5	<input type="checkbox"/>	State Bank of Texas (27074)	TX		2.345					
6	<input type="checkbox"/>	Frontier Bank (22710)	WA		2.341	2.441	2.721			
7	<input type="checkbox"/>	Bank of the Cascades (22407)	OR		2.340	2.490	2.680	2.751	2.950	
8	<input type="checkbox"/>	Midwest Bank and Trust Company (18117)	IL	1.880	2.260		2.450		2.650	
9	<input type="checkbox"/>	Great Southern Bank (29546)	MO	1.700	2.251	2.215	2.500	2.285	2.513	
10	<input type="checkbox"/>	Orion Bank (22427)	FL		2.250	2.350	2.550	2.600	3.050	
11	<input type="checkbox"/>	Nexity Bank (19794)	AL	1.760	2.240					
12	<input type="checkbox"/>	AmericanWest Bank (22441)	WA	1.890	2.230					
13	<input type="checkbox"/>	Amboy Bank (6423)	NJ		2.210	2.351	2.600		2.650	
14	<input type="checkbox"/>	Evergreen Bank (20501)	WA	1.881	2.201	2.401	2.671			
15	<input type="checkbox"/>	Advanta Bank Corp (33535)	UT	1.450	2.200	2.300	2.500		2.700	

These rates are quoted for QwickRate customers only and cannot be republished without the consent of the listing financial institution.

^{SP} Indicates a Special Rate Term is available

1 2 3 4 5 6 7 8 9 10 11

Records: 1 - 15 of 353

Provided by Karl Nelson, KPN Consulting

Issuer Benefits

- Non-brokered core deposits (time deposits <100k)
- CDs can be very stable
- No collateral requirements
- Can be used for one-time liquidity or pre-funding
- Reduce interest rate risk
- Open a virtual branch at a fraction of the cost of brick and mortar
- Prevent balance sheet re-pricing (cannibalization)

Provided by Karl Nelson, KPNConsulting

Deposit Classification

The FDIC classifies a rate board as a “non-brokered deposit listing service” if the rate board meets the following criteria:

Charge subscription fees only

- *Fees not charged on number or dollar value of CDs placed*
- *Performs no services except gathering and transmission of information*
- *The listing service is not involved in placing deposit*

Deposits obtained directly as a result of a bank listing rates on a rate board will be classified as non-brokered.

“Time deposits less than \$100,000” on schedule RC-E of the call report

Included in the UBPR calculation of core deposits

Does not affect your bank’s dependency on non-core funding liquidity ratios.

GMAC Needs More Help

Helping Hand

Amount Treasury has injected or will into GMAC in exchange for preferred shares



Sources: U.S. Treasury; WSJ research

Fitzpatrick & Paletta, "GMAC Asks for Fresh Lifeline," WSJ, Oct. 28, 2009

GMAC Issues \$4.25 Billion TLGP Debt

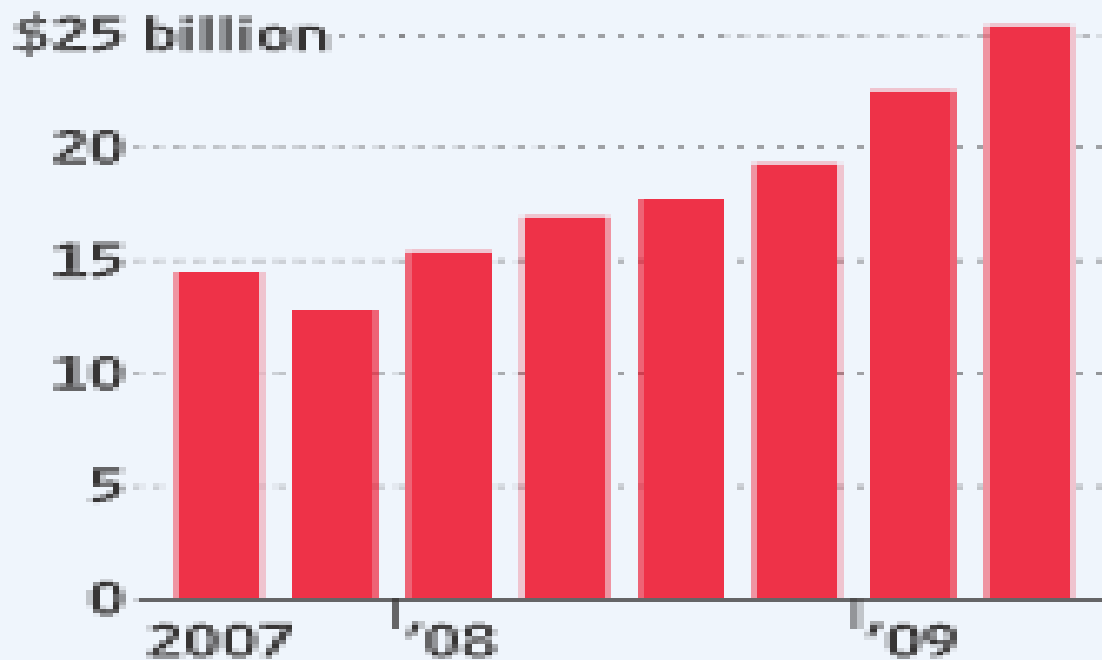
- Authorized to issue \$7.4 billion in FDIC-insured debt
- June 3 - issued \$3.5 billion in fixed-rate notes
 - (2.25% rate) maturing Dec. 2012
 - issued \$0.75 billion in floating rate notes
 - (3-mth LIBOR at 0.64%) maturing Dec. 2012
 - AAA rated by Fitch due to FDIC guarantee
- Oct. 28 – issued \$2.9 billion in 3-year bonds backed by the FDIC priced to yield 1.753% (0.316% over Treasuries); GMAC's non-guaranteed 3-year bonds yield 8.81% as GMAC's debt is rated Ca by Moody's

Ally Bank (Ally.com – Oct. 29, 2009)

- 1.70% Online Savings Account – linked to customer's current checking account – no minimum balance, no monthly fees
- 1.60% MMDA rate – no minimum balance
- 2.00% CD rate – 1 year
 - 2.70% - 3 years
 - 3.35% - 5 years
- No Penalty CD – 9-mth APY is 1.60% (no fee for early withdrawal)
- Check (Debit) Card – 4 free transactions from non-GMAC Bank ATMs

Deposit Surge

Total deposits at GMAC's Ally Bank have grown rapidly.
Quarterly data



Source: the company

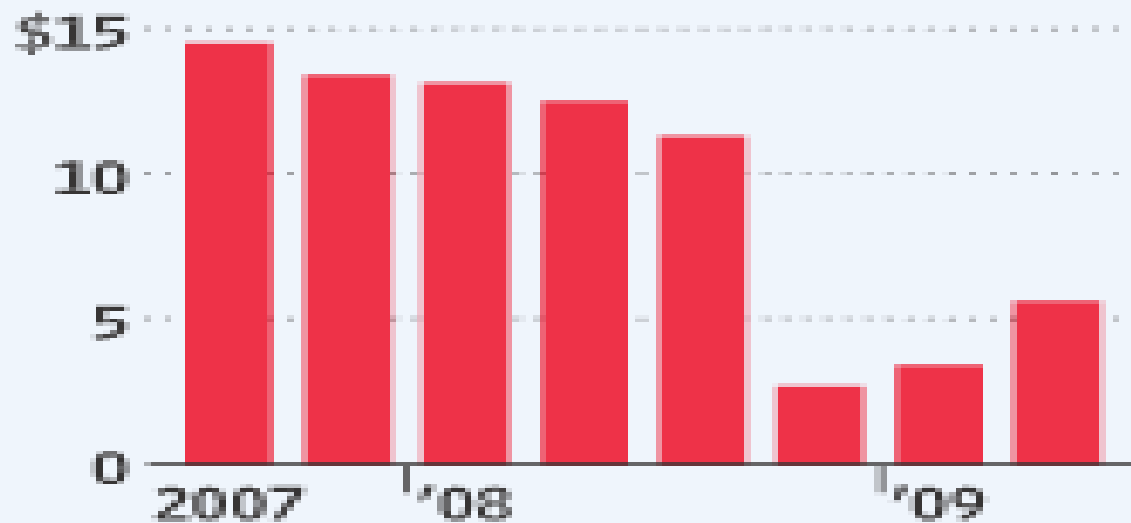
Fitzpatrick and Paletta, "U.S. Turns Screws on Bailed-Out GMAC," WSJ, Nov. 3, 2009

GMAC Wants to Make More Car Loans

Engine Trouble

New GMAC auto loans are far below peak levels.

Quarterly data, in billions



Source: the company

Fitzpatrick and Paletta, op cit, 2009

Ally's Aggressive Advertising

“Is not saying something a lie?”

In banking, there's profit and there's integrity. It shouldn't be a choice between the two. At Ally Bank, we value integrity as much as deposits. That's why we'll send an email alert if money sitting idle in your account could be working harder and earning more. It's jus the right thing to do.

Kiplinger (back of cover), November 2009

New Capital Reality

- Capital requirements are going up – for all institutions.
- Be prepared to operate with more capital
- What are the new minimum capital standards? [8%, 9% or 10% - new leverage capital standard? ; 12% or 14% - new risk-based capital standard?]
- Where do you get capital today?
 - TARP – matching approach?
 - Private equity firms
 - Bank capital merger partners
 - Existing shareholders, directors, friends & family

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