Basel III to Help Big Banks? A Calculation Tool to Show it's Impact; Texas Ratio Helps LO's Think About Bank Health

By: Rob Chrisman | Thu, Sep 27 2012, 9:51 AM

Even though last Saturday was the equinox, here's the weird thing: five days after the equinox today is the "longest" day of the year! If you're thinking about the sun and the earth, or time, you're barking up the wrong tree...just like statistics, and ways of reducing the deficit, there are different ways of looking at the same thing. In this case, there are a lot of ways to measure how long things are. "Thursday September twenty-seventh" is the longest day of the year! The longest in terms of text, that is: Thursday September twenty-seventh. Give that one to your kids!

As California goes, so goes the nation? We'll see, but Governor Brown signed into law several **mortgage-related bills**.

I am sitting here wearing my Countrywide golf shirt, drinking out of my Long Beach mug, my mouse sitting on my WAMU mouse pad, a little yellow Greenpoint duck somewhere in the drawer. (My Taylor Bean & Whittaker bourbon is hidden, otherwise my dog gets into it.) And now my Smith Barney t-shirt has made the cut! **Morgan Stanley has officially dropped the Smith Barney name from its wealth management business**, making the former Citigroup brokerage the latest **name casualty**. Morgan Stanley Smith Barney (kind of like that Bank of America Merrill Lynch name that is still with us) has 17,000 financial advisers in 740 locations, will now be known as "Morgan Stanley Wealth Management." Smith Barney's been around since the 1800's - a little longer than Household Finance (pencil holder) or First Magnus (cap).

"I am hearing that what **LO's are busy with is refinancing folks they refinanced 6 months ago**. True?" You bet it is true. Lots of folks that didn't qualify then don't qualify now, thus the hope for property values to increase so that equity can increase, slowly expanding the pool of eligible borrowers to...refinance. Rates are certainly cooperating. QE3 gave the mortgage market a shot in the arm as $40B per month in Fed purchases has helped to boost MBS prices. However, this policy change, in addition to others, is certainly creating some **turmoil in the "specified pool" market**. (That is the market where the agencies or aggregators slice and dice pools of loans, assembling groups of loans with certain characteristics that investors "specify" and for which they'll pay a higher price.) Higher prices/lower rates will likely increase prepay speeds but the immensity of Fed buying can also cause heartburn. When the Fed targets a coupon for purchases, paper can become scarce and this typically results in higher roll costs if a security hedge isn't filled and has to be moved to the next month. The higher cost or "specialness" of the roll translates into MBS becoming more expensive to use as a hedge. Consequently, traders, who typically use TBA trades to hedge their position, are being forced to consider other alternatives, including treasuries and swaps.

Why should anyone care about any of this? Specified pay-ups for these coupons will be lower. Pools of conventional loans of less than $85k, for example, were priced higher than "normal" production by 1.5 points at one point. Now, however, $85k max Fannie 30-yr 3.5's are now "only" 1.25 better. Meanwhile, Fannie and Freddie's recently announced an increase in guaranty fees will likely have the inverse impact of QE3 and will be passed along to borrowers in the form of higher costs/rates, thus slowing speeds. How's a Capital Markets guy supposed to keep up?

While the industry deals with QE Unlimited volatility, **now is not the time to forget Basel III and its proposed restrictions on servicing and capital**. The OCC and FDIC announced the availability of a **regulatory capital estimation tool** to help community banking organizations and other interested parties evaluate recently published regulatory capital proposals. The tool will assist these organizations in estimating the potential effects on their capital ratios of the agencies' Basel III Notice of Proposed Rulemaking (NPR) and Standardized Approach NPR. By the way, the comment period on current regulatory capital standards ends on October 22. The Basel III NPR focuses primarily on strengthening the level of regulatory capital requirements and improving the quality of capital. The Standardized Approach NPR proposes a number of enhancements to the risk-sensitivity of the agencies' capital standards. The tool is intended to help institutions estimate the potential effect the proposals could have on their capital ratios. It should not be relied on as an indicator of an institution's actual regulatory capital ratios and is not part of the NPRs nor of any final rule(s) that the agencies may adopt. The estimation tools are available for banks, savings associations and their holding companies. And if you just can't get enough, here is the link to the Basel III NPR and the Standardized Approach NPR.

A story in the Financial Times reports, "Rules aimed at curbing financial sector excess could **drive more business to the biggest banks** and make it even more difficult to allow the world's largest lenders to fail, the International Monetary Fund has warned. The IMF argued in a paper released on Tuesday that the Basel III rules - global regulators' response to the financial crisis - would exacerbate the too-big-to-fail problem, where governments were forced to rescue financial institutions deemed so large, or interconnected, that their collapse would wreak havoc on the entire financial system." "Big banking groups with advantages of scale may be better able to absorb the costs of the regulations; as a result, they may become even more prominent in certain markets, making these markets more concentrated," IMF analysts wrote in the chapter of its latest Global Financial Stability Report. The IMF cautioned that **the rules were also raising the incentives to develop new products to circumvent the framework**. There was also a 'high chance' that the framework would push riskier activity into less regulated parts of the financial system." Has anyone seen my SISA rate sheet?

"I am a retail LO in Georgia, thinking about throwing in the towel and going to work for a bank. A bank has offered me a spot, but then a friend told me that the bank's **'Texas Ratio'** is above 100. Does that matter for a lowly LO?" Sure it does. The Texas ratio is a measure of a bank's credit troubles: the higher the Texas ratio, the more severe the credit troubles. The actual ratio is calculated by dividing the value of the lender's non-performing assets (Non-performing loans + Real Estate Owned) by the sum of its tangible common equity capital and loan loss reserves. The history of recent bank failures suggests that any bank above 100 has a much higher probability of closing down. Per Pacific Coast Bankers, there are "248 banks remaining with a TR greater than 100% scattered across 39 different states. Overall, given there were 6,639 institutions ("banks") in the country, this group represents about 3.7% of the total. That is a strong improvement from the peak when it was much higher. Broken down by state, GA still has the most strained banks by this measure at 49, followed by IL (31) and FL (30). Taken as a group, these three states alone represent about 44% of all the troubled banks in the country." At this point, of all of Georgia's banks, 21% of them are strained with a TR of 100% or more, followed by Washington DC with 20%. For a list and more information visit here.

The M&A, MI, and investor updates have been a deluge in September. As always, it is best to read the actual bulletin, and "good luck" if you're looking for less documentation, lower net worth requirements, or easier processing.

Bank mergers continue. In the Pacific Northwest, **Columbia Banking System and West Coast Bancorp** (both are publicly held) jointly announced that the companies have agreed to combine their two leading Pacific Northwest community bank franchises in a transaction valued at approximately $506 million. The combined company will have approximately $7.2 billion in assets with over 150 branches throughout Washington and Oregon and will rank number 1 in deposit market share amongst commercial community banks in the combined states of Washington and Oregon.

"Republic Mortgage Insurance Company ("**RMIC**") has received a **Notice of Hearing** from the North Carolina Department of Insurance ("NCDOI"). The Hearing is scheduled for October 16, 2012, and its purpose is to enable the NCDOI and stakeholders to consider a revised Corrective Plan ("the Plan") submitted by RMIC on September 14, 2012, as required by the NCDOI Commissioner's Summary Order ("the Order") dated January 19, 2012. The Notice of Hearing and related information has been posted on the Company's website at www.rmic.com."

GMAC has made a few alterations to its Lock Loan Flow interface on the Correspondent Funding website. The Borrower Name, Borrower SSN, Co-Borrower Name, Co-Borrower SSN, and Street Address fields are no longer available when locking a floating loan; any corrections to these fields should be made by contacting the GMAC Registration Desk. Once a floating loan has been submitted for underwriting, all data fields will become inaccessible apart from the lock window and commitment type. To make any corrections or updates after the loan has been received and/or the underwriting team has made a decision, clients should, again, contact the GMAC Registration Desk. Clients are reminded that it is their responsibility to notify the underwriter of any data changes following a loan's submission.

Fifth Third reminded clients that, if title was held by an "ineligible entity" in either the last 24 months or in cases where it has been less than 24 months since the borrower purchased the property, refinance transactions are not permitted. "Any entity other than a natural person, qualifying Inter Vivos Trust or Illinois Land Trust" is considered to be an ineligible entity.

The Fifth Third Interested Party Transaction Policy has been updated such that an Interested Party is now defined as a family member of an employee who works for the entity originating the loan or someone who both works for and is seeking financing from the originating entity. Children, parents, grandparents, spouses, foster children, brothers, sisters, stepsiblings, uncles, and aunts are all considered to be "family." All such transactions will be reviewed to ascertain that the relationship has not compromised the transaction. A 4506T must be completed to verify the income, and sellers are required to document the 1008 and include commentary. These loans should be submitted through pre-close or post-close channels and flagged as being an interested party transaction. Failure to do so will result in the loan being referred to the Fifth Third Risk department for audit.

And verbiage concerning lender-paid broker compensation in the Fifth Third Broker cert. form has been updated, which is now available on the Wholesale Connect site. The updated form replaces the old one with immediate effect. The Principal Curtailment matrix has also been updated and is available on the product manual page of the site.

Enough investor stuff! Although rates were nudged a little higher yesterday, how high can mortgage rates really go with the Fed buying twice the average daily production? Prices started out well, but then moved back nearly to unchanged from Tuesday's close resulting in a few price changes. For news we learned that New Home sales declined for August.

Today we've had quite a bit of information. The weekly numbers for Initial Claims showed +359k, better than expected. Durable Goods for August fell by about 13%; it is always volatile but this was quite a drop! And Real GDP for the 2nd quarter was surprising at only +1.3%, much lower than expected. Our economy is heading in the right direction, but very slowly. Later the Treasury closes out the monthly note supply with the $29 billion 7-yr note auction. **In the early going the 10-yr yield, which closed Wednesday around 1.65%, is little changed (1.64%), while agency MBS prices are down.**

I don't speak or write Chinese, but you don't have to - in 60 seconds you'll learn that this is a pretty clever way to separate an egg.

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