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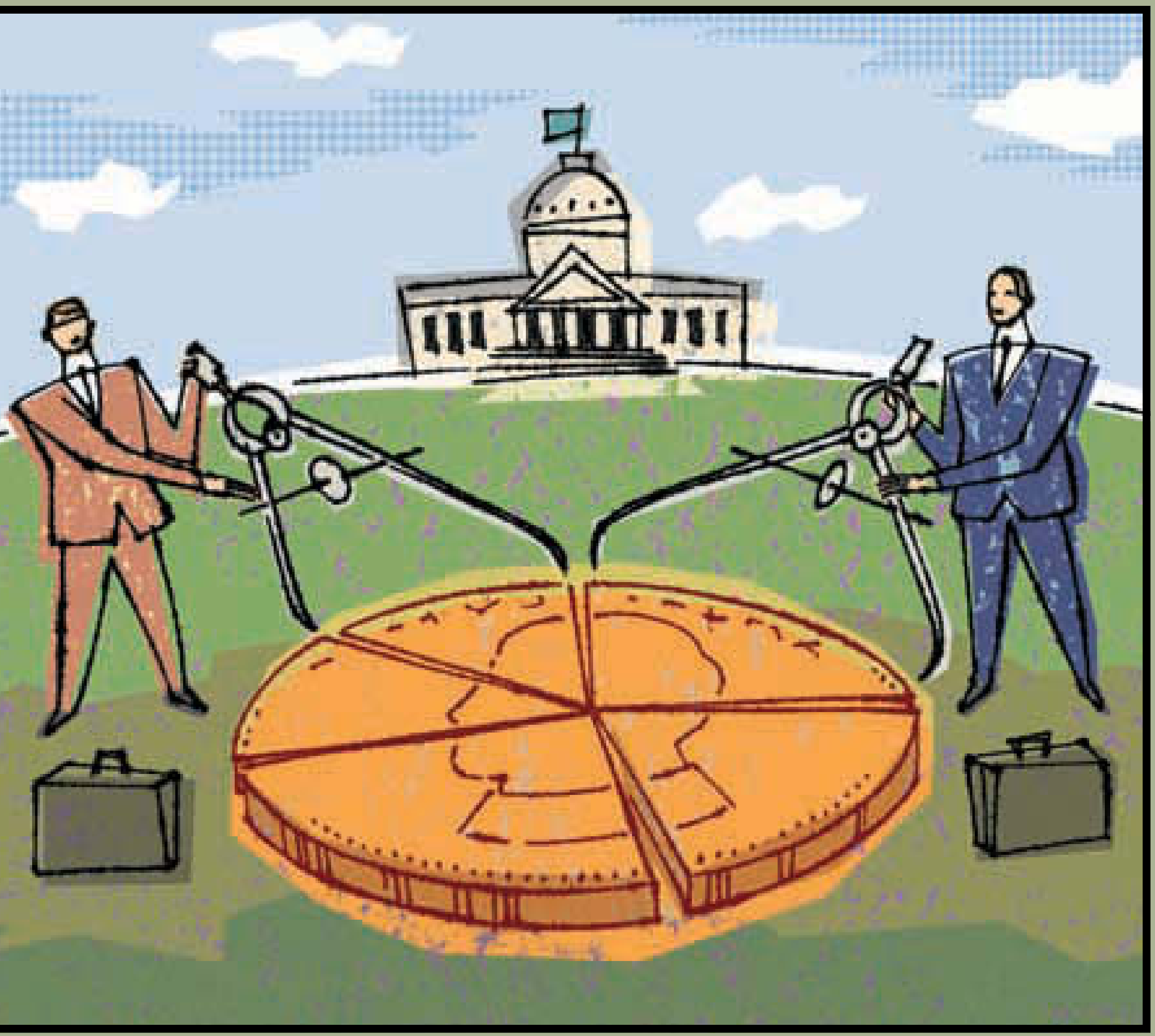

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Regulatory Changes and Restructuring

By Shawn O'Brien

Operating within the New Liquidity Reality

THE MARKET CRISIS has brought about a new liquidity reality; it's the banks that take a more proactive approach to funding that will thrive. Abundant liquidity is one welcome aspect of this new environment, but this won't last forever. Other current market factors impacting liquidity include higher deposit insurance premiums and the fact that some government programs are beginning to go away. Additionally, as economic activity increases and therefore interest rates rise, core deposits are going to become more difficult to obtain. All of the above make it more crucial than ever for banks to be identifying and utilizing a diversified mix of funding sources to prevent margin compression moving forward. Likely, none of this is news to you, as regulators have provided advanced guidance to this end, but with this new reality comes new considerations. Here's what you need to take into account well before the examiners arrive.

Know Today's Funding Options

It's vital that you really understand your funding options. Many banks don't know what's available to them. Some have not taken the time recently to re-evaluate funding sources and take advantage of options that they might not have even considered two or three years ago. Others are now limited in the funding sources that they can utilize based on their capitalization ratios. The bottom line is that all banks must constantly review and evaluate the different funding sources that are accessible to them and adequately diversify their strategies.

Why is this so important? Even if you aren't in need of liquidity right now, you can take advantage of funding sources outside of your local market, such as FHLB advances and non-brokered deposits, to reconfigure your balance sheet with lower cost funding. This will better position the institution for when rates rise.

Manage Funding Sources Wisely

Regulators are placing special emphasis on whether or not your funding sources are well- managed. This includes detailed policies and procedures and operating within the guidelines you've established. The more well-managed your liquidity polices and sources are, the greater confidence regulators will have in your overall liquidity position and may therefore grant you more flexibility in terms of concentrations and utilization of funding sources.

Plan for the Future

Right now it's easy to find short term, low cost funds, but don't be lulled into thinking that the hard part is done. The FED has already begun taking liquidity out of the market. When economic activity intensifies and interest rates increase, money will also return to the stock market, people will seek out institutions with the best rates and there will be greater loan demand – all of these inevitable factors will impact the availability of liquidity. These are the kinds of things you need to be thinking about today in order to be ready for tomorrow.

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One of the most fundamental ways to prepare the bank is to make sure that it's funded with multiple sources. Examiners want to see that you are not over-reliant on any single source of funding. Regulators are continuing to stress that you build deposits in your local market, but at the same time, they don't want you to overpay for those deposits. You should be investigating other funding options that will be more advantageous for the bank when rates begin to rise and the market becomes more competitive again.

Put a Dynamic Contingency Funding Plan in Place

Examiners want to see that you are continually and proactively managing your bank's liquidity position to prepare for the unexpected – your contingency funding plan (CFP) is essential to this effort. The key is that your CFP must be approached as much more than simply a check box for the regulators. The plan must be dynamic – always reflecting what could happen today if one of your funding sources was no longer available. Prepare for potential risks and make certain that all sources have been fully activated and tested to ensure that the bank can meet its short-, medium- and long-term funding needs. If you monitor and update this plan regularly, it will be a valuable tool in managing liquidity and risk moving forward.

Keep the Board Informed

One last aspect of today's liquidity reality is that your board is expected be more actively involved in the banks' liquidity policies. Your directors must understand the bank's primary and contingent funding sources, what options are available and that you are monitoring and managing liquidity according to regulatory guidance. If your bank's liquidity position hasn't been a regular discussion at your board meeting, it certainly should be.

It's a new liquidity reality. Rising rates and other factors will make funding less readily available to banks in the future, and will further compress their margins. It's important that you put plans in place now that proactively manage the bank's liquidity and prepare for what's ahead.

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Fast, decisive action on obvious performance and leadership weaknesses will show the regulators the board understands the issues and is taking strong action.

Execute Strategy in 90 Days

1. Focus on achieving results in 90 days. The enforcement action will provide objectives such as raise capital, increase earnings, improve compliance, address asset quality, etc. Keep it simple. Do not over complicate or commit to long-term projects. Develop an agreed upon aggressive plan to reach four major goals in 90 days. In a crisis, speed is imperative- 90 days is equal to a year.
2. Hold everyone accountable. The board to make sure everything happens, the CEO to execute, the chief credit officer to shift to workouts from sales, the CFO to cut expenses and raise capital, and bank advisors to provide timely, relevant advice.
3. Schedule a group accountability meeting in 90 days to ensure each objective is achieved in 90 days. Most bank boards who used this process achieved 90% of stated objectives. Celebrate the win – major changes in performance, attitude, behavior and results in 90 days. This approach has helped a number of community bank boards (including the CEO) exceed regulatory requirements. Everyone, including regulators, is impressed with decisive action, successful execution and achievement of results within 90 days. Judge by results.

When the boardroom team – the chairman, directors, CEO, executives and key advisors – take leadership responsibility, strengthen leadership performance and achieve major objectives in 90 days, the board will exceed regulatory expectations and the bank will survive and prosper.

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