



Working as Planned

Municipal bond monitoring tools satisfy regulators' expectations

By Jim Reber

The requirements of the much-revered Dodd-Frank Wall Street Reform Act continue to be implemented into community bank operations. While there is still a lot of ground to cover, the law's provisions that affect your bank's investment portfolio appear to have been addressed by the investors, and so far it appears to be to the general satisfaction of the regulators.

The fine print of the requirements (or the burr in the saddle) is Section 939A of the act that removes the ability of an investor to rely exclusively on the external credit rating, generally issued by Moody's, Standard & Poor's or Fitch. Beginning January 2013, community banks must arrive at a conclusion regarding the creditworthiness of their investments by examining quantitative information other than their credit ratings. This has, in turn, resulted in all manner of data packages, demographic tables and credit-scoring models popping up on the investment horizon.

Many of these investment tools

have proven to be adequate. By and large, one year after the new regs have gone into effect, portfolio managers and examiners are reporting success in the use of these data packages and compliance with the regulations.

Major aid to bottom line

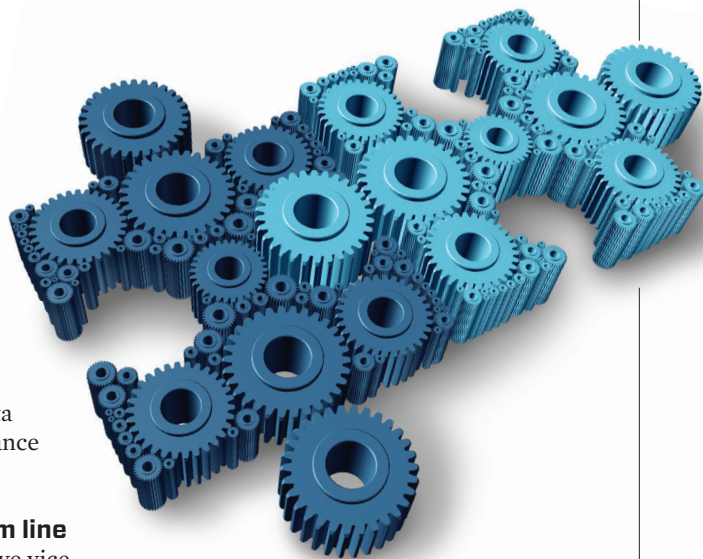
Art Kniffen is executive vice president of Southern Commercial Bank, a \$510 million-asset community bank in St. Louis. The bank relies heavily on portfolio investments, and in particular tax-free municipals, for its earnings. As of Sept. 30, it had 14 percent of its total assets in munis. It also had a recent exam that touched on its bond portfolio.

The examiners did a "cradle-to-grave approach with us," recalls Kniffen. "They wanted to see investment policies, and that our 'credit' file met our policies. They also made sure that our pre-purchase analyses and post-purchase monitoring were fully documented."

Kniffen made use of a variety of data sources to help in his file building.

"Bloomberg, Reuters, my own brokers' tools and, yes, the rating agencies' own write-ups. We also went back to what we've owned for three years and filled in the files," he says.

Did the examiners leave happy? "Yes they did," Kniffen says. "And that's not easy to accomplish."



'A good thing'

So says Tim Walters, president of the \$86 million-asset Citizens National Bank in Meyersdale, Pa. Walters had already been performing due diligence on the underlying qualities of municipal bonds before the new Dodd-Frank regs kicked in. "I just felt like safety and soundness of the bank dictated that I knew what was under the hood."

Not that Walters hasn't worked to stay efficient in his bank's bond-buying routine. "If I had a criticism of the new requirements, it's that a portfolio manager had better be quick in making decisions. Attractive muni paper doesn't sit around for three or four hours."

Walters uses data from issuers' websites—"much improved in the last year"—as well as online tables and subscriptions to quickly review and document his purchases. "By making us document our concentrations and ages of credit ratings and financials, we can be a lot better at seeing our exposures. In that sense, the new procedures help us keep our portfolios cleaner, and that's a positive," he says.



Heads Up for Hawaii

ICBA Securities will be very visible next month at the ICBA Community Banking Live 2014 in Honolulu. It will conduct three workshops and participate in the ICBA Services Network activities in the convention's Expo trade show. Be sure to visit our portal on the LodgeNet TV network in your hotel room for a daily activities listing.

For the asking

Rosemary Picard has availed herself of available tools to help her community bank purchase new investments, and to document the performance of the bank's current holdings. She is chief financial officer of Dean Bank, a \$245 million-asset mutual in Franklin, Mass. "I appreciate the efforts the broker/dealers have put into building these tools," she says. "If we had to develop them independently we would probably find bonds being traded away prior to completing the credit analysis."


Munis are a vital part of Dean Bank's investment portfolio, comprising about 30 percent of the total. Picard monitors the bank's holdings by downloading its investments to a spreadsheet that displays, among other things, demographics for the bond issuer's area. "We do make a note of the external credit ratings," she says. "We also document why, exclusive of the ratings, an investment meets our criteria from a credit-quality standpoint."

And in the vein of good house-keeping, Picard also keeps notes as to why a given purchase is fairly priced by comparing it to alternatives. She back-tests her bank's portfolio periodically to see if its purchases have performed as expected. "At the end of the day," she says, "we don't want to avoid the muni market. And these tools really help us."

Regulators' POV

"Banks are generally moving in the right direction of meeting the new requirements," says Eric Reither, senior capital markets specialist with the FDIC. "Many banks are addressing the pre-purchase

analysis expectation, but the ongoing monitoring procedures remain a work-in-progress."

So, if your community bank's documentation for pre- and post-purchase analytics, and its investment policies, are up to date, it appears you can expect no additional scrutiny from examiners. If not, be sure to gain access to the set of tools offered by the broker/dealer industry and other third-party data providers, and help your community bank continue to participate in the muni bond market. 

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