

Long Beach

BUSINESS JOURNAL

July 6-19, 2010

Financial Services Industry Remains Cautiously Optimistic In Choppy Economy



Kelly Williams III, president of Kelly Williams Insurance at the Traffic Circle, told the Business Journal he sees certain lines of business recovering this year as the industry as a whole lags behind. "Because business is down in general, I think there are a lot of carriers that have the capacity right now to sell insurance," he said. (Photograph by the Business Journal's Thomas McConville)

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Local experts in banking, lending, investing, accounting and asset management say the consistency of the nation's economic recovery is uncertain and they remain cautious about projections on if and when things will turnaround. Banks are playing it safe, the insurance business is fluctuating, accountants are preparing for possible tax changes and financial managers are encouraging consumers to review their assets before 2011.

Rod Banks, executive vice president of commercial banking services for City National Bank, said that in broad terms the industry is in a better situation this year, and that industry caution is paired with some optimism.

"The recession . . . made bankers in general become far more cautious," Banks said. "Most bankers had to make sure that they protected their balance sheets and at the same time took care of their clients. So obviously you've seen a lot of banks having to pull their horns back a bit, perhaps had to tighten up a little bit, but I think what you're seeing today is banks are still lending."

Banks said City National Bank has continued to lend through the economic storm while keeping watch on the direction of the economy.

Scott Anderson, senior economist with Wells Fargo, agrees that banks are going to play it safe through the rest of 2010, partially because of the recent stock market troubles and the deteriorating bond market affected by the European debt crisis. He said the strength of the recovery is uncertain for the next 12 to 18 months.

“One thing we have seen is a deterioration of credit quality, though, so it’s difficult to meet our loan goals,” Anderson said. “But we are working toward that end and we are growing new loans.”

Even with the state unemployment rate hovering around 12.5 percent, households having difficulties meeting their debt commitments, high credit losses and an overall impaired economy, Anderson said the financial situation is improving for banks.

“We had the banks’ stress test last year at the height of the financial crisis, and that actually helped the banks recapitalize,” he said. “Most of the larger banks were able to raise equity debt and capital, including Wells Fargo. It put us on a much stronger financial footing in allowing us to weather this financial crisis. It is putting us in a position where we can continue to lend.”

Peter Barker, California chairman for JPMorgan Chase, said he projects a slow improvement through the rest of the year. Barker is on the executive committee of Chase, overseeing six lines of business in the state including business banking, investment banking, mid-corporate lending, asset management, credit card business and treasury services business.

“Many of our customers are bringing people back into the workforce, and they have gotten through the period of the most uncertain time – which was the end of 2008 into late 2009,” Barker said. “It appears that the stimulus program and other pro-growth initiatives have kept us from having a more severe recession. Having been cautious, people are now seeing optimism and are planning for increased activities through the balance of 2010 into 2011.”

Banks told the Business Journal that depositories have adjusted accordingly to the current marketplace for financial services, which is an “entirely different” marketplace than it was two years ago.

“I think you’re going to see bankers beginning to increase employment, which is always a good sign,” he said. “I think ultimately you should see problem assets begin to decline. That will be one of the first signals you’ll see that we’re coming out of this thing. I would certainly trade today’s environment any day of the week as far as where we were a few years ago.”

Banks that have grown over the last two years have increased stability, he said, as Wachovia merged into Wells Fargo and Chase acquired Washington Mutual.

Anderson said the merger with Wachovia strengthened Wells Fargo, which has doubled in size to employing nearly 250,000 people and making it the sixth largest private employer in the country.

“We’ve been able to expand some of our product offerings, particularly in the investment banking area – some stuff we didn’t do before the merger,” he said. “We’ve also strengthened our wealth private bank and wealth management services as well, but we still primarily see ourselves as a large community bank and that hasn’t changed with the merger.”

Chase is also growing business banking as an overlay of its California retail system since its acquisition of Washington Mutual, Barker said.

“Where Washington Mutual may have been viewed as thrift with depositing and checking account activity, we’ve introduced business banking to those branches,” he said. “We’ve been hiring business bankers both into the branch system and into our system. We’ve supplemented that. We segment the market by size, so the bigger the company would determine where they would interface with us.”

Barker told the Business Journal that Chase has three levels of commercial banking – business, middle market and corporate. Each tier grows larger for various needs and companies. At the business and middle market tiers, he said Chase is hiring 325 additional small business bankers, with most of them working with firms that have annual sales of less than \$10 million.

“That adds 17 percent more bankers to the 1,900 bankers who currently support the less than \$10 million segment,” according to a Chase press release.

Along with creating jobs, Chase has a national program for small business lending through which it has committed \$10 billion of capital.

“We will provide more credit – and more one-on-one advice – to small businesses at this crucial time because they are so important to the U.S. economy,” Charlie Scharf, head of Retail Financial Services at Chase, part of JPMorgan Chase, said in the release. “We urge small businesses owners to use the additional capital to expand and create jobs, and spur economic growth.”

According to Barker, Chase made \$2.1 billion in small business loans – a 31 percent increase over 2009.

Another financial institution with a notable small business loan program is Goldman Sachs, which has partnered with several higher education institutions across the country to provide loans for businesses that have the potential to boost local economies. One of those institutions is Long Beach City College (LBCC).

The initiative, called “10,000 Small Businesses,” will provide qualified applicants business and management education, access to capital and business support services like technical services and networking.

“The Long Beach Community College District is thrilled and honored to have been selected as a partner with the Goldman Sachs 10,000 Small Businesses Initiative,” LBCC President Superintendent Eloy Oakley said in a statement. “Our college is committed to economic development and we are ready, through this new partnership, to further assist our local small businesses.”

The program is designed for approximately 30 local small business owners who have limited access to business education and few financial resources. Businesses must have been operating for at least two years, employ at least four people and posted revenues between \$150,000 and \$4 million in 2009, among other qualifications. Applicants must submit information by July 6, and the program goes into effect in August. For more information, visit www.lbcc.edu/10000smallbusinesses.

Possible Tax Changes, An Insurance Slump And Economic Uncertainty

As a certified public accountant (CPA), Blake Christian of the firm Holthouse, Carlin & Van Trigt said the accounting industry is seeing a pickup this year over 2009.

“We’re definitely seeing some increases in hiring,” he said. “We’re seeing increase merger and acquisition activity that was pretty dead for the last 18 to 24 months. So there’s definitely some improvement we’re seeing in our industry.”

At the end of 2010, several tax cuts implemented by former President George W. Bush will expire, raising tax rates to levels not seen in 10 years. Depending on the actions of President Barack Obama and his administration, the top income tax rate could jump from 28 percent to 39.6 percent, and the 10 percent bracket could be eliminated.

“A lot of our high net income clients are in the alternative minimum tax, which means their marginal rate is 28 percent,” he said.

“... so it makes a lot more sense to accelerate income into 2010 at a 28 percent rate rather than the 39.6 marginal rate in 2011.”

Christian said the conventional wisdom is that, from a political standpoint, the Democrats would let the tax cuts expire and taxes increase – if they maintain control of the Senate.

“[That way] they can’t be accused of raising taxes,” he said. “They’ll just say ‘That was Bush who did that.’ I feel pretty strongly that that’s what’s going to happen, and it’s not just the income tax that’s going to increase but the estate tax is going to jump back up to 55 percent.”

Christian said there are several other federal tax increases likely coming in 2011, and he is working with clients to plan ahead by accelerating income into 2010.

“I had a meeting with a client accelerating a bunch of capital gaining income because those tax rates are going to jump up 15 to 20 percent more than likely,” he said.

Christian said California’s tax rates are already high, leaving little wiggle room for increases.

“I think on the California side, we’re going to see more penalties under provisions, more fees,” he said. “That’s really their only route. I think you’re going to see some of that on the federal side also. You’re probably going to see some petroleum-based excise tax proposals to increase those and probably environmental cleanup-type things that are going to be imposed on businesses and to consumers to balance the budget.”

Tax credits for businesses are still out there, and Christian said he continues to work to get the word out about a statewide program called the Enterprise Zone. The local Enterprise Zone allows businesses within the focus area to claim tax benefits because their location is in an underserved and low-income region. In Long Beach, the Enterprise Zone spans 41.4 square miles and could assist more than 10,000 businesses. Christian said there are still many companies that aren’t claiming the benefits.

“Even though they may have not had a profit in the last year or two, they can go back and get refunds for four years,” he said. “Even when we go back and look at the third and fourth year back, they did have profits then and we’re able to get them that refund.”

According to Christian, many of his clients are using the Enterprise Zone program for “green” business upgrades – such as energy and technology improvements – and can get a 9.75 percent state credit. He said he is pressing to educate businesses on the zone as well as SB 974 – a bill just passed in the state senate that could reduce the benefit and make it harder for businesses to qualify. Christian urges businesses to take advantage of the opportunity soon, especially in this market.

“On the business side, in the credit markets, the big companies are able to get loans fully collateralized,” he said. “But you’re seeing the small- to medium-sized companies still struggling to get financing. There are a lot of companies with good ideas and growth plans that they just can’t execute because of the credit market. So it’s going to take a little while to get through.”

Kelly Williams III, president of local agency Kelly Williams Insurance, said he predicts certain lines of business to rebound throughout the year, rather than the industry as a whole.

“Because business is down in general, I think there are a lot of carriers that have the capacity right now to sell insurance,” he said. “So pricing is still fairly low and there’s a lot of competition going on.”

Williams said this is good for buyers, but depresses prices and in turn isn’t great for brokers.

He expects workers’ compensation prices to increase, which will likely drive up profits for his business and brokers across the

board. This isn’t necessarily a good thing for the economy, he said, but everyone has to have workers’ compensation coverage.

Williams said things are not looking good for workers in regards to health benefits, as employers are cutting back.

“Because their top line isn’t increasing, I think they’re starting to look at their expenses and cutting back to stay afloat and turn a little bit of profit if any,” he said. “Across the board benefits are being cut.”

The commercial side of the insurance business in general is a little low, according to Williams, but personal lines aren’t being affected.

“The personal lines aren’t part of it because a lot of it is required – auto insurance, home insurance – by lenders or by state law,” he said. “I think that has been a little more insulated from being affected. People might want to cut a little bit of coverage here and there, but it’s still required and they have to have it.”

Lisa Petrie, senior vice president of The Petrie Financial Group, part of the global wealth management company UBS Financial, told the Business Journal that she thinks economic times will continue to change slowly.

“There’s still some uncertainty out there,” Petrie said. “When you look at the recent pullbacks in the market – which we had one in May, and June was still a little more volatile – we’re probably looking at a longer-term recovery. We do have a new environment out there today.”

Petrie said a big part of the new environment is the coming changes through federal financial reform.

“There will be new policy limitations due to those structural changes, which will, when people figure out what that verbiage is, probably have a continuing choppy market going forward,” she said. “Then you add on Greece and the debt worldwide, plus even our own federal reserve commenting the other day that the recovery is moderating a little bit – all of those fall into what I would characterize as a more volatile, more choppy period of time as the market looks just toward the news of the day.”

Because the market is operating this way, Petrie said now is the time for consumers to figure out the best way to manage their funds.

“It becomes important that, for individuals, the selection and the approach to how they position their assets . . . our recommendation would be across all risk classes because it is a more volatile period of time,” she said. “We expect the markets to probably continue this choppiness for a while. There are still real positive things on the market as well, it’s just that the overriding, large, big picture economic changes throughout the world are certainly impacting our markets.”

Petrie said the banking regulations and other elements of the coming reform include new mandatory fees for banks.

“I’m sure that will be passed on to the consumer at some point in time in some form,” she said.

Consumers, Retailers Should Gear Up For Financial Reform

After months of work by both the U.S. Senate and the House of Representatives, and a nearly 20-hour conference session, a financial reform bill emerged recently from Congress.

The bill cleared the House in a party line vote, 237-192, with three Republicans in favor of reform and 19 Democrats against it. The bill won’t reach the Senate for a vote until mid-July due to delays caused by the recent passing of Sen. Robert Byrd and concerns raised by three Senate Republicans.

Scott Brown of Massachusetts and Olympia Snowe and Susan Collins of Maine expressed apprehension over a \$19-billion fee

on large banks and hedge funds. After Brown publicly threatened a no vote, the fee was brought back into conference on June 29 and removed from the bill. Brown has not yet confirmed his support for the bill.

The Senate is expected to vote on the bill on July 12, upon return from the Congressional recess.

President Obama remarked on the production of the bill after a meeting with Chairman of the Board of Governors of the Federal Reserve Ben Bernanke on June 29.

“This was a result of terrific work, I think, by my economic team, by members of the committee and Chairman [Christopher] Dodd and Chairman [Barney] Frank, and some good advice from Chairman [Ben] Bernanke in consultation during this process,” he said.

President Obama said the bill will offer citizens new protections for financial transactions, from credit card debt to mortgages.

“Not only will completion of the financial regulatory reform bill provide some certainty to the markets about how we are going to prevent a crisis like this from happening again, but it also ensures that consumers are going to be protected like never before on all the things day to day that involve interactions with the financial system,” he said.

Experts agree that financial reform is needed and are pleased with the initiative to put together a reform bill quickly.

“There was wide agreement – policy makers, bankers, consumer groups, Republicans, Democrats, whomever – that reform has to happen. There has to be some changes here. There were some key areas where there was some agreement,” American Bankers Association (ABA) spokesperson Peter Garuccio said.

The ABA and its members, along with nearly every banker they have contacted, according to Garuccio, support some key parts of reform, including ending ‘Too Big to Fail’ ideology and closing gaps in regulations across the banking industry.

“I think that the bill in many respects goes a long way to addressing those, and banks support them and always have,” Garuccio said. “But it also, as our CEO said the other day, goes pretty far afield from Wall Street reform and has a very negative impact on Main Street.”

Garuccio said the legislation will make it more difficult for both large and community banks to make loans to businesses, which could especially hurt small businesses.

“I think really the final analysis is that while there are some key Wall Street reform provisions that are in there, they’re overshadowed by the number of burdens that are going to fall on traditional banks, making it costlier for them to provide credit and ultimately raising the cost of banking products for consumers and tightening credit,” he said.

Garuccio told the Business Journal that the ABA sent a letter to U.S. Treasury Secretary Timothy Geithner in May explaining that the financial reform legislation would add about 30 new regulations to the 50 new or expanded regulations affecting community banks that have come online in the last two years. He said that while not every rule would affect every bank, the layers of bureaucracy will create further burdens on the industry.

In a statement on the conference passage of financial reform, ABA President and CEO Edward Yingling said, “We have worked tirelessly to ensure that members of the House and Senate understand and recognize these concerns. While we have had some success in this regard, in the final analysis, the legislation in question simply does more harm than good and will make it exceedingly difficult for banks to be the drivers of economic growth and recovery going forward.”

National Credit Union Association’s Chairman Debbie Matz feels differently. In a letter to House Committee on Financial Services Chairman Frank and Senate Banking Chairman Dodd, Matz thanked them and other committee members for pushing through the bill.

“I am confident that this measure will strengthen the American financial services sector, benefiting credit unions and credit union members in multiple ways,” Matz wrote. She touted the creation of the Consumer Financial Protection Bureau and a Financial Stability Oversight Council as crucial independent watchdog entities that will protect Americans and “monitor and address potential systemic threats of the U.S. financial sector.”

Steve Verdier, executive vice president and director of congressional relations group for the Independent Community Bankers Association (ICBA), said the ICBA supports the elements of the bill that benefit community banks and will work to change those that are harmful.

Verdier supports the provision in the bill that maintains that community banks continue to be regulated by their existing regulator for consumer law compliance. Another positive, he said, is that community banks can “expect to see a decrease in their deposit insurance premiums almost right away because the cost of deposit insurance premiums under the bill are shifted from community banks to the largest banks.”

The ICBA does not support the creation of the Consumer Financial Protection Bureau, which Verdier said would create stronger consumer regulations and in turn drive up the compliance cost for community banks. Another concern of the ICBA’s is price fixing on debit card interchange.

“That’s going to harm consumers and that’s going to harm community banks,” he said. “They’re going to try to impose price controls on debit cards and the control would fall on the relationship between the bank and the merchant. . . . The merchants are going to get a windfall and then hope to continue to enjoy the benefits of the debit card system.”

The ABA is also against the interchange fee element of the bill, which Garuccio said will impact local banks, merchants and consumers rapidly.

“The Fed has nine months to essentially create a price for debit cards, which is not something the Fed normally does. So it’s hard to see what they’re going to do and how they’re going to do it,” he said. “The real difficulty is that they’re limited in the factors that they can consider when determining the appropriate price. Certain costs aren’t going to end up in the equation, which means you’re going to end up with a price that’s lower than what it should be.”

Garuccio said that while it is difficult for banks to bear these challenges, it is consumers who will ultimately carry the weight of these fee adjustments in the form of other fees passed to them by retailers and banks.

“The consumer and the merchant groups, to their credit, have done a very good job of sugar coating it and making it look like it’s a good deal for folks,” he said. “In the end I think it’s your big box retailers who are going to benefit the most, and the rest of us are just simply not.” ■