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## Banking: New rules for a new game

More than a decade ago, a pair of expansion-minded competitors, Mid-State Bank & Trust and Pacific Capital Bancorp, parent of Santa Barbara Bank & Trust, rewrote the rules for the banking game.



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Through a combination of acquisitions and de novo branches, they built large banking networks that operated for the first time on a true, tri-county basis. Smaller players also began creating mini-networks while others started de novo banks in the hope of being taken over by a bigger competitor. And Mid-State's strategy was largely vindicated when it was sold to Dutch banking giant Rabobank in 2007 for what now seems like an impossible price of \$37 per share.

The banking IPO goldrush pretty much ended when housing markets in once-booming Oxnard and Santa Maria imploded. Bank stock prices have largely collapsed as commercial real state lending has hit the skids. A few banking companies, notably Montecito Bank

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& Trust, which has expanded to Ventura in recent months, have been able to buck the prevailing trend. But for most financial institutions, the future is about preserving capital, cutting your losses and hunkering down. Based on 25 years of observation about banking and business, here are some of the new rules for banking investors:

- **Deleveraging will be a key path to prosperity.** Pacific Capital Bancorp, still the region's biggest player, added more than \$1.7 billion to its balance sheet in the first quarter to fund its profitable tax

refund payments programs. In the past it was able to tap Wall Street for funding — but not this year. Look for Santa Barbara Bank & Trust's parent company's balance sheet to be a lot smaller in the second quarter, and for its capital needs to shrink as well.

- **Regulatory burdens will be time consuming.** The government wants to add a new financial consumer protection agency on top of onerous supervisory rules and Sarbanes-Oxley requirements for public companies. This takes management time as well as money.

- **Capital will be costly.** With the government essentially guaranteeing the survival of Bank of America, Wells Fargo and other banking giants, there is a much bigger risk premium for investing

in smaller institutions that are in many ways the lifeblood of small business. Sara Hamilton writes in the current edition of the Business Times about Ventura County Business Bank's hunt for capital, where it has a real disadvantage versus the giants.

- **Simpler structures will be the name of the game.** Bank of America is selling off First Republic, a longtime player in South Coast private banking, because it no longer fits with the Bank of America-Merrill Lynch combination. The expected sale of Bank of Santa Barbara (no relation to SBBT) is the direct result of Michigan-based Capitol Bancorp's consolidation and simplification strategy.

- **Doing your homework will count for a lot.** In mid-June the normally sharp analysts at Keefe Bruyette & Woods up-

graded Pacific Capital stock and then looked like idiots when it suspended its TARP and other dividends a couple of weeks later. Ditto many in the local media who made a big deal out of the dividend suspension and speculated wildly about what might happen on June 30. Anyone who carefully read Pacific Capital's most recent financial statements and Securities and Exchange Commission filings would have not been surprised and would have acted with more restraint.

- **The business cycle has not been repealed.** For banks that can navigate the next couple of quarters, there will be a turnaround. The next few months will tell us a lot about what the banking landscape will look like when the economy recovers.