

THE WAY OF THE DEPOSIT WARRIOR

by [Steve Brown](#)

There is an old saying in martial arts that goes, "To strike is to fail." Taken from the code of the samurai, the saying underscores the notion that physical contact is the least desirable outcome in a conflict. Far better to negotiate the situation, or never place yourself in a situation where fighting is required, than to have to resort to contact. While hitting is quick and relatively simple, striking an opponent can be life changing and exposes the fighter to an elevated level of risk. A wise fighter knows that even the most unskilled opponent can get lucky in an attack. Paying a high deposit rate, particularly a long-term one, is a strike to the opponent. Yes, it may solve a problem by increasing funding, but it is a tacit admission of a failure. Not only does a high deposit rate increase the cost of funds, but it makes the bank more interest rate sensitive, thus increasing the risk profile. Moreover, it takes only a day to gain a new customer by paying a higher rate, but it can take years to remove that customer from the balance sheet. A bank with a high cost of funds is less nimble, less liquid, less competitive on loan pricing and less profitable over time. One common refrain we hear is that the bank is forced into paying a higher rate due to competition. A true banker, like a true warrior, loves a challenge because competition gives them a chance to define themselves. A samurai would never fight every bully that rides into town, nor should an experienced banker worry about high-paying competition. The true banking warrior smiles when a rival pays a higher rate, for he or she knows that the competing bank is destroying value with almost every high-paying dollar they gather. You should worry when your competition stops paying high rates, for that might mean they have found a better way. Not competing on rate is never easy. It takes hard work to roll out a new product, research a new customer set, analyze true interest rate sensitivity of the account base, conduct a marketing campaign and build a brand. It takes a dedication to the shareholders to give up growth in exchange for better profitability and it takes discipline to borrow higher rate wholesale funds to protect a core deposit base. Building a better liability structure takes effort, but that is the essence of true banking. Anybody can pay the highest rate, but it takes skill to grow deposits on superior customer service. Paying a higher rate, like striking an opponent, has the positive attribute of rendering immediate feedback. You post a 5.5% 2Y CD rate and money flows in. Rolling out an image capture program to business customers or conducting a targeted direct mail campaign takes a year or more before the results are viewed, but it is the better path. Putting in the time and effort now, will pay off handsomely when times get tough. Interest rates will swing, loan defaults will increase and margins will be squeezed, but the true deposit warrior will be protected by their liability structure. Deposit gathering is the most important function banks undertake, yet in most banks, it is devoted on a fraction of resources that loans are. As Takeda Shingen, the 15th Century Samurai warrior said, "Dedication to your art is the only path to true mastery. Mastery of your art is the only guarantee of victory in battle."

CONSTRUCTION LENDING

We have seen an increase number of exceptions in commercial construction (up 12% for the year), both as to time of completion and budgetary overruns. While this isn't always a harbinger of lower credit quality, it is a factor that is heavily correlated to defaults. The rise in exceptions means that closer monitoring and management is required.

BANK NEWS

Expansion

Capitol Bancorp (\$3.6B, MI) announced it opened its 44th individually chartered community bank across 13 states. The new bank opened in Indiana and continues the holding company's process of opening separately chartered, locally managed community banks. So far in 2006, Capitol has opened 3 de novo's and has applications pending for 5 others.

RE Concern

FRB Governor Susan Bies (voting FOMC member) said in a recent speech that while real estate markets across the country "are very strong," there were "pockets" where "signs of trouble are emerging." She also reiterated that banking regulators were cautiously monitoring CRE lending concentrations and felt some banks' "strategic and capital-planning processes may not adequately acknowledge the risks from their CRE concentrations."

Significant Changes

A shift in electronic check clearing has led the FRB to go from 45 check-processing centers in 2003, to only 18 centers following recent cutbacks.

Baby Boomers

A new study by consulting firm McKinsey & Co. finds 40% of workers are forced to retire earlier than intended, primarily due to health issues or job loss.

Sold

First Citizens Bank (\$15.1B, NC) said it will sell two specialty insurance companies it owns to an insurance company for an undisclosed sum. The transaction leaves the bank with two additional insurance operations.

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