BETTING ON DEPOSITS

by Steve Brown

Everyone knows that casinos are in business to give away as little money as possible. While few may have considered the parallel, banking can be similar in many ways. Intense competition, lower core deposits, loan pricing pressures, tighter margins and increasing overhead (mostly due to regulation) are all putting the squeeze on bankers. For some, now is the time to cash in the chips and head home, while for others, placing additional bets seems to make more sense. Whichever group you are in, understanding what drives depositors and builds their loyalty is critical to long-term success. The days of simply categorizing funding sources into Call Report buckets are gone and bankers need to adapt. Despite industry changes, deposits remain a primary funding tool for independent banks. Depositor characteristics and the corresponding assumptions are one of the single biggest drivers of interest rate risk analysis and of most liquidity models. Banks that can more effectively quantify their deposit structure stand a better chance of reducing earnings at risk, volatility and liquidity exposures. In the current environment of extreme loan competition and a flat yield curve, banks with stable low-cost funding stand a better chance of maintaining their earnings and profitability. Those that have become reliant upon wholesale or highly interest rate sensitive lending, on the other hand, are likely to continue to see profits erode as the cost of funding "lag" catches up to current rates. It may sound intuitive, but many banks still have yet to identify populations of depositors in an effort to segregate rate sensitive from rate-insensitive groups. By completing this process, introducing new products, or allowing the most expensive clients to run off, bankers stand a good chance of increasing profitability. Banks should understand in particular, why certain depositors are not rate sensitive, what influences them and what twists and turns are required to keep them from leaving. One thing a bank should never do is to tie funding to an index. The entire industry is highly correlated to Libor, but that doesn't mean banks should offer deposit products that move every time Libor moves. Seems obvious, but many banks across the country still tie deposits to Prime, Treasuries, Fed Funds and other indices. Banks should track rate exceptions to uncover trends and provide immediate training to tellers as needed, to help them understand the problem with continually bumping up the rate. In theory, banks should continually review market rates, competition, balance sheet composition, liquidity needs and other factors to determine where and when various deposit rates should be set. In practice, many banks still decide to "go long" and pay up because their CEO "has a gut feeling" about things. National banks consistently post rates based on a percentage of an index and independent banks should too. So if you haven't started yet, put in place a quality program. Make sure to track customer behavior over time, test pricing to determine sensitivity, offer different options, identify common characteristics, track both volume and rate, understand and report why deposit rates were changed at given intervals and work hard to maintain accurate records. Banks that understand depositor behavior know when to roll the dice and when to walk away.

BANK NEWS

Acquisition

Green Bancorp (TX) will acquire Redstone Bank ($168mm, TX) for an undisclosed sum.

Hiring

A new poll finds 67% of college graduates first decide where to live and then where they would like to work.

Consumer Pressure

If you were wondering just how much gas prices are impacting people, consider that the 20% increase in price from the 1Q to 2Q translates into a 2.7% hit to the pocketbook. A gallon of gas at the pump costs $2.85 on average according to AAA, 75 cents more than it did last year.

New Clients

Studies find 57% of women do not like the idea of having all of their retirement savings in the stock market.

Employees

The Center for Retirement Research finds 38% of employees are forced to retire earlier than they expected.

Gone

In 1980, nearly 84% of employees had a pension plan, a number that has fallen to only 33% as of the end of 2003

Going

Surveys find only 33% of large companies still offer retiree medical benefits, less than half the level in 1988.

Employees

The BLS reports that the average employee holds 10 jobs between the ages of 18 and 38 years old.