

## BANKING EVOLUTION

by [Steve Brown](#)

If you want to know the strength of online banking, positioning and branding, consider Citibank Direct. Launched on March 29 of this year, this internet only bank has seen stunning growth. Citibank Direct is designed to bring in new funding and customers, avoid cannibalization of the brick and mortar deposit base, leverage up the brand, create a less costly delivery channel and extend the company's reach (to allow for increased cross selling opportunities). Specifically, Citibank Direct offers higher yielding e-deposit accounts to customers by delivering it through a lower cost network. Data released by the company shows the strategy is not only working, but having greater success than anyone had imagined. In the first 8 weeks of operation, the bank raised \$3B in deposits. Amazingly, of that number, a full 67% was from new customers. In short, the company had increased deposits by about \$75mm per working day, \$50mm of which came from brand new customers they had never done business with before. When asked about the success of Citibank Direct, Charles Prince (CEO of the parent company) further articulated that the bank had accumulated 10x the volume predicted in just the first 10 days after its launch. So far, the total money raised by Citibank Direct is the equivalent of opening 23 branches. The repercussions for independent banks of Citibank Direct are many and far reaching. To begin, that new money had to come from somewhere and banks across the country, including independent banks, were likely contributors. In addition, it has long been an expectation of independent banks seeking to sell themselves that one potential group of acquirers would be a larger national bank. If billboards, a flashy web page and phone support can bring in that kind of money, why would a national bank deal with all the headaches that occur during an acquisition? There is no doubt but that the universe of potential buyers of independent banks across the country just got smaller. Consider the impact as well on net interest margin. Given this success, more banks are sure to flood in with "me too" offerings. This will serve to increase the cost of funding for banks with limited access to international markets. Trapped on U.S. soil and under pressure from the internet banks, funding costs are expected to rise for independent banks, as competition eats away at margins. In addition, this move by Citibank also increases loan competition in previously geographically remote areas. Time and location have become irrelevant, as money can now fly to NY at the press of a single button. Citibank reports 40% of its customers who open online accounts live outside the bank's branch network areas. Further, the bank's online offerings allow users the ability to monitor account balances, view activity history, transfer funds between accounts, view check images, pay bills and make payments on a business or personal loan. This is particularly important to independent banks, as these are also the top 6 things small business customers (who use online banking at least 1x per month) say they want from their bank. Banking is evolving before our eyes. To stay competitive, we will all have to factor internet only banks into our strategic plans, monitor offerings and continue to innovate to better compete.

## BANK NEWS

### Acquisition

Community Bank Systems (\$4.1B, NY) will acquire Ontario National Bank (\$95mm, NY) in a transaction valued at nearly \$15.7mm, or 1.69x book.

### Wal-Mart del Mexico

The world's largest retailer has filed for a banking license in Mexico. The plan calls for 826 in-store branches.

### **Warning Signs**

A softening housing sector has added stress in CA, where lenders report the number of mortgage default notices surged 67% over the prior year. This marks the fastest increase in nearly 15Y. Meanwhile, the number of foreclosures jumped 215% over last year.

### **Portfolio Limits**

FHLMC has succumbed to pressure from regulators and has agreed to limit the growth of its mortgage portfolio to no more than 2% above its June 30 levels. FNMA agreed to similar cap growth in May.

### **Popular Item**

JPMorgan indicates that just 1Y after launching its contactless "blink" credit cards, it has signed up 7mm customers primarily in CT, CO, DE, FL, GA, NJ, NY, PA & TX.

### **Condo Pressure**

The slowdown in housing continues to take its toll on the condominium sector. A real estate research firm owned by CB Richard Ellis is reporting that the volume of apartment-to-condo conversions has plunged nearly 80% from last year and 92% from the high water mark reached last September.

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