

## A SMALLER WORLD WITH MORE PRESSURE

by [Steve Brown](#)

The world has changed and banking executives are altering strategies to keep pace. Interest rates are more volatile, net interest margins are being squeezed, regulatory scrutiny has been ratcheted up and risk is more prevalent. Perhaps that is why a recent survey listed "managing risk" as the single biggest issue senior executives will face in 2007. As top decision-makers complete strategic planning sessions, this issue will need to be addressed. Staying with the status quo and doing things 'the way they have always been done,' is apt to get one in trouble next year. As such, bankers should have a plan in place to not only address risk when it surfaces, but more importantly to also manage it along the way. Loan credit stressing, instrument-level ALM analysis, loan price modeling, enhanced ALLL testing and improved liquidity quantification are all on the hit parade for 2007. Let's face it - bankers will be exceptionally busy next year. Getting back to the survey, executives also said they expect to struggle with growth, in particular as they try to hold the line on profitability. Increased competitive pressures are wreaking havoc on older business models and bankers are being forced to adapt quickly. In the first 6 months of this year, large banks have reported double-digit growth in small business lending as they have all launched aggressive customer acquisition programs. All told, more than \$50B of this growth has reportedly come from refinancing of small business loans from independent banks. Consider that the longer the yield curve remains flat to inverted, the greater the pressure from larger national banks. Given higher levels of non interest income than independent banks, large banks have become more willing to lower their required margin for loans. Executives also ranked acquiring new customers as a critical issue to fuel growth. Additionally, since it costs as much as 7x more to acquire a new customer than retain an existing one, well thought out retention strategies are vital to a bank's success. Knowing which clients are in the top quartile is the first step, so look for bankers to accelerate programs and energies to get relationship profitability modeling up and rolling. Also making the list of key issues for 2007, executives said they planned on leveraging IT to reduce costs and enhance value; creating a sales culture focused on the customer; increasing customer loyalty; upgrading workplace performance; improving shareholder value; and enhancing programs to attract and retain employees. Next year will be a transition year for bankers, as education and competition continue to ramp up, business models are tested and profitability is tested. With long-term yields expected to stay at or near current levels, and the forward curve now projecting 100bp of interest rate cuts, it appears the banking world will get a whole lot smaller next year.

# BANK NEWS

## **FDIC Premiums**

BofA, JP Morgan and Wachovia urged the FDIC to reduce its minimum proposed assessment from 2bp to 1bp, claiming it does not match the risk inherent at their banks. Independent banks should start including this new premium pricing structure in projections, as by our analysis, many of our client banks will see premiums increase up to 4bp. The new FDIC pricing system not only ties the premium into supervisory findings and performance ratios, but would discount jumbo time deposits in the funding structure. Once this guidance is solidified (estimated to be in Nov.), BIG's Liability Coach and ALM customers will be getting additional recommendations on how to better optimize deposit premiums.

## **New Retail Strategy**

US Bank unveiled its new "Power Bank" strategy that involves increased marketing, longer branch hours and more staffing at branches. In addition, the program offers in-store attractions, such as coin counting machines and concierge services. This strategy was tested in Portland and St. Louis last year and is reported to have increased both product sales and profitability. Oddly, Union Bank of CA employs a similar strategy with the same name in CA.

## **Heavy Competition**

Given the high number of independent banks that make construction loans, note that Home Depot now offers contractors, plumbers, electricians and other small business customers the option to have their business payroll, credit card processing and personnel paperwork done through the retail giant. The biggest kicker – Home Depot also allows these businesses to ride their coattails and sign up for health insurance. The program is called Home Depot Business ToolBox and 12k customers have reportedly signed up.

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