DEPOSIT SPLITTING VOLATILITY

by Steve Brown

Research shows many consumers are having difficulty paying their bills. In fact, 52% have made late bill payments in the past 12 months, 33% make only a minimum payment on their credit card and 17% are carrying at least one credit card in their wallet or purse that is maxed-out. Compound that with a low savings rate and slipping home prices and one can see why bankers are worried about the economy and where the next dollar of funding is going to come from. Given the industry focus on funding, it is obvious why the concept of "deposit splitting" is intriguing. Driven by a strong stock market and heavy competition for funding, many large banks have turned to the brokered deposit market and incorporated splitting into their liability management process. Deposit splitting refers to the process that occurs when banks or broker-dealers break up customer funds into pieces of $100k or less and allocate it across multiple accounts (sometimes with multiple banks). In this manner, large balance depositors still receive FDIC insurance on their aggregate amount and the primary bank is able to accommodate the customer. There are no stated regulatory limitations on this type of activity. As one can see from the graph, the big banks are having a field day. The question remains whether this will have a long-term impact on the industry. For starters, this money source is larger in size and more transient. Over time, this increases volatility and interest rate sensitivity, particularly as more banks become involved. The silver lining for the banking industry is that deposit splitting also facilitates a process for investors to shift monies from money market mutual funds to insured deposits at a low cost and with relative ease. This could boost overall bank funding; as sector rotation shifts money back to the banking system (those trillions of dollars that switched to mutual funds belonged to banks anyway). One possible counterpoint to this idyllic scenario is that while a flood of dollars may flow back into banks, mutual funds will certainly react. Funds may make less money overall, but they will not go out of business and will fight to keep the money. In addition, splitting shifts around a lot of money and teaches customers to ask for higher rates. Over the long-term, core funding could dry up, narrowing margins further and potentially damaging equity value. In the short run, banks can take advantage of splitting and may want to do so. For starters, banks can talk to large depositors about breaking their money into 2 big piles. The 1st pile should be encouraged to be placed longer-term. This will help stabilize bank funding, as liability duration extends. The 2nd pile should be kept short to help meet the day to day needs of the client. While many other more complex permutations are possible, this structure keeps the customer happy (because the bank is working to help the small business improve) and the bank is happy because these customers are some of the most willing to refer others. The simple fact is that high-rate internet deposit accounts, heavy competition and downward pressure on fees will eventually force independent bankers to adopt a splitting strategy. Given increased interest sensitivity and a fundamental shift in funding structures, bankers should begin incorporating this into their analysis and strategies.

BANK NEWS

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Great Western Bancorporation ($3.2B, NE) will purchase Sunstate Bank ($201mm, AZ) for an unnamed sum.

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Fiserv will purchase NetEconomy for an undisclosed sum. NetEconomy is a European company that provides financial software for AML, fraud prevention and compliance management for financial institutions overseas.

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Goldleaf Financial Solutions will acquire Community Banking Systems (TX) for an undisclosed sum. CBS deals in Check 21 solutions.

Competition

LendingTree said it has formed an alliance with Bankrate.com that will allow customers visiting its web site to access high-yield savings rates.

Madness

Experts say 80% of employees participate in March Madness pools, costing companies an estimated $1.2B in lost productivity. Some companies have taken a different tack, allowing employees to watch portions of the tournament and using it as a job retention/satisfaction tool.