TURBULENT TIMES IN BANKING

by Steve Brown

A flowing river we understand. Throw a rock in it, and things begin to get chaotic. A smooth moving medium, be it water, air, fuel or blood, is predictable. Change certain conditions such as the surrounding space, speed or viscosity and actions get more complex. In fact, despite all of mankind's science and knowledge, we have yet to successfully model a turbulent system. Banking used to be predictable. A flat yield curve and greater competition, to name but a few catalysts, have made it more complex. Last week, two significant things happened. The first one was a strong employment report. This changed market perception and all but removed predictions of an FOMC rate cut. So much so, in fact, that Fed Funds are now projected to remain unchanged until September 2010. The 2nd significant thing that occurred was the release of 1Q performance numbers. Back in April in this column, and in many of our presentations around the country, we have been projecting 1Q performance based on our 100+ sample bank universe that we track in real time. The bad news is that we were accurate to within a 10% variance of the actual numbers. While regulators and other firm's discuss the industry, we track data for independent banks under $10B in assets, excluding institutions less than 3Ys old. For this target group, the 1Q data confirms strong turbulence in banking performance. Assets grew at about half the pace of the 1Q of last year, coming in at 6.4% versus almost 12%. ROE came in at 11.57%, sinking to its lowest level in 15Ys. ROA also hit a near-term nadir, finishing the 1Q at 1.20%. Finally, the number of unprofitable institutions reached 3.48% and about 50% of banks failed to increase earnings from the 4Q. While competitive loan pressure negatively impacted yields and performance, the biggest reason for the earnings drop was due to a 30+bp increase in cost of funds (to an average of 3.46%). This nasty combination pulled NIM down to a 16Y record low of 4.02% for this asset category. On average, more than 80% of financial institutions reported lower NIMs compared to the previous quarter. Expenses also climbed by more than 1.5%, as the efficiency ratio climbed and non-interest earnings fell. As banks faced up to slower growth prospects, more added to their investment portfolios (up 10%) than at any time in the last 5Ys. The good news in all of this is that asset quality was relatively unchanged. Reported fraud picked up slightly and an increase in delinquencies occurred on both residential construction and SFR mortgages. Other than that, the rest of bank loan sectors remained constant or improved. Net charge offs held steady at 0.17%, with larger banks showing a slight increase, while banks below $1B improved a touch. Loan delinquencies increased 6bp to 0.80%, the 3rd quarterly consecutive increase. Loan loss allowances rose 3bp to 1.26%, while core capital remained steady at 9.81%. For all institutions, 41 new banks started operations and 72 disappeared due to mergers. Of note, the longest period of time without a bank failure was broken when Metropolitan Bank (PA) was closed back in Feb., a first since June of 2004. The number of "problem" banks increased during 1Q from 50 to 53. As the data indicates, the banking market is indeed becoming more turbulent. While the chaos will not be modeled any time soon, bankers can deal with these changes. By controlling growth, spending more resources on funding and tightening credit monitoring/underwriting, banks can at least put the odds back in their favor and smooth out some bumpy spots.

BANK NEWS

M&A

Chittenden Corporation ($6.7B, VT) will acquire Community Bank & Trust Co. ($426mm, NH) for $124.1mm, or about 2.8x book.

M&A

Lone Star Fund V L.P. will acquire Accredited Home lenders Holding Co. (CA) for $400mm. Accredited has had troubles due to the subprime crisis.

Mobile Banking

Wells Fargo seems to be the first bank that has announced a mobile banking product targeted at business customers. Its new "CEO Mobile" will let customers access their accounts, wire funds, handle account administration, view exception items and set alerts by the end of this year.

Retirement Benefits

According to a WSJ/Harris poll, 69% of workers receive some type of retirement savings plan from their employer. 49% of those are in the form of a 401(k) of which, 36% have employers that match contributions. 29% of workers have a pension plan. Respondents said the most important benefits, next to health care are (in order): a comprehensive retirement plan, vacation time, diversity of 401(k) options and flex scheduling.

Customers

Bankers targeting new customers may want to go out and buy an issue of Forbes. In it, the magazine breaks down the best and worst paying jobs in the country. In order, the highest paying jobs are anesthesiologists, surgeons, obstetricians/gynecologists, orthodontists, oral surgeons, internists, prosthodontists, psychiatrists, general practitioners and chief executive officers.