CASTING FOR DEPOSITS

by Steve Brown

If you are planning to go fly fishing, you could pick a random river and start casting away or you could get scientific about it. You could learn from the locals, study the river, understand the light, watch the water flow, choose the right season and target a particular type of fish. The first method is faster and easier to see some activity, but you would be lucky to get even a nibble. The second method is almost as hard, because, let's face it - fly fishing is one of the most maddening sports known to man. The only reason why we caught a fish was that those little buggers were laughing so hard at trying to get the fly out of our hair, they floated to the top.

We digress. Our point to the story is that fish, like depositors, don't just jump in your net. You either have to attract them with the 5% promotional lure or use your skill and cunning to grab them at a lower cost. Put another way, if you are randomly trolling for deposits, we can tell you that you are most likely overpaying for funding by a minimum of 50bp to over 16% (if you are not paying attention and cannibalizing half your deposit base). If you are fishing for more deposits, here are a couple ideas:

First, call every loan client and agree to lower their loan rate if they have their primary depository relationship with you. It is amazing how many banks don't get around to doing this, as loan customers are already predisposed to do business with you. Yes, you hurt your loan yield, but, if cast properly, banks end up making it up on lower cost of funds and less interest rate sensitivity.

Next, fish in the right river. Just as you won't use a Prince Nymph fly (trust us, we are not fish people) for salmon, you wouldn't make construction loans if you wanted to build deposits. This is because construction loans are the least efficient for producing funding. For the every $1 of loans made, a bank gathers just 9 cents in deposits. On the other hand, consumers return 94 cents in deposits for every $1 of loans. C&I loans, by comparison, return an average of 55 cents for every $1 of loans. If you are focused on construction loans, and you have a problem with deposits, it is no wonder.

By the same token, the type of customer is important. While consumers are efficient at producing deposits, they are also slow, as they provide the smallest average deposit balances. The big fish, are municipalities (producing 22x more deposits than consumers), as they produce the largest average balances. However, before you go out and hook a bunch of public agencies, know that municipalities are highly competitive and are one of the more expensive sources of funds.

The fish you really want are law firms, doctors groups and accountants in that order. Here, if caught, these customer types provide the largest balances (at around $75k each), for the lowest acquisition costs, the cheapest cost of funds and the least interest rate sensitivity.

Like fishing, hooking desired deposits is never easy. Hopefully you will have more success than we had at our last fishing outing this weekend. Our lines got so tangled up that it took 3 beers, a blowtorch and a machete to straighten things out.

BANK NEWS

S&P

The rating agency identified 700 borrowers at risk of ratings downgrade, with the greatest risk to companies in media and entertainment. Financial sector companies made up 27% of new additions to list of potential downgrades.

Ambar

The monoline decided against splitting its structuring business from its muni bond business, as it completes its $3bn recapitalization.

Mortgages

The New Hope Alliance released a study that shows 1mm mortgage workouts have taken place since July (758k rec'd new amortizations and 278k rec'd new terms).

Dower

A Grant Thornton LLP study released yesterday shows that 56% of bank executives are pessimistic about the economy, and 54% are pessimistic about the business of banking. Another interesting finding is that 64% don't expect their local real estate market to hit bottom for 6 months.

Basel II

The OCC said that US banks aren't ready to adopt the new capital framework at its starting implementation date of April 1. The OCC knows this as banks must file notice 60 days before switching (but they have until Oct. 1 to adopt Basel II) and no bank has done so yet.

Wachovia

The bank announced that, through its card division, it would release its new pilot program on Facebook in an attempt to reach the under-30 market. Banks have yet to figure out how to capitalize off social networking sites. By our records, Wachovia becomes the 4th to try.