DEPOSIT TRICK #114

by Steve Brown

Here is a nifty little tactic that we learned from an astute banker in New Mexico. Let's say you are in a deposit market with banks that are paying a high rate for deposits. You issue brokered CDs (from us) and then you contact those high-paying banks and make a big deal about purchasing their CDs. Once you get on the phone, you say things like: "4.00%, is that a typo?," or "How can you afford to pay that?," or our favorite, "Heck yes, we will take it, our board members are so conservative, that they will never let us have any fun and give away value like that."

Whatever you say, the object is to make a big show of it, so it gets back to that bank's management. If the bank accepts your money, you borrow at 3.00% in the brokered market and then invest in the promotional bank at 4.00%, getting an arbitrage and interest rate free 100bp. Better yet, you increase the interest rate sensitivity of your competition by that 100bp - sapping valuable earnings from them.

On the other hand, maybe the promotional bank gets cold feet and decides to reconsider selling you a CD. In this case, they may get the message and drop their rates. If so, your mission is accomplished and you can congratulate yourself for being a leader in your marketplace. Do it a couple of more times to other banks in your area and pretty soon you have single-handedly brought your whole market in-line. Soon, your investment willingness will act as a signal to the market and deposit rates will trend lower for the benefit of all. Since there are no formal arrangements and no one has a dominate market share, no antitrust or price collusion rules are violated. If used effectively, a bank can bring down rates in the area by 30bp to 60bp.

One of the largest detractors from profitability is high rates on in-market CDs. As the Fed keeps dropping rates, banks that keep rates high hurt themselves more at a critical time. The lower rates go, the more sensitive bank earnings are to small changes in rates because of margin compression. That is, the same rate changes make up a larger percentage of profit. This is why it is critical to maintain margins as much as possible in today's low and falling rate environment.

A recent focus group we conducted drove home the point that customers are more sensitive to loan rates and fees than to deposit rates. As such, most of the pressure on deposits either comes from a combination of going after the wrong customer type and convincing ourselves that customers are more rate sensitive than they are.

Gas stations have been signaling their pricing for years on the corner with profitable results. By helping teach other banks in your area, the sanctity of deposit discipline, the industry will be made better off.

BANK NEWS

M&A

Commercial Bank ($443mm, TN) will purchase Union National Bank & Trust ($203mm, KY) for an undisclosed amount.

CRE Concentrations

The FDIC issued a letter re-stating the principals articulated in the 12/6/06 interagency statement entitled "concentrations in Commercial Real Estate Lending, Sound Risk Management Practices." Institutions should implement processes to: maintain strong capital levels, ensure loan loss allowances are appropriate, manage C&D and CRE loan portfolios closely, maintain updated financial and analytical information, and bolster the loan workout infrastructure. For more information attend an online seminar that we will hold next week on the topic by clicking on the 'CRE online seminar' link, provided in this articles related links section, and then go to the Event Center.

Wamu

The bank won a $383mm judgment against the U.S. Gov't over promises made during the S&L crisis of the 1980's. The breach-of-contract suite stemmed from WaMu's purchase of Anchor Savings Bank in 1995 and promises made by federal regulators at that time.

Consumer Stress

In a new report, Fitch said it expects credit card lenders could write off 7% of portfolios in 2008, compared to only 5.2% in 2007. Meanwhile, auto lenders originating loans to people with strong credit are expected to write off 2% of their portfolios this year, a 50% jump from 2007.