# HOW NOT TO BE #1

by Steve Brown

Sometimes branch personnel can get carried away. In a well intentioned effort to please customers, staff presses management to pay some of the highest deposit rates in the market. The bank creates an unofficial mandate to always be the 2nd highest rate in the marketplace for deposits. Branch personnel then strut around like peacocks in April sporting a "We pay the highest rates" button on their shirt feeling proud. Of course, the arc of their professional existence is changed when they find out that they have pleased their customers at the expense of their shareholders (and possibly their own bonus pool). They have made their bank more interest rate sensitive and raising their cost of funds.

Pegging deposit rates to the competition is detrimental to a bank in a variety of ways. First, the tactic is borderline co-dependent, as there is always one whacked-out bank or credit union in the market that wants to offer some stratospheric set of rates. As we have said, pricing to irrational competition makes a bank just as irrational and does not serve as validation. If 5 banks pay irrational prices compared to other channels (such as wholesale funds or shorter-term rates), then all 5 banks may indeed be overpaying.

Second, maintaining a certain position in the deposit market results in a consistent destruction of value. While other banks can come and go with their rates, a bank that always tries to maintain a certain position ends up competing against the worst of all banks. The best strategy is not to compete on rate at all, as doing so creates a more interest rate sensitive bank.

However, if a bank must compete on rate, then chose one point on the short-end of the curve, instead of a series of maturities. This better controls flow, lessens the economic impact and gives branches something to talk about. Additionally, sticking with a 1-rate promotion allows management to better focus their efforts in converting those customers to less interest rate sensitive deposit products. Having a single short maturity promotion keeps costs down and limits sensitivity.

Another recommendation is to continue to change the maturities you want to be competitive in. Maybe one quarter it's a higher rate in the 3-month area, while the next it is the 6-month. The trick is to move rates around so the competition and customers are kept guessing.

Consistency is good, except when it comes to deposits. Rate sensitive customers like consistency and often tell their rate sensitive friends about good deposit deals. Further, banks that consistently time when they move rates create rate sensitive customers that care enough to put off their investment choices if they know a bank always pays the highest rates at a specific time of the month. Moving rates and high-paying maturities around causes more of a marketing splash, generates brand interest and keeps rate-hungry depositors from taking advantage of you.

If you need help in setting rates, volume, duration or designing deposit programs that limit cannibalization, be sure to take advantage of our Liability Coach program that offers access to a consultant dedicated to watching your marketplace and helping your bank design the most efficient funding strategy.

# BANK NEWS

**Ted Spread**

The gap between 3-month Libor and 3-month Treasuries is back out to 1.69% indicating a potential credit /liquidity problem. Every time it has gone above 1.70% in the last couple of months, we have seen a major drop in equities.

**Economy**

The FRB's most recent Beige Book analysis shows the economy has deteriorated further. The report found consumers cut back spending, due to weaker employment and a credit pinch, while businesses have been negatively impacted by higher prices for energy and raw materials.

**OCC**

Comptroller John Dugan stressed that banks need to get more aggressive in recognizing their problem loans, stress-testing portfolios and engaging borrowers in aggressive workout strategies. Dugan suggested banks should reward officers that bring problems to light early.

**Earnings - PNC**

The bank reported 1Q earnings fell 18%, as it set aside a $151mm reserve to cover credit losses. Meanwhile, net charge-offs nearly tripled, soaring to $98mm (up from $36mm during the same period last year).

**Earnings - KeyCorp**

The bank reported 1Q earnings fell 38%, as the provision for loan losses jumped 400% to $187mm and it took $101mm in losses on loan sales and writedowns.

**Earnings - Merrill Lynch**

The investment bank reported a 1Q loss of $1.96B, driven by $6.5B of writedowns and a 40% drop in investment-banking fees. The investment bank took writedowns on asset-backed securities and hedges with financial guarantors. As a result, Merrill said it plans to cut 4,000 jobs or about 10% of its workforce.

**Earnings - Umpqua**

The bank reported 1Q net income of $24.7mm, a 17% increase over the same period last year. Other factors included a drop in non-performing assets to 1.06% of total assets (down from 1.18% at year-end), a drop in non-performing loans to 1.24% of loans (down from 1.50% at year-end) and $12.6mm from VISA's IPO.