CONCERN FOR BROKERED CD LIQUIDITY

by Steve Brown

In banking, one growing problem we see is liquidity. Over the last several weeks, a handful of major brokerage firms announced new credit requirements that effectively limit the number of banks that will have access to the brokered CD market. The bottom line is that fewer banks will be able to issue through this channel, so at a minimum, CD rates will be going up for both brokered and non-brokered CDs.

Even worse, some banks will find this option no longer available at any price due to their weakened condition.

Traditionally, as long as a bank was well-capitalized; they had access to the brokered CD market. Over time, the distribution side of the market defaulted to using the ratings of IDC Financial Publishing for simplicity and consistency. These ratings, which are based on a scale of 1 to 300, weight bank performance for size, return, capital and liquidity.

Over time, these quarterly IDC ratings have become the defacto standard in the market. Traditionally, a score of above 100 is needed to issue brokered CDs. To put this in perspective, banks with a 200 to 300 score are rated "Superior" (includes about 3,165 institutions); banks with scores of 165 to 199 are "Excellent" (1,501 institutions); 125 to 164 are "Average" (1,506 institutions); 75 to 124 are "Below Average" (969 institutions); and 0 to 74 are just simply the "Lowest" (25 institutions). The average national score is 203 as of the 4Q, down a near record 19bp from the prior period (although 1Q is expected to be an even larger percentage drop).

That brings us to activity over the last 4 months. Banks with scores of 100 or even greater have been running into problems. Volatility has many CD sellers running scared and the question of whether these ratings are enough has been climbing (Hume Bank, as an example, had a 103 rating when it failed). This is not to say the ratings are flawed (as all calculations underestimate credit risk), only that we are in an unprecedented time where bank credit quality is deteriorating rapidly. As a result, many broker-dealers are now refusing to show their customers certain banks with lower scores for fear of reputational and liquidity risk (impacting about 10% of the bank market). One major regional brokerage house has reportedly stopped using IDC entirely, choosing to institute its own internal credit review process. This has served to essentially raise the required IDC proxy score for issuing banks to somewhere north of 150 for this broker.

Because of how the ratings are constructed (with an emphasis on size), small banks are being excluded from the market in alarming numbers. Equally disturbing are several regional banks with a mortgage emphasis, which have also been excommunicated from the brokered CD marketplace. These banks now face strained liquidity, reduced flexibility and have increased the whole system level of risk. In addition, these institutions are left only to issue through their retail channels, driving the estimated cost of non-brokered CDs up 75bp to 125bp in some markets (well over 4.00% all-in rates). Even solid banks with IDC ratings that might have slipped to below 130 (due to higher loan loss allowances and faltering earnings) are now being charged a premium of between 5bp and 15bp to issue. This is serving to drive up the relative issuance cost for all banks.

We maintain a very active CD underwriting desk that specializes in putting your bank in the best possible light in the brokered CD marketplace. We also have tools such as our Liability Coach, Relationship Profitability, BIG Metrics, Asset-Liability Manager and Credit Stress Analyzer to help support management during this difficult time. Most importantly, we have a variety of other funding options available, such as Fed Funds, Portfolio Deposits, holding company loans and loan participation capabilities to help community banks bridge funding gaps and expand liquidity sources.

In this market, it pays to know and monitor your IDC rating and manage it as best you can. Whether or not your bank relies on brokered CDs for funding, it is recommended that you have a back-up liquidity plan in place to substitute issuance coming due in the next year.

If you believe tougher times are ahead, it may also behoove your bank to issue longer maturities, in order to secure a portion of funding now. While bank management has many initiatives to work on, funding should be one of the highest.

BANK NEWS

Online Banking

A survey of online financial users finds an 82% satisfaction level with banks, compared to 75% for credit card and investment companies. That is good news for banks, because studies also find highly satisfied online users are 31% more likely to buy multiple services and 54% more likely to refer their bank to others.

Low Customer Loyalty

A BAI study finds only 19% of customers consider themselves loyal to their primary bank and 56% say they consider the relationship at risk.

New Product

Wells Fargo is in process of rolling out its "vSafe" service. The new product will be the 1st online storage solution from a financial institution that lets customers store and organize important financial documents. Fees will be $4.95 per month for the first 1GB stored and will be waived if the customer uses certain account bundles.