KEEPING LIQUIDITY FLOWING

by Steve Brown

Studies show every home foreclosure within 1/8th of a mile radius will cause a 1% drop in price to the values of surrounding homes. We bring this up because it highlights one problem among many that has surfaced during the recent credit crisis.

As with home price erosion, we have also learned much about the value of liquidity. While we have touched on this value before, it surfaces again following a recent FRB analysis of the crisis. As part of its research, the FRB compared financial companies that did well during the crisis for the period ended 2007, with those companies that did not fare as well (i.e. Bear Stearns, etc.). The FRB did this in order to surface what actions top companies may have taken in order to ensure they had enough liquidity and that resulted in them having the least issues. As it turns out, these companies were more than just lucky.

In its analysis, the FRB found that companies that managed their liquidity and funding needs on a proactive basis performed well. Those that did best encouraged individual business lines to assess and communicate their funding needs to a central treasury team. The treasury group then funded each business unit based on actual market conditions and charged each one accordingly. By staying close and in continual contact during the crisis, these top performers were able to react faster to changing conditions and evolve their funding mix.

Also of interest, the FRB found companies that did not perform well did not have adequate plans to increase liquidity. The FRB analysis also found even companies with sophisticated risk management systems failed to properly assess contingent liability exposure, which further strained liquidity. As a result, these companies found themselves scrambling to raise liquidity in a very difficult environment.

Another key finding from the review was that the best funding managers had flexible tools that allowed them to quickly monitor and manage their liquidity position across business lines and to shift rapidly to changing market conditions. Strong technology, robust reporting and integrated systems were all critical components that helped this group outperform peers.

Companies that proactively solicited senior manager input, pooled their skills and tapped into their experience, generally performed well. In fact, some companies that performed well built up liquidity reserves in advance of the crisis because they were beginning to see deterioration and projected they might lose flexibility. These companies also typically incorporated liquidity stress testing to anticipate funding needs in advance of the crisis.

Finally, even though top performing companies were better prepared, they still could have done better with their contingency planning. Each one failed to fully anticipate the severity and length of market stresses and every one said they planned to improve their contingency plans based on what they had learned.

While the extent and severity of such a credit and liquidity crisis may not hit community banks as hard as a home in foreclosure, it does serve as a sobering reminder. Banks must be better prepared for market turmoil, while staying abreast of the valuation and behavior of new products and market sectors. No matter how well we all model or prepare, judgment remains a critical component.

Proactive communication among senior management teams is a significant success factor when responding to shifting market conditions that place unexpected stresses on the organization.

BANK NEWS

M&A

WBSB Bancorp ($438mm, WI) has agreed to purchase Continental Savings Bank ($200mm, WI) for an undisclosed sum. The merger will combine 28 branch locations in southeastern WI and operate under a new name to be determined at deal end.

Small Business

Within the first 5 months of this year, 400k businesses filed for bankruptcy, 23% higher than the same period in 2007. CA had the highest number at nearly 46k, double that of the 2nd highest state at 22.4k. Industries most affected have been construction, restaurants and trucking.

Unsatisfied

According to a CFI Group survey, in the past year, bank call centers saw the largest drop in customer satisfaction in comparison to 7 other industries. Customers are calling more frequently under complex circumstances, like the fear of home foreclosure, rather than simply to resolve technical issues. Bank customers are 4x more likely to switch institutions when problems are unresolved by the call. On the other hand, when problems are settled within the first call, customers are nearly 50% more likely to continue business with the bank. On another positive note, customers unable to resolve problems online fell to 30% from last year's 42%.

Self-Service Banking

A bank in RI will soon open a branch with ATMs and kiosks that will queue customers, provide wait times and dispense / accept cash and deposits. Another machine will count bulk cash and operate as a vault, eliminating the need for manual counting. Customers needing further services, such as cashing checks and loan applications, will be assigned a customer rep and given a wait time.