ADDITIONAL DEPOSIT INSURANCE

by Steve Brown

It is ironic that the Rescue Plan that failed to pass the House 2 short weeks ago found help in the Senate. In an effort to "protect the taxpayer," instead of putting more thought into the market mechanism for the reverse auction) or finding a way to recapitalize the banking sector) - it passed with $150B of added pork. While this is embarrassing, at least the passage of the Rescue Plan now ushers in a sigh of relief. Of course, one huge boon for community banks is the inclusion of insurance coverage (which was effective as of the close of Friday and goes until 12/31/09) from $100k to $250k. It also allows the FDIC to request the government cover an unlimited amount of losses. The question is, is that enough?

Unfortunately, the answer is no for our industry. The best example of the impact of deposit protection expansion occurred in Japan in the 1990's where a limit of Ã‚Â¥10 million (then about $95k) per account was moved up to an unlimited amount, where it lasted until early-2002. The good news from that experience is that unlimited coverage did prevent traditional runs on financial institutions. As several banks and securities houses failed, there were no lines out the door and no story for the evening news. However, few customers wanted to take a chance or have to deal with possible delays in getting their money out, so several "silent" runs took place (whereby households and businesses moved their money from one financial institution to another). This largely explains the huge growth Japan's Postal Savings bank experienced as a purely government-owned institution (and the country's largest bank). In addition to silent runs, the Japanese deposit guarantee also did not prevent more failures, as can be evidenced when Hokkaido Takushoku Bank and others were shuttered.

The next question is, what should banks do? The first step is to get the right signage and disclosures on your marketing collateral (http://www.fdic.gov/regulations/resources/signage/) related to FDIC insurance changes. Next, schedule another training session to teach ALL employees what the details of the additional coverage are, as confidence breeds confidence. One alternative is for banks to sit in on the 2-3 hour FDIC led calls scheduled throughout the next several weeks (http://www.fdic.gov/news/news/financial/2008/fil08085.html).

Thereafter, community banks should keep marketing on service and safety. That is, banks should resist the urge to specifically promote the added FDIC insurance coverage, as it implies your bank lacks safety without it. Just as depositors used to be rate sensitive, they are now safety sensitive. While marketing safety is important, marketing the excess coverage heavily may be risky because of the lessons learned in Japan. Should the bank have further problems or the excess coverage go away, banks could see run-off in their depositor base down the road. A better approach perhaps is to market the local aspect of your institution and the safety of the banking system in general (combined with superior service). This will keep shareholders, employees and customers on message to help retain long-term franchise value.

As we have seen in other countries, including Japan, it is doubtful the Rescue Plan will be a quick panacea. Banks must be prepared to wage a protracted campaign on many fronts and should have a strategic planning day just devoted to how message/tactics roll out around this new FDIC change.

BANK NEWS

Wachovia

After Citigroup's legal challenge to Wells Fargo's takeover of Wachovia, as of last night, Citi and Wells may end up splitting Wachovia. At present, Wells is rumored to be interested in the CA and Southeast branch network (as well as the asset management and brokerage units) while Citi might get the northeast.

Muni Pressure

MA became the 2nd state (behind CA) to ask the Treasury for a short-term loan to ease financial pressures

European Pressure

The German gov't moved to shore confidence by guaranteeing retail deposits. The action follows identical moves last week by Ireland and Greece. In similar fashion, Sweden, Denmark and Britain have all increased the amount of deposits guaranteed by their governments. Finally, banking giant BNP Paribas said it would buy 75% of Fortis (leaving 25% still held by the Belgian government).

Jobs Pressure

Planned layoffs at U.S. companies jumped 33% in September compared to the same period last year, according to a new survey by HR firm Challenger.

Might Work

In an effort to jumpstart home sales nationwide, real estate broker Coldwell Banker has convinced 25k people with homes it is listing to cut sale prices by as much as 10% during its first national 10-day sales event starting this Friday.

More Treasuries

To keep up with supply, the Treasury announced that it will reintroduce the 3Y Treasury Note and an extended maturity cash management bill.