

GETTING A GOLD STAR

by [Steve Brown](#)

A recent Harvard University study asked people what they wanted from their leaders, so we ask you. Is it (a) honesty, (b) vision or (c) intelligence? If you answered (a) honesty, give yourself a gold star, because that is the correct answer. Now that we all know the importance of honesty, we provide an honest assessment of the banking industry and conditions in general.

Deposits - A 2008 Federal Reserve study of community banks finds 80% say their cost of funds increased. Meanwhile, about 35% indicate commercial customers have reduced DDA balances, which is being driven more by a need to meet payroll and other priorities than moving money to another bank for rate. In addition, 20% of banks say they have seen customers reduce DDA balances and increase CD balances, as they have moved to increase yield. As funding has shifted, bankers have taken action in response. According to the study, about 45% of banks said they had increased their use of FHLB deposits, while about 20% had shortened maturities of CDs and about the same percentage had obtained more brokered deposits. As customers have reduced funding, banks have turned to the wholesale markets and more expensive CD funding to fill the gaps.

Branching - The same study above also highlighted some interesting trends when it comes to banks and branching. Not surprising, about 60% of community banks that open a new branch do so in an adjacent county. This, despite the fact that 90% of bankers said they felt increased competition for loans and deposits from outside their geographic area (either through the internet or other methods) than they had in the past 10Ys. Filling in a map is optically pleasing, but competitors are everywhere, so bankers need to think in 3 dimensions now. Rounding out the rest of the branch opening activity, about 35% of community banks opened in the same state (but another county), while 30% did so in the same county (but not adjacent to existing branches). Only 10% opened branches in a different state.

Boards - Community bankers are also keenly focused on corporate governance activities. In fact, the study found the average community bank has 7 board members and meets 12x per year. In addition, 75% have a code of conduct for directors and 60% provide ongoing training. Only 5% of community banks have a mandatory retirement age for directors and about 30% do a director performance assessment.

Products - Community bankers continue to improve product and service offerings. In fact, the study found the top 5 new services community banks plan to offer this year in order were remote deposit, stored value cards, cash management services, identity theft protection and online loan application capability. Those are certainly great services to offer customers and studies show doing so can be very effective in maintaining retention of existing customers, while capturing new ones.

Competition - As the industry has come under stress, community bankers have worried about where their competition will surface next. When it comes to lending, in order, bankers said their toughest competition comes from other community banks, conduits, credit unions & larger banks.

Customers - Banks feel they have a pretty good handle on customer interests, yet many struggle to match customer expectations. In short, the top 3 things small business customers want from their

bank are consistent service, tailored advice and geographic convenience. Offering high quality service and advice help ensure a bank will get high customer marks, yet only 20% of customers say their bank consistently does so.

There are lots of things bankers can do in order to get extra credit and a gold star for the day, but these are some of the most important to consider - honestly.

BANK NEWS

Citibank

The Treasury will convert as much as \$25B of preferred shares into common stock provided that private equity does the same (which several large sovereign funds have OK'd). Citi is not getting any new cash (yet), just a higher quality of capital. In addition, Citi announced that it will suspend dividends on both its preferred and common shares.

Chase Cuts

In expectation of future loan portfolio losses, JP Morgan Chase intends to cut 14k jobs (3.8k jobs more than previously announced in Dec).

FDIC Fees

To rebuild federal reserves, the agency is considering raising deposit insurance premium rates by 14-16bps to more than 2x current fees.

TARP

An additional \$365.4mm was distributed to 23 banks, totaling \$196.4B. Of the 350 recipients that have received TARP to date, 17 have already submitted reports on how they are using funds to the Treasury. We are told some 1,600 banks are still waiting to hear on submitted applications.

Employee Pay

A new report by HR firm Mercer finds 25% of companies plan to freeze employee salaries in 2009 and another 20% are considering doing so.

Lodging

Hotels reported occupancy in general fell about 11% at the end of last year, while the luxury hotel sector saw occupancy slip 15%. Things did not get better in Jan. either, as luxury hotel occupancy fell 24% during the month, while other hotels fell 16% (compared to Jan. of 2007).

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