DEPOSIT PROBLEMS AND THE CUP OF CRAZY

by Steve Brown

Bank of America will need more capital. We know this not because we have any great insight into the quality of their loan portfolio, but because the bank is being foolish when it comes to marketing deposit rates. If a bank is shortsighted in this department, you can bet they are not paying attention to other parts as well.

Bank of America never used to be this way. Lately they have been sipping from the chalice of banking lunacy. In the past 3 weeks, they have taken quarter page ads in the WSJ and other major papers touting their money market rates at 2.30%. Granted it is not a 5% promotion, but its huge given BofA's deposit discipline in the past.

Worse, lately they have put their rates right at the front door. If there is one tell-tale trait that shows bank management has taken their eye off the ball, it is the advertisement of a rate on a front door. When a bank does this, it always spells performance trouble.

It is one thing to advertise rates in the paper or online, it is a whole other thing to start posting that rate on windows and doors around the branch. When banks do this, they send a loud and clear message to the customer that they should care about rate. Mrs. Smith, who just cares about having access to her money, now starts to think about what rate she should be getting every time she walks in. Maybe she moves money out of her checking account and into a CD or maybe she takes her deposits across the street to Citibank that now has a 2.50% on the door (which it does in many markets), but in the end, the overt rate advertisement will end up hurting a bank's cost of funds. As Mrs. Smith was shopping for a better rate around town, she probably walked right past a Wells Fargo branch because they don't advertise rates (yes, for those wondering there is a correlation to stock price and deposit pricing, but we will save this for another day).

Worse than training Mrs. Smith, that rate on the door also trains employees. Management puts the sign up, so rate must be important they think. In addition, given all the things bank employees have to remember these days, what is the one thing that is going to be the easiest to remember - that is right, the simple rate on the front door - they get reminded every day they come to work. "Why Mrs. Smith, it is nice to see you, did you take a gander at our rate?" Take the sign down and employees will still be talking about rate. Marketing on rate is the gift that keeps on giving.

Here is a central tenet in banking - don't ever, ever, ever put a rate on the front door. That 2.30% rate may seem benign enough, but the training and cannibalization effects are enormous. If you do have a rate on the front door, please take more capital because chances are you are going to need it. This may seem harsh, but it needs to be said. We get asked all the time, what are the traits of high performing banks? The reality is that there are literally millions of ways to be a high performing bank. However, there are only a dozen traits of under performing banks. When it comes to the destruction of franchise value, posting a rate on the door ranks in the number 4 spot behind sloppy underwriting, loan concentrations and high rate CD promotions.

No one should need deposits that bad. If you do, that means you are either growing too fast or don't have the discipline to build franchise value. If this market doesn't convince you that statement is true, nothing will.

If you want to advertise something on your front door (and it is one of the most effective spaces banks own), now is the time to tout your bank's safety, service, your flexibility or your ability to understand the market. Please post this on your door. Send a message to your customer and employees that safety and service, not rate, is what you stand for.

Hopefully, BofA will stop drinking from the cup of crazy in time.

BANK NEWS

FHLB, Seattle

The agency reported a 4Q loss of $241mm largely due to write-downs of MBS, not backed by the Gov't. As a result, the bank becomes the first FHLB to eat through its reserve cushion and fall short of its risk-based capital requirement.

Housing Silver Lining

While the bottom of the market may still be further away, it was nice to read Zillow has seen the average number of loan refinancing requests jump 142% compared to Nov. of last year. Refinancing requests and lower home prices also helped push activity on the site up 60% YOY. We like to think this may indicate the start of a nascent recovery.

FHLB, Atlanta

In an effort to raise capital, the Atlanta Home Loan will increase its cap on stock member banks are required to hold and will move from daily to quarterly stock repurchase.

Home Loans

Des Moines and Indianapolis were the only 2 Home Loans that showed an increase in earnings for 2008. Across the system, advances were up 5.7%.

USA Today

The paper said that it will drop its effort to publish the 50 banks with the highest Texas ratio.