FLIPPING THE SWITCH TO SAVE MONEY AND LIQUIDITY

by Steve Brown

When you were a child, your dad probably walked around the house at night, mumbling under his breath about money not growing on trees and turning off lights in vacant rooms. We found it interesting when we saw a recent fact indicating 50mm office computers are not properly shut down in this country at night. If dad were able to visit those offices and take action, the result would be a nationwide corporate power bill savings of $2.8B. Not bad and easy to do. If only managing bank liquidity were as easy as flipping a switch.

At banks, asset quality issues are the most likely indicators to future liquidity problems. This is because deteriorating asset quality leads to additional loan loss provisions, higher OREO, reduced interest income and higher overhead expenses (as legal, administrative and staffing costs increase). All of these factors in turn, result in lower earnings, less capital, more regulatory scrutiny and nearly always - lower liquidity.

Most bank executives we know are strong in the lending arena, so it is natural that the tendency is to zero in on asset quality. As teams work around the clock to solve asset quality issues, the liquidity piece of the puzzle is usually left up to the CFO to solve. The issue of liquidity is bigger than that, so it should not be left up to one person to solve.

There are many ways to monitor liquidity pressure, but some of the best include setting up robust reporting to monitor trends and usage at ATM machines, through electronic banking and wire transfer activity. Having a good handle on inflows and outflows is a critical piece of strong liquidity management. Community bankers should also monitor early withdrawal fee trends. The more customers are worried about something they have read in the press about the bank or industry, the more willing they are to incur early withdrawal fees to get to their money. Another key area to monitor is uninsured deposits separate from insured. Having a good handle on absolute dollars and outflows in this area can provide a basis for quick action to eliminate exposures and reduce the potential for runoff. Finally, closely monitoring business accounts is also critical. Businesses usually leave larger balances at community banks, but they cannot afford to lose insurance or have to deal with a failed bank resolution, so many will simply transfer accounts to another institution at the first sign of trouble. While increased FDIC insurance certainly has helped stem the tide here, bankers need to remain vigilant and continue to closely monitor money movement to ensure ongoing liquidity remains intact.

Armed with reports, facts and figures, management now has the tools to begin taking steps to deal with liquidity stresses. Daily cashflow analysis is key to success and one of the first moves should be executing on a plan to retain current depositors. These customers know your bank the best and are the most likely to leave their money alone - as long as they can be convinced it is safe. To do that, management teams should run continual training programs with branch staff to make sure depositor communication is clear and concise. Helping customers protect their money in a time of concern takes more than just good intentions and stresses are everywhere, so community bankers should not wait to ramp up efforts in this area. In addition, branch managers raise awareness immediately when irregular deposit trends occur so management can take action.

No matter how well you manage your bank, recent events have shown us all how liquidity pressure can show up at any time. Having a plan in place that includes closely monitoring trends, vigorous reporting, continual employee training and early warning signs can help protect the bank from unintended issues. Now, if we could just get everyone in the world to shut down their computer for just one night, we could save enough energy to light up a small city for 10Ys with those 1B machines.

BANK NEWS

OTS Change

The OTS unexpectedly replaced acting director Scott Polakoff with chief counsel John Bowman. While not announced, it is assumed that this is a result of the issues surrounding the alleged backdating of capital at thrifts.

No Match

In what is likely to be a cost saving trend for banks, JP Morgan Chase will discontinue its matching contribution to employee's 401(k)'s by July 1.

IT Budgets

Analysis from Celent finds 75% of IT budgets at banks go to maintenance costs, compared to 86% 3Ys ago. Meanwhile, average IT spending as a percent of revenue for banks is about 7%.

Small Biz Lending

A study finds the top 3 ways small business owners' finance their companies is through credit cards (44%), earnings (43%) and bank loans (29%). Interestingly, banks seeking new customers might like to know that 50% of companies with 20 to 99 employees have a bank loan, compared to 39% with 5 to 19 employees and 34% with 100 to 499 employees.