THE LIABILITY COUNTERATTACK

by Steve Brown

One of the more popular opening moves in the game of chess is called the "French Defense," or the "French" for short. Made popular in an 1834 game where the French defeated the English, the defense is a must-know. When the white player attempts to establish a position in the center of the board, the black side counters with an aggressive stop and then a dismantling, with a chain of alternative players such as their knight or rook. For black, the objective is to let the other player know you mean business, while attempting to open up the center of the board.

When it comes to liability pricing, we often recommend the French for a defensive answer to a local high-priced deposit promotion. Instead of matching rate, the countering bank does some marketing Aikido and attacks with service.

Let us say the battle is over a money market account and the offending bank places a 3.45% rate in the marketplace. The countering bank then releases its thrust with the message - while rate is nice, it is inconsistent, and building a relationship is more important in the long run. We have seen this done effectively, particularly when the countering bank characterizes the rate promotion as "buying your business." The message from the countering bank must be an articulation and quantification of their service - such as enhanced cash management products, longer service hours, bundled solutions instead of a transactional account, etc. The important point here is that rate is stopped with service and not by countering with rate.

The defensive bank not only ends up slowing the advancing bank, but it has an excellent opportunity to differentiate itself on service. In addition, the counterattack serves to amplify the outcome, as the attacking bank ends up getting even more rate sensitive customers. This tactic works exceedingly well if you can also get the local press to cover "the battle of banks" that highlights the difference between rate and service. The countering bank CEO should try to work in the press quote - "We don't feel that paying a high rate to new customers, while ignoring businesses (or households) that have been with you the longest, is a basis for building long-term relationships." On top of everything else, the quote should help either speed cannibalization (increasing the cost of the offending bank) or drive more service oriented customers to your bank. Either way, it is a win.

To institute the French when it comes to the war over liabilities, banks must be ready and conversant in how to use marketing, sales and public relations for liability pricing. Having a press release and media advertisement ready to go is an excellent first step. Further, banks must be ready to articulate exactly what "superior customer service" means when it comes to deposit gathering, in order to polarize the high-rate bank.

Like chess, to win the deposit game, banks must view competition as a series of moves designed to reach an objective. In this market, building a stable and low cost set of liabilities is the fastest way to build franchise value and place your bank in a winning position.

BANK NEWS

Brutal Day

In an active Friday, 4 banks were closed by the FDIC, pushing YTD failures to 57. The failures were: (1) First Piedmont Bank ($115mm, GA) was acquired by First American Bank and Trust ($354mm, GA). First American entered into a loss-share agreement on $90mm of assets, acquired $111mm in assets outright and assumed all deposits for a 1.01% premium. (2) BankFirst ($275mm, SD) was acquired by Alerus Financial ($791mm, ND) and some loans were separately sold to Beal Bank ($4.2B, NV). Alerus assumed all deposits and $72mm in assets. In a separate agreement, Beal bought $177mm of loans. (3) Vineyard Bank ($1.9B, CA) was sold to California Bank & Trust ($10.8B, CA). California B&T, a subsidiary of Zions Bancorporation (%56.5B, UT), agreed to purchase about $1.8B in assets and all deposits, except about $134mm in brokered. (4) Temecula Valley Bank ($1.5B, CA) was sold to First-Citizens Bank and Trust Company ($14.4B, NC). First-Citizens will purchase $1.3B in assets and all deposits, except about $304mm in brokered.

M&A

First Business Bank ($105mm, CA) will acquire 1st Pacific Bank of California ($450mm, CA) for 33% of tangible book, or approx. $7mm. Under the terms of the agreement, each outstanding share of 1st Pacific Bancorp will receive $1.40 per share in cash and a percentage of the recoveries of certain charged-off loans and a lawsuit.

BofA

The Bank's 2Q profit dropped 5.5% to $3.22B after taking on $1B in restructuring charges and credit card chargeoffs of $2.06B. Non-performing assets jumped to 3.31%, up from 2.64% in 1Q and 1.13% a year prior.

Citi

The company posted a $3B profit with revenue rising 71% to $30B, largely resulting from the sale of Smith Barney. For the quarter, Citi increased loan loss reserves to $13B, nearly double the $7.1B set aside the same period last year.