# WHAT LADY LIBERTY CAN TEACH US ON BANKING

by Steve Brown

Lady Liberty turned 125Ys old this week and she looks darn good. More important than looks however, is her substance. The woman has taken the world's tired, poor, hungry, angry and tempest-tossed and has allowed them to breath free. In doing so, she has shaped America's identity as a nation of the second chance. She has stood for the notion that sometimes people screw up and just need a little freedom to make things right.

In similar fashion, banks have discovered the same thing. Instead of a Statue of Liberty, several banks have found success with a card or promise to make things right. The product attribute goes by different names at banks - "Stuff Happens," " The Opps Pass," "Skip-a-Fee" or "Waive It." Essentially, this allows the account holder a limited opportunity to get one of the following fees refunded: overdraft protection transfer, stop payment, NSF, return item fees or foreign ATM. Banks allow the refund of these fees either one time, 3x or once annually. Some banks record it on their system, while others just give out signed passes/cards that have to be brought into a branch for manager approval (think cross-sell opportunity). While largely a retail attribute, it is also used effectively for commercial customers.

While we don't have any firm evidence, the product should aid in customer loyalty, as it places an element of control into the account holder's hands. What we do have is evidence that by providing a special card, banks have taken a stronger stance in how they handle fee waivers. Banks that use such passes report a drop in fee waivers from 40% to 10%. Customers can decide when and how to use the waiver, which helps in the payment of future fees without complaint. For the average bank, this can result in a sizeable increase in fee income.

Legend has it that once you tour the inside of the Statue of Liberty you see her everywhere, as she follows you around looking out for you. Now we don't know if it is true or not, but if you can create the same marketing campaign for your bank - that would be a pretty nifty monument to service.

## STRESS TEST UPDATE

As an update on how the largest banks were doing at the end of 2Q on their Stress Test or what is formally known as the Supervisory Capital Assessment Program ("SCAP"), 2Q performance showed that the banks realized 64% of their total losses estimated by SCAP. Banks tracking the closest to the loss estimates are Citi, Cap One, JP Morgan, Bank of America and Key Bank. Banks that are doing the best - Regions, BB&T and PNC. Why the difference? As we said before, it is all about loan mix (the single most important thing you can do to help bank performance). Those with concentrations in credit cards, consumers and certain CRE sectors such as construction, industrial, retail and hospitality are performing the worst. We expect the commercial focused banks to continue to see elevated losses that should extend into early 2012. As an aside, while the market and the public are making much ado about positive bank earnings for the group of 19, deriving core earnings and performance has been difficult. In particular, the purchase accounting adjustments cover what is really happening. Wells Fargo is the perfect example with $4B of write-downs on the Wachovia portfolio. As such, it appears that some of the earnings hits have been front-loaded, making ongoing performance look better than it is.

## BANK NEWS

**Underwater**

According to Deutsche bank, by 2011 nearly half of all mortgages will be underwater. At the end of March, 26% of homeowners with mortgages owed more than the value of their property.

**Service**

A study finds mid sized firms prefer banks that are more assertive in pursing customers, loyal to employees (not firing left and right) and reinforce claims of safe banking with a high level of service.

**Internet Banking**

According to TowerGroup, the number of online banking users in the US is projected to grow 3.2% annually through 2012, with 40% of all transactions carried out through online banking.

**Loan Mods**

The FHFA reported declines in the number loan modifications to 10.4k in May, while foreclosure starts bumped up 5% to 90.6k. Loans 60 days or more past due climbed 7% to 1.3mm; the #1 reason cited by borrowers was lost income.

**Farmland**

The value of Ag farmland dropped 3.2% this year, the first decline in over 20Ys.

**New CRE**

According to a recent MBA survey, 2Q multifamily mortgage origination is up 50% from 1Q.

**More Securities Buying**

New analysis shows bank holdings of government securities climbed 15.6% from 1Y ago, nearly 2x higher than the average growth rate of about 8%, according to the Fed.