OD FEES ARE BLOWIN' IN THE WIND

by Steve Brown

We don't care what Michael Moore has to say about capitalism, we personally consider it a free market win that Mr. Anti-establishment himself, Bob Dylan, is shilling for a Citibank promotion. Next week, Citibank's 13mm reward account customers will be able to purchase Dylan's new Christmas album a week before the official release date. Dylan gets to sell more albums and create buzz, while Citibank gets to attract new customers and reward its existing ones for their deposit balances - it is a clear capitalistic win.

There is another capitalistic situation; however, that we are not sure is going to turn out in our collective favor - namely, overdraft protection (ODP). At present, there are at least 3 Bills being produced in Congress that seek to limit the amount charged by banks for providing ODP.

In true capitalistic fashion, several large banks quickly jumped on the anti-free-market move, by voluntarily cutting the fees on their overdraft programs. Bank of America, Wells Fargo, JPMorgan Chase, US Bank and BB&T all announced cuts starting either January 1st or July 1st of next year.

To date, these ODP scale-backs come in several forms. Most banks have agreed not to charge ODP fees on overdrafts that are less than $5 to $10 per transaction. In addition, 1 of the banks mentioned will require a stronger opt-in notification at time of account sign up, while another will require the dreaded notification at each ODP use (for debit and ATM transactions only). In addition, most seek to limit the amount of fees that can be collected by placing a 3 or 4 ODP maximum per day. Further, 2 of the banks will reorder transactions, so that the smaller transactions clear first. This leaves only the larger transactions to hit the non-sufficient funds status. This reordering will limit ODP customers from being charged fees when a series of smaller transactions bounce.

While getting out ahead of the anti-ODP fee trend, these banks will hopefully take some of the steam out of Congress. If all banks followed suit, we would expect a limited loss of fees for the industry of less than $250mm and an impact on less than 6% of retail and business customers.

Our prediction is that a hard rain is still a-gonna fall and Congress will successfully pass legislation that will place a much greater limit on overdraft fees. News stories abound touting how a destitute account holder was charged $245 by a mean bank that charged an account with no money in it. Never mind the credit risk banks have to shoulder by extending these customers an undocumented loan or the convenience of not having these customers report bounced checks or non-sufficient funds.

For budgeting purposes for the next 3Ys, we are advising banks that they should drop ODP fee revenue by 15% on average. That drop equates to about $300k for the average community bank and about $4.5B for the industry.

Lower non-interest revenues are not what the industry needs, however as Dylan sings, "the times, they are a-changin'."

BANK NEWS

FDIC

The Agency voted to require banks to prepay estimated quarterly risk-based deposit premiums for 4Q 2009, 2010, 2011 and 2012 (the first such move in history). The assessment rate would be based on 3Q and assume a 5% annual growth rate in deposits each year. In addition, the FDIC adopted a uniform 3bp increase in assessment rates effective 1/1/2011. Banks book the prepayment as a prepaid expense asset (carries a 0% risk weight) and draw it down as each quarterly payment comes due. The FDIC took the action amid expectations the cost of bank failures in the next 4Ys will be $100B. We wonder how long it will take for banks growing faster than a 5% rate to try to buy these assets at a discount from banks growing at pace slower than that.

Assessment Impact

The banking industry paid $5.6B for the FDIC special assessment in 2Q, which when combined with loan losses and higher ALLL requirements, pushed 25% of institutions into a loss position.

CC Regulation

The FRB has proposed rules amending Reg Z and moved up compliance (from Feb and Aug 2010 to Dec 1, 2009). The shift will impact the 74% of community banks nationwide that have credit card programs. Among other things, the rule prohibits rate increases during the first year; blocks banks from issuing cards to consumers under 21Ys old without a parent signature and requires banks to get consent before charging fees for transactions over the credit limit.

Branch M&A

Florida Shores Bank SE ($67mm, FL) has entered a deal to purchase 2 branches from Florida Capital Bank ($991mm, FL) for an undisclosed sum.

Customer Capture

JD Power reports nearly 60% of small business customers said they have not had any contact from their primary bank in the past year, while 30% reported a teller was their primary contact (despite the fact that the majority preferred to speak with a decision-maker).

Credit Cards

Moody's reports credit card chargeoffs soared 9% to a new record level of 111.49% in Aug.