# HOW NOT TO BE # 1

by Steve Brown

Sometimes branch personnel can get carried away. In a well intentioned effort to please customers, staff presses management to pay some of the highest deposit rates in the market. In so doing, the bank creates an unofficial mandate to always be the 2nd highest rate payer in the marketplace. Branch personnel then strut around like peacocks, feeling confident that their customers love the bank.

Of course, the arc of their professional existence is changed when they find out that they have pleased their customers at the expense of their shareholders. They have made their bank more interest rate sensitive and raised their cost of funds. Pegging deposit rates to the competition is detrimental in a variety of ways.

First, the tactic is borderline co-dependent, as there is always one whacked-out bank or credit union in the market that wants to offer some stratospheric set of rates. Pricing to irrational competition makes a bank just as irrational.

Second, maintaining a certain position in the deposit market results in a consistent destruction of value. While other banks can come and go with their rates, a bank that always tries to maintain a certain position ends up competing against the worst of all banks. The best strategy is not to compete on rate at all, as doing so creates a more interest rate sensitive bank. However, if a bank must compete, then chose one point on the short-end of the curve instead of a series of maturities. This better controls flow, lessens the economic impact and still gives the branches something to talk about. Additionally, sticking with a 1-rate promotion allows management to better focus their efforts in converting customers to less interest rate sensitive deposit products. Having a single short maturity promotion keeps costs down and limits sensitivity.

The other recommendation is to continue to change maturities where you wish to compete. Perhaps one quarter it's a higher rate in the 3-month area, while the next it is the 6-month. The trick is to move rates around to keep the competition and customers guessing. Consistency is good, except for when it comes to deposits. Rate sensitive customers like consistency and often tell their rate sensitive friends about the good deposit deals at specific banks. Further, for banks that are consistent in their timing of when they move rates, rate sensitive customers care enough to put off their investment choices, if they know a bank always pay the highest rates at a specific time of the month. Moving rates and high-paying maturities around causes more of a marketing splash, generates brand interest and keeps rate-hungry depositors from taking advantage of you.

In this period of lower rates, now is the time to restructure liabilities in order to make the bank less interest rate sensitive. By doing the hard work now, profitability can be increased an average of 30% when interest rates shift higher. If you need help in setting rates, volume, duration or designing deposit programs that limit cannibalization, be sure to take advantage of our Liability Coach program. It offers full-time access to a consultant dedicated to watching your marketplace and helping your bank design the most efficient funding strategy. For more information, contact us today.

## 4Q EARLY LOOK

Yesterday we picked up Call Reports for the first 540 banks to file for Q4. While this does not necessarily indicate a trend overall, for this group of banks the 4Q generally showed an improvement as expenses and the cost of funds dropped. Looking at the most inclusive group of banks ($50mm-$10B) we can see that ROE increased by over 13% to end the year at 6.95%. For this group of banks, the 4Q was the second quarter of ROE growth for the year, and was a marked improvement over changes in the prior periods. We've published a sample BIG Metrics dashboard so you can take a look at the early data yourself. Just click on https://biganalytics.bancinvestment.com and look for the "Q4 Early Data" dashboard in the lower right-hand corner. In the coming days, we will have a representative sampling of banks to allow us to recap 4Q trends in full.

## BANK NEWS

**Earnings**

US Bancorp said 4Q profits rose 82% due to higher interest income, more fee generation and slowing ALLL. BofA also released 4Q earnings and posted its 3rd loss in the past 5 quarters. BofA net income was a loss of $5.2B caused by growing consumer defaults and charges related to the repayment of TARP.

**Construction**

The American Institute of Architects projects construction spending on hotels, office buildings and retail centers will fall 13% in 2010.

**Debit Cards**

Debit card charges as a proportion of all card purchases (credit and debit) have increased 11 percentage points to 59% from 2003 to 2008. The Nilson Report estimates debit card usage to tip over 67% by 2013.