OLYMPIC FREE CHECKING

by Steve Brown

In a culture overwhelmed by media-hyped athletic star power of the Kobes, Tigers and A-Rods, the honest Olympic comeback holds a place in our hearts. Yesterday was such a day for the US, as despite injuries, Seth Wescott went from 17th to 1st to win the gold in snowboard cross. While Bode Miller, America's most decorated alpine skier (and the guy who let everyone down in 2006), put in a run of a lifetime, he won only the 3rd ever downhill medal for the US.

In similar fashion, many media-hyped banking products, such as free checking, are now being displaced by banks that are trying to make a comeback in profitability. All the rage in 2006, more than 70% of large banks offered free checking. Last month, Citibank quietly announced that their EZ Checking account will no longer be free, with direct deposit or 2 bill payments per cycle. Now, only a $1,500 combined balance will qualify accounts for the waiving of the monthly fee. Citibank, like others, found that lower account average balances in their retail accounts or use of bill pay, didn't compensate the bank for the expense of maintaining a retail checking account.

Citbank follows HSBC (one of the quickest banks to realize the unprofitable status of free checking), Fifth Third, TD Bank, Regions, M&I and a host of others that have all moved away from free checking. Because of their cost structure, most free checking accounts became unprofitable when the Fed Funds rate dropped below 2% back in October of 2008. Since that time, banks have been relying on overdraft protection fees to provide the sole profitability for free checking. Given the likely changes in consumer regulations , providing overdraft protection now looks a whole lot less profitable (by 20% to 50% depending on how the final regulations shapes up). As such, banks are making changes now and discontinuing free checking is one of them.

If you use a risk-based relationship profitability system, such as the one we provide to community banks, you will have a good basis for redesigning your product line for a comeback. Some banks are phasing out free checking entirely, some are raising minimum balances or requiring more debit usage, while others are limiting free checking to only the 1st year.

If you are thinking about redesigning your product line for profitability, you may want to make it to our 2010 Executive Management Conference coming up in San Francisco, May 2-5th (http://www.pcbb.com/conference.html). There, we will not only be talking about what will drive profitability over the next 5Ys, but review the latest new retail and commercial products as well. The market, branch delivery, commercial lending, free checking, premier checking, targeted balance savings accounts and the infamous rewards checking product are all radically changing. This conference will be one of the first to look at community bank profitability against the backdrop of the economy, lower (but rising) interest rate sensitivity, risk and greater customer sophistication.

If you can't join us, our recommendation is to review all of your products for profitability, as banks can no longer afford a product such as an indexed-CD when rates rise. By doing nothing more than restructuring your product line and shifting customers to profitable lines of business, banks can bring shareholders higher returns and usher in more bank profitability. Until then, be sure to cheer this week for our favorite battered skier, Lindsey Vonn, who may also be poised for yet another Olympic comeback.

BANK NEWS

President's Day Customer Service

Bucking a long standing tradition, several banks such as JP Morgan Chase and TCF, were open yesterday, a rarity for a Federal holiday.

No Closures

It could have been the snow storms in DC, the Olympics or something else entirely; but not one bank was closed by the FDIC over the long weekend.

C&I Volume

According to the FRB, loans dropped $3.7B to $1.31T last week, following a $5.9B drop the week prior. From Jan 09 to Jan 10, C&I loans have fallen $17.6%.

Competition

GECC indicates small business lending by banks fell 4.2% in 2009, while it climbed 5.1% at nonbank lenders.

M&A

According to SNL, the median price-to-book ratio of deals announced in 2009 was 108%.

Customer Info

A study by BAI finds 66% of consumers say they would prefer to interact with their bank remotely vs. using a branch. Interestingly, 85% of all new accounts are still opened at branches.

Freddie Mac

The Company will purchase all fixed and arm securities from mortgage securitizations that are 120 days delinquent estimating to nearly $70B. The move comes after the new standards for ending off-balance sheet accounting and holding all loans on the books. As this will increase prepayment speeds, community banks are assessing the risk of what this means to their mark-to-market. Banks with 30Y MBS holdings, found that they have suffered more than a point reduction in value, while 15Y product is slight. Expect the same for FNMA holdings.