DEPOSIT TRICK #114

by Steve Brown

Here is a nifty little tactic that we learned from an astute banker. Let's say you are in a deposit market where banks are paying a high rate for deposits. You issue brokered CDs (hopefully from us) and then you contact those high-paying banks and make a big deal about purchasing their CDs. Once you get on the phone, you say things like: "The 2.00% you have advertised, is that a typo?," or "How

can you afford to pay that?," or our favorite, "Heck yes, we will take it, our board members are so conservative they will never let us have any fun and give away value like that."

Whatever you say, the object is to make a big show of it, so it gets back to that bank's management. If the bank accepts your money, you borrow at 0.65% in the brokered market and then invest in the promotional bank at 2.00% - getting an arbitrage and interest rate free 135bp. Better yet, you increase the interest rate sensitivity of your competition by that 135bp - sapping valuable earnings from them.

On the other hand, maybe the promotional bank gets cold feet and decides to reconsider selling you a CD. In this case, they may get the message and drop their rates. If so, your mission is accomplished and you can congratulate yourself for being a leader in your marketplace. Do it a couple of more times to other banks in your area and pretty soon you have single- handedly brought your whole market back in-line with reality. Your investment willingness acts as a signal to the market and deposit rates will trend lower for the benefit of all. There is no agreement and no one has a dominate market share, so antitrust or price collusion rules should not be an issue (but check with your lawyer first if you have any doubts). If used effectively, a bank may be able to bring down local rates by 30bp to 60bp.

One of the largest detractors from profitability is high rates on in-market CDs. Given the pressure on margins high rates can hurt market profitability. The lower rates go the more sensitive bank earnings are to small changes in rates (because of margin compression). That is, the same rate changes make up a larger percentage of profit. This is why it is critical to maintain margins as much as possible in today's low rate environment.

A recent focus group we conducted drove home the point that customers are more sensitive to loan rates and fees than to deposit rates. As such, most of the pressure on deposits either comes from a combination of going after the wrong customer type or convincing ourselves that customers are more rate sensitive than they truly are. By making your competitors more rate sensitive, your deposit will also attract more rate sensitivity in the future as rates rise.

We will share more deposit tactics in the future, but we want to close by pointing out that gas stations have been signaling their pricing for years on the corner with profitable results. By helping teach other banks in your area the folly of their ways, the sanctity of deposit discipline is maintained and the industry will be made better off over time.

ONLINE WORKSHOP ON USING TREND ANALYSIS

Join us Tuesday, March 9th as we explore best practices in Bank Trend Analytics using our proprietary peer analysis tool, BIG Metrics. Learn how trend analysis can help you quickly identify regulatory "hot buttons," quantify the impact key performance trends are having on your net income and effectively communicate your findings to management and the board. Save time and improve the quality of your analysis by attending our webinar. Register online (see related links section below)

BANK NEWS

Unintended Consequences

The ABA is urging banking regulators to modify risk-based capital rules at the end of this quarter due to technical problems with FASB Statement #166 Accounting for Transfers of Financial Assets related to loan participations and SBA loans. Under FAS 166, LIFO or FIFO loan participations would not quality for sale treatment (because such loan participations repay principal to the participating bank prior to the originating bank and the cash flows are not proportional) and the sale of SBA-guaranteed loans would have to be held on the books of the bank for 90 days (because SBA requires secondary market sales to maintain a 90-day recourse period, in the event of a prepayment or default).

Examination Pressure

The ABA has sent a letter to banking regulators highlighting areas where it said "overzealous" examiners are acting contrary to the agencies' recent statement on meeting creditworthy small businesses' credit needs. The ABA said such practices are not consistent with the new interagency statement and the information was collected from real-life examples based on discussions with community bankers at a recent national conference. The ABA said it was taking the action to highlight issues that are inhibiting bank lending to small businesses and other customers.