FEE INCOME, PACKAGING AND BIG HEADPHONES

by Steve Brown

The 3 hot trends right now are dressing prep (the Preppy Handbook is coming back out), "Power bracelets" (wrist bands with holograms or embedded chips), and premium headphones. Banking also

has 3 popular trends: greater reliance on fee income, increased cross-selling and less leverage. These trends are interrelated, because leverage gets much of the blame for capital erosion. In particular, some believe the use of "non-core capital" (such as trust preferreds), combined with hot or wholesale money, caused the banking system collapse and exacerbated problems when asset quality issues arose.

Through examinations, new regulation and new assessment calculations, regulatory agencies are deemphasizing leverage throughout the industry. As a result, banking is looking for other ways to make money, without taking on material credit risk. As such, investment in fee income lines is making a resurgence. Low interest rates, slow loan growth and higher overhead costs are butchering bank profitability. Banks like Wells and Bank of America, are finding one way to solve this dilemma is to increase cross-sell ratios. While this means additional selling effort is required, what is really effective is bundling products together during customer acquisition. This allows banks to increase deposit duration, generate more fees and grab market share.

Here is an example of a suggested execution. While you deleverage, convene a product committee to create 3 retail bundles and 2 business bundles. The trick is to make every account package fulfill a certain need or appeal to a cross section of your demographic spectrum. While you have the basic products, now think what fee income lines would be useful to help profitability and set your bank apart in the customer's eyes.

Here, we might suggest adding something like PCBB's International Services. Not only do foreign currency and wires appeal to sub segments of both the retail and business customer, but they also generate fees that should average about 1% of your current operating income. This all happens with very little credit risk. In fact, any business customer of yours that imports or exports goods, any consumer customer of yours that travels overseas and any entity with foreign financial relations (like a sister company or a child in the military) will be attracted to this service and generate more fees for your bank. Basically, our program gives community banks a way to capture fees from international services and leverage our substantial expertise, all without any upfront costs. This helps the bank meet its strategic objectives and can be bundled with any number of additional products, such as ID Theft protection, payroll services, wealth management or retirement planning. While you can certainly charge for services such as foreign wires individually, you will likely make additional money by packaging them over time into a bundle that includes other services as well.

The average community bank produces annual fee income to equal about 1% of their total earning assets. Meanwhile, larger banks usually do a better job, at an excess of 3.0%, as they generate fees from international services, securitizations, investment banking, venture capital and other lines.

However, it doesn't have to be like this, since such large bank product lines require more specialized expertise, are more capital intensive, volatile and more highly regulated. Community banks can do just fine and approach 2% of their earning assets by adding products or services that don't add materially to the risk profile of the bank. Then, by bundling these products with existing deposit and loan packages, profitability can be improved. Do that and you might just get excited enough to get yourself a pair of headphones big enough to make a DJ jealous.

BANK NEWS

Vote

The Senate will vote this afternoon on passage of the small-business lending bill. The bill would create a $30B fund of capital community banks could draw from to boost small business lending and increase the SBA 7(a) guarantee maximum loan size from $2mm to $5mm, among other things.

Reposessions

RealtyTrac reports Aug. bank repossessions of homes came in just below 100k - an all time high.

Deferred Tarp

The Washington Post is reporting more than 120 institutions have missed their scheduled quarterly dividend payments or about 1 in 6 that raised capital in this manner. The Treasury report showed that at the end of Aug, 6 banks had missed 6 dividend payments each, while 1 bank had missed 7 payments. The Treasury has the authority to appoint 2 board members to banks that miss 6 or more dividend payments, but has yet to do so.

Customer Continuity

JPMorgan Chase suffered a blow to its reputation, after the bank's retail and small business customers could not use online banking for 24 hours due to an online outage. No explanation was given and Chase won't say how many of its 16.5mm online customers were impacted.

Muni Cuts Coming

The latest analysis finds fewer than 50% of state retirement systems in the US can pay for 80% of promised retirement pensions. This compares to only 19% that were in such dire straits just 2Ys ago.