WHAT NOT TO DO

by Steve Brown

Sometimes we worry about what the big banks are doing and sometimes we just have to bask in their stupidity. The reward for the highest rate in the nation for a savings or checking account goes to Discover Bank ($60B, DE). While we hate marketing on rate, if there was ever a bank that it makes sense for, it is Capital One (the 2nd highest rate in the nation) and Discover. These banks derive shareholder value from their lending so they need to feed the beast and funding is critical. Discover creates value by managing credit card debt and targeting customer profitability through optimized pricing and attributes (balances, terms, etc.) tailored for the customer. As a result, Discover, strategically is able to pay an above average cost of funds, because of its niche lending position, resulting in above average margins. Since few community banks can say this, offering a 1.35% in this market would not only damage shareholder value, it will most likely be terminal. When rates go up, a community bank trying to match this offer will be impacted both by credit and by rate sensitive funding that erodes margins.

However, that is not our point. We can overlook a stupefying rate, the fact that there is no minimum balance or other relationship required to get the rate and even the fact that the bank continues to increase the rate because of competition from Capital One (thereby further teaching customers to be more rate sensitive). That is because the bank gets kudos for a cool website, one of the best online account opening procedures, a useful calculator and use of really hot social and internet media usage to market the product.

Given all of that, we are at a loss why the bank makes a colossal blunder that no community bank should emulate. Not on the first page, not on the second page, not on the third page, not on the fourth page, but at the end of the 5th page, Discover reveals that it will charge you a group of fees. Somewhere on the 3rd page the bank reveals their "Rates and Fees," but then just gives customers a "Partial List of Fees." Considering they touted "simplicity," we find it insulting and no way to start a relationship. We always recommend putting the full relationship on marketing material, as you never want to talk a customer into a relationship only to immediately seem them become dissatisfied.

However, this isn't the worst part. As if burying your fee schedule in the fine print wasn't bad enough in this day and age, the most egregious transgression in our opinion is the fact that also buried in that fee schedule is a $20 fee for closing the account within 90 days of opening! From a customer perspective, hard to find fees and charging for closing the account, sends a strong signal that this is all about rate. We rarely see a bank that charges a fee to shut down an account, let alone an online one that has a 31% efficiency ratio. If the bank really wanted to offer quality service, it would not put up such a barrier.

We were interested to see if our game theory driven conclusion held water and so decided to check up on how the bank was doing. Sure enough, this bank is not scoring points these hidden fees and there are plenty of examples on the blogosphere.

This product positioning gives community banks an excellent lesson on how not to start a customer relationship and how not to market for the long-term.

BANK NEWS

Loan Participations

As part of the FDIC securitization safe harbor ruling at Tuesday's Board meeting, an important piece was also included on loan participations. In it the FDIC ruled last-in, first-out (LIFO) loan participations will meet the safe harbor specifications if the terms of the agreements would have met sale accounting if not for the pro rata requirement of FASB 166. Of note, this applies only to LIFOs and not for FIFOs or other non-pro rata arrangements.

CRA Rule

Banking regulators announced a final rule on CRA requiring regulators to consider low-cost higher education loans to low-income borrowers; and allowing regulators to consider a financial institution's capital investment, loan participation and other ventures (with minority-owned financial institutions, women-owned institutions and low-income credit unions) as factors in assessing the institution's CRA record. We suggest you may want to add some flags to your loan system and start tracking this if you think your bank might be involved in M&A activity anytime soon.

Branch Closures

Johnson Bank (WI) said it will close 4 offices in AZ (5 other locations are unaffected) as it seeks to maintain performance amid depressed economic conditions.

Pessimistic Bunch

A survey by Grant Thornton LLP finds only 15% of bank executives think the economy will improve in the next 6 months (down from 35% at the last survey) and roughly 50% expect the economy to experience a double dip.

Not In Favor

The Basel Committee (made up of global bank supervisors), has joined the ICBA, ABA and many other groups in opposing FASB's proposal to force banks to mark to market all financial instruments (including loans).