ARE YOU NUTS?

by Steve Brown

Around these parts, squirrels are quite common, which isn't surprising when you consider there are actually some 300 different varieties of squirrels. These guys love to "squirrel away" food and are known to dig up many a yard as they hide nuts all over the place. When it comes to how some banks deal with their deposit pricing, we wonder sometimes whether people are squirrely or just plain nuts.

Ask any investment banker and they will tell you that the majority of a bank's value lies in its core deposit base. Inexpensive core deposits, especially non-time deposits, provide the foundation of support for any bank stock and in turn, shareholder value. We focused on loans when times were heady, as bankers pushed growth fueled by investor desire. Those days have passed now and investors are bank to placing more emphasis on a strong deposit structure. All things being equal, investors nearly always reward banks that have a low cost core deposit base and aren't quite as nice to those banks that are more reliant on high cost CDs or wholesale funding sources. Simply put, low cost core deposits deliver stable funding that supports stable income streams - exactly what the average investor is seeking.

Why is it then that some banks spend such a large amount of resources on loans, instead of building a lower cost and less sensitive deposit structure? Perhaps it is because for years it was all about asset growth, or perhaps loans are simply more fun to talk about than where funding is going to come from and how it should be managed. After all, funding is plentiful, while most banks are struggling to find loans that work, so it makes sense discussion around loan generation can easily dominate any meeting. We should continue to seek to change that.

Consider that since 2008, banks have been shrinking as they have deleveraged the balance sheet. During this period of low loan demand, banks continue to have an opportunity to focus on balance sheet management and more importantly, perhaps, on the funding side of the equation. We suggest that the next time you are in a meeting where everyone is trying to figure out how to boost net income; more attention is diverted to funding. As we often forget, there are two sides to producing income that include assets and the funds that support them. Reducing the cost of deposits through a continual and ongoing disciplined approach, measuring results as steps are taken and refining things as you go along can be multiple times more powerful.

Consider that banks nationwide in the 50th percentile for deposit costs (as of the end of the 2Q) was 1.41%. While that sounds like a very low rate historically (after all, we are at historic lows for many Treasury maturities), it pales in comparison to the group of banks in the 10th percentile, which have driven deposit costs down to only 0.81%. Assuming a deposit portfolio of $100mm, the difference equates to about $600,000 annually!

No one thinks moving deposit costs lower is a quick fix or is easy to do. In some markets for sure, it is also more difficult than others. But, developing a plan, sticking with it and making slow but steady progress can help drive significant results over time (while boosting shareholder value).

If you need an extra push to get your ALCO team moving in unison on this issue, want to better understand what competitors are doing, or simply need ongoing support to make this happen at your bank, give us a call and we can send in a coach to help. In the meantime, at least you know where the nuts in the yard are buried when it comes to deposit pricing and finding new and improved ways to enhance shareholder value.

BANK NEWS

FDIC Lawsuits

The FDIC decided to go forward with 50 lawsuits (for total claims in excess of $1B) against officers and directors of failed banks. To date, the FDIC has brought only one suit against the executives at IndyMac, alleging officers increased compensation as a result of loans that were approved, but had a low probability of getting repaid. As a reminder, from the S&L crisis of the 80's, 24% of the 1,813 failed banks saw at least one FDIC lawsuit.

CMBS

In a sign that liquidity is coming back, this week JP Morgan brought the largest commercial real estate securitization of the year (but only the 7th to date) at a $1.1B placement. The 10Y, "AAA" rated tranche was priced at a low spread of 1.5% over the swap rate, or 4%.

Deposit Fees

According to a new ABA study, 53% of bank customers do not pay any fees. In addition, 14% pay $3 per month or less, while 9% pay between $4 and $6 per month

Growing Cash

Households added $32B to checking accounts in the 2Q, with nonfinancial businesses growing time deposits and savings by $46B.

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