JUMPING EFFICIENCY FOR THE NEW YEAR

by Steve Brown

Happy New Year! Now it is time to get back to work. We take a running start at fulfilling one of our New Year's resolutions - namely to help you get your distribution more efficient. While this most likely means closing a portion of your branches and reducing square footage under management, it

also means developing smaller branches and expanding your footprint through electronic means. For community banks to compete effectively with the large banks on deposits and loans, overhead costs must be reduced. This means reducing rent and shifting branch personnel into more of a sales role.

Our latest data comes from last month's Fed survey that looked at payment trends from 2006 to 2009. In short, the research showed the use of checks declined 6.5% annually during that time, while credit cards usage was flat and debit/prepaid cards grew at a double digit pace. This means consumers and businesses were walking into branches a whole lot less, as they were substituting debit cards for checks and getting cash at other places such as grocery stories. While the trend wasn't new, what was new was the composition. Checks from consumers to businesses declined an eye-opening 11%. That is 5mm fewer items the banking system is processing since 2006, or more than a 15% reduction in total volume. Equally interesting is that businesses only showed a modest decline (2%) in check writing. Further, the only sector of check writing to increase was consumer-to-consumer payments (a 3% annual increase). Finally, the study showed the steady growth in self-service channels, such as ATMs and remote deposit capture.

The Fed's data screams that your branch is set to become a very lonely place. As checks disappear, more and more payments will move electronically. Consumers were the first to adopt online bill pay and businesses are beginning to follow suit. In the next 2Ys, we expect to see a 5% annual reduction of business items. We also predict growth in person-to-person electronic payments in the next couple of years, as more individuals transfer cash through electronic means (such as Paypal and Square). In addition, the rise of the app will further create another self-help distribution point, further eliminating the need to go into a physical bank branch.

To place these trends in perspective, consider that an active branch in 2000 processed about 300 deposit items per day per branch (retail and business). Our preliminary 2010 data shows that deposit activity is now about half that. We believe this trend only accelerates, due to better penetration in online channels, remote check capture, remote cash capture, person-to-person payment applications and online/app banking. By 2015, we think branch deposit activity will be halved again. This means, without productivity increases, per transaction branch processing costs will be an unsustainable $8 per transaction on average.

Of course, productivity will increase. Namely, we look for more and more large banks to reduce the number of branches. While community banks will be able to pick up traffic, it won't be the traffic they want, as the larger balance customers also tend to be more sophisticated and will migrate towards electronic platforms. The problem is, as large banks become more efficient, community banks will become less so, unless the branch strategy is addressed. Community banks can win the delivery game and it starts by having a multi-channel strategy to serve the customer how they want to be served. We believe most banks should have a strategic initiative to expand their electronic channels, while making their current branch network more efficient.

Related Links:
FDIC SBLF Underwriting Guidance

BANK NEWS

SBLF

The Treasury has posted updated underwriting information on the Small Business Lending Fund (applications are due by Mar 31 and terms are forthcoming for mutual institutions, Sub S and community development loan funds). The standards offer little new insight, but reinforce "prudent" underwriting for small business loans. See our "Related Links" section below.

Back In

A measure that continues unlimited FDIC protection for Interest on Lawyers Trust Accounts (IOLTA's) has been signed into law and the FDIC is in process of releasing guidance and language banks can use to notify depositors of the extension. IOLTAs will now receive unlimited insurance coverage as non-interest-bearing transaction accounts through Dec. 31, 2012.

Settlement

Bank of America agreed to pay FNMA and FHLMC more than $2.6B to resolve claims arising from 787,000 loans sold through 2008 by "legacy" Countrywide based on faulty information. The bank took a 4Q impairment charge of $2B and a $3B provision.

2010 Bank Failures By State

The states with the most bank failures in 2010 in order were FL (29), GA (21), IL (16), CA (12), WA (11), MN (8), MO (6), MI (5), SC (4), and MD (4).