PLANNING FOR INTEREST ON BIZ CHECKING:

by Steve Brown

News of the 1-month shift in the zodiac has really been throwing us off. We, like millions of other Americans need a newspaper or magazine to tell us who we are and what will become of us. For February, should we "be open to new relationships" or "focused on getting things done?" In a world where Virgos are Leos you can understand our confusion.

This is not only bad for us, but bad for you, as we were hoping to have a recommendation for banks on what to do about business interest checking after Reg Q is no more in July. We were using the stars for guidance, but that doesn't seem to be working. Since no major bank that we know of has yet made a decision on the product, we are still gathering information (in order to see how many community banks offer the product and what larger banks do with their current zero balance account offerings). To date, the general consensus is that most community banks will not be offering interest on business accounts unless competition demands it (which we expect will build momentum). While the fear of driving up the cost of funds and making a checking customer more interest rate sensitive is real, our recommendation is banks give this product some thought. It is important to have at least a rough game plan, as moving quickly could be important. As such, here are a couple of thoughts on a potential product:

Target Audience - making the product available to the masses would be a mistake in our opinion. Instead, target higher balance accounts for several reasons (that may not be readily apparent). One is that these accounts probably already enjoy a similar structure at larger banks, through money market mutual funds or through brokerage accounts. Two, contrary to popular belief, these accounts are often LESS interest rate sensitive than smaller balance accounts. As such, banks can get by with not only a lower rate, but with less impact on convexity.

Demographic - we suspect that many banks may only offer this product selectively in certain markets. Here, less competitive and lower balanced markets may be avoided, preserving profitability. The interesting part here is that while many markets grew hyper-competitive and homogenous from 2004 to 2007, things in 2011 are vastly different. Kansas City for example, used to be one of the most competitive markets around, but it has recently been "desensitized" for a variety of reasons. As such, we suspect it will not see the immediate introduction of interest business checking, while San Francisco's different structure might.

Service Product - Another idea to consider is not to make this a service product, in order to keep your customers segmented. In other words, we would probably not suggest (depending on what geography), offering free items and deposits. If service is more important than interest for a customer, let them stay in your premium checking account. However, if they want to switch, lower your impact by charging for all checks at least $0.15 per item (average is $0.42). On this point, we would still not charge for deposits, online banking or bill pay (because of how it makes the account more valuable). We would place a $20 monthly fee (average is now $19.50) on the product that could be waived with balances above $1,500.

Finally, on the notion of paying interest, we would not get too crazy. We might start with 3 tiers set at $10k, $50k and $100k respectively. If we were to price these today, we would suggest 0.05% (for under $10k), 0.10% for over $10k, 0.20% for balances up to $100k and then 0.35% for balances over. In talking with some business owners, paying interest appears to be more important than the actual rate of interest, when choosing a bank.

We will be discussing this more at our EMC Conference. In the meantime, look for us to conduct a survey, as we consult the stars and try to figure out who Ophiuchus was.

BANK NEWS

Bank Closures (11 YTD)

Regulators closed 4 banks on Fri: 1) The First State Bank ($44mm, OK) was sold to Bank 7 ($131mm, OK). Bank 7 gets 1 branch, all deposits (no premium) and nearly all assets. 2) Evergreen State Bank ($247mm, WI) was sold to McFarland State Bank ($361mm, WI). McFarland gets 4 branches, all deposits and essentially all assets. 3) FirstTier Bank ($782mm, CO) was placed into the FDIC created Deposit Insurance National bank of Louisville, which will remain open until Feb 28 to give depositors time to open accounts at other banks. 4) First Community Bank ($2.3B, NM) was sold to US Bank (MN). US gets 38 branches, all deposits and essentially all assets.

M&A

Susquehanna Bancshares ($14B, PA) has entered a deal to purchase Abington Bancorp ($1.2B, PA) for $273mm. Both banks posted a 4Q profit; Susquehanna noted a 185% YoY rise to $9.7mmm and Abington, a $1.9mm gain.

C&I

According to data from the FRB, C&I loan volume grew in community banks over the 4Q, including a $5B jump in the early half of Jan to $376B (returning to 2009 levels).