AN OFTEN OVERLOOKED ASPECT OF BANK DEPOSITS

by Steve Brown

In a little town called Weston, MO, the tallest building for miles around is a prohibition-era pub called O'Malley & Sons. It doesn't look like much from the outside, but its appearance is belied by the fact that 6 stories of the building are underground. This more-than-meets-the-eye picture is the perfect allegory for the architecture of a bank's deposit base. Similar to this Midwest pub, the strength of a bank's liability structure may lie below the surface and not be readily apparent for all to see.

An example of this phenomenon comes from 2 banks elsewhere in the State of MO. Both banks are about $500mm in size, have similar retail/commercial orientations, branch footprints, solid 15%+ ROEs for 4Q and both have the same impressive cost of funds of around 0.85%. While both are top performers, one has a more profitable structure that is not readily apparent. One bank, who we will call Bank A, has focused on building relationships through account packages and DDA customers. Bank A pays about 35bp more for its accounts in the form of non-interest expense. However, Bank A produces 3x more in fees, more than making up for the difference. Bank A has a net non-interest income level approaching 2% of assets, compared to Bank B, which is closer to the nationwide average of 0.5%. It also should be pointed out that Bank A has only an average level of overdraft and debit fee income, thus insulating it from changes under the new wave of banking regulation. Bank A makes more money in fee income than the average bank, because it has a well-structured DDA offering menu that has a competitive fee structure. Other items that drive Bank A's value include a higher percentage of liabilities in DDA compared to CDs, a greater number of accounts in packaged/bundled products (higher cross-sell ratio), very little fee waiving and no free checking. In other words, Bank A, like most community banks, is very good at providing a superior customer experience. The difference between Bank A and the rest of the pack is that Bank A is not afraid to charge customers for that experience.

Bank A's structure lies in stark contrast to other banks that may offer a high yield checking product or heavily promote a no fee environment. While both tactics will acquire customers, they also detract from value. As we often say, being a top performing community bank is an act of doing a lot of little things right over and over. Bank A is a perfect example of such. This is one reason why we have a Liability Coach group that does nothing but serve as an outsourced chief deposit officer to assist you. This team helps banks structure, price and execute in order to build a deposit base that is not only profitable now, but multiple times more valuable in the future. If rates rise, Bank A will out perform as its liabilities have a longer duration, with more positive convexity. If rates continue to stay low, Bank A will continue to outperform, as the higher level of fee income will keep ROE high without asset growth. If you think your deposit team could use a little help to squeeze out extra value from your deposits, contact us so we can provide you with more information on our Liability Coach product. In addition, you may want to make plans to attend our EMC Conference (Early registration savings only last through next week) in May, as we will be spending several sessions discussing deposit pricing and structuring in the current rate and regulatory environment to help attendees get that extra edge in performance.

BANK NEWS

M&A

Vista Bank Texas ($456mm, TX) will purchase Founders Bank ($146mm, TX) for an undisclosed sum.

SEC Rule

Banks that offer deposits, cash management or loans to municipalities could be forced to register as a municipal adviser under an SEC proposal required under Dodd Frank (http://tiny.cc/zahnf). At issue is Dodd Frank requires registration of any company or individual that gives "advice" to a municipality, without defining the term.

New Program

The SBA is offering a new refinancing loan program structured like a traditional 504 that will allow small businesses to refinance commercial mortgages or balloon payments due prior to 12/31/2012. Under the program (http://tiny.cc/2k1zg), borrowers must contribute 10% equity.

Foreclosures

SFR Delinquencies dropped in the 4Q to a 2Y low of 8.2% (30days or more past due) or 4.3mm homes, however foreclosures remain at record highs.

Debit Cards

Regulators noted yesterday that new limits on swipe fees may harm community banks, despite the cap exemption under $10B in assets. The market may not accept higher charge fees, driving smaller banks to accept the same lower fees as bigger ones.

Regulatory Actions

In case you missed it, the American Banker reported that 36% of the 7,647 financial institutions were under either a formal or informal regulatory action at the end of 2010.