BUCKING CONVENTIONAL DEPOSIT FEE WISDOM

by Steve Brown

Given all the fear of radiation coming to the US from Japan, a series of studies caught our eye indicating higher-than-normal levels of radiation may help prevent some cancers. While this seems counterintuitive and far from a scientific fact, the theory is that certain types of radiation strengthen cell resistance to radiation induced mutation. A Dept. of Energy study done by John Hopkins found that 700k shipyard workers exposed to abnormal levels of radiation had a 25% lower cancer mortality rate. A similar University of Pittsburgh study compared radon levels and lung cancer rates in 1,729 countries and found an inverse correlation between lung cancer and radon levels. Other studies done on those involved with the Manhattan Project, Chernobyl, Hiroshima and Nagasaki show no material spikes in cancer, outside those in the immediate vicinity of heavy radiation dose. Now we can't vouch for the studies and don't want to draw any conclusions, but the research made us question the standard assumption that radiation, in any form, is cancer causing. In similar fashion, we felt the same way when we looked at current data coming from Bank of America and Chase that show that putting a mandatory and non-waivable fee on deposit products may be the best way to increase risk-adjusted ROE. While far from conclusive, both BofA and Chase caught our attention by rolling out basic, non-interest bearing checking products, in selective test markets, to both businesses and consumers. Each of these accounts has a $6 to $25 monthly fee that cannot be waived through direct deposit, using your debit card or holding higher balances. In addition, many of these accounts charge for set up ($25 is common) and/or bill pay (an average of $5 per month). These accounts are being introduced after preliminary research shows that in some markets and/or for some customer types, behavior doesn't change when a mandatory fee is put into place. That is to say, if you give people the opportunity to waive fees by doing certain actions (such as keeping minimum balances or utilizing a debit card), less than 10% will actually do it. Profitable customers that you want to keep are already doing these behaviors, while unprofitable customers are complacent and will pay the fee. If behavior to increase profitability doesn't change or is more inelastic (non-sensitive) to fee changes, then the theory goes it is better to institute a mandatory fee in order to increase profitability. Yes, you might lose some customers, but overall profitability will be enhanced. Customer defection can be mitigated by proactively transitioning those that have a variety of other products into more of a premium or mid-level account, so their fees can be waived and their accounts retained. Remaining customers will self-select and either become profitable or move over to another bank and make that bank less profitable. We are not entirely convinced that BofA and Chase are making the right move for the long run. Competition may undercut their effort by making the higher-end of profitable customers more fee sensitive and thus more subject to move. However, going back to charging for deposits and bill pay is a trend we are paying close attention to, as this may be another evolution as banks move away from free checking products and attempt to generate more fee income. By looking at customer and product profitability, it might be that, like a little dose of radiation, the best course of action could be to institute a small dose of mandatory fees.

BANK NEWS

FDIC Suit

The FDIC is suing executives of Washington Mutual and their wives for a reported $900mm, accusing them of negligently going on a "lending spree, knowing that the real- estate market was in a bubble" (a strategy that maximized their compensation); and transferring cash and homes into trusts in an effort to shield the assets from legal claims. This is the 6th lawsuit by the FDIC since 2007 and WAMU was the largest bank failure in US history.

Insanity

An assemblyman in CA has introduced legislation that would bill banks $20k for every home foreclosed. If this goes through, look for CA's economy to get hit even harder, as home loan origination and servicing costs skyrocket and banks raise fees to offset the costs. The money collected would reportedly be used to cover foreclosure costs, property tax losses, support school districts, police and fire departments.

Municipalities

While dire default predictions are not expected to play out, Moody's said it has a negative outlook and expects more credit downgrades than upgrades this year for states, cities, towns and other issuers of municipal debt. Moody's also indicated this year will be the roughest for states and cities, since most of the easy budget cuts have already been made and additional cuts will be more difficult and painful.

NIM 2010

On average, the nation's banks saw NIM drop 12bp to 3.71% from the 1Q of 2010 to the 4Q. Meanwhile, community banks with assets below $10B saw NIM increase 9bp to 3.77%.

Multi-Family Lending

The national vacancy rate in this sector fell from 7.1% to 6.6% in the 4Q of 2010, according to commercial real estate research company Reis. Meanwhile, the National Association of Realtors predicts multi-family vacancy rates will decline to 4.9% by the 1Q of 2012.