ANOTHER EXAMPLE OF ADD ON SERVICES

by Steve Brown

Long time readers know we are big fans of banks utilizing add on services as a way to differentiate deposit account packages, generate fee income and increase the duration/convexity of liabilities. Today's example that we offer analysis on is Mercantile Bank of Michigan (Mercantile). While most banks would have just offered a positive pay feature as a means of fraud prevention, Mercantile turned the paradigm on its head and not only offered positive pay for fraud, but repackaged the product as a cash management service called "Funds Manager." This optional service allows both businesses AND consumers to go online and see pending transactions as early as 11am in the day. This allows customers to see what checks and ACH items will hit their account at the end of the day, so that customers can then transfer money before the close of the day, in order to cover any shortfall (thereby saving on bounced items or overdraft charges). Let's break down what this service does for Mercantile. For starters, the Funds Manager feature is an excellent item to package with a premium deposit account. In addition, whether used or not, it serves as an innovative feature that another competing institution most likely won't have. As banks rush to build out their cash management offerings, a feature like Funds Manager is key, particularly given the low marginal cost to provide, as the process is nothing more than a redisplay of electronic data (for many core system providers) to customers. When it comes to fee income generation, Mercantile achieves about a 40% penetration for its commercial customers and about a 29% penetration from its retail customers. The Bank charges $30 to commercial customers and $4 to retail customers. Given that its online customer base is approximately 8k clients, this one service generates approximately $400k per annum for the Bank. If marketing and economics weren't enough, adding on a feature like Fund Manager also gives the account some other positive attributes in building franchise value. Allowing customers to see their account intraday allows two things to happen, the net effect happens to be positive. One is Fund Manager allows better cash management accuracy, which provides an incentive for the customer to hold lower balances, as they need less cushion to handle items yet to clear. However, because of this improved accuracy, customers end up using this type of account more as their primary operating account, thereby running more items through the account. The net result is an estimated 8% increase in average balances, compared to accounts that don't have a service like Funds Manager. As a result of these higher balances, accounts become less interest rate sensitive, thereby resulting in better convexity characteristics. Rising rates usually mean a stronger economy, which means more transactions for businesses. As a result, more transactions usually mean higher balances as operating expenses grow with increases in revenue. Higher balances in a rising rate environment are exactly what banks want to drive franchise value. Mercantile's Fund Manager product is an excellent example of the type of services banks should be thinking about to increase performance. In similar fashion, our International Services is a cost free add on that can separate your bank from the competition, generate fees and boost balances. At our upcoming "Lunch and Learns" and "Tactical Workshops" in Chicago (6/22), Los Angeles (8/18), Baltimore (9/13) and Richmond (9/15); we will be focused on new products and strategies that banks should be thinking about for both loans and deposits (to be successful in light of the current regulatory changes). If you are near one of those venues, be sure to stop by and let us buy you lunch, as we exchange ideas. Until then, think about what add on services you can include in your account line-up in order to build out your liability products and enhance profitability.

BANK NEWS

Banks Closed (47 YTD)

Regulators closed: 1) First Commercial Bank of Tampa Bay ($99mm, FL) and sold it to Stonegate Bank ($762mm, FL). Stonegate gets two branches, all deposits (0.50% premium) and essentially all of the assets under a loss share. 2) McIntosh State Bank ($340mm, GA) and sold it to Hamilton State Bank ($284mm, GA). Hamilton gets four branches, all deposits (0.50% premium) and 74% of the assets under a loss share.

M&A

PNC Financial will buy Royal Bank of Canada's US retail banking business for $3.45B. The acquisition adds 424 branches, about $19B in deposits and $16B of loans to PNC's existing business. The price paid for the transaction is about a $112mm discount to RBC's tangible book.

Sifi Bank

It looks like regulators are coalescing are the standard that the world's top 30 "systemically important financial institutions" (Sifi) should maintain a capital buffer around a max of 2.5% above the current Basel III standards. This buffer would be tiered, w/the biggest of the big (8 of the 30) subject to the highest requirements (2.5%). The top tier would include institutions like C, BAC, DB, HSBC, BNP, RBS and Barclays. The next tier would include GS, MS, UBS, and CS (around 2%). The 10-15 remaining institutions would face surcharges of between 0.5 and 2%.