INTERSTATE LOAN-TO-DEPOSIT RATIOS

by Steve Brown

At the end of last month, the FFIEC issued the target loan-to-deposit ratios by state that regulators will use to determine compliance with section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (See link to document in "Related Links" section). Section 109 prohibits a bank (or bank holding company) from having a branch outside of its home state primarily for the purpose of deposit production. In order to provide some structure around this, Riegle-Neal provides a test to help with statutory compliance. Here, regulators compare a bank's loan-to-deposit ratio within a home state to a benchmark in a particular state where the bank is branching. A second step is conducted if a bank's statewide loan-to-deposit ratio is less than 50% of the published ratio for that state, or if data are not available at the bank to conduct the first step. In these cases, it is up to the banking regulator to subjectively determine if the bank is reasonably helping to meet the credit needs of the communities served by the bank's interstate branches. A bank that fails both steps is in violation of section 109 and is subject to regulatory criticism.

This regulation was made for banks with our philosophy, as if we didn't have a bankers' bank and we were allowed, we would be going after cheap retail and commercial deposits and only make loans if we had to in order to win the customer. Except for certain types of niche lending, deposits, if priced right, are a vastly better value both in terms of risk-adjusted net income and earnings multiple at sale. However, in order to keep credit flowing, regulators feel that if they grant you a banking license you should be making loans as well. As a result, Section 109 came about. It is a regulation that will come more and more in play as banks branch out under Dodd-Frank and/or take advantage of potential M&A activity. To help banks better work with Section 109, we wanted to highlight a couple of points that banks that may help banks deal with this issue.

For starters, the as-of date for the loans-to-deposits ratio was last year (June of 2010), but the loans/assets ratio has been falling significantly for many banks since then creating a possible problem in itself. Another point is that the FFIEC did not back out brokered deposits from the home office deposit totals which will skew ratio for those banks that still have large brokered positions and perhaps subscription deposits like CDARs. On this point, for share of deposit reports, brokered/wholesale deposits are assigned to the home office which can overstate a bank's market share of deposits artificially. Given all this, there may be more than a few banks that will be finding themselves receiving extra scrutiny (conversely, some banks that will receive undeserved free passes). The biggest issue arises for banks that operate in single metro areas that cross multiple states. If you are a bank in Kansas City, for example, and have customers in both MO and KS, your analysis gets extremely tricky. In similar fashion, the methodology raises questions about what does this mean for banks that purchase out of state loans. It is unclear to us if purchased loans will be included in locally assigned loan balances.

Using the loans-to-deposit ratio has always given us some concern as you can have two banks with identical loans/assets ratios, but if one has higher capital (or collateralized deposits reported as repos) than the other, then the banks will have significantly different loans-to-deposits ratios. Is a bank with a higher loans/assets ratio but a lower loans/deposits ratio necessarily originating fewer loans than a bank with a lower loans/assets ratio with a higher loans/deposits ratio?

The bottom line here is that the regulation leaves room for some "analytical interpretation" that banks should be aware of as they look across state lines either as part of an acquisition or on a de novo branch basis. As part of our Liability Coach product, in addition to helping banks structure and price their liabilities, we also work with banks to manage, monitor and document regulatory items such as this.

Related Links:
SECTION 109 HOST STATE LOAN-TO-DEPOSIT RATIOS

BANK NEWS

SiFi and Exec Pay

The FDIC issued a final rule that sets forth the order of payment and procedures for a structured liquidation of a large, systemically important bank. As expected large banks will have to submit annual liquidation plans and quarterly credit exposure reports. Of particular note, under the structure, the FDIC could clawback executive and director pay for up to 2Ys (unlimited in cases of fraud) if said individuals were deemed "substantially responsible" for the failure.

Tax Holiday

One of the things we are closely watching is if a tax holiday gets folded into the debt ceiling talks. Should this occur US companies with large offshore earnings would flood the US with cheap bank deposits. We estimate that this is about $1.2T in funds. Unfortunately, D.C. has been silent for the past 2 weeks on this issue.

Cards

Credit card delinquencies rose 12bp to 3.4% for 1Q, as higher food and energy cost took its toll. While up over 4Q, it is still below the 3.88% rate for the same period last year.