CREDIT CARD CAPITAL PLANNING

by Steve Brown

The latest data finds the percentage of credit cards that charge an annual fee has grown from 14% in 2010 to 21% today. On average, these same cards carry an average variable annual rate of 14.46%. Not a bad all-in return even after charge-offs and capital charges. Speaking of capital, today we explore the new world of capital planning for community banks and discuss best practices that you may want to consider the next time you charge into this area.

The capital plan from our viewpoint is a key component of any bank's strategic and business plan. It forms a strong foundation upon which many great endeavors can be supported. To do that the right way, the plan should incorporate projections that extend existing risk management practices. Such analysis should also be robust enough to explore what could go wrong and the impact that could have on overall performance.

From a more detailed perspective, community bank capital planning should incorporate both base case and stressed scenarios. Here, management and the board should challenge the likelihood of a given scenario and whether the potential impact to capital exceeds risk tolerances. Doing so can help the team refine the plan to make sure risk and reward is balanced. When doing scenario testing, be sure to calculate the impact over a longer term period of 2Ys and not just a few quarters. In addition, be sure to calculate the impact on both the bank and the holding company, so a comprehensive view is captured. Overall, the key here is to look at different scenarios and determine what a negative outcome could mean to capital levels.

As you build up the capital plan, most of the brainpower of the group should focus on the assumptions. Any modeling you do can be skewed if the assumptions are faulty. As a result, make sure to carve out enough time to challenge any and all assumptions to be sure you have done a decent job in protecting the bank from a "garbage-in-garbage-out" result.

Another common issue that can surface is to be sure the analysis looks at both the income statement and the balance sheet. In other words, banks need to make sure volume gets adjusted over the analyzed period in-line with the scenario. Loan concentrations, growth by sector, credit loss assumptions, loan classifications and risk all need to be baked into the process. As if that weren't enough to keep you busy, it is also important to consider assumptions around funding (wholesale, core, contingent funding, cost, etc.), capital composition, dividend restrictions, provision expenses and other such factors. Each can have a significant effect on net income and performance, so ensuring the analysis is robust, comprehensive and forward looking will give you the tools needed to go to the next level.

Finally, once you have gone through all that work and effort on the capital plan, be sure to use it going forward. It isn't supposed to be bound in a big binder and thrown on a shelf somewhere. Rather, when used effectively, it is the roadmap the board and management can use to support decision making, understand the impact of an adverse situation on a given business line, deal with concentrations and support overall risk management.

Capital planning done right is a good and challenging process that gives everyone comfort, as a plan is designed and refined. As with the monthly credit card bill, reviewing how you spent your money and whether you got what you wanted can deliver better results the next month. Perhaps it is time to review the capital planning bill to see where you can improve even more.

BANK NEWS

Earnings

Citigroup posted stronger-than-expected 2Q earnings at $3.3B, up 22% from year ago levels. Lower trading revenues and US loan growth caused revenues to fall 7%. Despite the decline, gains in the international consumer division and lower loan loss provisions boosted the bottom line.

Interest on Business Checking

Both the FDIC and the Fed released final rules on Req Q that rescind past regulations that prohibited the Depression-era rules on paying interest on checking. The twin rules better defined what "interest" means in light of deposit insurance and go into effect next week, as we watch to see what banks do in response.

US Downgrade

S&P announced there was a 50% chance it would downgrade the US in the next 3 months and perhaps as soon as the end of July. If a downgrade were to occur, the entire term interest structure of rates would shift out. Ironically, because this would be a re-definition of risk and because of how the accounting rules are written, this wouldn't create an investment impairment on bank's balance sheets.

Spooky & Shocking

You may not have noticed it yesterday, but the yield on the 3M Treasury was NEGATIVE 1bp. Risk is high and deposits are so extreme worldwide that investors are willing to pay the US Gov't just to hold the money and return the principal 3 months from now - 1st time in history.

Summer Work

According to the BLS, only 48.9% of workers aged 16 to 24 could find summer jobs this year. That is the lowest on record (going back to 1948) and the first time it has dropped below 50%.