EXTENDING LIABILITY DURATION IN THIS ENVIRONMENT

by Steve Brown

Be honest, if you are over 40, you have most likely been there. You are in a restaurant and have forgotten your reading glasses. Not being able to read the menu in dim light, but not wanting to give into age, you decide to play it cool and just point to what you want for dinner. It is a little awkward when the waiter says "Do you really want "A 17% gratuity will be added to parties of 8 or more"? Which you say (because you can't hear well either in a crowded restaurant) - "Yes, but please put the dressing on the side."

Growing old is no fun, however growing old at a bank should have its benefits. As money flows into DDA accounts from CDs, money market mutual funds and the stock market, one thing banks are faced with is how to manage liability duration. While the interest sensitivity is low now, astute bankers (and regulators) know that a 400bp shift up in rates will have a significant impact on a bank's asset/liability position. In other words, the new money that is flowing in to DDAs now, is serving to shorten deposit duration of one of the longest duration liabilities on the balance sheet. As such, banks are becoming more liability sensitive to upward rate movements.

To mitigate that risk, banks are finding ways to extend liability duration. Cross selling products is one way that we have discussed in this column in the past. Layering in remote deposit capture or a loan, extends both duration and convexity of the deposit base. In past columns, we have also discussed using goal oriented savings accounts that pay a bonus rate if a certain long term savings goal is reached. In similar fashion, we have also talked about business-oriented financing plans that is a combined savings account and loan product that allows businesses to save for the down payment of certain large ticket equipment purchases such as MRIs for doctors or additional fleet delivery vehicles.

Today, we highlight another idea in that banks should consider tying business package fees or attributes to the length of time they have been a customer of the bank. While there are a number of ways to do this, banks can reduce an elite business bundle fee from $100 per month to $75 per month, once the account gets past 3Ys. Alternatively, the bank could add attributes such as an unlimited number of wires past 2Ys and free remote deposit capture or electronic invoicing past 5Ys. Banks could build out a menu of items to 15Ys in order to aid in retention, but also dramatically increase the duration of deposits. In doing so, this single business account could potentially eclipse the value in almost every other account including business checking.

At the next new product committee, look at your average life of your customers and then design a customized schedule to incent them to continue to use your bank in the future. Brainstorm ideas of what product and services can be profitably bundled to increase usage of this type of account. Instead of giving away items for free, you are giving away items to a positively selected group of accounts that have said they want to be your customer for the long term. This not only creates future margin value, but also allows your bank to trade at a larger multiple to both book and earnings by increasing its core balances and quality.

With some banks throwing around $100 or $250 incentives to move business accounts, this structure would better protect and reward customers that don't mind growing old with you.

BANK NEWS

SBLF - Not Done Yet

Another 61 community banks received approval for a total of $608mm. This brings the total to 191 community banks for $2.4B in funding. In the coming weeks, it is rumored that another 200+ banks will be notified of approval so that 400 of the 900 that applied will ultimately receive funding.

FDIC Office

Citing workload analysis and in recognition of the improved health of the banking industry in the Midwest, the FDIC will close its temporary satellite office in Schaumburg, Illinois on Sep. 28, 2012.

Interchange

The Fed, in an attempt to clarify some open issues on prepaid cards, compensation and usage, issued a 2nd set of FAQs on the debit interchange rule. In particular, the rule clarified the hot topic that a prepaid card retains its exemption as long as it doesn't use an electronic authorization of payment (like a card linked to a bill-payment service).

Slow & Sluggish

In testimony before the congressional "super committee" trying to reduce the federal deficit, the head of the non-partisan Congressional Budget Office said his agency projects economic growth of around 1.5% for 2011 and 2.5% in 2012 (down from 2.3% and 2.7%, respectively, projected last month). He also said the economic outlook was "highly uncertain."

Surging Defaults

The Education Dept. reports borrowers of federal student loans defaulted at an 8.8% rate for 2009 (the latest reported period), up from 7% a year earlier. The 2009 rate tied 1997, but was below the peak of 22.4% reached in 1990. Overall, borrowers attending for-profit colleges defaulted at more than 2x the 7.2% rate for those at public colleges and 3x the 4.6% rate at private nonprofit institutions.