REDUCING YOUR FUNDING COSTS

by Steve Brown

The picture at the left was cut from the Quarterly Banking Performance (QBP) report from the FDIC and is as of the 2Q of 2011. The blue line represents banks $1B or less, while the red line is for larger banks. The graph captures the quarterly cost of funding for the two groups of banks and is the subject of our discussion.

When times as tough as they are now, bankers search everywhere for ways to save costs and increase revenue. One thing the chart at the left shows is that larger banks on average fund themselves at about 32bp less than banks $1B or smaller in assets. In percentage terms, that adds up to about 30% less, so it is quite a differentiator when it comes to performance as well.

Sometimes we forget to focus on what is right in front of us and we would venture to say that is exactly the situation with funding costs. Research will tell you that there has been massive consolidation in the industry over the past few decades, which is both good and bad. As of the 2Q, in fact, the data shows banks over $10B now control 77% of all deposits in the banking system. When you layer in banks above $1B the percentage jumps to 88%. There are many different issues with this consolidation that are too numerous to mention here, but one good thing that community bankers can tap into is pricing power. As the graph shows, the largest group of banks enjoys a 30% lower cost of funding than banks under $1B, despite having the exact same insurance costs and roughly the same set of products.

Instead of grousing about the consolidation and worrying about what you are going to do to compete, we say embrace the consolidation to your advantage. If you look around your town, you are probably competing with 5 or more large banks. These banks as seen above are setting their funding levels 30% less than you are, so the time to strike is now. Depending on your current position, revisiting your funding cost and structure can reduce your current rates and help you capture this benefit.

When lending activity is slow and banks cannot get the top line of NIM to move, shifting the focus to the funding that supports your assets is a great way to go. Ask the management team whether they are doing everything possible to reduce funding costs so you can survive on lower margins and in an environment of greater loan competition. If not, take your highest cost of funding and ask yourself why you haven't yet reset it lower Ã¢Â€" particularly given you are so awash in funding right now. The flow of deposits remains strong, so now is the perfect time to try a few experiments in your market to see what works in reducing your funding costs and improving performance.

To get an even better handle on where all the action is happening, so you can tweak pricing on your own deposit offerings, we again review the QBP. We find that during the 2Q, total deposits increased by 1.7%, pushed along in large part by noninterest bearing (up 9.5%); savings and checking (up 2.5%); and time deposits (up 2.1%). Viewing the change over the past year, domestic deposits are up by 7.3%, with interest-bearing deposits rising 3.1% and noninterest bearing climbing 23.7%.

Working to reduce funding costs of a bank is never an easy proposition. It takes time, dedication and a focused effort to make it happen. While a consolidation of deposits among a handful of banks is usually a bad thing, the fact that those banks now control so much of the industry funding can help your bank as well. This is one reason why reducing what you pay for funding makes sense. It takes time, but for every $10mm in funding you reduce by 30bp, you pick up about $30k annualized. Do that a few times and you can really have a positive impact on the bank.

BANK NEWS

M&A

Happy Bancshares ($1.6B, TX) will acquire Signature Bancshares ($116mm, TX) for an undisclosed sum.

New Fed Approach

The WSJ is reporting that the Fed is examining whether to adopt more explicit unemployment and inflation targets so that the goals are clearer to the public. While this idea will likely not be ready for this week's meeting, it will be discussed with potential changes by year end.

Housing

New analysis by Bloomberg finds bad mortgages have cost the 5 biggest banks in the US about $65.7B since 2007. BofA was hit the hardest at $39.1B (Countrywide); followed by JPMorgan ($16.3B); Wells ($5.1B); Ally (old GMAC, $3.3B) and Citigroup ($1.9B).

CIT

The Company is selling a $1B portfolio of C&I loans in 72 mid-sized companies. We are looking into whether any community bank has interest

Corp Cash

US companies are sitting on more than $2T in cash and equivalents, up more than $88B from the end of Mar. Cash now accounts for an average of 7.1% of a companyÃ¢Â€Â™s assets, the highest level since 1963.

New Survey

A new poll by CNBC of market professionals finds 70% expect the FOMC to do a twist (buy longer maturity Treasuries and sell shorter ones to drive down longer term interest rates) and 82% think Greece will default on its bonds in the next 3Ys.

Holiday Retail

A survey of major retailers by a global consulting firm finds 68% plan to keep holiday hiring at roughly the same level as last year, while 25% expect to reduce the number of seasonal workers they hire. One primary driver for lower seasonal hiring was a shift by consumers to online.

Housing

CoreLogic reports 10.9mm or 22.5% of all residential properties with a mortgage were in negative equity at the end of 2Q, down slightly from 22.7% in 1Q.