CARRYING UNPROFITABLE CUSTOMERS

by Steve Brown

In case you missed it this weekend, wedged in between football, golf, soccer and Nobel Prize announcements, there was the 2011 North American Wife Carrying Championship in Sunday River, Maine. This sprint through various obstacles was won by a couple from Farmington and is a true test of both physical ability and strength of relationship. Before you judge, it should be known that the winner not only gets to advance to the World Championship in Finland, but receives the wife's weight in beer and 5x her weight in cash. The prize turned out to be 9 cases of beer and about $600, making a profitable afternoon for the winner. In contrast, the recent Bank of America $5 debit card charge fallout has many banks and credit unions scrambling to grab disenchanted customers. Politicians and the media have also jumped on this bandwagon and implored customers to move to credit unions and community banks. Our point today is to be careful accepting these new customers, for many of the same reasons we have previously written about. Namely, BofA has a similar relationship profitability system as our BIGProfit system and thus understands the value of a relationship. The $5 monthly fee is either going to a) make unprofitable customers slightly more profitable because they will either pay the fee or increase their balances above the $1,500 approximate threshold or, b) remove unprofitable customers from the account rolls by pricing them to leave. Either way, BofA becomes more profitable. After Mr. Durbin told the world to "walk with their feet," he basically gave the Bank a huge helping of free marketing to become more profitable. What would be a mistake is for an unknowing community bank to grab these customers without fully understanding the potential economics. At a minimum, banks chasing these customers should do some modeling before hand to see if they can take the hit to short term profits and then have an articulated plan in place about how they are going to make these customers more profitable over time. While we would have advised BofA to undertake a different strategy (like charging for checks, not the uber-sensitive debit) with more customer-friendly marketing, we do support the move. The state of costs, cross-sell and interest rates are such that a retail account that uses their debit card 4 to 5xs a month and keeps an average checking balance of $400 in their sole account probably loses the average bank about $163 per year. If you add a heavy dose of check writing, that unprofitability goes up substantially. For debit charges, the average cost to process a transaction is approximately 19 cents for the average community bank under $1B (not including fraud costs). The Durbin cap leaves a negligible 6 cents of profit to make up for other account activity, such as using a branch, paper checks or free online banking. In addition, the aggregate balances and FDIC charges add up to more red ink. We would have never imagined that carrying your wife over hills and mud would be more profitable than building customers, but today's economics demand banks take a look at their charges in order to right-size accounts and adjust to the new economics of low interest rates, high costs and a slow growth future.

BANK NEWS

Closed (76 YTD)

Regulators closed: 1) The RiverBank ($417mm, MN) and sold it to Central Bank ($770mm, MN). Central gets 6 branches, 81% of the assets under loss share and all deposits. 2) Sun Security Bank ($356mm, MO) was sold to Great Southern Bank ($3.4B, MO). Great Southern gets 27 branches, all deposits and 99% of assets under loss share.

Loan & Deposit Growth

Fed data for the 25 largest banks shows total loans grew 1.2% in the 3Q vs. 2Q and core deposits jumped 6.8%.

Closer

Banks are said to be close to signing a foreclosure settlement w/state AGs according to Fox Business, but key issues such as the amount of legal liability banks will be released from and whether key states such as CA and NY will participate could hold up the $20B deal.

Keegan In Play

Private equity firms Blackstone and Carlyle Group have reportedly teamed up to bid for Morgan Keegan (a unit of Regions Financial). Bids are due in the next 2-3 weeks and Regions reportedly hopes to sell the unit for $1.5B.

Consumer Credit

Uncertainty in the economy was the likely catalyst that pushed consumer credit down at a 4.6% annual rate in Aug. the first decline in 11 months. Demand for auto and other non-revolving loans fell at a 5.2% annualized rate, while credit cards and other revolving credit fell at a 3.5% annualized rate.

SEC Registration

H.R. 1965, a bill that would raise the current (and 40-year old) 500 shareholder SEC registration limit to 2,000 (and also raise the deregistration threshold from 300 to 1,200 shareholders), made it out of Subcommittee and will get scheduled for the Floor.

Private Label MBS

A Fitch study shows that more than 33% of prime borrowers in private-label securitizations are currently in a negative equity position. That percentage is expected to go to 50%, unless the current housing decline trend stops.

Working Longer

Older people are trying to return to work or delaying retirement after seeing their accounts drastically reduced by the economic crisis. A new study finds 50% of workers plan to remain employed after they retire, mostly in part-time jobs; 40% expect to retire later and 33% plan to work past age 70 or never retire.