JELLY BEAN BANKING AND BRANCHES

by Steve Brown

The precise origin of the Easter Bunny is not known, nor is it known why the Bunny brings children candy and colored eggs. That is ok, since we love to eat jelly beans of all varieties, so how they appear or why they appear is much less important. After all, don't you also have a few fond memories as a child of running around the grass picking up plastic eggs filled with jelly beans? Things were so festive in fact, that even your parents would let you gorge yourself on jelly beans. What a great reminder of one of the tastiest things in life.

Like the millions of jelly beans that spill out of an open candy bag that tips over, banks used to have thousands of branches strewn throughout the country. In fact, banks were on a tear, building branches like crazy in the U.S. from 1990 to 2006, roughly doubling the number and taking it to one branch for every 2,200 adults in the country. While there are still 98,192 offices at last count (June 2011), quietly and almost imperceptibly the total has fallen in the past 2Ys by 1,348. That makes sense when you consider the level of bank closures, the burden of new government regulations, the shifting behavior of depositors (to internet, ATM and mobile) and the overall difficulty of generating profitability throughout the entire branch network.

Large banks have begun to close or explore closing branches, as can be seen with the recent announcement by Bank of America (closing 10% of its branches) and comments by JP Morgan (said about 70% of customers with less than $100k in deposits would be unprofitable given legislation that cap fees). BofA said it captures about 40% of all the deposits people make with the bank through its network of ATMs. Further, JP Morgan said that even after excluding overhead (such as branch rent expenses), 1 in 7 retail customers would still not generate enough revenue to cover the $300 it costs the bank just to maintain their accounts. As such, banks are expected to pull out of some markets where they just can't make a go of things and focus energies elsewhere.

Still other analysis, including one by real estate firm Jones Long LaSalle, estimates banks will reduce their footage per office worker from 200 square feet ("sf") to 50sf by 2015. That makes sense when you consider that according to research by Moebs, operating a checking account costs large banks $350 to $450 per year, while community bank costs are in the range of $250 to $350 per year.

Overall, branches just matter less to people, so banks are taking a hard look at the cost-benefit of each one. Analysis by the FDIC indicates the typical bank branch may cost upward of $2mm to open, while still others estimate the approximate cost to open a 3,500sf branch costs $2mm to $2.5mm (and another $350k to $400k per year to operate). In addition, research by MarkeTech finds location is critical to success, as traffic patterns and the ability of consumers to access a branch explain 45% to 55% of the deposits it captures. This is yet another reason why closures are likely, as banks deal with the up to 16,000 branches nationwide that consulting firm Novantas says are unprofitable.

Finally, consider a recent survey by the ABA. It found that 62% of people prefer to bank online vs. all other methods now (up from only 36% in 2010) and only 20% still prefer using a branch. Given there are 4x the number of branches around the country than there were before the advent of ATMs, online and mobile banking, further consolidation in this area is expected.

As you ponder the branch network, changes driven by the iPad, the ATM or online banking, don't forget to take time out to grab a handful of jelly beans. We don't know about you, but a few brightly colored beans go a long way in clearing the mind.

BANK NEWS

M&A

Western Capital ($158mm, ID) will buy Northwest Bank ($104mm, OR) for an undisclosed sum. The deal creates a larger and stronger bank focused on business clients and will be named Northwest Bank.

Disposition

Fifth Third Bancorp has sold $3B in assets related to 16 mutual funds to Touchstone Advisors and another $5B of money market assets to Federated Investors, as the bank exits the mutual fund business.

Sold & Closed

A mortgage servicing firm owned by Morgan Stanley, Saxon Mortgage, has been sold for $73.8mm to Ocwen Financial. Saxon also announced it would close some facilities and lay off about 680 employees in May.

Foreclosures

Now that the large banks have settled on their foreclosure mess, the tide has begun to rise again. RealtyTrac indicates that although foreclosures fell slightly nationwide from Jan to Feb, they rose in 21 states and soared in some, such as Tampa (+64%), Miami (+53%) and Chicago (+43%).

Reserves

The Fed has approved a rule that simplifies reserve requirements and amends Regs D and J. Implementation will occur in two phases (7/12/12 and 1/24/13).

CRA

As part of a new CRA push, PNC rolled out a program in 10 states targeting low and moderate-income taxpayers that will provide volunteers to assist tax preparation and filing; financial education and fee-free refund check cashing or prepaid cards.