MAKE A DEPOSIT - GET A MERCEDES

by Steve Brown

If there was an award for bank marketing chutzpah it would go to C1 Bank ($830mm, FL). At C1, if you open a $1mm 5Y CD at a rate of 1.20%, they will give you a choice of one of four brand new Mercedes Benz cars, including the 2012 SLK 350 (www.c1bank.com/mercedes-benz/). While this isn't our favorite CD promotion (we dislike most all CD marketing), this bank gets credit on a few different levels. First, the Bank didn't market on rate. Marketing on rate is the easiest thing in the world to do and points to the fact that the marketing department is just phoning it in; if extra basis points is the best they can do. While this promotion still trains customers to expect more than great service and giving away a car is a close second to giving away a big rate, the promotion takes the focus off a stark percentage figure and limits the Pavlovian- response that leads customers to drool over APY. From an economic standpoint, the giveaway is about a $60k value, when you consider tax and license fees (about the same as paying a 2.4% rate for 5Ys). That is about 50bp above where most aggressive banks are paying and about 100bp higher than where banks should be paying. While pricy, considering the campaign has already garnered national attention, the free press has some value and could make up a portion of the difference. However, part of the poetry of this promotion lies in the fact that behaviorally, it does two things. One, a car has a different value to different people. If you argue that a household with $1mm of cash to invest doesn't place full value on the car, the opposite is usually true. The type of consumer that is able to purchase a CD of large size is one that likely values a car such as the SLK 350 and puts a price on the perceived value of the promotion of getting something for nothing. While seemingly irrational, a promotion such as this gives an excuse to purchase the car. That can be very valuable because of spousal limitations (you all know what we are talking about), social stigma, convenience, etc. Not only does this promotion give you the justification to purchase a new car; but do you think that if you live in Florida you are not going to brag about it to your friends and neighbors? Few consumers will do the math that if they invested in a corporate bond with similar credit (of course, only the first $250k is insured) they could afford an even larger car. To top it off, getting the car also sends the signal that you just happen to have $1mm in cash lying around. To some, that sends another signal of exclusivity. Finally, we point out the most overlooked aspect of this whole promotion is liability duration. US Bank is offering a 1.90% 5Y CD that in an up 200bp rate environment, has a duration of approximately 2.1. This is because the negative value of being short the call option for redemption overwhelms the value of the 3-month breakage penalty. As such, in an upward rate moving and volatile environment, the negative convexity skyrockets sevenfold, serving to decrease liability value. Contrast the US Bank effective duration with C1's Benz promotion. Giving away a high value item such as a car tends to keep depositors morally obligated to the term more than a 3- month penalty. In addition, C1 included a partial yield maintenance provision in their offering, combined with a $3k breakage fee. These factors give C1's promotion a theoretical (since we have never observed how balances react) duration of 4.6 and little negative convexity in an up 200bp environment. The difference in value is probably almost $60k by itself. While we are not advocating giving away a car with a CD, we are advocating trying creative marketing promotions that deliver positive quantified value. As highlighted today, banks shouldn't let tradition stand in their way, as they combine the best of marketing, sales and risk management to come up with ideas that can deliver more than an SLK for every shareholder.

Related Links:
C1 Bank Mercedes-Benz CD Promotion
PCBB 2012 Executive Management Conference

BANK NEWS

Hostile M&A

The parent company of Pacific Western Bank ($5.4B, CA) has launched an unsolicited, all-stock bid to acquire First California Financial Group ($1.8B, CA), after a prior offer was rejected. PacWest reportedly sent a confidential letter to First California's board on May 3 offering to buy the bank for $7.25 per share or a 32% premium above the closing price that day (about $212mm).

More Competition

The WSJ reports JPMorgan Chase is test marketing a reloadable prepaid card in some 200 branches and plans to roll it out to all of its branches this summer. JP wants to generate more fees, attract new customers and maintain existing ones. The Chase "LiquidÃ¢Â€Â card has a monthly maintenance fee of $4.95 and doesn't charge customers for reloading the card or withdrawing cash from ATMs.

New Competition

Barclays PLC will launch a new online bank in the U.S. and fund its credit card business with high yield online CDs paying 1% to start.

Small Biz Pressure

Analysis of 200k small businesses that use QuickBooks software from Intuit finds average revenues are up 9.5% since the recovery began, but remain below the 9.7% drop that occurred following the downturn and 11% below the pace of inflation over the same period. No wonder they are still feeling pain.

Greece

Analysts from Citi now put the odds at about 75% that Greece will leave the Euro in the next 18 months, after voters sick of austerity programs threw out pro-bailout political parties. Based on GDP, Greece is the 12th largest country in the EU and if it were a U.S. state, would be the 15th largest (just slightly larger than MD and smaller than WA).