YAWNING AND PREDICTING THE INDUSTRY PATH

by Steve Brown

Have you ever wondered why people yawn? Researchers have studied this for years and still are not completely sure. They know that both people and animals yawn and yet the definitive cause remains a mystery. Conjecture includes such options as yawning is a response to boredom; it brings in more oxygen; it stretches the lungs and is a way to increase heart rate, stretch muscles and make you feel more awake; it redistributes surfactant (an oil-like substance in our bodies that keeps lungs lubricated); or that it keeps the brain cooled down so we can think better. No one knows for sure why we yawn, but we can say that reading about yawning and looking at the picture probably caused most of you to yawn this morning. On the off chance that boredom is the driver for yawning, we move on this morning to a discussion about the industry.

People often ask us to project the number of banks that will be around in 5Ys and whether we are worried that the group we serve, community banks, could be squeezed out by the biggest banks. It is true that the top 5 U.S. banks now control 52% of industry assets and the top 100 brings the percentage to a whopping 84%. It is also true that in 1970, the top 5 banks only controlled 17% of industry assets and the top 100 took the total to 54% - a major shift over the past 20Ys or so. Even more startling, the top 10 banks now control assets that equate to 50% of U.S. GDP. That is an enormous concentration of risk and power and yet despite all of this, there were still 7,357 banks operating in the U.S. as of the end of 2011, so community banks continue to play a key role in economic growth and lending.

To get a handle on what may be, it is interesting to look back and see what has already happened. Over the past 5Ys, closures, new banks and mergers have resulted in a net contraction to the banking industry from 8,534 banks (at the end of 2007) to 7,357 (at the end of 2011). Running the calculation for each year, the average comes out to an annual decrease of roughly 3.6%. So, starting again with 7,357 banks and applying a flat 3.6% decrease to each year going forward, we end up 5Ys from now (end of 2016), with 6,125 banks operating in this country. Some will say that is still a large number of banks, but the changes to the industry are also important to understand. Consider for instance that in 2011, only 2 new banks opened vs. 155 that opened 5Ys prior. Consider as well, that about 430 banks have collapsed over the past 4Ys and another 800+ remain on the FDIC watch list. As such, more changes are likely in coming years, so expect the trend to hold, at least for now.

Beyond the past 5Y trend, the industry is also working through thousands of pages of new regulation that is changing how the industry operates. Capital standards are rising, bankers are rethinking business models, competition is intense given low loan activity and cost efficiency programs are everywhere. Regulatory pressure is intense and bankers are struggling to keep it all together as they try to service customers in need. All of these factors are putting enormous pressure on management teams and boards. The good news is that for bankers who stick it out and survive over the next 5Ys, the future looks bright because the very pressures you are feeling now will eventually and inevitably squeeze out lower performing banks and return your pricing power. It will likely still take some time for that to occur, but the good news is that the path appears to be set.

As the recession grinds on for bankers, things remain in flux for sure, but at least the historical data shows there will still be 6,000+ community bankers out there doing what they do best when we eventually come out of this economic funk.

BANK NEWS

M&A

Capital Bank Financial ($6.5B, FL) has increased the price it will pay for Southern Community Financial ($1.5B, NC) by $3.6mm (about 7.4% higher to $52mm) and modified the deal from cash and stock (originally was 60% in stock) to all cash. In addition, Southern shareholders could receive even more depending on loan portfolio performance over the 5Y period after the deal closes.

Operation High Roller

Security firms McAfee and Guardian Analytics report criminals have launched a sophisticated automated attack on large balance bank accounts, attempting to steal $2B. Hackers recorded login information, added requests for more customer information, intercepted one-time only passwords and even posted false balances so the victim remained unaware of the theft.

Bankruptcy

The City of Stockton, CA (with 300,000 people) is expected to formally file for bankruptcy, after 90 days of negotiations with 18 creditors failed to reach a deal. The city would become the largest city ever to file.

Busted

24 people were arrested in 13 countries, as a global undercover operation targeted credit-card hacking. The FBI set up a stolen credit card forum and exchange where it sold and purchased information that led to the arrest. As an aside, a typical stolen credit card number sold for about $21 on the site.

Competition

As part of a legal settlement, Chase will stop charging their $34 overdraft fees on transactions $5 or less.

Competition

Wells Fargo has increased the monthly fee for its value checking product from $5 to $7 (if customer agrees to receive only online statements) and to $9 if they want statements in the mail. Wells has made the change for new customers only and fees can be waived with a minimum daily balance of $1,500 or direct deposits totaling $500 for every settlement period.

SARs

While total SAR filings were up 10%, 1Q mortgage fraud SARs (composing 9% of all SARs) were down some 31% according to FINCEN.