TALKING IN YOUR SLEEP ABOUT BANKING

by Steve Brown

Somniloquy is the clinical definition of talking in one's sleep. The good news for those who talk in their sleep is that while it is considered an abnormal behavior, it is also very common and is not usually a medical issue. For those of you who have to deal with sleep talkers, medical professionals say not to worry because talking usually doesnÃ¢Â€Â™t last more than 30 seconds each time. Another strange thing about sleep talking - it can be loud, quiet, mumbled, or clear, so pretty much anything goes. Before we put you to sleep with our soliloquy, we focus again on areas of the bank where bankers are finding success in generating more bottom line performance despite sleepy industry conditions.

Here again, we use data from banks with assets between $100mm and $1B. Overall, expenses for this group of banks again adhere closely to the 80/20 rule, but things are flipped from the asset piece reviewed yesterday. Here, noninterest expense is 78% of total expenses and interest costs are 22%.

When it comes to noninterest expenses, the big dials you can turn that drive most of the cost for community banks are salaries and benefits (51% of total noninterest expenses), premises (12%) and a whole bunch of "other" that adds up to the rest. To get more performance here, at a high level you either have to find a way to boost productivity or deal with branches and offices. Of note, since 2008, salaries and benefits in aggregate for this group of community banks has declined 5% overall.

Interest expense is also driven by a few key variables. Here, 86% is driven by the cost of deposits, while the remaining 12% is the cost of borrowed money. In this area, bankers have done a good job driving down the expense load. Deposit costs are down 63% since 2008 in aggregate and borrowed money expenses are down 55% over that same period. Doing so allows banks to hold onto some of their margin, at least. To improve performance even more, keep working down your deposit costs and running off higher wholesale funding.

For expenses, adding up the cost of salaries, benefits, other non-interest expenses, deposits, premises and borrowed money captures 99.2% of the total. Given limited resources around the bank these days and soft loan demand, focusing in on expense areas where you can get the most bang for the buck just makes sense. One of the trends we have seen developing here is a stronger move by banks to accelerate their mobile banking offerings, as they explore more video ATMs.

Banking is all about taking risk to generate performance, but the type and sources of risk one takes matter. Currently, we have seen community banks go out longer on their maturities on the asset side in order to generate more yield (albeit only a small added benefit). This increases mark to market risk when rates rise, so if you are going to do that, seek loans over securities when possible. This is because loans do not have to be marked to market, while securities do. Another area community banks have fallen into is around credit risk. Once rates rise, floating rate loan costs rise and the borrower becomes more strained. If the economy isn't roaring along, this can reduce debt service on the loan and increase defaults. This is counter to what most expect will happen, but when rates are this low, an up 300bp scenario is still a pretty weak economy overall, so beware.

Nothing is simple when it comes to banking these days, but that doesn't mean it is time to sleep. Instead, know that low rates and high competition will pressure NIM lower over time. As such, assign teams to solve your biggest problems and seek out options to help your bank. Experiment with mobile, augment your online experience, review video ATMs and review anything that might improve fee income. In the meantime, have a good weekend and be sure to get some sleep to clear your mind.

BANK NEWS

M&A

Spanish banking giant Banco Bilbao Vizcaya Argentaria said it will sell its banking operations in Puerto Rico to Oriental Financial Group ($6.4B, PR) for $500mm in cash. The deal adds $5.2B of assets and 36 branches to Oriental's franchise.

Branch Closures

Bank of Montreal (BEMO) said it will close 24 branches in the U.S. in early Oct., as it integrates Marshall & Ilsley (which it acquired about a year ago). At the end of the 2Q, BEMO had 672 branches in the U.S., so the closures represent about 3.6% (most of which will be in WI).

Libor Scandal

British Treasury head Osborne said Citigroup, UBS, HSBC and RBS were being probed for allegedly providing false information on Libor. Barclays just paid a fine of $453mm to settle charges for its part in this scandal.

Basel III

The FDIC will hold a series of 6 regional sessions to discuss the multiple Basel III capital proposals and help community banks. The location and dates will be Dallas (7/20), NY (7/23), Atl (7/26), KC (7/26), Chicago (7/31) and SF (8/1). More info will be out soon so save the dates.

World's Record

Comerica announced that it was certified by Guinness as collecting the most paper in a 24-hour period when it held a public shredding event in Dallas several weeks ago. The event was designed to highlight the proper handling of records to prevent ID theft.

Municipal Stress

A report by Pew Center on the States, finds state governments face a gap of $1.4T between what they have promised public workers in retirement and what they can pay ($757B short for pension obligations and $660B short for health care liabilities). States in the worst shape were CT; IL; KY and RI; while those in the best shape were NC, SD, WA and WI.

No Jobs

The unemployment rate has remained above 8% for 40 consecutive months.