GROUP DYNAMICS AND INDUSTRY ANALYSIS

by Steve Brown

Seeing the picture, you might be smiling as you think about your next scheduled meeting. As you do, you might be interested to know that research from the Virginia Tech Carilion Research Institute finds small group dynamics (such as cocktail parties, jury deliberations, etc.) can reduce the IQ of some people in the group that are susceptible. For these individuals, social feedback can have a huge effect, reducing cognitive abilities and capability to solve problems. Wow, that is just weird, but also sort of interesting if you ask us. Another interesting thing happening in the banking industry is also one of the most concerning. Over time, large banks have absorbed so much in total industry assets that those over $10B now control 80% of all assets and the top 660 banks control 90% of all assets. That means the remaining 6,586 community banks are fighting tooth and nail for the remaining 10% of assets. Clearly the largest banks control the assets in the industry, but more concerns surface when you consider community banks are so reliant on net interest income to drive performance. Banks with $1B or less in assets derive 80% of total revenues from net interest income. That is tough when you consider the very largest bank competitors out there have just reported 3Q net interest margin (NIM) levels at the lowest levels in more than a decade. Such tight NIM is driving fierce competition for loans, so the sooner banks take action to try to stabilize the loan portfolio, the better. That means bankers will have to seriously consider reducing loan rates by 50bp to 100bp on the best customers in order to retain them over the next 12 months. This is just a reality of market conditions, so realizing that and moving to adjust makes it more likely you can maintain relationships with your key customers and protect the longer-term value of your franchise. As if that weren't enough, community bankers are also struggling with increased costs related to operations, new regulations, legal and other factors. These issues are combining with faster prepayments on existing loans and securities to put enormous stress on profitability. Banks can normally manage through these things, but the problem with buying securities at these levels is that the yield doesn't even cover overhead. That means bankers will have to take on more credit risk or more structure risk. Unfortunately, doing so also compounds risk in an already strained business model. There are some things you can still do, however, to protect your franchise. As part of a comprehensive plan, focus efforts to drive down the efficiency ratio to the 60% - 65% range. Next, take a long hard look at your branch structure. Mobility statistics and adoption rates are surging and fewer and fewer customers are coming into the branches anymore. You have to go get them where they work, so it is time to consider closing unprofitable branches. Where you can, don't be shy about charging for services. NIM isn't there and the infrastructure costs cannot decline quickly enough, so action must be taken. Dig into your relationships, understand where opportunities exist and surface areas where you can start charging more for services rendered. Then, experiment until you find what works and roll it out across the franchise based on customer segment. These are just a few areas where community bankers are working to protect their franchise during this difficult period. Times are tough and margins are declining, so no matter the size of the team you assign to solve a given problem, know it will be difficult. It also doesn't take a high IQ to understand difficulties in the industry will remain for some time to come. As one CEO recently pointed out - "This ain't a game for sissies." Keep fighting, make sure your groups work closely together to solve issues, and take action as quickly as possible to protect your best customers over the longer-term.

BANK NEWS

M&A

BBCN Bancorp ($5.1B, CA) will buy Pacific International Bancorp ($209mm, WA) in an all stock transaction valued at about $8.2mm.

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Royal Bank of Canada will buy Ally Financial's Canadian auto-finance and deposit business (with 580 auto dealerships across Canada) in a cash deal worth about $3.1B to $3.8B.

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TD Bank Group will buy Target's credit card portfolio with a current gross outstanding balance of $5.9B. The agreement is for 7Ys and makes TD the exclusive issuer of Target-branded Visa and private label consumer credit cards to U.S. customers.

Credit Reporting

The CFPB has begun accepting consumer complaints about credit reporting agencies, including incorrect information on a credit report, issues with an investigation, inability to obtain a copy of a credit score or file, or dissatisfaction with the reporting agency's resolution.

Debt Collectors

The CFPB is taking a hard look at debt collection agencies and will place them under federal supervision starting Jan 2, 2013. The CFPB will focus on collectors that have annual receipts of more than $10mm (about 175 companies that account for 63% of the business). There are roughly 4,500 debt collection companies in the U.S.

Moble Banking

A study by comScore finds about 50% of Americans own a smartphone, which is amazing when you consider the iPhone was only released 5Ys ago.

Student Debt

A report by the Institute for College Access finds the average student loan debt for the college class of 2011 reached a record $26,500, up 5% from the prior year. About 67% of those who earned bachelor's degrees last year took out loans to support themselves.