Solving Great Myesteries

by Steve Brown

One of the great mysteries over the centuries in high mountain regions has been the occasional sighting of a large, white, furry creature that walks upright on two legs. It is known as a Yeti, Bigfoot, or Sasquatch and it seems to hunger for a certain type of Wheat Thins. We always assumed this creature was an imaginary mutant animal like the jackalope or the Loch Ness Monster, but an Oxford scientist has isolated DNA from some hair samples and claims he may have found the answer. He found that the Yeti is most likely an ancient predecessor of a polar bear. While it could be a hoax or merely polar bear hairs imported from the Arctic to the Himalayas, similar samples were found in two locations some 800 miles apart. Even so, until a live one is captured, the mystery continues.

Another great mystery of banking life, proven primarily by anecdotal evidence, is the disappearance of interest rate sensitivity in deposit customers. Deposits have been very stable over the last few years. Interest rates are low, people are more risk averse and most seem content to leave piles of excess cash sitting in core deposits. That is great for banks, so most generally haven't spent a lot of time worrying about when these deposits could exit. Lately though, some banks have begun to see some runoff and have responded by raising deposit rates. It's been a tough few years to generate earnings, but with deposit rates so low, it doesn't seem like a little pre-emptive deposit rate bump should hurt anything, right?

No, that is absolutely wrong. Most management teams search for return on the asset side of the balance sheet, with primary focus on the loan portfolio. Like it or not, the pricing of loans is primarily driven by competition with a bit of extra available for relationship, but beyond that pricing is tight. Funding costs, however, are an area where banks can still have some control. Remember, every basis point of your bank's cost of funds impacts income $10,000 per $100mm of deposits. So if you can cut your funding costs by 10bps over time and your deposit base is $100mm, you have saved $100,000 per year!

It used to be you could just walk around to the branches of the biggest banks in your market, get their rate sheets and then add 10bps or so to the funding levels you would pay customers for deposits. Those days are gone and it now takes more than a tweak here and there to manage funding costs. This is a key strategic undertaking and when done right can give you more room to come down on loan pricing to meet the competition.

Let's think about two sales strategies to illustrate. First, we begin with the premise that cross-selling another product will increase the value of the customer relationship. Bank A leads its sales efforts with CDs and then works to cross-sell a checking account or money market to those same customers who buy CDs. Initially, this seems like a sound strategy as the checking account will reduce the overall cost of funds for that customer. But, the CD customer is still likely to be interest rate sensitive because that is how they entered the bank. Also, if the checking account is small, the reduction in cost of funds (COF) will be small. If the bank entices that same customer to open a checking account by paying a higher rate on the CD, the impact on COF is the opposite of what was intended.

Next, consider that Bank B has a loan customer and maybe a checking account as well. The bank offers this customer a CD to earn a little interest on their excess cash. This could drive up the COF for

the customer, but this customer chooses to work with the bank for reasons other than rate. As a result, the customer is less interest rate sensitive on both the deposit and the loan side. Plus, with an additional product, the relationship just deepened. In this case, the CD protects the checking and loan relationship.

Reducing your funding costs from current levels may seem about as easy as trapping a Yeti, but it is possible with consistent work. PCBB offers a service to help and it can make a difference. Call or email to find out more about our Liability and Strategic Coach service so you can compete more effectively.

BANK NEWS

M&A

NewBridge Bank ($1.7B, NC) will acquire Capstone Bank ($375mm, NC) for about $63.6mm in stock.

Settled

Wells Fargo has settled mortgage repurchase claims with the FHFA and will pay about $1B.

FOMC Confirmation

Janet Yellen is tentatively expected to have her confirmation hearing on Nov 14.

Capital Spending

A KPMG study finds areas community bank executives plan to increase capital spending in the next year include technology (50%), new products or services (34%), acquisition of a business (23%), expanding facilities (21%) and dealing with/controlling regulatory issues (21%).

GDP

JPMorgan projects Q4 GDP will be 1.5% and will grow to 2.0% at the end of 2014.

Social Time

SocialMedia reports the amount of time marketing teams spend weekly using social media to boost their business in order is 1 to 5 hours (36%); 6 to 10 (26%), 11 to 15 (11%) and 16 to 20 (8%). Those spending more than 30 hours per week totaled 7%.

Libor Lawsuit

FNMA is suing 9 of the world's largest banks, alleging they caused it to suffer about $800mm in damages due to their Libor manipulation.