Staring at Sensitive Communication

by Steve Brown

There was a recent study about the use of eye contact in business interactions. The study explored what sort of contact works best, what is scary and what looks shifty and dishonest. Most of us consider looking someone directly in the eye as the best way to gain trust. It is good to know, however, that the study found this approach may be less effective when seeking agreement or trying to convince others of an important point. The study also found that the right amount of eye contact was different, depending upon whether the person was talking or listening. The listener looks respectful and attentive by using eye contact, while the speaker can come across as domineering by using too much eye contact. Hopefully most of us have sensitive instincts, so we can change the approach depending on the situation. Maybe if people back away from you in meetings it is because you are staring too much.

Communication in banks between management, lenders and CFOs is likewise tricky and requires sensitivity and empathy - so try taking a walk in the other guy's shoes. Right now, management may be shocked at the low interest rates on loans that the market requires, lenders may complain that they can't meet the rate of the competition unless they lower rates, and CFOs can't figure out how to generate earnings.

There has been a meaningful rise in interest rates a few times this year as conditions have changed. With hindsight, this could have allowed banks to capture higher lending rates. Unfortunately, between slowing economic numbers and utterly unhelpful fiscal food fights, interest rates have dropped back considerably. In this low rate environment, what are bankers to do and in what direction should they be staring to see trends?

Loan growth is already difficult and competition is driving rates down even further. Managers are struggling with the fact that loan spreads are thin, so they may not be competing for loans at the prevailing market rate. However, this move (targeted at preserving the bank's NIM) comes at a significant cost. Consider that simply sitting and doing nothing doesn't change the fact that higher coupon loans originated 3 to 5 years ago are paying off, so NIM is compressing no matter what. Assuming that banks will continue to have a lot of liquidity for the foreseeable future, the CFO is left with the option of buying low yielding securities with risk to interest rate movement, or financially accepting lower coupons on loans to maintain performance over time.

No one likes the current loan coupon levels and we have all stared into the abyss now and again. But banks that continue to fight this compressing trend and try to keep higher coupons are naturally moving off-market by chasing worse credit quality (increases credit costs and capital losses), booking smaller loans (raises efficiency ratios and costs), booking transaction business with rate-sensitive customers (rather than initiating relationship business) or not booking loans at all (reducing profitability). The result for all of these strategies is to decrease return on equity and damage long-term performance.

Our advice is to stop staring and get involved. You cannot fight the market, but you can find spots that make sense given your community and bank structure. Holding the line on NIM just isn't possible without increasing risk, so keep moving forward.

The management team must help everyone understand the risk of inaction and we want to help you do that. If you could use a little help communicating the risk, contact us for a spreadsheet and we will send it out to you. Email if you would like to receive it.

BANK NEWS

Revenue Hit

A KPMG study of community banks finds executives say the areas most likely to negatively impact revenue are regulatory compliance costs (35%), low loan demand (25%), problems w/residential mortgages (23%), new capital requirements (23%) and margin compression (20%).

Cyber Risk

A Deloitte online poll finds 47% of business executives and managers say fraud protection is a high priority for them yet only 9% said their company has increased their fraud protection and detection budget substantially in the past 12 months (although 22% had increased them marginally while 21% had kept them flat).

Fee Income

A KPMG study of community banks finds executives say the areas that have the greatest potential to boost fee income are loan related fees (43%), credit cards (35%), ATMs (25%), checking accounts (24%) and mobile banking fees (19%).

Wealthy Customers

A Citibank survey of wealthy people (worth $25mm+) finds they have about 39% of assets in cash, 25% in stocks, 17% in bonds and other investments of about 17%. About 77% of this group expects interest rates to rise.

Leveraged

Thomson Reuters reports leveraged buyout activity among companies has driven debt levels compared to earnings before interest, taxes, depreciation and amortization (EBITDA) to 6.15x for large transactions vs. 5.90x in 2012.

Customer Targeting

A survey by SocialMedia finds the primary channels business to business marketers use in social media are Facebook (29%), LinkedIn (29%), blogging (19%), Twitter (16%) and YouTube (4%).

Municipal Risk

Research finds there have been more than 600 municipal bankruptcies in the past 75Ys.

Libor

The European Union is reportedly preparing to fine European banks $5B related to the Libor scandal.