The BOLI Assassin

by Steve Brown

Everyone in the banking industry knows that it has been a challenging time to generate earnings, but we heard a story the other day with a different idea that we thought we should pass along. There was a bank which had an executive who unexpectedly and tragically died. The bank held a bank owned life insurance (BOLI) policy for this executive and upon his death, there was a death benefit to the bank. This was at the height of the financial crisis and in the end, this infusion of cash from the bank's BOLI kept the bank from posting negative earnings in the quarter and for the year. In times of contracting NIM, shrinking loan portfolios and low yielding bond portfolios, one must at least consider such imaginative solutions. All joking aside and despite what follows, we don't suggest you should bump off your executives to hit your earnings targets.

Picture this scene in the board room with the executive management team. Shareholders are cranky and are tired of being told to wait yet another quarter for a meaningful dividend. Something must be done to generate earnings right now! Straws are drawn on who will make the ultimate sacrifice and the BOLI assassin is called. The CFO would need to assess the policies where the death benefit would exceed the carrying value in order to have the benefit reported as a gain and recognized in current earnings. Tough times require tough solutions.

Somehow we are not sure there will be wide adoption of this earnings generation strategy even though a lot of banks are pretty desperate to generate earnings. So much about the competitive environment makes every move feel defensive. Rates on loans have to be lowered to win a deal or even keep a current customer. Competition is high. Existing fixed assets on balance sheets are experiencing margin compression as rates rise. Existing floating rate loans may experience declining debt coverage as rates rise. Bankers just can't seem to catch a break.

It is time for banks to start investing in assets that will improve earnings when rates go up, rather than trying only to figure out how to manage the interest and credit risk on what is already there. A steady pipeline of new business exists in some markets but it's probably not the norm for most banks.

Let's think about doing more with what you already have. Is your bank reaching out to customers before their loans mature and offering them the opportunity to refinance at a better rate or to lock in a low rate for a long term? If you are not, you can be fairly certain that your competitor is given all the technology and information available now, so refinancing risk is inherent in the existing loan portfolio. Refinancing isn't pushy behavior, but it is pro-active behavior that not only protects your existing business but makes customers feel highly valued. Loss of current NIM is an issue of course, so some banks just hope the customer will stay until the end and roll over at that point. While rolling a loan prior to maturity may reduce NIM in the short term, it is an unfortunate reality and it sure beats losing the client altogether.

This is where techniques like hedging or proactive deposit management can provide benefit. If you hedge your good customer's loan, then their rate and payment is fixed and that makes them happy. The instrument on your books floats, so that makes you happy, but your current interest income may decline at first so that makes you sad. While the immediate decline of interest income doesn't feel good, it is far better than seeing a valuable customer leave. The same can be said for proactive deposit management whereby you can reduce funding costs so you can more easily digest lower asset yields.

It's time to get proactive and focus on ways to build a book of assets that will react positively when rates rise and a funding base that will hold the line to give you room. There is no need to hire an assassin when prudent management can do the trick. Plus, putting on the costume in the picture can get a little weird when you are strolling around the bank.

BANK NEWS

More Security

MasterCard and Visa are working together to jumpstart a group designed to improve security around card processors, following the breach at Target and other retailers. One purpose stated by the duo will be to push forward the move to move to chip-based EMV cards.

Small Biz

The National Federation of Independent Businesses (NFIB) reports small business optimism dipped in Feb to a level normally associated with recession or below average growth expectations.

Competition

In an effort to build its brand, Wells Fargo said it will launch a self published online magazine called Wells Fargo Stories. The magazine will feature stories about employees and customers and include articles about Wells Fargo.

Risk Manager

In short, the job of a risk manager is to identify things that could hurt the bank and then work with other employees to stop them from occurring (or protecting the downside within acceptable levels). Further, when issues arise, it is their job to quickly pull together key players that can solve the problem and work quickly to resolve (plus limit the impact).

Unwinding Stimulus

The Fed is reportedly considering using the interest rate it pays on excess balances left with it as a primary mechanism to unwind stimulus in the market, rather than moving Fed funds rates as it has in the past. Discussions are preliminary and we will keep a close eye on things since so many community banks use Fed funds and Prime (based on Fed funds) for liquidity and lending purposes, respectively.