The Tightwad Bank

by Steve Brown

A village in western MO near the KS border is actually called Tightwad. The name reportedly came from an incident in the village general store in the early 1900s, when the Postmaster came in and bought a watermelon. Because the Postmaster needed to make his rounds, he left the watermelon at the store intending to pick it up later in the day. While he was gone, another customer came into the store and offered more money for the watermelon. Seeing an opportunity, the storekeeper reportedly accepted the higher offer and the Postmaster didn't get his watermelon. Since he was the Postmaster and he was not amused by this turn of events, he exercised his prerogative and renamed the Post Office to Tightwad.

If you haven't been there, this town of 63 people has a caf?, tavern, convenience store and a $7mm bank. The current bank began as a branch of the Reading State Bank but in 2008 it took on the name Tightwad Bank. The bank certainly has a sense of humor and is making the most of things by selling shirts, ball caps and coffee mugs with its name emblazoned on them. This just goes to show you there is always a creative way to generate non-interest income, regardless of the size of your bank.

Non-interest income has always been the magic pixie dust community banks have searched for since the beginning of time. Because of structure and other factors, it is also much more difficult for community banks to generate than large banks. As if that weren't enough to deal with, one of the biggest components of non-interest income historically has been service charges, which have seen an aggressive regulatory crackdown. Whether your customers are tightwads or not, the disappearance of overdraft fees is a major reason banks struggle to increase non-interest income.

Delving a bit deeper into the data, we find the components of non-interest income differ greatly between community banks and larger banks. For example, banks with assets $10B+ have much more trading revenue, plus items like venture capital revenue. Meanwhile, banks < $10B rely more on service charges (24% for banks < $10B VS 17% for larger banks according to SNL) and fiduciary fees (16% for banks < $10B VS 7% for larger banks). Looking back to 2007, the makeup of the non-interest income pie is even more different, with much more coming from service charges driven by overdraft fees.

As a whole, the percentage of operating revenue coming from non-interest income for large banks has been around 40% for many years. However, since the financial crisis this number has dropped to the mid-30s. By contrast, non-interest income at banks under $10B has remained steady around 25%.

Increasing non-interest income is challenging for banks of all sizes, but this is especially true for community banks. The simple problem is that there is only so much that can be squeezed in fees from existing customers or from internal cost cutting.

At this point in the cycle, the good news for community banks is that loan demand is picking up so building non-interest income is becoming less important. In an encouraging and related sign, late 2013 survey data shows 45% of banks said they intend to hire commercial lenders over the next year and another 20% intend to hire additional staff for their retail and administration teams.

No matter your own bank's situation right now, hopefully these signs point to an opportunity for growth and increased profitability. In the meantime, we recommend your bank continue to be a tightwad with expenses as you invest in growth.

BANK NEWS

Wire Fraud Alert

A high-level bank regulator has alerted us of a fraud scheme involving hackers in Europe and China. Under the fraud, the email address of the president of a company is cloned and an email is sent from that address asking banks to wire funds to accounts overseas. Then, when bank personnel call the company to verify the wire request, the CFO of the company confirms it believing the email is from the president of the company. Be careful because the best case scenario is you lose the customer! Be especially careful of wires going to Romania, China or Hong Kong.

M&A

First National Bank of Pennsylvania ($13.4B, PA) will acquire OBA Bank ($386mm, MD) for about $94mm in stock.

M&A

MainSource Bank ($2.9B, IN) will acquire Merchants Bank and Trust Company ($225mm, IN) for $33.8mm in cash (40%) and stock (60%).

Branch Sale

Bank of America has sold 11 branches in MI to Huntington National Bank ($59B, OH) for a 3.5% premium. The branches reportedly have about $450mm in deposits.

FDIC Study

A study of banks by the FDIC finds there are more banks with assets between $100mm to $1B now than there were back in 1985, showing community banks are resilient despite industry and economic pressures. During this same period, however, banks with >$10B in assets grew more than 10x. In really good news from the study - community banks failed, merged or closed at a lower rate than larger banks during this period.

Competition

Bank of America said it has rolled out chip and PIN cards (EMV cards) to smaller business clients that use their credit cards globally.

Branch Closures

Citigroup said it will close 33% of its branches in South Korea as it seeks to cut costs and adjust to changing customer behaviors.