An Empty Cart Is A Good Thing

by Steve Brown

There is a memorable scene in the movie Monty Python and the Holy Grail where Eric Idle walks along with a cart carrying victims of the plague and calling out. The movie is set in a medieval period, so the cart rolls down the narrow streets as Idle bangs on a triangle and calls "bring out your dead!" One man runs out of his house concerned that the next pickup won't occur for several days, so he puts his not-quite-dead grandfather on the cart. The grandfather protests, saying "I'm not dead yet, really I'm getting better." You may recall that things don't end so well for grandfather and the skit shows Monty Python, while very funny, was often not gentle!

Five or so years ago, there were a lot of people who thought the U.S. banking system was in a similar state as plague ravaged Europe in the times of King Arthur. Folks were just waiting for the cart to come along. Since then however, the industry has healed slowly but surely and the trend is continuing to get better.

It is true that many banks failed. There were 140 failures in 2009, 159 in 2010 and 92 in 2011. That level has since dropped to 51 in 2012, 24 in 2013 and now only 5 through Feb 2014. Meanwhile, as the rate of bank closure by regulators has slowed, the number of mergers and acquisitions has held relatively steady. In fact, the math shows about 1% of banks under $1B disappear every quarter - a percentage that has held pretty much the same for decades.

Beyond bank closures, another metric many analysts track for bank system strain is the Texas Ratio (i.e. how much bad stuff do you have compared to your capital to support it). As credit quality has improved the number of banks with a Texas Ratio over 100% (tipping toward failure) has declined. Consider the number fell to 203 banks at the end of 2013 vs. 235 at the end of Q3 2013 and 300 at the end of 2012. That is indeed improvement. What is interesting in the data; however is that the median adjusted Texas Ratio has improved from the beginning of the crisis but has not dropped dramatically. The median ratio in Q4 2013 was 161% vs. 155% Q3. This data shows how long it can take for some borrowers to heal, despite a recovering economy. It also may provide evidence of intractable problems in some of the remaining banks with high Texas Ratios.

Comparing a few data points together, consider that as of the end of 2013, the average Texas Ratio for banks under $1B was about 21%. That is just under the broader national average of all banks, so as goes the industry so go community banks. Shifting to the percentage of nonperforming assets to loans, we note that since the end of 2009 banks under $1B in assets have seen a decline from 4.0% to around 2.8%. Finally, also during this time, the allowance for loan loss reserves has dropped steadily from a national average of 3.23% at the end of 2009 to 1.72%.

Lots of banks we talk to worry about net interest margin (NIM) and who could blame them. Here, we point to a recent SNL Financial analysis that looked at earnings reports across the industry. It found gradually improving NIM across the last 2 quarters of 2013 - a great sign indeed. Further, commercial bank NIM rose in Q4 to 3.25% from 3.24% Q3. While this remains below the 3.36% of a year ago (when looking at all banks), for banks under $1B, NIM has risen to 3.72% in Q4 from 3.70% in Q3. Perhaps even more important, it has held steady from the level of a year ago.

Banks have been swamped by liquidity as loan demand has been difficult to find. It is surfacing though and looks sure to continue to increase as the year progresses. Given a lower yield from securities, improvement in NIM will continue to happen as investments are reallocated into loans.

Whether you enjoy Monty Python movies or not, there is always something to smile about if you ask us. As with banking, the rate of improvement may not be moving very fast, but it is happening so the medieval cart is empty. Enjoy the recovery and look for loan demand to continue to pick up in coming months and quarters!

BANK NEWS

Mobile Growth

We took a quick look at public documents from some of the largest banks and found the following: JPMorgan Chase had 16.4mm mobile banking users as of Q1 2014 and saw YOY growth of 24%; Bank of America had 15.0mm (19% YOY growth) and Wells Fargo had 12.5mm (24% YOY growth). Hopefully this data gives you more information when weighing branch expansions and changing customer behavior over time.

Strange Situation

A Bank Director survey of bank executives and directors finds more than 50% say they plan to buy a healthy bank this year but only 5% say they are willing to sell.

FX Extension

The CFPB has proposed revisions to rules around international money transfers for consumers to allow federally insured institutions to estimate 3rd party fees and exchange rates until 7/21/2020 (a 5Y extension from the current deadline to comply).

More Cyber Risk

Comptroller of the Currency Thomas Curry warned in a speech that he expects cyber criminals "will turn their attention to community banks" because large banks have more sophisticated defenses and specialized expertise and don't rely as much on vendors for IT and security services. As such, he indicated exam teams will focus additional efforts on controls and risk management practices at vendors that provide services to banks and thrifts.

Customer Risk

A 2013 survey by the National Small Business Association finds the average cost of a cyber attack to a small business was $8,699.