Managing Rising Funding Costs

by Steve Brown

We recently held our annual PCBB Executive Management Conference and our biggest priority from the event was to give community bankers real ideas to take home and immediately apply. The amazing thing about this event is that ideas come from many sources including speakers, other bankers and even attendee experiences. One interesting idea surfaced at a dinner where some impressive drinks were served. These drinks were so fancy, in fact, that our over-the-top waiter described one as "smells like green grass on a rainy day." We wanted to laugh, but after smelling the drink, we had to say that the waiter nailed the description 100% and we bought into the "infused drink" craze.

One area where community banks try to infuse logical thought processes (albeit to varying success) is in controlling funding costs. Here many banks we talk to feel they have done so much that little more can be done, but we find opportunity still abounds.

Over the past few years, bankers have experienced a period of funding stagnation, with Fed funds rates sitting at rock bottom and money flowing into the coffers. Everyone knows change is coming, but most think Fed tightening is at least a year away. After all, inflation remains low and economic readings are still mixed, so that seems about right. Consider that it has been 11Ys since the last tightening! That is a long time, so it is equally interesting to note that there are probably quite a few on your staff who have never experienced a rise in Fed funds.

That is probably one reason why regulators are expressing so much concern about what may happen to funding costs and deposit portfolios when that time comes. Regulators are very worried about "surge deposits" that might exit banks once rates begin to rise. That is a risk, but what can a banker do? We suggest you roll your deposit structure back to 2006 levels (pre-crisis) and apply that to your current funding base to see what your bank might look like and what risks may exist. At the very least it will help you better prepare.

We all know that deposit rates will increase at some point, so how you manage this change both now and in the future are critical. Most banks have the lowest cost of funds that anyone can remember right now and depositors are probably the least interest-rate sensitive than they have ever been. That is great, but once rates start to increase, we would expect customers to wake up as well and become more rate-sensitive. The internet delivers much more information than in past rate cycles, so expect your customers to respond in a more educated and more expedient fashion. To minimize the level of sensitivity, don't wait for this and instead take action now to understand customers and the options you may have.

Banks that take steps now to act purposefully (vs. reacting without a plan) stand a much better chance of controlling funding costs over the longer term. Eliminate rate sales, like special rates on CDs, to avoid destroying earnings or rate-sensitizing customers. Then play to your strengths as you help customers understand the outstanding customer service you provide. Avoid price discussions at all costs, as you train customers to assess their overall relationship with your bank and understand its value.

Your bank will probably never be known for serving odiferous infused drinks that "smell like green grass on a rainy day," but customers need to get a special feeling when they deal with your bank every day. If your customers are banking with you for a reason other than price, you have a better chance of exceeding their expectations with each interaction as you infuse the relationship with strength to withstand much more than a change in interest rates.

BANK NEWS

Clarification

We wanted to clarify our story from yesterday about Union First Market Bank ($4.2B, VA) closing 13 branches to save expenses. We should have indicated further that the closures in question specifically relate to overlapping branches picked up as a result of a recent acquisition (StellarOne).

Customer Shift

Community banks should note an estimated 3mm business owners are expected to sell their businesses in the next 5Ys.

Layoffs

Bloomberg reports Barclays could lay off 7,500 people at its investment bank as it seeks to boost performance and adjust to weaker fixed income and securities activity.

Better Situation

The latest survey of economists by the National Association of Business Economics (NABE) finds 80% expect the economy will grow at least 2.0% this year and 53% said business sales growth is increasing.

Layoffs

JPMorgan Chase reports it has laid off 3,000 people in its mortgage banking unit since the end of last year, as mortgage activity has declined.

Warning

The OCC is warning banks to understand the implications of where data is stored or transmitted and to have appropriate risk management practices in place, as the regulator seeks to tighten up cybersecurity around bank vendors and service providers operating in foreign countries.

Biz Customers

Research by Vocus finds small business owners list the following areas as those where they spend the most marketing dollars: email (15%), events or tradeshows (14%), person to person (13%), print ads (11%), direct mail (10%), social media (8%), search engine optimization (8%), online display ads (7%), TV advertising (5%) and radio advertising (4%).

Internet Connectivity

Research by NPD Group finds the average household has 6.5 internet connected devices.