Who Is The Competition?

by Steve Brown

Humans are a competitive species, and probably have been so since the beginning of time. As we have developed our habitat over the eons, most of us have moved away from our hunter/gatherer beginnings, and a lot of our competition has moved to the physical in the form of sports. Some people actively participate in sports, while others like to be spectators. The result has been significant growth in the professional sports industry and the resulting flow of money to support it. In the end, while fans may chant "beat the heck out of those guys," the reality is that a team's success in competition is significantly determined by financial forces fans can't see. Because it is their business to know, bankers understand financial success determines which teams can afford the best players, coaches and stadiums, and consequently, (with a few notable exceptions) who wins.

In this area, we recently surveyed hundreds of community bankers. We looked at a number of issues community bankers are dealing with currently and found similarities with the sports world, particularly around competition. We asked this group of community bankers who they identified as their primary competitors for loans, and the top response was other community banks at 31%, 26% said it was the top 10 largest banks and 23% said it was banks with assets $10B or more.

Despite this heavy competition from all angles, 63% of these bankers said they expect their loan portfolios to grow more than 5% over the next year, so things are looking up. That number could even be low when you consider that the latest ABA Bank Economist Survey expects growth of 9%--let the good times roll.

Interestingly, despite recent announcements in the press and loan growth into the billions, only 10% of survey respondents thought non-bank lenders were a significant competitive force. In fact, when asked specifically about peer-to-peer (P2P) or non-bank competitors, 50% said it wasn't much of a concern right now and 18% said the P2P model was unlikely to work due to the complexities of lending. Only 16% felt P2P lending was likely to catch fire. As this area is still evolving, we will have to wait and see who is right, but it is interesting.

Of the P2P lenders, Lending Club is the biggest, and while it initially acted as a facilitator between individuals who wanted to lend and those who wanted borrow, the model has become a lot more institutional. Lending Club has recently entered into a strategic alliance with Union Bank (and other large banks), which plan to purchase loans it generates through the platform. While still early goings, it appears P2P lending platforms are increasing the efficiency of underwriting small loans cheaply and the large institutions want to buy the loans for their portfolios. For its part, Prosper (another P2P lender) says it now sells 60% of its loans to institutions, up from 0% in 2013. Given increased institutional interest in buying loans, it is no wonder that spreads have narrowed over time. Whether you are a fan (or not) of this sort of lending, we have even heard talk of securitizing these loans.

In any case, we think P2P backed by large institutional money could represent a significant competitive challenge to community banks. Perhaps that is why 16% of respondents said "it is a concern and we are monitoring it." As things evolve in this area, we also think this is a good approach.

BANK NEWS

Big Fight

Bloomberg reports the DOJ is asking Citibank to pay $10B to settle investigations into the sale of certain mortgage backed bonds prior to the financial crisis, while Citi is countering with $4B. This follows a demand for Bank of America to pay $17B vs. $12B offered that also surfaced recently.

Economic Growth

CNBC reports the Fed's most recent economic projections in Mar have GDP of 2.8% to 3.0% this year, which doesn't seem to be attainable given the Q1 decline. Perhaps that is why the World Bank just reduced its expectation for U.S. GDP from 2.8% to 2.1%. Or, perhaps it is why the CBO is projecting an average GDP of just 2.1%.

Cyber Attacks

The May 2014 RSA Fraud report finds there were 52,554 phishing attacks in Apr, a 24% increase vs. Mar. Meanwhile, banks are the most targeted entities with 58% of total volume.

No Homes

A survey by the National Foundation for Credit Counseling finds 18% of people don't think a home mortgage is worth the risk, the lowest level in 19Ys.

Surge Deposits

The CFO of JPMorgan at a recent investor conference said they expect Fed balance sheet contraction and the reversal of quantitative easing to result in $100B of deposit outflows for the bank. While a larger scale, perhaps community banks can use this same ratio to stress test your own deposit base to see what happens.

Home Equity Lending

Inside Mortgage Finance reports that home equity lines of credit and home equity loan borrowing increased 8% in Q1 YOY, the biggest increase in a quarter since 2009. Banks are typically offering such loans only to borrowers in good locations and to a maximum of 80% to 85% of the home's value.

Risk Management

Reuters reports large banks (so trickle down is likely) are expending more resources to identify and manage operational risk. The move comes after billions in fines have been paid in recent years.