Schlock, Schmaltz And Nostalgia

by Steve Brown

There are some songs that everyone loves, and yet critics and those with discerning taste absolutely detest them. These songs are devoid of sophistication, subtlety or wit. They are derided by the sophisticated as mere schlock. They tend towards melodrama and are shamelessly emotional. We are talking about "You'll Never Walk Alone" from Carousel or Barry Manilow's "I Write the Songs". They are the opposite from Led Zeppelin's "Stairway to Heaven." No matter how you see it, the definition of schlock is something akin to the nostalgic fondness for things past that were pleasant but inconsequential.

We bring this up because many in bank management could use a little nostalgic fondness from their regulators these days. In all fairness, bankers are reporting that their most recent exam was easier than the previous one (some 45% in a recent PCBB survey said somewhat easier and 10% said much easier). The burden of regulation hasn't gone away by any means, but it seems regulators have changed their focus somewhat. Credit problems have mostly cleared up, but a host of other issues are of concern including impending tightening Fed policy and its impact on interest rate risk. No one knows exactly when, but after a flat Fed Funds rate for more than 5Ys, it will represent a shift in both strategy and customer behavior.

There is also new concern about liquidity, due to the large customer migration to core deposits from time deposits. This is called "surge" deposits in regulatory circles and it essentially is the concern that deposit levels will drop back to around 2005/2006 levels for banks. Many wonder what the impact could be and many worry about the potential for a substantial shift in customer behavior when more attractive deposit rates appear.

To prepare, you might start by looking at historical data to estimate how customers will react. The good news is that there is plenty to be learned by looking at your bank's deposit mix in the past. One issue though is that most banks have insufficient history to judge. Certainly data from the past 5Ys will be of little use, so what do you do even if you have data back to the last increasing rate cycle? We note that the last Fed tightening cycle began 10Ys ago and many competitive forces like internet banks and non-bank institutions simply didn't exist then. Your bank may be able to do the math, but do the results make sense?

Regulators want to see that banks have adequate liquidity in a variety of economic scenarios, so stress testing is critical to understand the impact despite industry changes over the years. Banks have reported that during exams, regulators want to know under what economic circumstances the bank has issues in a liquidity stress test, plus has contingency funding plans in the event of various negative outcomes.

How does a bank aggregate the information to do such a test? To begin, the information is very complicated to compile manually and most ALM models measure economic value rather than cash flow, so it isn't all that easy. Most banks will likely use two models to achieve the desired result, but the assumptions in the models may differ so your bank may get dinged on model governance if these can't be reconciled.

For our part, PCBB has taken the approach with our outsourced ALM model service that both economic and cash flow views are necessary, as well as a reconciliation of the assumptions. The assumptions can then be stress tested as well, to get a truly comprehensive view.

Viewing the history of your deposit portfolio with nostalgia may offer context but the resulting tune is unlikely to give you a satisfactory base upon which to build contingency plans. No bank would ever say the baseline for analysis is based on schlock, but without further analysis, it just might be. Call us to see how our ALM service carries a tune that will save your bank time and effort.

BANK NEWS

M&A

First State Bank ($722mm, TX) will acquire North Texas Bank ($146mm, TX) for an undisclosed sum.

M&A

American Bank ($325mm, WI) will acquire InvestorsBank ($204mm, WI) for an undisclosed sum.

M&A

First Midwest Bank ($8.2B, IL) will acquire Great Lakes Bank ($576mm, IL) for about $58mm in cash and stock.

Loan Warning

JPMorgan reports bankers are privately saying higher C&I lending is primarily going to fund dividend payouts, M&A and domestic energy and not much is going toward business expansion.

Fined

The Wall Street Journal reports Citigroup is close to a deal where it would pay $7B to settle allegations it sold bad mortgages prior to the credit crisis.

FOMC

The Fed said they will end their bond buying program by Oct, but timing of rate hikes continues to be debated.

Squeezed

The Wall Street Journal reports that despite expense controls and cost cutting, noninterest expenses (salaries, IT investments, compliance costs, etc.) at the 6 biggest banks have climbed 9.6% from 2009 through 2013, while revenues fell 9.7% during the same time. Meanwhle, this group of banks has cut about 7.5% of their staff since 2011.

Interesting

Fed Richmond President Lacker said he sees sustained economic growth above 3.0% in the near future as "unlikely" and that a rate of 2.0% to 2.5% is probably the more likely scenario.

Good News

The latest report from Biz2Credit.com finds approval rates for small business loans increased in June.