How To Balance Customer Profitability& PPP Forgiveness

by Steve Brown liquidity customer profitability PPP

Summary: Financial institutions are flush with cash and looking for opportunities to turn it into long-term assets. With loan activity still mixed and PPP forgiveness leading to more cash, community financial institutions are looking for ways to manage their balance sheets. We give you two steps that you can take today.

Today is National Peanut Day. Since school is back in session and many school children eat peanut butter and jelly (PB&J) sandwiches for lunch, we thought it was interesting that the average student will have eaten 2K PB&J sandwiches by the time they finish high school! That is an abundance of peanut butter and jelly!

Right now, though, bankers are more focused on the abundance of liquidity. Cash is sitting readily available at financial institutions to deploy into earning assets. But, with loan demand weak and interest rates still low, options to make excess cash work to the advantage of the community financial institution (CFI) are minimal. CFIs are poised and ready to pounce on opportunities when rates begin to increase. In the meantime, how much further will our margins be compressed? With excess money out in the market, the economy is certainly stimulated, but lending opportunities are mixed and credit spreads may continue to tighten.

PPP forgiveness and your balance sheet

An issue that CFIs need to keep in the forefront of their minds is to watch asset mix changes due to Paycheck Protection Program (PPP) forgiveness. Asset levels have been overinflated due to PPP volume for most lenders. As PPP loans are forgiven, total assets are likely not to decline, but rather shift into even more cash residing at the CFI. As this cash is received, earnings may drop as opportunities to lend remain highly competitive and scarce.

As PPP loans make up a higher percentage of the total loan portfolio for CFIs over larger financial institutions (FIs), inflated loans to assets ratios are prevalent for smaller institutions. CFIs under $5B in assets are reporting current loans to assets ratios of 64% as of March 31, 2021; this compares to 58% if the remaining PPP volume is rolled into liquidity and retained by the institution. For national FIs over $5B in assets, loans to assets ratios are less affected by PPP volume, but still are under 50% of total assets.

As of May 24, 2021, $81.5B in PPP loans were still under forgiveness review and $159.1B in forgiveness applications had yet to be received by the SBA. With such a large amount of potential movement from the loan portfolio to further increasing cash, it is vital to consider what your CFI's balance sheet may look like while forecasting for the year ahead.

What can CFIs do today?

1. **Search out opportunities to improve customer profitability.** This is something you can do with your current data. Review your customer relationships to see which ones are more profitable

than others. For those that are less profitable, do you have plans in place to change that? For your most profitable customers, how can you increase wallet share? Are there any other services they may need that you don't currently provide?

2. **Uncover prospects to increase income.** Right now is a good time to look for opportunities to expand your fee income through areas such as international services, cash management, and wealth management. Review transaction history and engage your tellers, customer service centers, and other client support staff to ensure that they know you provide other services to support clients. Then reach out to your profitable customers and make it easy for them to add more services. This may mean breaking down barriers between departments or changing incentive plans. But, it would be worth it. Providing valuable services to your business customers will not only increase your bottom line and improve your balance sheet, but also boost their loyalty.

COMPETITIVE AND CONSISTENT LOAN PRICING

Achieve a 360-degree customer relationship view so you can determine the best loan pricing based on your customer data while driving higher bank profitability. Learn more about Profitability FIT.

ECONOMY & RATES

Rates As Of: 09/13/2021 05:33AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.05	0.01	-0.04
6M	0.06	0.00	-0.03
1Y	0.07	0.00	-0.04
2Y	0.22	0.01	0.10
5Y	0.82	0.04	0.45
10Y	1.33	0.02	0.41
30Y	1.91	-0.02	0.27

FF Market	FF Disc	IOER (Interest on Excess Reserves)
0.08	0.25	0.00
SOFR	**Prime**	**OBFR (Overnight Bank Funding Rate)**
0.05	3.25	0.07