Three Ways To Generate Income

by Steve Brown   deposits net interest margin yield curve

Summary: With increasing interest rates, community financial institutions stand to enlarge their net interest margin. Yet, lending competition is fierce in many areas, so it won't always be easy. We give you three ways to generate income in the current rate environment.

Did you know that the Twitter logo bird's name is Larry after Larry Bird, the Boston Celtics basketball player? Twitter's co-founder, Biz Stone, was the one who named it Larry in tribute to the player and his favorite basketball team. Fittingly, the bird's name was announced in a tweet.

You may find bankers tweeting more about interest rates these days, as the industry is embarking on a year of expected rate increases. With the recent 0.50% interest rate hike and several more to come, bankers have more opportunities for interest income. Yet, competition for loans in some regional markets remains cutthroat, and in some cases, loan interest rates offered to customers have remained lower than the yield curve. Luckily, rates on deposits are not expected to increase as quickly as seen in prior cycles of increasing rates, due to the current liquidity excess. With this type of rate environment, here are three ways for community financial institutions (CFIs) to generate income.

1. **Managing yield**

A rising interest rate environment, especially one where deposit rates likely will have a lower beta, is a great opportunity for CFIs to gain some ground on net interest margin (NIM). Pricing loans adequately to take advantage of the rising rate environment is vital, as well as keeping in mind that those loans will likely still be on the books when deposit rates are raised to catch up with market rate increases. The competitive loan demand that some institutions are seeing has resulted in the borrower commanding certain loan terms. However, it is imperative to consider the institution's profitability for today and the immediate future. Different rate structures and terms, prepayment penalties, reasonable loan fees, and credit risk management can all help protect the profitability of the institution.

2. **Reducing costs**

Costs on deposits have been quite low during the past 2Ys, as institutions have been flush with excess cash, thanks to stimulus funds. Institutions should take advantage of the low cost of deposits, as it will eventually rise with increased competition. Also, a part of reducing costs is reducing overhead. If CFIs have been hiring during this tough job market, costs of salaries and benefits have probably increased. Yet, it's also possible that your institution has improved overhead costs, as some employees have worked remotely and had limited travel. Managing noninterest expenses and improving your efficiency ratio should be top of mind to remain competitive with rates and not have to chase more risky borrowers to get higher yields.

3. **Generating ancillary income**

Although we can expect NIM to improve with the increasing rate environment, generating noninterest income is an important addition to an institution's profitability. Large banks historically generate significantly more fee income than CFIs. Since fee income generation can be an important part of an institution’s bottom line, it’s in the best interest of the CFI to keep a close eye on service charges or other fee generation opportunities. This may be more difficult if CFIs have to follow suit with the largest institutions in getting rid of or reducing overdraft and nonsufficient funds fees. Generating additional income not related to NIM can also be difficult, if the institution does not have other sources of income such as trust, international, or cash management services. Adding noninterest, income-generating products and services to the institution can help balance out fluctuations in NIM.

Finding ways to boost your income as rates go up and deposit betas stay low is key for your bottom line. Making shifts to manage yield, reduce costs, and generate supplementary income today will help you stay competitive now and in the future.

INTERNATIONAL SERVICES TO GROW WITH YOUR CUSTOMERS

Capture more customers and increase fee income with our international services. Contact us today to learn more.

ECONOMY & RATES

Rates As Of: 05/20/2022 05:42AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	1.05	0.20	0.99
6M	1.52	0.11	1.33
1Y	2.10	0.01	1.72
2Y	2.63	-0.09	1.89
5Y	2.84	-0.12	1.58
10Y	2.84	-0.10	1.32
30Y	3.04	0.04	1.14

FF Market	FF Disc	IOER (Interest on Excess Reserves)
0.83	1.00	0.90

SOFR	Prime	OBFR (Overnight Bank Funding Rate)
0.79	4.00	0.82