

Singing About Bank Failures and Cost of Funds

by [Steve Brown](#)

We saw that 1960's icon and Canadian musician Joni Mitchell is having her 70th birthday. She's an artist we enjoyed as a kid and into adulthood, as her intelligent style migrated from folk to jazz and beyond. Her talents covered a broad spectrum as a singer/songwriter. She influenced artists such as Madonna, Prince and Led Zeppelin, and was known during her most popular era for her frank and sometimes brutal criticism of her colleagues. She also turned the same criticism back on herself with scathing autobiographical lyrics--it seemed no one was exempt from dissection.

It's never fun to be criticized, but a little banking industry self-examination to find the causes of failure and weakness is a smart thing to undertake, as there are lessons to be learned. Over 400 banks have failed since 2007 and much of the blame was placed on problems in the credit portfolio. However, one of the other ingredients in the failure of many of these banks was a high cost of funds and wholesale funding.

In our current times of high liquidity, we have to pause and recall what business was like in 2007; loan growth was through the roof, and many banks could not keep up with the deposit growth. As a result, many banks used every available avenue to bring in funds: Brokered deposits, FHLB advances and CD rate specials in banks' own market footprint were all common. We know all of these funding sources cost more than core deposits, but times were good so bankers really didn't care very much. As long as loan growth continued, everything was mostly okay.

Looking back at banks that failed, we wondered just how high the cost of funds had climbed in these banks. Our analysis found the median interest bearing deposit (IBD) cost of funds (COF) ranking for these 421 banks was in the 90th percentile. Clearly these banks' cost of funds was problematic, and that in turn drove behavior that one could argue was a search to find enough margin to overcome those high costs, ultimately resulting in taking on riskier and riskier assets. Then, when credit portfolios began to crumble, the wholesale funding base began to erode. Without a solid base of core deposits, these banks could not find merger partners given the credit crunch and for some, the FDIC could not find buyers.

That was then, and the cost of funds is much lower now. As such, many banks may feel there is not much more to be done on that side of the balance sheet. While it is true that few banks carry brokered deposits and high rate specials have mostly gone away as banks are very liquid--memories fade. The key to success is to remember this lesson and recall that work on funding costs must be constant. This is one of the few areas banks can control and it has a big impact on your loan performance; consider that banks with solid core funding can make a reasonable margin with a lower lending rate given lower funding costs.

There's a lot more to funding than a tweak here and there, and it takes an institution-wide approach that begins with management and ends with the most important work being by sales staff. Give PCBB a call to find out how we can help your bank improve earnings now and reduce interest rate risk in the future. Banks that have higher funding costs than peers are at a disadvantage when it comes to the rate you can ultimately accept on a given loan, so take steps now.

ECONOMY & RATES

Yesterday

Yields inched downward 1bp as pending home sales proved to be a disappointment, coming well below expectations.

Today

Yields have notched downward about 1bp as market participants gear up for a number of releases including building permits, Case Schiller, House Prices and Consumer Confidence.

Rates As Of: 11/26/2013 09:01AM (PST)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.07	0.00	0.00
6M	0.10	0.00	0.00
1Y	0.12	0.00	0.00
2Y	0.29	0.00	0.00
5Y	1.31	0.00	0.00
10Y	2.69	0.00	0.00
30Y	3.79	0.00	0.00
FF Market	FF Target	Fed Disc	
0.00	0.25	0.00	
Prime	Unemployment	Oil	
3.25	0.00	\$0	

[More Market Rates](#)

BANK NEWS

M&A

Wilmington Savings Fund Society, FSB (\$4.4B, DE) will acquire First National Bank of Wyoming (\$299mm, DE) for about \$64mm.

M&A

Citizen's State Bank (\$325mm, NE) will acquire Cass County Bank (\$48mm, NE) for an undisclosed sum.

M&A

ViewPoint Bank (\$3.6B, TX) will acquire LegacyTexas Bank (\$1.7B, TX) for cash and stock. Under the terms of the agreement, ViewPoint will issue 7.85mm shares of common stock plus pay approximately \$115mm in cash.

Less M&A

SNL reports bank and thrift M&A activity remains below the pace of last year with 189 deal announcements YTD (through Nov 19) vs. 212 at the same point last year.

Warning

Regulators are warning banks to avoid offering short term high interest deposit advance loans, because such loans can trap consumers and may violate the Truth in Lending Act and other consumer-protection laws. Banks offering such loans must make sure the loans are affordable and underwritten with attention to the borrower's ability to repay according to regulators to avoid issues.

Regulation

Regulators have increased the dollar threshold for consumer credit and lease transactions from \$53,000 to \$53,500 effective Jan 1 2014 (due to higher CPI).

More Cards

Equifax reports the total number of open retail issued credit cards has jumped to 183mm, the highest level since Sep 2009.

Competition

Bankers should note that Google is offering a debit card (no annual or monthly service fees) tied to its Google Wallet product that works anywhere MasterCard is accepted.

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