THE KAFAFIAN GROUP INC.
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Fourth Quarter 2016 **Volume 8 Issue 4**

TKG Perspective

Teaching & Speaking Engagements

Washington Bankers Association
Executive Development Program
Washington Athletic Club
Seattle, WA **April 5**
Bank Profitability

Montana Bankers Association
Executive Development Program
Helena, MT **April 6**
Bank Profitability

Utah Bankers Association
Executive Development Program
Wasatch Retreat and Conference Center
Salt Lake City, UT **April 7**
Bank Profitability

Pennsylvania Bankers Association
School of Banking
The Penn Stater Conference Center
State College, PA **June 4-8**
Strategic Decision-Making and Organizational Structure

Conferences, Conventions & Other Events

New Jersey Bankers Association
Economic Leadership Forum
The Palace at Somerset Park
Somerset, NJ **January 20**

Southeastern Conference for Community Bankers
Conference
Hyatt Key West
Key West, FL **January 25-28**

Bank Director
Acquire or Be Acquired Conference
JW Marriot Phoenix Desert Ridge
Phoenix, AZ **January 29-31**

American Bankers Association
National Conference for Community Bankers
JW Marriot Orlando
Orlando, FL **February 19-22**

Which Bank Will Blink on Rate?

By: Jeffrey P. Marsico, Executive Vice President

It happened, I received an e-mail this week for a 13-month CD special. The ad insisted it would make me happy. Instead, sadness. Sad that this bank thought I wouldn't notice they were front-running a likely Fed rate hike. Sad that the bank fell back on old tricks, getting customers to bite on an odd-lot CD term that will reprice at a lower rate when it matures. Sad that they got my e-mail address.

Staring down the barrel of a rate hike, and the specter of future and faster hikes, how does your institution feel about how fast you will have to reprice deposits? Because we are coming off of unprecedented times. Times that had the average balance of a money market account go from $47 thousand at the end of 2005, to $129 thousand today (data taken from TKG's profitability peer database).

Why do you think that happened? And what will customers do with that money when deposit rates become more enticing?

I know your ALCO models predict what might happen. But if we dig deep, we know that we don't know. That doesn't mean we can't look around us to predict pricing pressures applied by our competitors, like the bank that solicited me for the 13-month CD.

So I took a look at metrics, publicly available in Call Reports, that were indicative of a competitor's need for funding, and therefore will drive their pricing decisions.

I focused on the St. Louis MSA. Why St. Louis? I have friends that are getting married there in the next few months, and they work for one of the banks on the list below. Together, at the same bank. I will defer to them on the wisdom of this. St. Louis also has a good baseball team, and they are not likely to win as many World Series as the Yankees in my lifetime.

I looked at the top 10 deposit market share banks that were not SIFIs. True, SIFIs had a 52% market share at June 30, 2016. But the 10 non-SIFIs listed below own 29%, not an insignificant amount. Further, SIFIs' need for funding is much more complicated as they have greater access to the capital markets, and don't necessarily rely on drawing funds from St. Louis.

Here is the list, their St. Louis MSA market rank, in-market deposits and deposit market share at June 30, 2016.

Deposit Market Share Rank		In-Market Deposits (000)	Deposit Market Share (%)
3	Commerce Bank	6,450,739	9.25
4	Enterprise Bank & Trust	2,980,987	4.27
7	First Bank	2,187,788	3.14
9	Midwest BankCentre	1,449,099	2.08
10	Central Bank of St. Louis	1,310,776	1.88
11	UMB Bank, National Association	1,288,303	1.85
12	Busey Bank	1,189,821	1.71
14	First Collinsville Bank	1,081,209	1.55
15	Midland States Bank	1,060,598	1.52
16	Reliance Bank	917,596	1.32

Source: S&P Global Market Intelligence

Once I identified the community banks, my next task was to identify the financial metrics that highlighted their need for funding as rates rise, and therefore the likelihood that they would be early movers in the pricing game. Here are the metrics I used:

- Deposit Growth minus Loan Growth (year over year)
- Loans / Deposits
- Securities / Assets
- Pledged Securities / Securities
- Time Deposits / Deposits
- Borrowings / Assets
- Cost of Funds

I ranked each of the above banks based on each metric, assigning the bank a "10" if they had the top rank, and a "1" if their ratios were lower. So, if UMB Bank NA had the lowest Loan / Deposit ratio, as they did, they received a "1" for that metric. If Central Bank of St. Louis had the highest Loan / Deposit ratio, as they did, they received a "10". That means that each metric received equal weight in my analysis.

I tallied all of the scores to determine which bank needed the funding most, and is therefore most likely to be the first mover in elevating rates and putting competitive pressures on other market participants. The results are below.

Rank		Score
1	Midland States Bank	57
2	First Collinsville Bank	47
3	Reliance Bank	47
4	Midwest BankCentre	47
5	Central Bank of St. Louis	45
6	Busey Bank	41
7	Enterprise Bank & Trust	39
8	UMB Bank, National Association	25
9	First Bank	19
10	Commerce Bank	18

I predict that Midland States Bank will be the first to offer a compelling rate to raise deposits in a rising rate environment. They have a relatively small securities portfolio, high Loan/Deposit ratio, and their loans have been growing faster than their deposits, among other indicators.

There are some tight scores immediately below Midland States, and upon looking through the data I believe Central Bank of St. Louis would be next, in spite of having a slightly lower score than the three banks tied for second. Their Loan / Deposit ratio was 98% and their securities portfolio was similar to Midland States, at only 10% of assets. Reliance and Midwest, conversely, have securities portfolios of around 22% of assets to fund their growing loan portfolio. So the scoring system is not absolute, especially when there is clumping such as in the second through fifth ranks.

My friends' bank looks like it can sit on the sidelines during a rate war, a good position to be in. Unless they succumb to competitive pressures, and that parked money in money market accounts starts following rate around St. Louis.

Who will blink in your markets?