Second Quarter Results…Problems Simmering?
by Charles B. Wendel

Note: This newsletter will be sent out on 9/11. Fifteen men from my Brooklyn high school died in the Twin Towers on 9/11. Some were bankers and some were firemen. All should be remembered, cherished, and prayed for.

Last Thursday the FDIC released its Quarterly Banking Profile, highlighting Q2 performance. Let's look at some of the messages concerning past performance. More important let's consider some future actions that banks need to take or should have already taken.

Here's the topline summary it provides:

- Net Income Decreased From the Prior Quarter, Driven by Lower Noninterest Income
- The Net Interest Margin Declined for the Second Straight Quarter
- Unrealized Losses on Securities Increased Quarter Over Quarter
- Loan Balances Increased From Last Quarter and a Year Ago
- Total Deposits Declined for a Fifth Consecutive Quarter
- Asset Quality Metrics Remained Favorable Despite Modest Deterioration

Let's peel this back a bit.

- NIM, while down 7BPs from Q1 is 48 bps higher than last year.
- Total loans increased 7% from the prior quarter while credit card outstandings year over year are up13.8%. Whether that is a positive revenue change or a precursor of an emerging quality problem is TBD.
- There are only 43 designated problem institutions, holding just $46B in total assets. These small banks are candidates to be put out of their misery. It's worth noting that banks less than $100 have total loans past due (30-89 days) of .51% versus .30% for banks of $1-10B.
- And the industry and its employees continue to shrink. Now there are less than 4,200 banks, a 3 % decline from last year with employees down almost 4%.
- It is an easy bet that smaller banks will continue to disappear. The 733 banks with assets less than $1B (1,372 in 2018) and 2,920 banks (3,399 in 2018 with assets between 100mm and $1B) will continue to struggle for quality growth while investing more in IT, fraud control, and other support services. And how can they maintain to attract and keep top performers?
- And the big continue to get bigger. There are now 142 banks with assets from $10-250B and 14 with assets above $250B, up from 125 and nine, respectively in 2018.

The main story for banks seems to be deposit related. It was just a few years ago when many banks were discouraging deposit growth; those days are over. Total deposits dropped almost $100B from Q1 to Q2, but insured deposits increased $85B while insured dropped by $180B. Wholesale funding closed this gap. Banks that stuck with a deposit focus as opposed to a lemming-like approach (not may did) are in a better position today.

Banks should be considering:
- Deposit-only officers.
- Increased compensation for any bankers who capture low-cost deposits.
- Increased focus on deposit centrique industries, packed products to attract deposits, among other options.
- Teaming with third-party firms to provide consumers with protection for deposits $250K+.
- A good Internet search will turn up multiple options for banks to consider. Probably the best move for a bank centers on creating or recreating a deposit generating culture, a culture that many banks lack. Of course, none of this is new news, but many banks fail to operate with a consistent focus in this area. One suggestion is to look to at industry best practices to better understand the approach of bank and non-bank industry leaders.
- The hard part is to institute and commit to a multi-year execution plan. The best deposit generators have developed, adapted, but stuck with their plans. Catch up involves a difficult road to travel.

On the loan side, credit card debt, personal loans, and CRE should be worrying. For some, high interest rate credit cards are the last option for an overstretched consumer. While it hardly serves as a scientific sample, I've been observing more people using two cards to complete a purchase, indicating how tight their finances are.

And no one knows what will happen on the CRE front. Factors like hybrid work, the perception of increased crime in urban business areas, and the overall hassle factor may all contribute to CRE problems. Monday's *Wall Street Journa*l notes that CRE borrowers are seeing more demand for deposits as part of a loan offer. That's a very old opportunity than many banks have failed to focus on.

In summary, the second quarter results had no big surprises, but banks should heighten their focus on selected deposit and loan issues, as always. My one concern is that the next crisis comes from an area that has yet to be recognized by banks or anyone else. Management should spend some time considering where an untoward surprise might occur.

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