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CONFERENCE CHATTER

Monday, October 10, 2011 4:30 PM ET

FinPro warns community bankers on excess liquidity, urges turning away deposits and bending on loan pricing

By Robb Soukup

The fundamental worry bankers associate with liquidity is that it will one day dry up, but FinPro President and CEO Donald Musso on Oct. 7 told community bankers that the biggest danger they face in the current environment is that a flood of liquidity will wash away their institution.

"Inverse liquidity is the number one problem facing the industry," Musso said during a presentation at the firm's 2011 Presidents and Directors Conference in Morristown, N.J. He urged the executives in the room to move as quickly as possible to deal with the problem and said it could become the next feature of the current environment that fells a number of institutions.

"This time, we need to get out in front of it. We cannot wake up December 31st and have 20% and 25% cash sitting on our books. That's an unacceptable position," Musso said during his presentation, which was wide-ranging and touched on a number of issues facing the community banking world.

He also has little regard for one of the most heavily adopted strategies that banks are using to deal with excess liquidity building up on their balance sheet. "Buying a ton of securities, long duration securities, to move cash out into investments is a lousy strategy as well," he told the audience.

He laid out other potential tactics for dealing with the problem. Musso said he believes some banks will likely shrink their balance sheets, at least temporarily. He also said the executives may have to start turning away some customers and perhaps trim their product offerings if they have excess cash. "You need to stop offering certain kinds of deposits. You don't want the cash … if there are no loans and there are no investments what the heck are we going to do with all of this cash?" he said. He urged executives to drop rates even lower, perhaps down to 15 basis points, and also said banks should let borrowings and brokered deposits run off. He also suggested that executives need to carefully examine single-relationship customers, determine how profitable the customer really is and whether the institution really needs that customer.

Another result of excess liquidity, he argued, is that institutions must be willing to compete on loan pricing with the industry's largest institutions. That means filling certain loan buckets, he said, even at prices that might seem uncomfortable — though he made it clear that he was not advocating taking on more credit risk. "Unfortunately we don't have the luxury of not doing [it.] … Right now the big banks are out-pricing us in the market and taking all of the available loans," he said.

"If we don't have some appetite for low-priced loans, this inverse liquidity problem is going to get out of control," he warned. He said investment purchases should be a last resort for institutions dealing with excess liquidity and questioned the quality of many investment options banks are being asked to consider.

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