

Special Report



Impact of branch weighting on the prevailing rate

HIGHLIGHTS

- Branch-weighting lowers the prevailing rate by an average of 12 bps compare to simple average.
- All four products used by the FDIC for determination of high-rate area are lower with the branch weight.
- Longer-term CD's APY increase with the branch weighting.

Dr. Dan Geller

January 2010



275 Greenfield Ave. San Anselmo, CA 94960 Phone: 415 448-8800, Fax: 415 259-0701
Email: info@marketratesinsight.com Web: <http://www.marketratesinsight.com/new>

ABSTRACT

This report examines the impact the newly-mandated FDIC Final Rule (FDIC Final Rule 2009) has on the prevailing rate of a high-rate area. Specifically, this report focuses on the new method of calculating the prevailing rate, which requires the addition of each branch of each bank as a separate data point for the purpose of calculating the prevailing rate.

The analysis in this report compares the prevailing rate based on the previous method, i.e. simple average of the competitors, with the new method, which introduces the number of branches of each competitor as a weighting factor.

OVERVIEW

On January 1st 2010, the Final Rule, which governs rate restrictions under section 337.6, becomes mandatory for banks that are less than well capitalized and banks that are under capital maintenance provision. Aside from restrictions on Brokered Deposits, the Final Rule mandates that all such institutions can not exceed the FDIC Rate Cap unless they receive a determination from the FDIC that it is operating in a high-rate area.

Although the language of the Final Rule describes the statistical method of calculating the prevailing rate as “a simple average” of rates paid by all insured depository institutions and branches for which data are available” (FDIC Questions and Answers 2009), de facto the outcome of this statistical methodology is a weighted average based on the number of branches. The reason the new methodology for calculating the prevailing rate has a “double meaning” is because it contains two variables – banks and branches. Hence, the simple average derives from the sum total of the APY of all the data points (banks and branches) divided by the number of data points. However, the weighted average derives from the fact that some banks have more branches than others, and therefore, their weight on the prevailing rate will be greater.

To be considered for determination, the bank has to demonstrate that the prevailing rate in its market area(s) exceeds the FDIC National Rate for a minimum of three of the four deposit products (“litmus-test products”) by at least 10 percent. The non-jumbo (less than \$100,000) product types that will be reviewed are: money market deposit account, 12-month CD, 24-month CD, and 36-month CD (FDIC Questions and Answers 2009).

It is important to note that if an institution seeks and receives a determination that it is operating in a high-rate area, based on the four-product litmus test, the prevailing rate for its market area should be used when determining conformance for all local deposits, even in those situations where the national rate is higher for a deposit product. In other words, if a determination was granted for a high-rate area based on three of the four litmus test products, all the deposit products of these institutions in this market area may be priced based on the prevailing rate.

FINDINGS

1. We found that 98 percent of the branches nationally are affiliated with multi-branch institutions, and 2 percent of the branches are single-branch institutions.
2. We found that single-branch institutions price higher than multi-branch institutions in five of the eight examined products with an average of 41 bps, and a range of 28 to 61 bps.
3. We found that Multi-branch institutions priced higher than single-branch institutions in two of the eight examined products at an average of 22 bps, and a range of 17 to 26 bps.
4. We found that the four products (litmus-test products) used by the FDIC for high-rate area determination have shown a 16 bps drop in APY when the branch weight was applied.
5. We found that the branch-weighted-prevailing rate has lowered the APY of the simple-prevailing rate by an average of 12 bps for the examined products.

IMPLICATIONS

The new FDIC method of calculating the average rate of a high-rate area is going to lower the prevailing rate by an average of 12 bps due to the weighting of the branches. Furthermore, the new method will reduce the prevailing rate for the four litmus-test products by an average of 16 bps.

ANALYSIS

Multi-branch vs. single-branch institutions

In order to establish the ratio of multi-branch to single-branch institutions, we obtained bank and branch data from the FDIC. According the June 30, 2009 FDIC Summary of Deposits (2009), there are a total of 8,185 institutions with 99,564 total branches. Of the total branches 97,550 (98 percent) branches are affiliated with multi-branch institutions, and 2,014 (2 percent) are affiliated with single-branch insinuations (Table 1). Note that slight changes in these figures may have occurred since June 30, 2009 due to bank closure and bank mergers.

Although this ratio of multi-branch to single-branch institutions is national, there is a very high probability that a similar ratio exists in most of the 360 Metropolitan Statistical Areas (MSA) in the US.

Table 1 - National distribution of multi-branch and single-branch institutions

Category	Number of Institutions	Number of Branches
Multi Branch	6,171	97,550
Single Branch	2,014	2,014

Source: FDIC, June 30, 2009.

Average APY of multi-branch vs. single branch institutions

We analyzed the variance between the average APY of the multi-branch institutions and the single-branch institutions and found that single-branch institutions price higher than multi-branch institutions in five of the seven products featured by the FDIC at a range of 28 to 61 bps and an average of 41 bps. Multi-branch institutions priced higher than single-branch institutions in two of the seven products with a range of 17 to 26 bps and an average of 22 bps (Table 2).

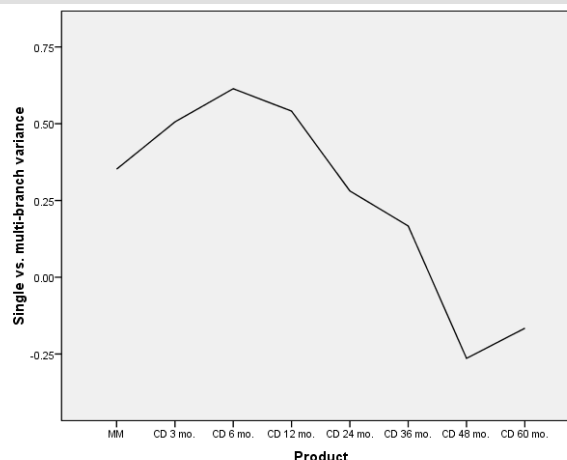
Of high importance is the observation that when comparing the average APY of multi-branch institutions to the average APY of the single-branch insinuations for the four litmus-test products, the single-branch institutions are priced higher. This means that when the weight of the branches is applied, the prevailing rate will decrease due to higher incidence of multi-branch institutions in each market area.

Table 2 - Average APY of multi vs. single-branch institutions

Product	Avg. APY multi branch	Avg. APY single branch	Single vs. multi-branch variance
MM*	0.28	0.63	0.35
CD 3 mo.	0.21	0.71	0.51
CD 6 mo.	0.35	0.97	0.61
CD 12 mo.*	0.68	1.22	0.54
CD 24 mo.*	1.17	1.45	0.28
CD 36 mo.*	1.46	1.62	0.17
CD 48 mo.	1.77	1.51	-0.26
CD 60 mo.	1.95	1.78	-0.17

Source: Market Rates Insight obtained on 12.14.2009.
* Note: highlighted products are the litmus-test products by the FDIC.

Figure 1 - APY variance between multi-branch and single-ranch institutions



Simple average vs. weighted average APY

We applied the weight of the multi-branch institutions to the multi-branch APY, and the weight of the single-branch institutions to the single-branch APY in order to arrive at a weighted average APY for each of the examined products. We then calculated the variance between the simple average APY and the weighted average APY for each of the examined products (Table 3).

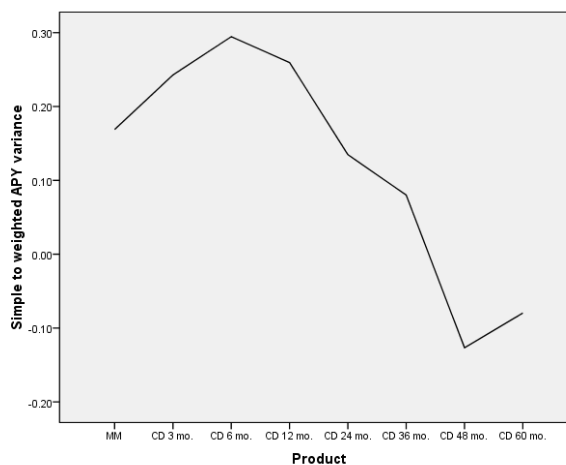
We found that the weight of the multi-branch institutions has decreased the prevailing APY in six of the eight examined products at an average of 20 bps and a range of 8 to 29 bps. We found that the weight of the multi-branch institutions has increased the prevailing APY in two of the eight examined products at an average of 10 bps and a range of 8 to 13 bps. It is important to note that in all four litmus-test products the weight of the branches lowered the prevailing rate.

Table 3 - Impact of multi-branch weight on the prevailing APY

Product	Simple Avg. APY	Weighted Avg. APY	Simple to weighted APY variance
MM*	0.46	0.29	0.17
CD 3 mo.	0.46	0.22	0.24
CD 6 mo.	0.66	0.36	0.29
CD 12 mo.*	0.95	0.69	0.26
CD 24 mo.*	1.31	1.17	0.13
CD 36 mo.*	1.54	1.46	0.08
CD 48 mo.	1.64	1.77	-0.13
CD 60 mo.	1.86	1.94	-0.08

Source: Market Rates Insight obtained on 12.14.2009.
 * Note: highlighted products are the litmus-test products by the FDIC.

Figure 2 - Variance between the simple average and the branch-weighted average APY (0=baseline)



LIMITATIONS

The scope of this analysis is national, and the findings should be viewed accordingly. It is possible that the findings may vary somewhat in specific areas due the variance in rates and ratio of multi to single-branch institutions. It is highly recommended that this analysis is done for specific markets before determining on a pricing strategy.

REFERENCES

- FDIC (2009) Section 337.6 Brokered Deposit Restrictions and Deposit Rate Limits, Questions and Answers, Restrictions under Section 337.6, November 30, 2009, available at <http://www.fdic.gov>
- FDIC (2009) Final Rule CFR part 337.6, Interest Rate Restrictions on Insured Depository Institutions That Are Not Well Capitalized, available at: <http://www.fdic.gov/news/board/May29no8.pdf>.
- FDIC (2009) Summary of Deposits, October 15, 2009, available at: <http://www2.fdic.gov/sod/index.asp>

About the Author

Dr, Dan Geller is the Executive Vice President at Market Rates Insight, overseeing the research and analytics services of the company. These research and analytics services provide value added to clients, over and beyond the standard rate surveys, by helping them interpret the data, identify trends and price their deposit products with the utmost precision and competitiveness.

Among the many projects headed by Dr. Geller are the publication of the weekly National Pricing Indicators, special reports on trends in the banking industry and predictive analytics for deposit pricing. Dr. Geller has worked with many banking clients on establishing a scientifically-based model for deposit pricing that allows pricing executives to price their deposit products quickly, easily and with a high level of predictive outcome such as impact on balances.

Dr. Geller earned his Ph.D. in Business Administration from TUI University, and has published numerous peer-reviewed studies in scientific publications.

About Market Rates Insight

Market Rates Insight (MRI) is the premier provider of competitive-pricing information and analysis to the banking industry. MRI focuses on serving the pricing needs of financial institutions—not consumers. Therefore, only MRI offers the higher level of pricing comprehensiveness and sophistication of systems demanded by the industry.

In addition to competitive-data that MRI provide to financial institutions, MRI also provides analysis and tracking of industry indexes to thought leaders worldwide. MRI’s analysis and indicators are viewed weekly by many thousands of banking and credit union professionals

THE WALL STREET JOURNAL

Banks Wage Rate War for Deposits

By *DAVID ENRICH*

Consumers Benefit as Institutions Move to Shore Up Funds, but Profit Margins Suffer

Unlike previous periods of turbulence, the Fed’s rate-chopping campaign isn’t relieving the pressure this time. In the past, reductions in the federal funds rate have helped level off interest rates on CDs and savings accounts, according to **Market Rates Insight Inc., which tracks pricing trends for financial institutions.** "This time around, it’s much more fierce," says Dan Geller, executive vice president of the San Anselmo, Calif., firm.

BusinessWeek

Should You Test-Drive a Hybrid CD?

By *David Bogoslaw*

Since June, rates for indexed CDs have climbed an average of 8.1%, while non-indexed rates have declined more than 14%, according to Dan Geller, executive vice-president of **Market Rates Insight, which provides competitive-pricing information and analysis to the banking industry.**

"This is the type of deposit that low-risk-minded people can take and sleep well at night because, unlike investing in the stock market or a mutual fund, it will not impact your principal adversely if the market goes down," he says. "Granted, the return potential is not as

AMERICAN BANKER
On Focus and In Depth

To Predict Deposit Rates, Take a Look at Jobs Data

By *Katie Kuehner-Hebert*

When the unemployment rate is high and economic activity low, the need for deposits to fund loans is less acute, said Dan Geller, executive vice president at **Market Rates Insight, a San Anselmo, Calif., firm that tracks deposit pricing.** That means banks can pay "the minimal amount they can get by with on deposits."

The Market Rates Insight study found that nearly 80% of the movement in the national average rate on

CREDIT UNION TIMES

Short-Term CDs a Hot Commodity

By *Michelle Samaad*

"It’s a mixture of uncertainty and the job market," said Dan Geller executive vice president of **Market Rates Insight, a San Anselmo, Calif. firm that tracks rates loans, fees and rates.** "The bottom line is people prefer to make short-term commitments in case they need the funds."

According to 1,300 banks and credit unions tracked by **Market Rates Insight,** the premium paid on short-term CDs increased from 66.3% in January to 100.4% in September, an increase of 34.1%. Short-term CDs are defined as those with a one year or less term. Mean-