Why Ohio Community Banks Should Be Selling Insurance and Investments

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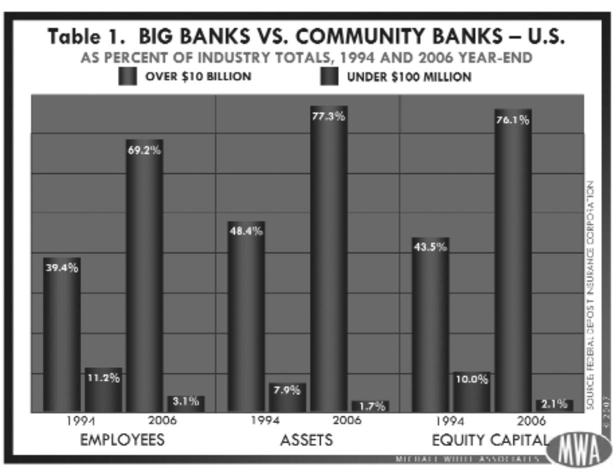
Certain competitive conditions and market forces urge banks, nay, impel banks, to participate in non-interest fee income activities. First, it is harder to make money from traditional banking functions and spread business. Second, competition from nonbanks is heightened, from mutual fund complexes to securities firms to insurance companies. Third, large banks have an increasingly dominant position in banking and have been squeezing community banks into smaller shares of everything. Fourth, profitability and return on equity have been declining among community banks. In providing insurance and investment services, community banks can earn good money selling them and beat back some of the competition. Unfortunately, Ohio community banks are not getting their fair share of insurance and investment product income when compared to their peers.

The Old Grey Mare She Ain't What She Used to Be

Banking's previously fundamental role in financial intermediation continues to decline. Net interest margin has been declining since it peaked in 1992. At 3.31% in 2006, it reached its lowest annual average since 1988, according to the FDIC. The number of community banks under $1 billion in assets have declined by 4,176 or 37.7% since 1992. Earning interest income, managing net interest margin and charging transaction fees are no longer sufficient to sustain the business of banking.

Community banks face tough competition from nonbank competitors offering investment and savings alternatives to deposits, like mutual funds, which, in 1990, equaled one-third the amount of commercial bank assets, but in 1998, actually exceeded them.

The gap between the largest and smallest banks continues to widen. In 1994, banks over $10 billion in assets controlled slightly less than half the industry's assets. (See Table 1.) By 2006, big banks controlled 77.3% of all banking assets. Community banks' share of banking assets declined 78.5% since 1994.



Ohio banks have experienced a similar gap, except that, in 2006, those under $100 million in assets had an even smaller share of Ohio banking assets (0.2% in Ohio vs. 1.7% nationally).

Need Interest in Noninterest

Average return on equity (ROE) for community banks with less than $100 million of assets has fallen steadily for over a decade to 7.34% in 2006. Worse yet, 13.0% of all FDIC-insured institutions of this size were unprofitable in 2006, more-than-double the 6.4% ratio of unprofitable institutions in 1997. And, barely half (50.8%) of the smallest community banks had earnings gains.

A major cause of the difference between big bank and community bank ROEs is their difference in generating noninterest income. Noninterest income represented 47.8% of big-bank net operating revenue in 2006. Banks under $1 billion in assets lagged significantly in this department.

Ironically, all asset classes, except the largest one, have experienced a decline in their ratio of noninterest income to net operating revenue since 2000, the first full year in which the Gramm-Leach-Bliley Act was in force. (See Table 2.)

Table 2. NON-INTEREST INCOME AS % OF NET OPERATING REVENUE – UNITED STATES

	2006	2004	2002	2000
COMMERCIAL BANKS	43.3%	42.3%	42.1%	42.8%
UNDER $1 BILLION				
UNDER $1 BILLION	24.0%	25.7%	27.0%	26.5%
OVER $1 BILLION	45.9%	44.9%	44.6%	45.8%
OVER $1 BILLION				
UNDER $100 MILLION	20.5%	19.7%	20.3%	21.2%
$100 MILLION - $300 MILLION	21.5%	23.6%	24.0%	21.7%
$300 MILLION - $500 MILLION	26.9%	27.6%	31.4%	36.2%
$500 MILLION - $1 BILLION	26.4%	30.4%	32.4%	30.9%
$1 BILLION - $10 BILLION.	31.6%	37.9%	39.2%	37.4%
OVER $10 BILLION	47.8%	46.0%	45.6%	47.5%

SOURCE: FEDERAL DEPOSIT INSURANCE CORPORATION

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Ohio community banks had even lower ratios of noninterest income to net operating revenue than the national ratios. (See Table 3.)

Table 3. NON-INTEREST INC. AS % OF NET OPERATING REV. OHIO VS. UNITED STATES, 2006

	UNITED STATES	OHIO
COMMERCIAL BANKS	43.3%	25.5%
UNDER $1 BILLION		
UNDER $1 BILLION	24.0%	18.6%
OVER $1 BILLION	45.9%	26.7%
OVER $1 BILLION		
UNDER $100 MILLION	20.5%	15.5%***
$100 MILLION - $300 MILLION	21.5%	15.3%
$300 MILLION - $500 MILLION	26.9%	16.1%
$500 MILLION - $1 BILLION	26.4%	18.6%*
$1 BILLION - $10 BILLION.	31.6%	31.0%
OVER $10 BILLION	47.8%	55.2%

SOURCE: FEDERAL DEPOSIT INSURANCE CORPORATION * ADJUSTED FOR ONE OUTLIER (***=THREE OUTLIERS)

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Something must be done to beat back big-bank and nonbank competition, expand community banks' opportunities to generate fee revenue, and produce a better return. Only basic investment in new strategies will produce greater community bank profitability.

Plenty of Gas in Banks' Tanks

Do community banks have the financial wherewithal to invest in these new strategies? Most certainly! Consider their total Risk-Based Capital (RBC) ratios. In 2006, banks with assets between $100 million and $1 billion had an average RBC ratio of 13.96%, nearly 40.0% greater than that required for a "well-capitalized" bank; and banks under $100 million in assets averaged 19.5%, nearly twice the "well-capitalized" requirement.

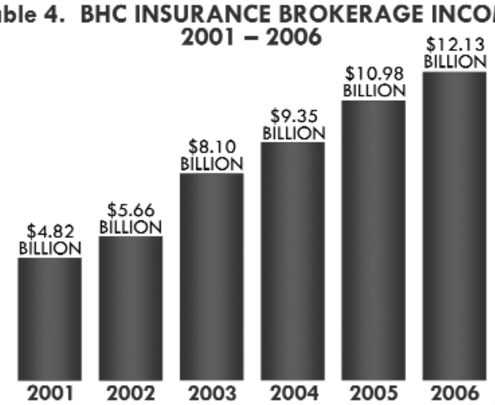
The same is true of community bank equity capital ratios. The smallest community banks average a high equity-capital-to-assets ratio: 12.7% nationally in 2006, 13.2% in Ohio. Proportionally, they have more than the largest banks.

These ratios affirm that community banks have sufficient capital resources to invest in noninterest fee income activities such as selling annuities, insurance and investments. They must deploy their capital more effectively to produce better returns on equity.

If It Ain't Brokered, Fix It

In 2006, bank holding companies (BHCs) earned a record $12.13 billion in insurance brokerage fee income, up 10.5% from $10.98 billion in 2005 and two-and-a-half times from $4.82 billion in 2001. (See Table 4.) Nationally, BHC insurance brokerage revenue grew at a compound annual rate of 19.5% from 2001 through 2006, according to the Michael White-Symetra Bank Holding Company Fee Income Report™ and Michael White-Symetra Bank Fee Income Report™. Symetra Financial sponsors this research, whose findings are derived from analyses of call report data submitted by almost 8,000 commercial banks and FDIC-supervised savings banks and nearly 1,000 top-tier large BHCs.

Table 4. BHC INSURANCE BROKERAGE INCOME 2001 – 2006



SOURCE: MICHAEL WHITE-SYMETRA BANK FEE INCOME REPORT

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Only did smaller banks under $300 million in assets grow at a negligible rate by comparison.

How do Ohio banks compare? Not so well. (See Table 5.) Ohio banks under $1 billion in assets trailed the U.S. mean insurance brokerage income $113,912 to $35,260.

Table 5. MEAN INSURANCE BROKERAGE FEE INCOME OHIO VS. UNITED STATES, 2006

	UNITED STATES	OHIO
COMMERCIAL BANKS	$1,117,370	$2,441,100
UNDER $1 BILLION		
UNDER $1 BILLION	$113,912	$35,260**
OVER $1 BILLION	$10,602,777	$13,798,333
OVER $1 BILLION		
UNDER $100 MILLION	$58,717	$7,880*
$100 MILLION - $300 MILLION	$85,139	$23,269
$300 MILLION - $500 MILLION	$189,062	$28,667
$500 MILLION - $1 BILLION	$372,006	$142,800*
$1 BILLION - $10 BILLION.	$1,752,144	$196,750**
OVER $10 BILLION	$49,273,231	$21,555,333

SOURCE: MICHAEL WHITE-SYMETRA BANK FEE INCOME REPORT *ADJUSTED FOR ONE OUTLIER (**=TWO OUTLIERS)

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Excluded from mean calculations for this asset class was a significant outlier whose results deserve mention: Spirit of America National Bank in Milford with $8,122,000.

Exceeding the national mean for banks with assets between $100 million and $300 million, Consumers National Bank in Minerva with $118,000 and The Andover Bank in Andover with $91,000 led this asset class.

A similar result occurred among banks with assets between $500 million and $1 billion, where national mean insurance brokerage income of $372,006 exceeded Ohio's $142,800. Although an outlier excluded from mean calculations, The National Bank and Trust Company in Wilmington stood out with $2,028,000 in insurance brokerage income. World Financial Network National Bank in Gahanna ranked second with $764,000.

Mutual Funds & Annuities

In 2006, BHCs earned $19.33 billion from the sale and servicing of mutual funds and annuities, up 50% from $13.01 billion in 2001. (See Table 6.) Since 2001, BHC mutual fund and annuity revenue grew nationally at a respectable compound annual rate of 8.2%. The growth trend in mutual fund and annuity income has been steady, except among banks under $100 million.

How do Ohio banks compare? These findings are mixed. (See Table 7.) Only 19 percent of Ohio banks under $1 billion in assets engaged in mutual fund and annuity sales last year, and they trailed the U.S. mean mutual fund and annuity income $142,594 to $112,025.

Only three Ohio banks under $100 million in assets reported mutual fund & annuity income.

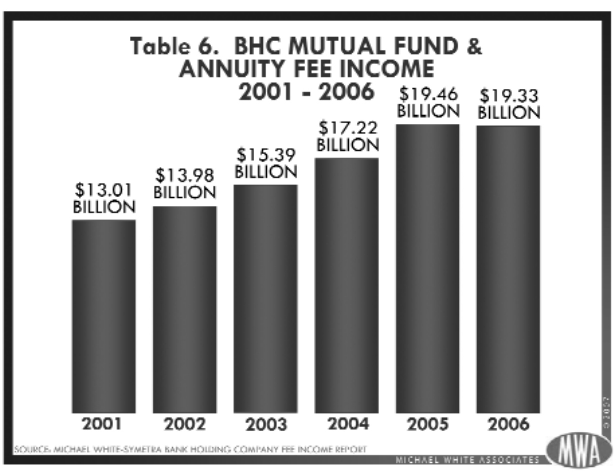

Table 6. BHC MUTUAL FUND & ANNUITY FEE INCOME 2001 - 2006

Table 7. MEAN MUTUAL FUND & ANNUITY INCOME OHIO VS. UNITED STATES, 2006

	UNITED STATES	OHIO
COMMERCIAL BANKS	$2,830,081	$17,918,200
UNDER $1 BILLION		
UNDER $1 BILLION	$142,594	$112,025*
OVER $1 BILLION	$15,221,062	$69,990,000
OVER $1 BILLION		
UNDER $100 MILLION	$32,558	$25,333
$100 MILLION - $300 MILLION	$100,823	$60,353
$300 MILLION - $500 MILLION	$184,409	$125,556*
$500 MILLION - $1 BILLION	$280,620	$204,455
$1 BILLION - $10 BILLION.	$1,277,566	$488,000*
OVER $10 BILLION	$71,827,493	$108,405,667

SOURCE: MICHAEL WHITE-SYMETRA BANK FEE INCOME REPORT *ADJUSTED FOR ONE OUTLIER

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Among Ohio banks with assets between $100 million and $300 million, United Bank, N.A. in Bucyrus made a good showing with $178,000 in mutual fund and annuity fee income, followed by The First Citizens National Bank of Upper Sandusky with $161,000, The Farmers Citizens Bank also in Bucyrus with $156,000, and Consumers National Bank in Minerva with $150,000.

Among Ohio banks with assets between $300 million and $500 million, The Citizens National Bank of Bluffton was an outlier with $1,160,000 in mutual fund and annuity income. Another good performer was Heartland Bank in Gahanna with $487,000.

Finally, among banks with assets between $500 million and $1 billion, The National Bank and Trust Company in Wilmington ranked first in mutual fund and annuity income with $408,000. Other leading performers included The Farmers National Bank of Canfield with $393,000 and First-Knox National Bank in Mount Vernon with $337,000.

Despite low participation by Ohio community banks in insurance and investment sales in 2006, the news is not all bad. Some Ohio community banks are successfully selling these products and reaping meaningful rewards because they are fully committed to those activities. Here's hoping these examples encourage other Ohio bankers not yet engaged in, or fully committed to, these sales activities to undertake them so that they may reap similar rewards.

Dr. Michael D. White is president of Michael White Associates (MWA), the ICBA's Preferred Provider for bank insurance consulting and research services, headquartered in Radnor, PA, and at www.BankInsurance.com.