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Municipal deposits are a small portion of most bank's total deposits, but they can lead to cross-selling opportunities.

Politics and the public payroll — banks play along

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Government deposits have never been viewed as being as profitable for banks as retail and commercial work. But it is still extremely competitive, as banks service a variety of governmental entities with an ever-expanding list of product offerings.

Large banks and community banks compete to handle the needs of suburban municipalities, water and sewer authorities, school districts, colleges and large cities like Philadelphia. The key product offerings are on the deposit side — payroll and cash management.

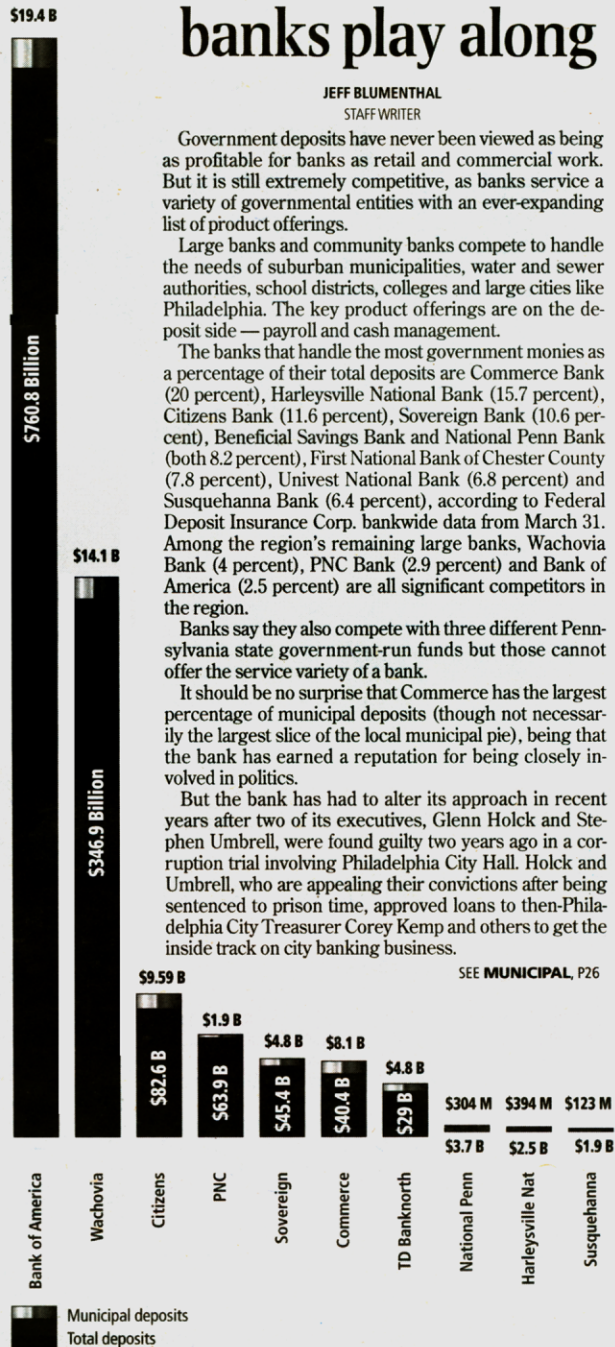
The banks that handle the most government monies as a percentage of their total deposits are Commerce Bank (20 percent), Harleysville National Bank (15.7 percent), Citizens Bank (11.6 percent), Sovereign Bank (10.6 percent), Beneficial Savings Bank and National Penn Bank (both 8.2 percent), First National Bank of Chester County (7.8 percent), Univest National Bank (6.8 percent) and Susquehanna Bank (6.4 percent), according to Federal Deposit Insurance Corp. bankwide data from March 31. Among the region's remaining large banks, Wachovia Bank (4 percent), PNC Bank (2.9 percent) and Bank of America (2.5 percent) are all significant competitors in the region.

Banks say they also compete with three different Pennsylvania state government-run funds but those cannot offer the service variety of a bank.

It should be no surprise that Commerce has the largest percentage of municipal deposits (though not necessarily the largest slice of the local municipal pie), being that the bank has earned a reputation for being closely involved in politics.

But the bank has had to alter its approach in recent years after two of its executives, Glenn Holck and Stephen Umbrell, were found guilty two years ago in a corruption trial involving Philadelphia City Hall. Holck and Umbrell, who are appealing their convictions after being sentenced to prison time, approved loans to then-Philadelphia City Treasurer Corey Kemp and others to get the inside track on city banking business.

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Sources: FDIC, the banks

Note: Citizens Bank totals do not include data from its Charter One Bank affiliate.

MUNICIPAL: Bidding cuts into profitability

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Commerce Bank paid the National Association of Securities Dealers a \$600,000 fine, exited the municipal bond market, eliminated its political action committee and said it would no longer loan money to politicians.

Fred Graziano, Commerce's president of regional banking, said the bad press from the legal issues has had no effect on the bank's government business. He said Commerce has more than doubled its municipal deposits since the two executives were charged in June 2004.

Local analysts say government work is not as lucrative as it used to be because banks have not been as aggressive about cross-selling their municipal finance capabilities.

Patrick Ward, CEO of startup Penn Liberty Bank, is familiar with government banking from his time as CEO of Commonwealth Bank and later as an executive at Citizens Bank. Ward said banks with excess deposits and larger securities portfolios tend to be the ones more involved with government work because they are highly collateralized. Commerce, for example, generates a lot of deposits and has a large securities portfolio.



Ward

Ward said larger banks service the entire region and cross-sell their municipal finance capabilities while community banks focus on the municipalities in their smaller footprint and do not have as much ability to leverage the deposits into other work. Startups like his do not have the extra collateral to make government banking worthwhile, he said.

Fox Chase Bank CEO Tom Petro said he is not a big fan of municipal banking. Fox Chase has chosen not to enter the competitive field. Petro doesn't like the fact that the business relationships are established through a political process. Because the deposits are secured through a bidding process, Petro thinks it dilutes the

potential profitability as banks have to pay a higher price for the deposits, offer lower fees for services or sometimes both.

Charles Bohnenberger, senior vice president of government banking at Sovereign, agreed that government deposits cost more but disputed that the process was controlled by politics and not business-relationship building. Bohnenberger said Sovereign's group consists of a combination of career bankers and ex-government officials focused on building relationships to allow them to get to know the market.

Greg Ewing, senior vice president and Pennsylvania state director for government banking at Citizens Bank, said government banking is profitable because if a bank can get a larger percentage of a municipal entities' employees to open accounts, there are numerous cross-selling opportunities. Governmental entities are not always looking for the cheapest deal, he added, but rather sometimes one that is safest for taxpayers and employees.

Mark Smith, commercial banking executive at Wachovia, said despite the constricted fee-based growth that the entire banking community has experienced over the past two years due to the flat or inverted yield curve — when long- and short-term interest rates converge — the bank has seen double-digit revenue growth with government banking due to its ability to leverage other products.

Cassandra Toroian, chief investment officer at Paoli's Blue Rockefeller, said banks used to be able to pay less for governmental deposits but enhanced competition has brought less advantageous rates.

"It's tougher to cross-sell bond underwriting and pension asset management because politics gets involved. [Governmental entities] are not choosing the best company for the job like in a normal business setting. A lot of times they are making those decisions based on politics and that can make the work less than steady for banks."