BankBeat Community Banking Podcast
Episode 1: Steve Daggett

Jackie:

This is the BankBeat Community Banking Podcast and I'm Jackie Hilgert, editor-in-chief. BankBeat is the online source for community banking news and opinion and is published by the same company that has, since 1992, published NorthWestern Financial Review magazine. Today I am at the Bank Holding Company Association's 2018 Spring Seminar, which offered a high-performance banking panel which featured three successful bankers who shared their insights into what it takes to innovate in today's environment. One of those bankers, Steve Daggett, joins us today. Steve is president and CEO of Midwest Bank, Detroit Lakes, Minn., a $435 million in asset institution, operating seven locations in what is regarded by those who live in the Twin Cities as "The North Country." Midwest Bank has strong numbers: its ROA is 2.40%; its ROE is 25%; and its efficiency ratio is about 49%.

Steve, you've had strong loan demand at Midwest Bank and you've had high loan-to-deposit ratio. How do you fund this loan demand in a rising interest rate environment?

Steve:

Funding is a challenge regardless of the interest rate environment and it's been a challenge we've identified as something we'll continue to place additional efforts on, in particular on the loan-to-deposit side. I think our business development efforts will be successful. We have used some broker deposits which we've avoided, but that's largely because we've had a lot of loan growth in the first quarter. We think that's going to level off. We place a high emphasis on the deposit generating, and think there are some opportunities by being aggressive on the interest rate side of it, because we've got a good margin, so we can afford to go a little bit longer. We also think that since rates have climbed a bit that people are more willing to tie up money for 4-5 years than they were when the numbers started with a low one. Now that the numbers have climbed up a bit, perhaps we'll have some opportunities there. Even if the numbers don't climb, we think there are some opportunities for us there – maybe we'll go the broker route and get money relatively cheap. Now, we can't place too much reliance on the brokers with our high loan-to-deposit and so it's a challenge, but it's one we've identified and one we've operated with over a 15-year period. Our lowest loan-to-deposit was at 90% and we got up to 114%; when we got to 114%, we got it back down to 100%. It's sort of our measuring stick that lets us know we need to put more emphasis on it and we can do that.

Jackie:

You're a former regulator and you have some opinions on broker deposits, could you share some of those opinions?

Steve:

I know that examiners have strong feelings about brokers and they usually tie them to when the Great Recession occurred and that the large number of banks that failed had a heavy usage of broker deposits. That was not the reason they failed; they failed because of bad asset quality. One might say that if the banks didn't have this deposit source they wouldn't have funded these bad loans. Well, put a restriction on their growth and loan. If you have concerns about their asset quality, put restrictions on their asset quality. Don't punish everybody else because of the broker deposits. I know that many times broker deposits are cheaper than the local funding sources. So, you talk about regulatory burn out; if we could save 15 basis points on a funding source that's much cheaper, and the only reason we don't want to do it is because the regulators think so many banks failed because they used broker deposits. To say that is to say that a bunch of cars got into a car accident that were all painted red. The reason they got into an accident is not because they were painted red. That's the reason I have an issue.
One of the things examiners talk about is that there's been a change about ICS deposits and CDARS deposits; that if you're well capitalized you're no longer considered rated as broker deposits. However, if your capital levels deteriorate then you're considered brokered again. Examiners talk about saying, you know what, we won't let you know what your rating is because we don't want to put a run on the bank. But think of the scenario where the bank has a lot of ICS deposits. These ICS deposits many times are municipalities. Now, when a large deposit has always banked with you and they come in and say, I would like to invest more with you but there are FDIC insurance loans. We say, you know what, we've got an option through ICS and CDARS that you could have up to $25 million and that would all be insured. They love it.
Now put us in that same scenario where we go from being low capitalized and now we start to say to them, especially on the ICS side of it, you know what, I'm sorry but we can no longer have your money market deposit. They'll ask why not. Because it's considered brokered. They'll most likely be confused and respond: It's not brokered; I never dealt with a broker. I just talked to you and we brought our deposit over and so why is it brokered? We'll inform them: Regulators consider it brokered. They'll further their questions: Why did you have it before and now you can't have it? We respond: Because our capital levels have dropped to the point where examiners have concerns. Now, do you think that has potential? Isn't that self-defeating their whole point that they don't want to have this get out there and have a run on the bank? That doesn't make sense to me.

Jackie:

You've done a good job developing credit culture at your bank and that wasn't easy. You've had some years where loans were bad.

Steve:

I’ve been with the bank for 22 years now. We had a good stretch where we had solid asset quality, very low problem loans and were doing well overall. Then we had a stretch about 3-4 years long where our responsiveness to credit was just done by email. Which we’ve always had been doing, but it wasn’t the best approach. Because we didn’t have a discussion we started to see deterioration in our asset quality. We knew we needed to change our process on it and adopted an officer loan committee approach. Every bank has a loan committee. But where I think ours has been different is that we’ve incorporated every single member of the bank on the lending team as a member of that officer loan committee at least once during the year, and we rotate them quarterly. When you mention a credit culture I think that’s where we’ve done a good job - by everyone being involved. Even if not everyone is a voting member, what they’re able to hear is that we’re driven by repayment capacity; we can be flexible in collateral if we need to be. But we must be focused on being repayment driven, and we mention that every single meeting. Every person that’s part of that process committee is hearing about reinforcing our credit culture each week. I think as a result that’s why we’ve seen such a good stretch, especially over the past seven years. And I like to believe it’s due to us being in a good area and the economy being pretty good, but also that it’s largely a function of reemphasizing that credit culture on a weekly basis.

This transcript has been lightly edited for clarity.