Financial Managers Society

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Time-deposit Pricing and Sales Options

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The management of time deposit funding is often approached very casually within financial institutions. It is not unusual to find bankers setting rates across the available terms to maturity by scanning the competitor's current offerings and positioning their own offerings within a band towards the bottom, middle, or top of the competition. Additionally it is often observed that a static rate sheet is sent to the front line bankers who have no other sales tools than the rate sheet and no sales training for this product line. This casual approach represents a distinct opportunity for financial institutions to increase profitability in an area that often makes up 10-40% of their balance sheet.

There are many approaches to time deposit management that allow pricing to be refined and integrated into selling and product design strategies, ranging from simple to complex; defensive to offensive; and common to cutting edge. This white paper presents findings from decades of Neil Stanley's work in the field of time deposit management that has resulted in numerous innovations and patents. We present techniques that can be readily implemented to improve profitability and retention of a financial institution's best customers and accounts. We also define the competitive threats that financial institutions will need to address as the competition for funding evolves.

Quantifying the Scope of These Issues

Time deposits are certainly a legacy offering within financial institutions. Due to their long-term presence within the industry, few managers within financial institutions today leverage the many financial and customer benefits enjoyed by high-performing peer institutions. Time deposits are an ideal example of something running on auto-pilot in most financial institutions in spite of their typical size and financial impact potential.

A few key metrics help bankers recognize this potential:

- The percentage of the balance sheet funded by time deposits
- The change in time deposit funding volumes over the past 12 months and 5 years
- The current annualized CD interest expense
- The current and anticipated reliance on brokered CDs and wholesale funding
- The relative pricing of retail CDs compared to brokered and wholesale funding

We suggest that executives identify these metrics early so that they can bring perspective to an issue that is typically off the "radar-screen."

Identifying the Need for Change

Our evidence indicates that the best way financial institution executives can position their organization to better compete for and win the most profitable retail deposit funding is to begin by engaging those managers within their financial institution currently accountable for pricing and sales with some basic questions about the current process:

1. How would our retail bankers handle any of these situations?
   a) Current customer claims that a competitor is offering a 1% rate on a 23-month CD special that they are going to move their money to.
   b) Non-customer calls asking for CD rates and won't give you any information about them.
   c) A customer with a $43,000, 3-year CD currently yielding 1% here at our bank and maturing next Wednesday asks what do you think I should do with this money?
   d) A customer the retail banker has not talked to in a long time is on the list of CDs maturing next month with $115,000 in a six-month CD term. What if anything should the banker do?
   e) What do bankers say to a customer who says they want to keep their money in short-term investments because they think interest rates will be going up?
   f) If a customer needs their CD to mature on their birthday 2 years from now and they have $19,000 to deposit today, what can the banker offer them?
   g) In a conversation with someone we suspect has CDs at other banks the customer tells the banker that all their money is currently invested and the next maturity is not until 24 months from now.

2. Tell me about our pricing process. How do we set retail deposit prices?
3. I am curious how we track our time deposit pricing and sales results. How do we measure our success?
4. Do we have any current improvement initiatives in process regarding time deposit funding? What initiatives have we had in improving our process regarding time deposits recently?

With awareness of the scope of the financial impact potential and responses from those accountable to these basic questions in hand, executives can begin to work through a process of exploring the opportunities within the following checklist.

Survey of Time Deposit Product Design, Pricing, Selling and Management Practices:

The list below was assembled as a comprehensive compilation of tactics and strategies that have and can be used to configure, price, and manage time deposit funding. We believe the great majority are worthy of adoption by most financial institutions.

By implementing appropriate selections from these key approaches bankers find that they develop a competitive advantage for attracting and retaining profitable funding while empowering their front line staff to sell consultatively, which creates and deepens relationships with customers and members. This is clearly the kind of break-through financial executives are looking for in today's competitive environment. Progressive bankers leverage the following approaches to experience these sales benefits while adding 10-40 basis points of profitability on 10-40% of the balance sheet and reducing reliance on brokered and wholesale funding:

Product Design

1. Step-Up / Rising Rate / Ladder CD – Allowing depositors to gradually increase the yield by increasing the term.
2. Trade-Up / Bump-Up / Jump-Up CD - The option to increase the rate during its term if the institution offers a higher yield for the same term or the remaining term.
3. CDtwo® Market Value CD – Effectively bond issuance without SEC registration
4. Cash Flow Accounts / Bank-Issued Annuities – emphasizes flexibility
5. Indexed CDs – The option to tie the CD rate to a major index such as the S&P 500.
6. No Penalty CD – Allowing consumers to liquidate all or part of the CD before the end of the term without paying a penalty. *We generally discourage.
7. Add-On CD – The option to add additional funds to the CD during its term. *We generally discourage.
8. Callable CDs *We generally discourage.

Pricing

9. Structure all deposit accounts to automatically renew as standard accounts of the closest shorter maturity.
10. When forced into a match it or lose it situation, offer a CD yield on a simple savings account via an invitation-only "Limited Edition Savings."
11. Optimize CD early withdrawal penalties to more adequately protect the bank.
12. Negotiable Early Withdrawal Penalties – Emphasizes flexibility.
13. Relationship Pricing – Require a relationship in order to receive preferred CD pricing.
14. Sweepstakes Promotional Invitations – Preferred pricing coupons.
15. Restrictive Promotions such as Election Day (limited timing) and Landlord CDs (limited situations).
16. Pick-Your-Rate CD Promotion – Emphasizes bank's flexibility.

Selling Practices

17. Offer multiple stages in the CD sales process.
18. Effectively use FDIC: Electronic Deposit Insurance Estimator for client situations.
19. Display offers in dollars at maturity.
20. Show how our offers stack up against the competition in dollars at maturity.

21. Offer to customize the maturities of time deposit accounts.
22. CD Revolution® Refinancing Process
23. Display for depositors how much rates would have to rise in order for the shorter-term accounts to be worth as much over time as the longer-term ones available now.
24. Promote that we always honor the primary terms of our commitments regardless of the practices of our competitors.
25. Promote the ability to access money for a fair cost via our CD loan options.
26. Maximize use of FDIC coverage including use of CDARS.
27. Portfolio cash value analysis at any future date
28. Portfolio GPS maximization at any future date

Management Practices

29. Equip and empower front-line bankers to sell consultatively.
30. Consistently measure contribution to net interest margin from new and renewed time deposits.
31. Time and define promotional specials to minimize the impact of re-pricing maturing CDs at promotional yields.
32. Target Maturities of Competitor Promotions - Maximize the cost efficiency of promotional specials.

Narrative on Each Approach

1. Step-Up / Rising Rate / Ladder CD – Allowing depositors to gradually increase the yield by increasing the term.

This account generally has an explicit formula for how the interest rate on the account will progress over time. The financial institution is contracting to pay increasing rates of interest and must be prepared to pay the blended interest rate over the life of the deposit. If the depositor does not receive options to add-on or reduce the balance in the account it is mostly a marketing gimmick. Fairness of pricing depends on how closely the stated interest rates are to the forward implied yields over the life of the time deposit.

2. Trade-Up / Bump-Up / Jump-Up CD

The option to increase the rate during its term if the institution offers a higher yield for the same term or the remaining term. Generally this is mutually attractive to bank and depositors due to depositors rarely being efficient with this one-time option. There is very little risk to the bank if it allows depositors to trade up to the currently offered yield on the closest remaining term.

3. CDtwo® Market Value CD – Effectively Bond Issuance without SEC Registration

Financial institutions can offer a redemption program that makes their CDs equivalent to bonds. The patented option for market value redemption transforms the passive CD into an investment that can be actively managed by the investor (just like a bond). Financial institutions get protection from rising rates and CD holders get the full benefit of longer-term interest rates <u>and</u> the ability for their accounts to appreciate in value. The process helps financial institutions purge accounts that have become relatively expensive when market interest rates fall. Utilizes patented processes.

4. Cash Flow Accounts / Bank-Issued Annuities

The ability to set up an annuity-like deposit account with a time deposit APY that produces cash flow over time while any additional future distribution would be fair-valued based on the financial institution's replacement cost of the funds withdrawn ahead of schedule. This approach provides a simple account that best delivers the bank's best offer to pass along the full returns and risk of longer term investments while providing the ultimate in account consolidation in this one flexible account. Depositors get a CD yield and planned cash flow. They can also make unplanned withdrawals that are valued according to the replacement cost to the bank. If the bank saves interest expense because rates have declined the additional unplanned withdrawals add to the cash flow. If the bank experiences additional interest expense because rates have increased the additional unplanned withdrawals take away from the depositor's cash flow. Utilizes patented processes.

5. Indexed CDs – The option to tie the CD interest rate to the results of a major index such as the S&P 500.

Financial institutions promote this as a way for investors to combine the safety and security of a traditional CD with a potential return that is tied to the performance of the market without direct market risk. Market-linked CDs feature 100 percent principal protection if held to maturity, FDIC insurance coverage (up to applicable limits) and growth potential with limited downside risk. These offerings do require derivative financial instruments which require the depository and the depositor to share a significant portion of the value with a third party who provides the required hedge against the inherent risk. Although correlated to the market index, upside results are generally quite muted compared to the actual index results. Another negative aspect of these accounts is that the values offered are outside of the scope of the financial institution's control.

6. No Penalty CD – Allowing consumers to liquidate all or part of the CD before the end of the term without paying a penalty.

The fear of penalties impedes many would-be depositors. To eliminate their fear, many financial institutions have produced time deposit accounts which give depositors access to all or part of their funds anytime or at various intervals of time throughout the time deposit term to maturity. Typically, there is no counter-balancing/equitable benefit to the financial institution granting this option. *We discourage other than ultra-short special purpose promotions.

7. Add-On CD – The option to add additional funds to the CD during its term.

Another explicit option financial institutions can grant to the holder of a fixed-rate contract for a fixed-period of time is the ability to add to the investment. This option can restrict the size and timing of the addition. For example, the contract can limit the total additions to be no more than the original size of the deposit and additions may be granted only on the semi-annual anniversary of the account opening date. Typically, there is no counter-balancing/equitable benefit to the financial institution granting this option. *We discourage because of the skewed optionality toward depositor when rates fall.

8. Offer Callable CDs

Just like a regular CD, a callable CD is a certificate of deposit that pays a fixed interest rate over its lifetime. The feature that differentiates a callable CD from a traditional CD is that the issuer owns a call option on the CD and can redeem, or "call," the CD for the full amount before it matures. Depositors get excited about the higher yields, but often claim they did not understand what they had agreed to when the issuer subsequently calls the CD before maturity and leaves the depositor to reinvest at disadvantageous interest rates. *We discourage because of the negative impressions created when depositors are negatively surprised.

9. Structure all deposit accounts to automatically renew as standard accounts of the closest shorter maturity.

A simple standard practice to have every time deposit automatically renew within the list of the financial institution's standard CD offering terms at the next shortest term to maturity helps the bank maximize the benefits experienced as a result of a significant portion of customers' predictable inaction at maturity in order to retain the most funding at the lowest possible cost. Minimizing the requirements imposed on the depositor in this way at the time of maturity makes it easier on the depositor and much more likely that the depositor will accept your standard rate offerings at the time of renewal. Most bankers find this to be a simple and easy adjustment if they are not already doing it.

10. When forced into a match it or lose it situation, offer a CD yield on a simple savings account via an invitation-only "Limited Edition Savings."

In the critical moment when the owner of a maturing deposit decides they would be better off to move to another financial institution retail bankers have the opportunity to make a compelling offer that is advantageous to both depositor and financial institution. Every depositor is looking for high yield and short commitment. Time deposits extend commitments in return for higher yields. Once a depositor has demonstrated their willingness to lock up the money for a CD term, the bank is assured that the depositor does not intend to treat these funds as liquid. This allows the financial institution to profitably offer CD yields on simple savings accounts.

11. Optimize CD early withdrawal penalties to more adequately protect the bank.

As interest rates fell to unprecedented low rates in modern financial history, the penalties that were structured on the basis of "months of interest" have fallen dramatically. These penalties protect the financial institution from depositors terminating these investments prior to maturity in order to trade-up to higher yielding investments as interest rates rise. If penalties don't reflect the financial consequences of breaking the contracts, bankers will find that astute depositors, financial counselors, and progressive financial institutions will encourage their depositors to withdraw their low-yielding, long-term deposits once they begin to be highly valued by the bank holding the deposit.

12. Negotiable Early Withdrawal Penalties

Emphasizes flexibility of the financial institution by offering to customize the early withdrawal penalty on each CD by negotiating variations in annual percentage yield – in other words, substitute a weaker early withdrawal penalty if the customer is willing to take a lower APY. This provides the depositor the opportunity to address any concerns they have about the aggressiveness of the financial institution's standard early withdrawal penalties. With the ability to dynamically adjust early withdrawal penalties and calculate the equivalent APY given the slope of the current yield curve bankers can offer choices to appease the customer's anxieties about penalties relative to competitors. Utilizes patented processes.

13. Relationship Pricing – Require a relationship in order to receive preferred CD pricing.

A key aspect of community banking is the ability to differentiate pricing. Relationship pricing when done well enables bankers to reward customers according to the value the customer brings to the financial institution. Although this can take various forms, it can be as simple as requiring active DDA accounts to receive promotional, customized, and Limited Edition Savings offers.

14. Sweepstakes Promotional Invitations – Preferred pricing coupons.

By direct marketing a preferred pricing coupon to targeted customer prospects financial institutions can prompt positive attention within their recognized customer prospects. These pricing coupons can contain an explicitly stated offer or can be blind (coded or rub-off) where the prospective depositor does not find out the extent of the offer until they contact the financial institution.

15. Restrictive Promotions such as Election Day (limited timing) and Landlord CDs (limited situations).

Like sweepstakes promotions, these promotions can be used which are limited in scope but can be broadcast by use of many distribution channels including…

- Brochures / fliers
- Lobby table tents
- Deposit receipts
- ATM receipts
- Banners
- Billboards
- Hard-copy newsletters
- Email newsletters
- Direct mail with letters or postcards
- Bank website
- Social media – Facebook
- YouTube
- Phone calls
- Newspaper
- Radio
- Television

Through the restrictions embedded in the offer the financial institution limited the marginal cost of the funding initiative because they establish a felt-fair reason to not offer the attractive options across-the-board to everyone.

16. Pick-Your-Rate CD Promotion – Emphasizes bank's flexibility.

A corollary of customizing maturity dates of time deposit accounts is that it gives the financial institution the ability to advertise a customer-centric approach like this.
Most banks offer a fixed set of maturities. Here at Sample Bank, our flexibility to create a customized CD maturity allows you to pick your rate and then discover the shortest possible CD term which will get your desired rate.
Example…You pick X.XX%. Our bankers will consult our pricing system to determine the shortest possible term in months for which we can offer your requested X.XX% and offer you that rate with a term of Y months.

17. Offer multiple stages in the CD sales process.

Retail bankers are unnecessarily vulnerable to pricing push-back from customers unless they have options. While retail bankers are generally not properly prepared to handle pricing discretion, it is reasonable to expect that they can effectively handle the opportunity to graduate customers to more attractive pricing when the customers can be properly qualified for "exceptional pricing" within an established process. For more details on this reference a previous FMS White Paper at http://www.fmsinc.org/Documents/MemberCenter/WhitePapers/PricingLeversForTimeDeposits_Pt1.pdf

18. Effectively use FDIC: Electronic Deposit Insurance Estimator for client situations.

Through access to the FDIC website at https://www.fdic.gov/edie/ retail bankers can easily and quickly reduce anxieties from their largest depositors who are worried about the extent of their FDIC deposit insurance. Basic familiarity with the EDIE process and output will prepare a retail banker to demonstrate and empower the depositor to run scenarios which build confidence in the financial institutions ability to provide the simple, safe, and predictable investments they are looking for.

19. Display offers in dollars at maturity.

While every depositor always wants higher interest rates they seldom identify the actual impact of their account options in dollars. This simple approach enlightens the customers' decision process and empowers the bankers' consultative sales process.

20. Show how our offers stack up against the competition in dollars at maturity.

Displaying offers in dollars delivers significant impact when other options are considered. Prepared with the current offerings of local and non-local competitors and regional averages, the retail banker can become a trusted financial advisor who presents their offerings in light of alternatives with the comparative data that makes the most sense to depositors. High performance bankers help customers answer the following question "How would these choices make a difference in the dollars in my pocket?"

21. Offer to customize the maturities of time deposit accounts.

Any complete financial institution core system today facilitates structuring time deposit maturities on any future date, yet few financial institutions take advantage of this opportunity to de-commoditize their offerings with a customized maturity. This basic functionality is so simple and customer-centric that it is an instant winner. Customers expect banks today to cater to their needs, this is a very simple way to excel in customer-centricity. The bank does need a pricing platform to be able to offer an appropriate rate/APY for any term the depositor selects.

22. CD Revolution® Refinancing Process

As interest rates rise, financial institutions will have a powerful and unique opportunity to help depositors refinance their fixed-rate term deposits to new higher market rate offerings. There will be no need to wait to maturity to engage potential depositors when bankers can show depositors how a switch before maturity can compensate the depositor with more money at the current maturity date if they pay the penalty immediately and open a new CD with the same maturity date as their original CD. This patented approach will be celebrated by depositors who find out they can earn significantly more money by upgrading before maturity. For those who find out they are not able to profitably upgrade they will be placed in a targeted marketing campaign program just prior to the maturity of their current deposit. This is facilitated by the process because the retail banker has just learned of the balances, maturity dates, and extent of the depositor's other banking relationships. Utilizes patented processes.

23. Display for depositors how much rates would have to rise in order for the shorter-term accounts to be worth as much over time as the longer-term ones available now.

Prudent investors consider the cost of foregoing higher yielding current offerings while waiting for interest rates to rise. By displaying the longer-term results of scenarios which depositors consider reasonable and likely, depositors can optimize their investment decisions relative to their personal interest rate expectations.

24. Promote that we always honor the primary terms of our commitments regardless of the practices of our competitors.

The vast majority of financial institutions intend to honor the interest rate, maturity dates, and early withdrawal penalties they have established through the life of their current term deposit contracts. Bankers may be unaware that depositors are skeptical of their commitments to these items and may not be aware that other financial institutions have taken liberties with their abilities to change terms before maturity of the accounts.

25. Promote the ability to access money for a fair cost via our CD loan options.

CD loans are a very simple and acceptable banking practice which may be unnoticed by the market place. Promoting the availability of CD loans at modest spreads to the CD interest rate, financial institutions can assure depositors of the simplicity, safety, and predictability of their time deposit offerings.

26. Maximize Use of FDIC coverage including use of CDARS.

Maintain robust relationships with the largest depositors using Promontory Interfinancial Network's CDARS program.

27. Portfolio Cash Value Analysis at any Future Date

The ability to calculate the estimated combined contractual liquidation cash value of the entire investment portfolio held at any institution and globally at any future date. This presents a concise look at the contractual and most likely cash value of the portfolio at any date over the horizon. This is a unique consultative selling option that contributes to depositors sharing details of accounts held at other financial institutions. Utilizes patented processes.

28. Portfolio GPS Maximization at any Future Date

The ability to model and simulate the consequences of possible future interest rates and probable efficient use of early withdrawal options embedded in time deposits on the depositor's entire future portfolio liquidation cash value. This functionality simulates the future value of the portfolio and maximizes that future value given the constraints of current cash and time deposit investments; the market's implied forward yields; the depositor's bias about future interest rates relative to the market's; and the depositor's personal horizon date. It can be thought of like a "GPS" for the depositor's portfolio. Utilizes patented processes.

29. Equip and empower front-line bankers to sell consultatively.

In an environment where banks have allowed their offerings to be viewed as commodities with few retail bankers having been trained to address the needs and wants of their depositors, a pricing and sales platform enables and empowers retail bankers to address the goals and anxieties of the depositors with confidence and solutions that yield more funding at lower cost.

30. Consistently measure contribution to net interest margin from new and renewed time deposits.

Without measurement no one knows the success or failure of the financial institution's pricing and sales processes. Success is more than volumes alone, because high volumes at high cost can be disastrous. Success is more than low cost, because low cost at no volume can be disastrous. An effective measurement system for time deposit funding must simultaneously consider volume, yield, term to maturity, and spread to opportunity costs (profitability).

31. Time and define promotional specials to minimize the impact of re-pricing maturing CDs at promotional yields.

When seeking to attract new funds, wise bankers scrutinize their own maturing schedules to avoid running attractive offers when a larger than average portion of their own deposits are coming up for renewal. By targeting the time periods when the fewest deposits are maturing the financial institution improves the odds of capturing new money at a relatively lower marginal interest expense cost.

32. Target Maturities of Competitor Promotions to maximize the cost efficiency of promotional specials.

When timing promotional activities high performing financial institutions track the maturities of their competitors' aggressive promotions and consider launching their most aggressive promotional campaigns when their competitors are likely most vulnerable to attrition of accounts they attracted via their promotions at an earlier date.

Neil Stanley

Neil Stanley has been a banker for over 25 years. Neil was the CEO of $750 million Northwest Bank in Spencer Iowa which operated in Omaha, Des Moines, Fort Dodge and the Northwest Iowa regions. Prior to Northwest Bank, Neil was an executive for over 22 years with what became the largest privately held banking organization in the country – First National of Nebraska / Lauritzen Corporation. He served First National as Chief Investment and Liquidity Officer and Lauritzen Corporation as Vice President in general administration and supervision of community banks. In 2009, Neil founded **Bank Performance Strategies**. The company helps client financial institutions use proven and innovative methods to lower their cost of funds while retaining and attracting properly-priced, longer-term core retail deposits. Neil also serves WebEquity Solutions as Retained Counsel for Banking Strategies where he created the initial design for WebEquity ALLL.

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