Financial Managers Society

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Keep More Profitable Deposits

By Neil Stanley, CEO, The CorePoint
and Ken Olan, CEO, CAKE Performance Group

Unique Insights | Implementation Guidance | Strategic and Tactical Direction | Immediately Relevant

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With loan growth on the mend in much of the U.S. and margins tight, reliable deposit strategies will once again take center stage. Presented here is a simple, yet dynamic sales strategy, available to every financial institution, that can help retain more of the quality deposits already on the books.

Bankers throughout the country are increasingly focused on attracting properly-priced funds and creating more practical, customer-centric ways to retain quality deposits. Financial institutions have invested greatly in core infrastructure and are hungry for better strategies to leverage the tools they already have.

The FDIC Quarterly Banking Profile for Second Quarter 2015 reports that, nationwide, loan balances for community banks increased 2.7% from the previous quarter and 8.8% from the previous year. The 12-month growth rate for community banks was almost twice the rate of non-community banks and the 5.4% average for all banks. As loan demand increases and the Federal Reserve considers moving interest rates, bankers will inevitably be forced to manage both sides of the balance sheet more strategically.

One of the largest single sources of sustainable deposits for institutions is still certificates of deposit. While CDs may seem passe' to some as a relic of days past, their importance has never been more relevant for stable funding strategies in a Basel III world. Most community banks fund 10-40% of their balance sheet with time deposits. CD retention management is even more important when you consider the broader relationship opportunities associated with these customers who often have discretionary financial resources.

Managing a CD portfolio has long created a banker's dilemma, because of the "cliff" of certainty at the end of each term. In other words, consumers come to a clear, almost perfectly predictable decision point as each CD matures. From the institution's perspective it's "Retain or not retain, that is the question." And how CD monies are traditionally retained, through awkward rate negotiations, can create stomach acid for the front line who earnestly wants to maintain an intact relationship.

CDs are viewed by consumers in a very specific way, simply because of their definition. It is a game of rate and term--or at least it is usually approached that way. Front line bankers dealing with rate-shoppers are often put in a match-it or lose-it position causing tension and frustration for bankers and customers alike. The good news is that better options are available.

Indeed, financial institutions can create a third choice using the tools that are already in their operational toolkit – a choice that gives the front line customer contact people a more powerful and practical method of working with customers to retain these deposits.

Consider a simple savings account specifically designed to retain maturing CD funds at reasonable interest rates. Is such an innovation relevant in this market? Our experience says, “absolutely!”

This type of account offers customers yields comparable to currently offered CDs, but without term commitments or early withdrawal penalties. We realize this unconventional strategy may sound outrageous, and you might be tempted to stop reading now. After all, why would any banker want to offer savings accounts that pay CD yields? Keep reading, and we promise to share the secret approach that creates a recipe for success.

For now, though, just think about the depositors. Do consumers like competitive rates and liquidity? You don’t have to think long about that question to come to the obvious answer. Bankers who have adopted this strategy recognize that there is always someone willing to pay higher CD rates than theirs. But, with this savings account, these bankers have a chance to keep depositors satisfied without paying higher rates.

So how can the bank offer a savings account with CD yields? This kind of account is never promoted via broadcast or direct marketing. Such an approach would be counter-productive, since we are talking about a product that is designed to defend deposits, not to attract new ones.

This unique product is specifically designed to be the retail bankers’ “Ace in the Hole” or last resort, when a current CD depositor has indicated they believe none of the bank’s products are suitable for re-investing their currently maturing CD funds. It is a powerful tool to pull out at the point in the process when the banker believes the funds are lost without being able to offer a viable, authorized alternative that doesn’t require a conversation with upper management or the CFO to get approved.

What we’re referring to here is an exclusive, invitation-only product that can be offered to valued depositors with whom there has been a historically loyal relationship. This is not a tool for hot money. It is a solution designed to sustain quality banking relationships.

From the customer’s perspective this type of account not only offers a competitive return, it gives them something equally important--liquidity. Once the funds are moved into this account, the customer can withdraw these funds at anytime. This gives them the desired control they don’t have with CDs although they still get a CD-level yield. The magic of offering this kind of solution is that the customer perceives the bank’s esteemed sense of value of their relationship. How so? Because they have been personally invited to take advantage of this exclusive, high-yield savings account. It’s a win-win that speaks empathy, respect and relationship value.

From a service-centric banker's perspective, the ability to offer such an account enhances his or her relationship-banking role by having another tool available that allows the banker to more deeply develop quality solutions. This valuable resource enables the banker to move the conversation from a traditional, predictable and narrowly focused interest rate and term negotiation to something richer and of potentially greater value to the depositor.

Bankers like the fact that these special deals empower them to reward customers with whom they have a relationship. Retail bankers love it because it enlightens, equips, and empowers front line bankers who previously felt very vulnerable to dissatisfied depositors. This account retains core deposits at reasonable interest rates for the institution, and the innovative approach gives the bank a progressive position in the mind of depositors.

Now for the counter-intuitive secret formula – deposits are prohibited. The account structure prohibits deposits and therefore eliminates the disintermediation of checking and savings funds. This is a familiar restriction to CD customers who don't expect the opportunity to deposit additional funds to their CDs, so customers don't care. They are happy, and the bank is protected from the pain that is typically associated with high-yield money market accounts. Without this prohibition on deposits, negotiating in this way with depositors possessing maturing CDs will not produce positive results. Customers are reluctant to withdraw funds from the special purpose savings account because they cannot replenish these funds without investing first in a CD and then later transferring to the special purpose account. The prohibition on deposits is critical to success.

Another benefit of this offering is that because these are not transaction accounts, operating expense associated with these accounts is minimal.

The bank retains control of pricing this variable rate account, and although it should not be formally indexed, the pricing can be based on a predictable formula. With this account the bank has a better opportunity to price CDs profitably and use their special purpose savings account to retain a substantial portion that would otherwise leave at maturity.

Bank management and shareholders embrace this solution. Sometimes with things we are very familiar with, we fail to look at the situation with "fresh eyes." This is one of those instances where bankers often believe that everything about offering CDs is obvious, but this negotiating strategy uncovers otherwise untapped potential. To our knowledge no one has ever tried this approach and subsequently discontinued.

The retention impact on funding volume and interest expense has been significant in numerous banks where this technique has been used. For example, one bank using this approach retained $30 million in this special purpose account, in the first two years of its deployment, within a total deposit portfolio of approximately $625 million. Without this special purpose account those funds would have likely been lost to competitors. We can only guess at how much the cost of bank deposits would have increased on this $30 million and the rest of the repricing portfolio if the bank had not adopted this strategy and instead raised CD rates and negotiated with rate-sensitive customers to retain these funds by price alone.

We’ve found that industry veterans are often surprised when they discover this simple and easy way to use their existing core systems and empower their people to dramatically improve retention of properly-priced deposits. While many bankers are talking a lot today about the beta coefficients on their deposit accounts, bankers using this strategy promptly recognize that they can lower the interest expense required to retain deposits in any rate environment. One banker recently responded that he intended to forward this idea to his team with the following questions “Do we do this now? If not, why not?”

Bankers can always get more funds by paying more than the market. But truly successful bankers have learned that using price alone to attract and retain deposits is not a long-term, sustainable relationship strategy. High-performing bankers use this special purpose savings account to save the accounts they really want – the *profitable and loyal* ones.

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