WIPFLi LLP
CPAs and Consultants

Deposit Accounts: Addressing Market and Pricing Issues

August 1, 2007

Last in a four-part series on creating profitability POWER.

Every financial institution must develop plans to increase deposit growth. One of the keys to developing a sound strategy is to understand customers' banking and savings activities, behaviors, and patterns.

Consider the following scenario: As the stock market reaches record levels, the cost of deposits will increase if customers change their savings habits by increasing allocations to mutual funds. Their belief may be that the equity market will provide higher and more consistent returns than a bank deposit. This could prompt a wholesale reallocation of funds from bank deposits to the equities market.

The result is that the banking system's demand for replacement deposits will accelerate and cause an increase in the cost of funds based on the theory of supply and demand.

When interest rates increase, the industry will most likely experience a change in deposit mix. Over the past four years, CDs under $100,000 have increased marginally, while savings and MMDA accounts have enjoyed record increases as customers wait patiently for interest rates to increase and equity markets to recover further.

The implications for cost of funds and retention are noteworthy. Every dollar that leaves the institution has to be replaced. It could easily become an environment where deposits grow at a lethargic pace while equity markets command the lion's share of the funds customers have to invest.

POWER up deposit growth

In keeping with the focus on Profit Opportunity Within Every Resource (POWER), here are some effective measures an institution should consider to address pricing and retention issues on loans and deposits:

- Track the retention rate for renewing loans and CDs by product or lender.
- Establish the loan and deposit volume that must be generated in order to achieve a no-growth scenario.
- Require each lender and customer service person to have goals for acquiring new business.
- Evaluate the merits of a sales training program.
- Determine whether the program for notifying customers of maturing CDs should be modified to let customers know of bank CD specials.
- Track how much of the increase in outstanding CDs is attributable to transfers from other deposits within the institution.
- Develop a system for monitoring the financial institutions to which deposits are being transferred. It could be other institutions, credit unions, mutual funds, etc. This will help in evaluating and addressing any competitive advantages they may have.
- Carefully evaluate tiers and the rate differentials associated with each loan and deposit tier.
- Consider offering CD specials when there are no significant maturities in existing CDs.
- Identify the institution's most competitive deposit product and determine whether it is profitable.
- Identify the institution's most competitive and profitable loan product.
- Explore why customers do business with the institution: price, convenience, employee relationships, products offered, or other. Understand the reasons and replicate them.
- Determine the reasons why customers stop doing business with the institution.
- Determine the average length of time customers who have closed accounts have banked with the institution.

These are simple suggestions, but any one of them can uncover opportunities for growth.

Ultimately, the reality is that if an institution has $50 million in deposits and an 85% retention rate, it must replace $7.5 million of deposits each year to achieve no increase in outstanding deposit balances. Whether the funds are replaced in your market or from some other source, it requires a plan.

About Wipfli LLP

The mission of Wipfli's Financial Institutions Practice is to educate, advise, and assist financial institutions in successfully navigating the complex environment they face. Our clients range from small community financial institutions to multi-billion dollar organizations. The practice consists of certified internal auditors, certified compliance specialists, former financial institution personnel, former regulators, and licensed certified public accountants regionally recognized for their knowledge and expertise. Whether your needs include regulatory compliance, profit improvement, risk management, strategic planning/board development, information technology, audit, or tax, let our experts assist you. For more information, visit www.wipfli.com.