BAI Banking Strategies

Beyond the Static Rate Sheet

As interest rates begin to rise, bankers trying to sell retail time deposits will face competitors deploying an array of new terms and options. By NEIL STANLEY

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The banking industry has run off $1 trillion, or one-third, of its time deposits since 2008, according to the Federal Deposit Insurance Corp. That was good for banks as long as interest rates were going south. However, since April 2013, we've seen a doubling of the five-year Federal Home Loan Bank (FHLB) advance rates, which represent an alternative funding source for financial institutions. Five-year rates at the FHLB of Des Moines, for example, have been over 2% for several months at a time when the average five-year bank certificate of deposit rate as reported by FDIC has been around 0.75%.

This 125 basis point advantage makes term retail deposits once again valuable. When the surplus of local deposits is gone, replacing a retail deposit with wholesale funding such as FHLB advances will be painful!

Toxic Tactic

While most community bankers have generally been in a state of hibernation regarding time deposits, much has changed. Many bankers will likely be surprised to find that the simplistic tactic of "paying more to get more" will not only be difficult to execute, it can be toxic in this ultra-competitive world. The margins are just too thin to waste on above-market pricing. Several factors have contributed to the environmental changes while bankers were busy with other priorities associated with the recent financial crisis.

Interest rates, for example, went beyond low; they went ultra-low, as the 10-year U.S. Treasury reported by the Federal Reserve reached 1.43% in July 2012. This unprecedented low rate environment has gravely wounded bankers' abilities to sell certificates of deposits (CDs) using a static rate sheet approach. The combination of record-low CD rates with record-high bank earnings has tainted the acceptability of time deposits in the minds of customers.

Meanwhile, smartphones and internet offerings have placed information and analytic power in the hands of the CD customer. This means that the current generation of CD customers is ready, willing and able to gather more information and analytic power than your retail banker with a rate sheet.

At the same time, some strategically aggressive financial institutions have developed new defensive and offensive approaches. Many bankers will be surprised at the new arsenal that will be arrayed against them to exploit the weakness within conventional time deposit products when the demand for longer-term core deposits intensifies. Note, for example, the filing of a U.S. patent application for a process that the inventors could use to refinance CDs from other financial institutions into the large well-known U.S. bank they were associated with at the time of the application.

Finally, consider that CD customers have significant financial resources and needs and many options for deploying those resources. It's essential for your staff to learn how to professionally negotiate with the next generation of Baby Boomer retirees. Without an effective way to engage the legitimate needs of this customer base, the banking industry is wasting a great opportunity.

The bottom line is that some banks will exploit the weaknesses of other banks as interest rates rise. Strategic bankers today are preparing their retail bankers to dynamically customize CD maturities; display in dollars how their offers compare with competitors; offer a CD-type yield on a savings account to retain deposits; offer gains to depositors who want to withdraw expensive CDs early; promote the refinancing of CDs as rates rise; and buy-down early withdrawal penalties like mortgage customers buy-down points. While you may not need to do all of this immediately, failing to address these new dynamics will leave your retail bankers virtually defenseless if all they have to offer is static rate sheets.

At the end of the day, the winners will be the strategically forward-looking banks and their depositors. The losers will be those bankers who won't look beyond what appeared to be the successful approach to time deposit funding over the past 30 years. The status quo will not be a safe place.

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