FINANCIAL PERFORMANCE

Deposits Everywhere … And No Place to Put Them

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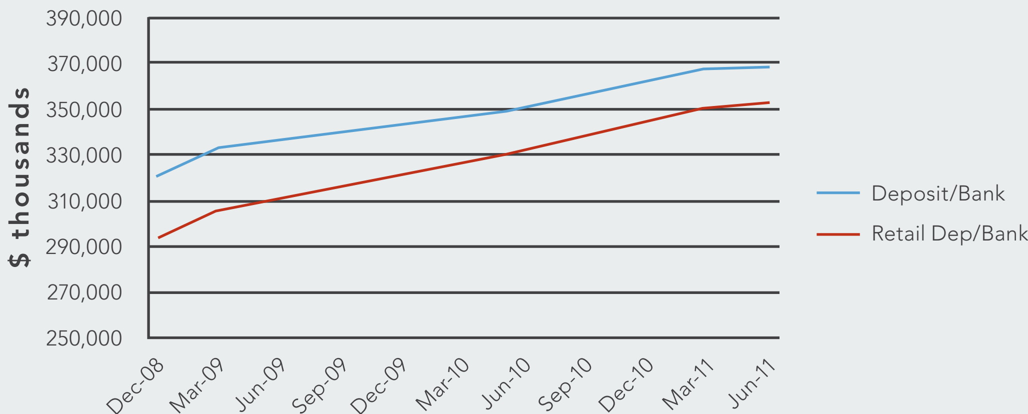
Interestingly, much has been written recently in financial publications about the need to prepare for rising rates and pressure to originate deposits in the future. While planning for eventualities is always a good procedure, many bank and credit union executives must shake their heads wondering how they are going to deploy the current glut of deposits in this low interest rate environment. Most good forecasters, including pronouncements from the Federal Reserve, indicate that the economy will not be experiencing high or even moderate interest rates until at least 2013 and possibly beyond. Also, economic events can always lay well thought out assumptions asunder, but it seems increasingly likely that rates will be tame for a couple more years. With gyrations in the stock market and a large number of baby bumpers and others saving for retirements, lack of deposit flows at this point doesn't seem to be a problem for most institutions. This is particularly interesting in light of the continued decline in deposit rates. As can be seen in the following table, average MMDA rates have decreased by about 50 basis points from March 2009 through late September 2011 and twelve month CD rates have fallen by about 1.1% during that period.

National Average Deposit Rates

	$10,000+ MMDA	12 Month CDs
Sept. 2011	0.35%	0.65%
Sept. 2010	0.46%	0.83%
Dec. 2009	0.60%	1.14%
Mar. 2009	0.86%	1.72%

Using our customized database on community banks based on FDIC data (we exclude most banks over $20 billion in assets, bankers banks, and specialty banks like credit card institutions or foreign entities), average deposits, both total and retail, per community bank have risen substantially since 2008, as shown on the following graph.

Growth in Deposits per Community Bank ($000)



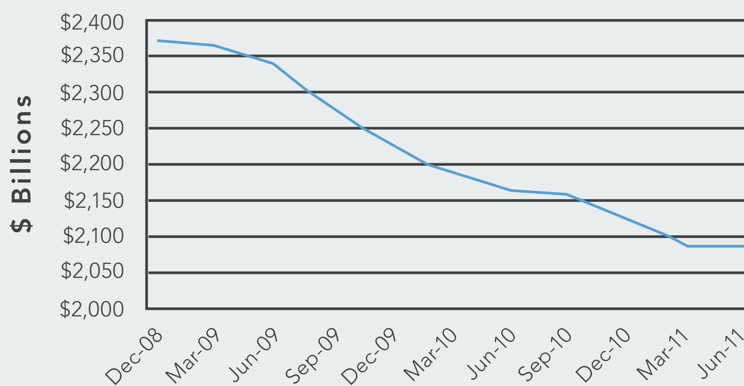
Growth in deposits is generally not a bad development, but if there isn't complimentary growth in loans, the funds are just invested in low yielding securities. This situation can be captured by the loan to deposit ratio shown in the following table which continues to decline from 2008 through 2011. This is true not only at the mean and median (50th percentile) of all community banks, but even when examining the top quartile.

Loans-to-Deposits at Community Banks

	Jun-11	Dec-08
Mean	77%	92%
Median	74%	86%
Top Quartile	85%	98%
Bottom Quartile	61%	71%

Financial institutions have plenty of funds, but in many cases there are not a lot of good opportunities to deploy those funds. The last chart shows growth or perhaps lack of growth of loans at community banks.

Total Loans at Community Banks



Should we prepare for a period of deposit shortage, the answer is definitely yes. This may be a time of plenty deposit-wise, but as Joseph and the Egyptians learned, times of plenty can quickly turn into famine. After all, if one examines the first decade of 2000, except for a few years in 2002-2004 and at the end of the decade, banks were scrambling for deposits during most of the period. Now is definitely a good time to be preparing for those periods when deposits will be scarce. Bankers need to make sure that their systems and procedures are in place to handle the inevitable need to raise more funds through deposits.

What are some procedures and process that we should consider? If your institution isn't taking action in the following areas you need to get started. Below is a short check-list of items a well-managed institution should be initiating.

- Have a Profitability committee that meets at a schedule time regularly;
- Collect market intelligence on competitors;
- Review national and regional market rates and economic information;
- Produce reports on upcoming maturing CDs;
- Have good means to monitor closed accounts; and
- Use a deposit pricing model to understand the profitability of actions taken or to be initiated;

Having a Profitability committee that meets regularly is one of the most important actions a financial institution can pursue. This is sometimes referred to as a Deposit Pricing Committee or just the "Pricing Committee". This isn't the Asset Liability Committee (ALCO), but can be a subgroup reporting to ALCO. This group should meet at least twice a month at an assigned time, but even better would be a weekly meeting. Some bankers use the excuse that there really isn't a need in the current economic environment, since they haven't had the need to change rates in the last year. Examining the first chart in this article, the big question might be why haven't we lowered rates? There have been rate movements over the period that should have led to lower deposit rates. The membership of this committee should be kept to a few people, three or four at the most. However, one of these members should represent the branch network and might be, on a rotating basis, an assistant branch manager or senior CSR.

This group needs to collect data to make informed decisions. They should obtain a survey of competitor's rates from a provider such as RateWatch. Knowing what the competition is doing is important. Also, this group needs to be aware what is happening with national market yields. Knowing the maturity of CDs, sounds simple and it is usually easy to produce a report from the core system, but is your institution getting such a report, is it understandable and is it in a usable form to make decisions? Finally, does the institution have a good mechanism to monitor closed accounts and understand why the accounts are closing?

Lastly, there is the question of having a pricing model to measure the ROE and profitability of pricing actions undertaken by the financial institution. In the current environment, many deposits are not profitable, does the Profitability committee understand when they make a pricing decision the effect on the volume of deposits as well as the institution's ROE and profitability. The model should be a formalized system that accurately measures the deposit's contribution to the institution's profitability. Models such as, ProfitStars' Margin Maximizer Deposit Suite, can provide guidance to the committee on properly pricing the institution's liabilities and hopefully lowering the cost of funds.

A final thought, in this period of low rates, is to simplify the deposit structure at the financial institution. A popular idea over the past decade was to create, every few years a new "high yielding" deposit program. This was often an MMDA type deposit, but sometimes a NOW or even savings account. The idea was to have a new program, with a few extra bells and whistles that allowed the institution to provide an "aggressive" price to attract new deposits while not pricing up all the other deposits in that same product category. We support this notion and in general think it is a good idea. The problem is that some institutions now have a half a dozen MMDA or NOW programs. This might be a good time to consolidate them into one or two programs. Currently rates are pretty similar across the board, even "high yielding" MMDAs or NOWs have rates only a few basis points higher than some of the lower yielding programs. Now is the time to consolidate and simplify so that you have room to introduce new programs when needed in the future.

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