Deposit Strategies in a Fed Tightening Cycle

Every new rising rate period is a little bit different.
Is your institution prepared?

Joe Kennerson, Managing Director
Billy Guthrie, Managing Director

In just the first few months of 2022, as the Fed funds futures curve has taken off the prospect of rising interest rates has quickly evolved from a hypothetical to one of the hottest topics in ALCO. And institutions have taken notice, moving deposit strategy discussions from the back burner to the forefront in short order.

But those banks and credit unions that are hoping to get by with the same ideas and tactics that worked in previous Fed tightening cycles may be in for a rude awakening, as what may appear to be the same old game is in fact unfolding on a very different playing field. The current picture, after all, includes the highest inflation in more than three decades, an incredibly steep short end of the yield curve, historically low asset yields/margins, massive average balances, and a hugely lopsided ratio of non-maturity deposits to CD balances.

Now more than ever, institutions need to focus on:

- Developing a *fluid* deposit plan
- Finding clarity amid their new deposit bases
- Better utilizing predictive analytics as they formulate these plans

Will firms base deposit strategy on gut feelings – or quality data? The answer to this question will have significant bearing on how successfully institutions may navigate the current environment – as well as the inevitable rate increases yet to come.

The Importance of Predictive Analytics

While most institutions understand that it's folly to expect certainty when it comes to planning for the future, the high performers understand just as well that data can be invaluable in helping to create clarity. If an institution looks only at historical averages and not the trends underlying those numbers, it won't be able to see how different scenarios might play out. Predictive analytics allow for dynamic forecasting, which can serve as a basis for a deposit plan that is fluid and adaptive to changing conditions.

For example, dynamic rate forecasting should include a bottom-up analysis of variables such as:

- The yield curve (including short- and long-term variables)
- Competitive pricing levels
- Spread lags
- Account sizes

Using the client database to augment historical information allows an institution to better forecast interest rate and pricing scenarios, resulting in a more confident outlook. Likewise, dynamic volume forecasting should be a bottom-up analysis of variables such as longevity, account size, and rate offerings against both the market and the competition. Here again, institutional data and historical information combine to offer a more comprehensive view of the road ahead.

Even with the excess capital that many institutions still have on hand from the recent stimulus-fueled years, the question remains as to whether that money will stick around as the rate environment changes. CD money has moved elsewhere, for example, but where exactly? There's a lot of money sitting idle in non-maturity deposits – does your institution know who's behind that money and what they might do when rates move? The answers to these questions are likely in the data, but you have to know where and how to find them.

Data-Based Deposit Strategies

With the information from a combination of historical and predictive data in hand, an institution can start to address some of the key pieces of its deposit strategy – with the goal of achieving greater clarity – by focusing on some of the most crucial action items, such as:

- Evaluating current and future liquidity needs
- Reviewing the parameters of negotiated deals
- Identifying at-risk depositors
- Revisiting balance tiers
- Assessing potential core checking initiatives
- Reviewing new product options and market initiatives

- Discussing how to minimize cannibalization amid new growth opportunities
- Tracking migration and marginal cost of funds on new specials
- Identifying CD customers sitting idle in non-maturity deposits
- Strategizing on upcoming CD maturities

In working through this list, some areas that may demand particular attention include:

→ Building checking accounts from within, **focusing on those existing business customers who are more engaged** with things like debit cards, direct deposit and active bill pay

→ Crafting money market specials that consider factors such as minimum balances/tier structures, relationship-based pricing, new money requirements, and **opportunities that are targeted** to a specific region or type of customer

→ Identifying **at-risk depositors** by looking more closely at potential rate sensitivity

→ Revisiting money market tiers to be sure the **customer base is properly segmented**

→ Looking closely at CD threats and opportunities, with an eye toward determining where departing CD money has gone and how to best get it back **without cannibalizing other products or courting too many single-account relationships**, which are more likely to jump at the promise of another special elsewhere

→ Reviewing upcoming CD maturities and formulating a **sensible retention strategy**

Voltaire once said, "doubt is not a pleasant condition, but certainty is absurd." The goal for any institution amid the current Fed tightening cycle should not be absolute certainty, but rather *heightened clarity*. And when it comes to your deposit strategy amid these ever-shifting conditions, the best chance for clarity lies in the data.

For More Information

For more ideas on deposit initiatives, data analytics, and applying lessons learned from previous cycles in today's evolving environment, contact **Joe Kennerson, Managing Director, Darling Consulting Group.**

For more insights from Joe and Billy, click to hear the replay of their recent webinar, **"Deposit Strategies in a Fed Tightening Cycle."**

Joe Kennerson
Managing Director, Darling Consulting Group

Joe Kennerson is a Managing Director at Darling Consulting Group, where he works directly with senior management teams on building customized balance sheet strategies to improve earnings and manage risk. Joe is an expert in overall Asset Liability Management and educates ALCOs on the inevitable balance of financial performance and regulatory appeasement. In 2021, Joe spoke at 28 industry associations reaching nearly 3,000 bankers. He helps bring clarity to the complex and delivers a high level of energy to his ALM presentations.

Joe has been with DCG since 2005, where he has benefited from working with nearly a thousand ALCOs throughout the country on ALM and strategic initiatives. He lives in Boxford, MA with his wife and two children and has been an active member of the Big Brothers Big Sisters program. Joe is a graduate of the University of New Hampshire with a degree in finance.

Billy Guthrie
Managing Director, Darling Consulting Group

Billy is a Managing Director at Darling Consulting Group, working directly with financial institution executives to validate and better understand key deposit assumptions utilized in risk models. In addition to supporting core deposit study analyses, he also educates DCG's client base on utilizing data analytics to support strategic deposit decisions through Deposits360°®, DCG's proprietary tool.

Billy began his career with DCG in 2008 as a financial analyst. He is a graduate of the University of New Hampshire with a degree in finance and management.