FMS Update

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Looking Inward

The key to deposit challenges may be your current customer base

WHILE many institutions have been anticipating a Fed rate move with an eye on its potential for providing a little bit of juice to their long-dormant net interest margins, they may not be paying enough attention to the flipside – the possibility that a rate increase may mobilize customers and inspire them to start shopping their deposits. Justin Bakst, a managing director at Darling Consulting Group in Newburyport, Mass., says this reality may come as something of a shock to those who have gotten comfortable with their deposit bases.

"During the 2009-2010 timeframe, there was really aggressive pricing for money market accounts," Bakst explains. "Institutions that were seeing huge growth during that period may think those deposits are now part of their core funding base, but as we get into a higher-rate environment those deposits are going to suddenly have more incentive to move. So institutions need to be aware that this dynamic exists – these customers are out there, and they've just been waiting for an opportunity to jump."

Opportunity for Institutions, Too

In a recent webinar presentation for FMS, Bakst laid out the case for why pursuing deposits outside of the institution as rates start to rise may be less critical than holding onto and growing the current deposit base. It starts, however, with institutions first waking up to the new reality that their core deposits may finally be at risk.

"Many institutions have unfortunately had their head in the sand, and I can understand why," Bakst says. "We've just seen a huge buildup, so this hasn't been a focus because it hasn't needed to be a focus. For most institutions, liquidity hasn't been a challenge over the last several years, so they've put the time, energy or resources elsewhere. But we're already starting to see that dynamic change."

Indeed, many community institutions have probably already noticed an uptick in competition for deposits in their local markets – competition that is only likely to grow more intense if and when rate increases once again become a regular, ongoing piece of the economic puzzle. The key, according to Bakst, is for institutions to realize that this environment provides not only a challenge, but also a great opportunity.

"The number one opportunity and challenge for community institutions in the next rate cycle is mining their existing portfolios," he explains. "This is an underutilized aspect of expanding their funding bases. Many institutions spend most of their marketing budgets on gathering new opportunities, when the existing portfolio is where the most potential lies to broaden relationships."

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>
> *Justin Bakst, Managing Director, Darling Consulting Group*

Parsing the Possibilities

In order to find out where the opportunities in their current portfolios lie, institutions need to take the kind of closer look that they may have been neglecting prior to now.

"We've been in this low-rate environment for so long, and in many markets there have been considerable buildups of non-maturity deposit balances and

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shifts from CD specials into those NMDs," Bakst says. "Many institutions haven't taken the time to quantify what kind of exposure exists and what they might see in behavior patterns as rates start to rise and some of the competition begins to aggressively price CD specials and other products."

Getting more from of an existing customer base means broadening relationships, which makes it critical to understand who those existing customers are and what they're doing. That involves digging deeper into the data for a better idea of which customers hold the potential for long-term profitability going forward – that is, those 20% who likely hold 80% of the institution's deposits, and who are therefore crucial to retain and grow. These customers may be rate sensitive, after all, but the quality of the relationship they possess and the service they receive may be enough to trump price.

"The most important things to be aware of are customers with multiple relationships (checking, loans), how long they've been with the institution, how their deposit balances have changed during that time and whether they're utilizing available technology like mobile banking and direct deposit," Bakst says. "You're looking for those 'stickiness' factors that will really help hold onto those customers as competition begins to heat up."

In other words, for as important as competitive analysis is sure to be in regards to deposit behavior in the upcoming rate cycle, so too will be self-analysis. ■