First Focus for 2019: Deposits
by Charles Wendel

I hesitate to be yet another voice focusing on the need for banks to put more attention on deposits. However, other than risk management, there may be no other area of more critical importance to banks right now.

Current deposit issues. First, the loan to core deposit ratio is rising:

- The industry ratio at 9/30/18 was 90%
- For banks from $1B-250B, ratio is 100%
- For banks over $ 250B, ratio is 81%
- For credit unions, ratio is 85%

Of course there are also some banks where the ratio exceeds 100%. At the same time, over the last nine months the cost of earning assets has increased from .48% to .70% (source for above: Cornerstone Advisors).

These numbers show that the biggest banks may possess the market power to continue to attract deposit. However, other institutions need to operate with focus and a sense of urgency to maintain and grow their deposit franchise. This topic should be among the highest priorities at most banks.

Today, banks face both an increased need and increased cost for deposits that will likely continue into 2019 and beyond. In some cases banks are operating as if this is a temporary problem, one that will right itself as rates stabilize. Instead, something systematic may be happening that will alter the ability of banks to rely on stable deposits going forward as they have in the past.

Here are some reasons why this is a long-term, systemic issue:

More engaged and aware customer. Banks can no longer depend upon their customers' lack of knowledge about deposit options or rely on the inertia factor. Media coverage has helped customers to become aware of multiple rate rises by the Fed. Aggressive direct mail, on line, and related marketing has shown customers multiple high-rate offers from both traditional and challenger banks. These rates can exceed their current bank's deposit interest rates by 200 basis points, a head turning difference.

This may also impact the value of some M&A activities. One deposit acquisition approach that some banks have used in the past involves paying premiums to buy deposit rich banks in slow growth markets and then using those lower cost fund to finance loan opportunities elsewhere. Some banks may be finding that those slow-growth depositors are also moving their money, eroding the value of the acquisition.

More aggressive competitors: When you Google "highest interest rates today" multiple offers of rates above 2.0% and approaching 2.5% appear. CIT, Amex, Marcus, Barclays, Capital One, and Simple all show offers. Interestingly, Simple, a 2009 startup, is offering rates lower than its big name competitors.

Deposit displacement: A number of consultants and industry writers have highlighted the amount of dollars that are now held outside of bank and credit union accounts. Factors include:

- Health savings accounts: $45B
- P2P payments: One source estimated that Venmo has $2.2B sitting in user accounts
- Starbucks and other retailers- Starbucks has $1.2B in deposits on customer loyalty cards. The total gift card market was about $180B in 2018, suggesting deposits held in retailers mobile apps will grow
- Robo advisors. AT Kearney estimates that assets held in robo-advisor tools will reach $2.2 trillion by 2020. While this might point to a business opportunity for banks, it's also a threat. Kearney believes half of those assets will come from currently non-invested assets—in other words, bank deposits

Shifting demographics: We all know that the power of Baby Boomers is declining, as millennials become the dominant demographic group. Millennials certainly appear to have lower excess dollars to keep on deposit and are particularly prone to the Starbuck, Venmo, Robo phenomenon mentioned above. The emerging Gen Z group likely offers an additional and different set of deposit challenges.

Challenger banks. Related to millennials, private equity investors have been continuing to fuel the growth of these startups that are another deposit challenger. Why? American Banker quotes a CB Insights report that says "Challenger banks address common consumer problems that have largely gone unaddressed by traditional banks."

Faster payments. Monday's *American Banker* reported that businesses are expecting faster payments with "round-the-clock settlement" and that the Fed is working on creating a faster payments systems. One impact of this change when it comes may be dollars in business and consumer DDAs for less time.

What to do? The point of the above comments is to encourage those banks that are not doing so to put a bright spotlight on deposit retention and growth. Virtually every institution is aware of this issue and most are taking steps to address it. ***But, are banks doing enough, quickly enough?***

FIC created a checklist of ten actions that banks should take related to maintaining deposits. None of these suggestions is revolutionary or even new, but they are still critical. Their value exists in assisting banks to enhance the consistency and rigor of the deposit retention and growth process.

1. Put someone in charge
2. Focus bankers on deposit generation as a high priority
3. Focus on current customers first
4. Revisit your product set
5. Review deposit-related compensation

6. Consider a deposit-only sales staff
7. Pilot “concierges”
8. Emphasize deposit-|rich segments
9. Rank and review monthly; act on performance results
10. Repeat step 9

Next week, we will discuss each of these steps and the issues banks should address as part of this effort.