SAVINGS VS. CDS: WHAT IS GOING ON?

by Steve Brown

There is a trend with a handful of banks that raises a question - How rational is the rational player? Rates for CDs should always be higher than savings rates in a positively sloped interest rate environment because a) there is a time value of money (at a cost difference of about 44bp per annum according to forward rates), b) CDs are less flexible than savings and come with a certain, stable duration, and c) CDs require a certain minimum to open. This is why it is interesting when we see banks invert their local deposit interest rate structure by offering savings rates that are as much as 20% to 50% higher than term CDs less than 5Ys. For example, ING offers 80bp for savings, or the same rate as a 4Y CD, while Capital One pays 60bp on their savings, the equivalent of a 3Y CD. What is going on here? Why would a bank pay so high for a savings account and why would investors ever choose to go into these banks' CD product? The answers merit review as it speaks to the heart of deposit account structuring. In short, there are 5 main concepts going on that, in total, explain the behavior. 1) People and organizations don't pay attention and constantly pay for convenience. In other words, at any given bank, an estimated 5% to 15% of customers blindly roll CDs over without ever researching alternatives. Why pay a premium for customers that simply want convenience? More to the point, what is your bank doing to make it as easy as possible for these self-selecting customers to roll their CDs over so you can increase this percentage to above 25%, where it is at banks that have mastered this tactic (like ING). 2) Investors will pay for the discipline that the CD maturity imposes on them. Here, an estimated 3% to 5% of customers (both business and retail), desire a CD as a form of forced savings. The penalty on the CD and fixed maturity help impose discipline by limiting access to funds. Why provide a premium to these customers? Are there better products your bank can offer to help customer's save (answer: there are)? 3) Some customers desire stable and set interest income that a CD provides. Knowing both a maturity and a rate gives the customer comfort, as does a monthly, quarterly or semi-annual interest payment. Since the savings rate can vary, some customers will pay a premium for certainty. This is particularly true for those customers on a fixed retirement income. Ironically, Capital One and ING do something smart by making the contrast from the savings rates to CDs so stark. This has some customers believing, by structure, that long-term rates will drop and that the savings account is a relatively better bargain for the long term. 4) Similar to #3, some customers are scared of volatility and want to wait for higher rates. The more volatile the market, the more customers fall into this category. At times we have seen as much as 50% of a bank's deposit base go out of CDs and into an interest-bearing non-maturity deposit account (usually a MMDA) to wait for higher rates. Note that while the behavior is the same as type #3, it is a customer with a different need and rate view. Finally, for the 5th reason, there is the impact of marketing. Banks that offer higher savings rates than CDs tend to spend more marketing and sales resources on their savings accounts, while keeping their CD options relatively quiet. Savings accounts, if done right, can have a longer duration than the bulk of a bank's CDs and some feel this is the better investment. However, we will quickly add that it is extremely hard to achieve that type of interest rate sensitivity by paying higher savings rates. This means that these banks are either deluding themselves that their savings accounts are less interest rate sensitive than they are, or have a plan to convert these customers to a longer duration. Regardless of the reasons customers and banks choose to invert their deposit rates, lessons abound and will be a subject of both deposit account structuring and asset-liability management that we will cover at our upcoming EMC

Conference in May. Being fluent in how to work with customer behavior and design accounts that best leverage this behavior is critical to taking advantage of the current market - join us and sign up now.

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BANK NEWS

M&A

Jefferson Bancorp ($130mm, MD) will acquire Carrollton Bancorp ($365mm, MD) for about $25mm in cash and stock. Private equity firm Hovde Acquisitions owns substantially all of the shares of Jefferson.

No Investment

Hana Financial Group (South Korea) and Saehan Bancorp ($576mm, CA) have agreed Hana will not acquire a 51% ownership stake in Saehan and have mutually terminated their acquisition agreement.

Partial Owner

First Mariner Bank ($1.2B, MD) clarified that it acquired 25% of Cecil Bancorp ($463mm, MD) stock as a result of the collection process of a defaulted loan, but it is not interested in pursuing an acquisition of the bank.

Fed Focus

In a speech given yesterday, the Fed Chair said he supported new steps to curb "shadow banking;" requiring money market funds to maintain capital buffers (or to redeem shares at the market value of underlying assets rather than at a fixed price of $1); improving monitoring of financial innovation; curbing intraday credit in tri-party repo markets; boosting the level of required bank capital; and incorporating bank stress tests as a regular feature of the supervisory landscape.

New Controller

Thomas Curry will succeed acting Comptroller John Dugan as the 30th Comptroller of the Currency. Curry has served on the FDIC Board since 1/2004.

Extending TAG

An ICBA survey of bankers finds 79% advocate extending TAB beyond Dec. 31 of this year. Some of the reasons cited include: ensuring a level playing field with larger banks, benefits to small business customers, a fragile global banking system, a fragile economic recovery and protecting municipal deposits.

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