Retaining Customers as Rates Move Higher

stress testing profitability marketing customer experience

Summary: The next great boom in refinancing will likely be in CDs and other deposits, which are vulnerable to customers who decide to pay penalties and reinvest at higher interest rates. A rising-rate environment is also a potentially fruitful hunting ground for fintechs and neobanks, which already offer higher rates than traditional institutions. We discuss three strategies to help CFIs hold their best customers and stress test for CD and deposit losses.

The phrase “keeping up with the Joneses” was popularized by Arthur R. “Pop” Momand in his 1913 comic strip series of the same name. The comic series featured the McGinises, a middle-class family fixated on competing with the Jones family, who never actually appeared in the comic. Although the Joneses in Momand’s comics were harmless and fictional, when it comes to your institution’s deposit customers, the “Joneses” pose a very real risk to your bottom line.

If your community financial institution (CFI) is like many of your peers, then you’ve had bountiful deposits in recent years. Unspent stimulus checks, spending that never happened because of pandemic-related lockdowns, and the safety of insured deposits all brought an unusual increase in consumer deposits. The Paycheck Protection Program and a turn toward the safety of having cash on hand meant abundant deposits on the commercial side, as well.

Better still, you haven’t had to pay a lot for those deposits. At the beginning of 2022, a one-year CD paid an average of 14bp. Now, of course, the Fed has raised interest rates, and with them, much of the world of debt. As of early August 2022, 30Y fixed-rate mortgages averaged 5.32%, and a one-year CD paid just 57bp — but this is almost certainly going to change. Not only will CFIs need to pay more to attract new deposits, but they will also probably need to pay more to keep the deposits they have.

The need might not be urgent now, because loan demand is still relatively low at most financial institutions. Eventually, though, a combination of rising interest rates, inflation (which stood at 9.1% for the year ending in June 2022), and competition from fintechs and digital banks will adjust depositor thinking.

“*Sitting on the sidelines and paying no rate is going to become less and less tenable as time goes on,*” says a director at Curinos. “Y*ou are going to have a lot of clients saying, ‘Wait a second, my loan rates have gone up by a percentage point or more. Why are my deposit rates still sitting down at nothing?’*”

How vulnerable are your deposits? A CFI could, of course, simply raise rates across the board. It may be smarter, however, to consider some questions before increasing the rates your CFI pays on CDs and other deposits:

- What’s our ideal deposit level? At present, how close to that level are we?
- How long do we think our institution will benefit from the events that created this deposit surfeit?
- How sticky are our deposits? How long do we think deposits will stay if we don’t raise rates?
- Should we expect to see some deposits go elsewhere? Has this already happened?

Answering these questions should give you a sense of what you need, what you already have, and how quickly it might disappear. If you find your CFI in a position where raising rates is favorable or necessary, here are **three strategies** to help formulate your plan of action.

1. **Consider targeted increases.** With that information in hand, you're ready to make a choice. Your CFI could raise rates for every depositor. Or you could focus your increases on the most valuable relationships that are most likely to leave in search of better rates.

"*How do you think about the need to give a higher rate to customers in a way that protects the most valuable relationships that the bank has, when you still don't need deposit growth?*" Stockton asks. "*You don't want anyone to walk out the door and feel that they've been treated unfairly, but you don't want to price way up either.*"

Ideally, you won't lose any customers. But if customers walk out your door, they should be single-service customers, not the core, most profitable clients with whom you have the deepest relationships. Analytics that take relationships, deposit products, and geography into account can help you make these predictions.

2. **Watch the competition.** Yours won't be the only CFI pursuing this strategy. Keep tabs on what other financial institutions, including digital and fintech, are doing to attract new customers.

Keep in mind that, like all financial institutions, you can only see your competitors' public-facing marketing. Stay aware of their marketing offers to prospects, while remembering they will also push out special offers to their most-valued customers, discuss higher deposit rates in person, or even concede if an existing customer insists on higher rates as a condition of staying a customer.

3. **Stress test your portfolio.** Don't forget to stress test your loan portfolio to determine the likely results of raising CD and other deposit rates in an environment where benchmark rates are also headed up. You may find that you're in a position to both keep existing customers and attract some new ones.

The most important part of retaining your deposit business right now is to keep a watchful eye on the local market and assess where your CFI currently stands in relation to it. Develop a plan of action for either raising rates across the board or making special offers to your most valuable customers, based on what your competition is doing. If you play your hand right, there can be better gains than losses for your institution as deposit rates rise.

STATE-OF-THE-ART ANALYTICS WITH EXPERT INSIGHT

ECONOMY & RATES

Rates As Of: 08/18/2022 04:47AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	2.68	0.27	2.62
6M	3.15	0.24	2.96
1Y	3.23	0.29	2.84

2Y	3.25	0.36	2.52
5Y	3.03	0.35	1.76
10Y	2.87	0.22	1.36
30Y	3.13	0.11	1.22

FF Market	**FF Disc**	**IORB**
2.33	2.50	2.40
SOFR	**Prime**	**OBFR**
2.29	5.50	2.32