

Retail Deposits: Pricing to Win in a Tight Market

By Sherief Meleis and Richard Solomon

Current intense pressures on the U.S. retail deposit business likely will persist for several more years.

In the recent turbulent market environment, the retail deposit business is more valuable and essential than ever, but it is also under tremendous pressure. As financial institutions compete ferociously for balances to meet liquidity needs, banks have been unable to fully capture the pass-along benefits of Federal Reserve (Fed) rate cuts, and they have seen deposit margins narrow even more dramatically than in prior falling-rate environments.

In this environment, the deposit business has been the scene of a pricing revolution, with banks steadily increasing their understanding of how to identify and exploit pockets of opportunity within the overall market. Banks are increasingly applying credit card-like marketing science and targeting techniques, and they are continuously refining their ability to apply that knowledge in specific settings—by local market, customer segment and type of product.

It is within this context that Novantas studied best practices in deposit pricing, drawing on the participation of 25 leading North American financial institutions. The goal of the 2008 study was to identify the strategies, management practices and capabilities that drive top performance at every stage of the pricing continuum and also clarify the key issues and actions that banks must be prepared to deal with in the quest to elevate their capabilities.

Five aspects of progress emerged:

- With regard to **methodology**, banks are pricing much more granularly based on an understanding of competitive prices, customer price elasticities and overall economics for many more pricing “cells.”

- In **funds transfer pricing (FTP)**, banks are placing a greater value on deposits and using advanced modeling to develop targeted algorithms to set transfer prices for various tranches of the portfolio.
- With **process and governance**, banks are centralizing analytical functions and decision making and also standardizing processes to reduce the risk of calculation and posting errors.
- With **pricing analytics**, leaders are using much more sophisticated modeling techniques; incorporating automated processes to ensure accuracy, consistency and efficiency; and winning the “arms race” in pricing capabilities.
- Finally, in **organization and resources**, leaders are supporting their sophisticated pricing initiatives with considerable investment in technology and staff resources.

Crown Jewel

The retail deposit business remains the crown jewel of the banking industry, by our estimates comprising more than \$300 billion of shareholder value, or roughly one-third of the industry total. Underscoring the significance that investors place on the retail deposit business, a Novantas quartile analysis of the top 50 banks shows that, on average, every 10 percent comparative increase in the ratio of core

Sherief Meleis is a Managing Director and Richard Solomon is a Principal in the New York offices of Novantas LLC, a management consultancy. Contact them respectively at smeleis@novantas.com and rsolomon@novantas.com.