HOW TO CAPTURE AND KEEP WEALTHY CLIENTS' CASH

BY MICHAEL JORDAN AND ADAM STOCKTON

The recent rate cut hasn't dampened competition for deposits among wealth managers and broker-dealers. Indeed, acquiring and maintaining wealth deposits is especially difficult against a backdrop of changing consumer preferences and a volatile equity market.

Sweep deposits are continuing to see outflows to the equity market and money market mutual funds. At the same time, wealth savings and CD products are seeing low growth despite higher betas and the increased use of exception pricing. And new entrants like robo-advisors and other fintechs are luring client balances through enhanced digital experiences, reduced fees and above-market sweep rates.

There's little question that traditional wealth managers need to step up their game. They need to analyze customer behavior and motivation, learning how these clients manage their cash and how they want it to be managed by a professional.

MORE THAN JUST AN ACCOUNT NUMBER

Wealth clients should be a banker's dream: they're affluent, they value personal financial relationships and they have a cadence of regular interactions with their advisors. But, like their retail- and commercial-banking brethren, wealth managers too often treat all customers alike.

In reality, wealth clients are also sophisticated and demand more from their advisor relationships than retail customers. They may also be driven by factors that are different from retail bank customers. While some investors move in and out of equities at a moment's notice, others are attracted to the reduced fees and above market rates offered by robo-advisors. Still others consider the advisor relationship to be a significant part of their investment plan.

Firms must enhance their analytical understanding of their client base to determine the needs, desires and motivations of each customer segment. Novantas research shows that wealth customers manage deposits and investments across traditional allocations of "today", "tomorrow" and "someday", but the choice of product within each of these pools depends on the rate environment. Banks that don't understand their customer's behavioral preferences will be caught flat-footed if they don't have the proper products to serve each of these deposit pools. (See sidebar.)

For instance, a wealth customer's choice of cash products — across deposits and money market mutual funds (MMMF) — are generally tied to market returns. But the allocation between each cash option is tied to rate competitiveness. Deposit managers must not only compete with other cash products, but they are also competing with an equity bull market that may get extended due to the latest rate cut.

TIME FOR NEW STRATEGIES

To maintain cash in deposits, wealth deposit managers have deployed strategies that include increasing the rate paid on sweeps to combat MMMFs and other substitute products. Banks have seen limited success with this strategy and often end up paying more rate without seeing an increase in balances. (See Figure 1.)

Other banks have taken a page from the consumer playbook by offering promotional products, such as money market deposit accounts and CDs, to attract and maintain deposits. These products carry higher promotional and standard rates than their retail counterparts and are frequently exception-priced, making them a costly strategy. Novantas has seen some banks with upwards of 70% of their wealth portfolio being exception-priced. Banks have seen varying levels of success with these tactics, depending on promotional structures, rate competitiveness and the amount of acceptance from financial advisors.

THE POWER OF WEALTH-CUSTOMER ANALYTICS

by Michael Jordan | Principal | mjordan@novantas.com

The successful management of wealth deposits, whether broker-dealer or private bank, requires a deep understanding of how client funds are allocated across the "today," "tomorrow" and "someday" deposit pools.

Novantas has conducted research that found customer savings preferences are purpose-driven. "Today" funds generally associated with the primary banking relationship, while "tomorrow" and "someday" money is spread across traditional retail banks, brokerage accounts and even direct banks. Given the high proportion of "tomorrow" and "someday" funds within wealth managers and broker-dealers, it is critical to understand how different products serve these needs in different rate environments. It is also a complicated task because these pools contain pockets of funds that have different levels of rate sensitivity.

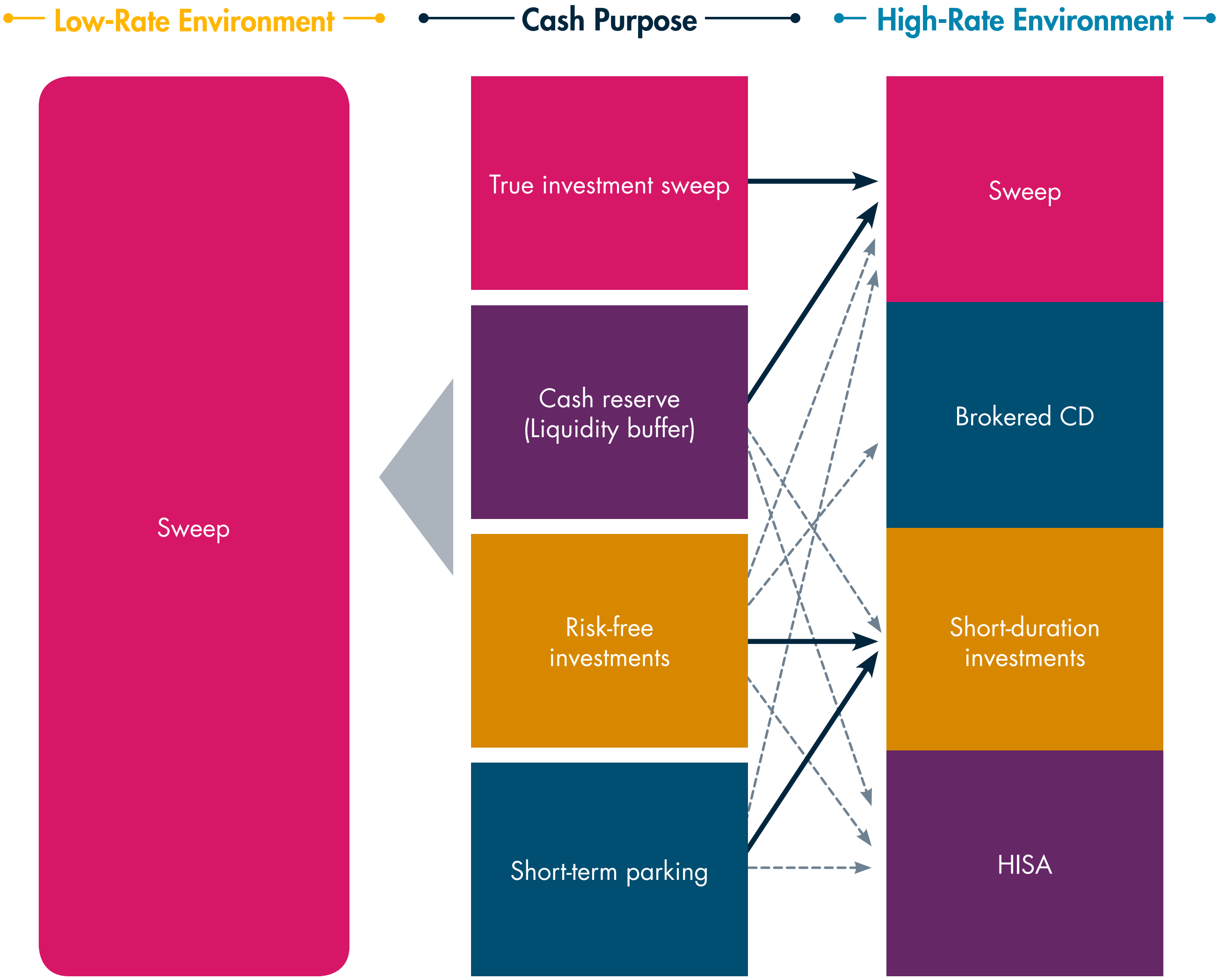
The last time rates were low, sweep deposits served all the cash needs of "tomorrow" and "someday" funds. Customers used the funds for true sweep purposes, such as if they were between investments, and for short-term parking, cash reserve and a risk-free investment option. As rates rose, customers who were more elastic sought higher-yielding options that served their "tomorrow" and "someday" cash needs more directly than the traditional sweep. These customers moved funds to high-yielding savings, short-duration investments and even brokered CDs. Banks that didn't have a complete product shelf or were lacking sophisticated analytics were forced to compete for these customers. At the same time, they were also forced to re-price inelastic customers, leading to higher portfolio costs.

By moving to a more targeted approach to pricing rate-based wealth products, firms can retain these elastic balances while refraining from raising the rate paid on the entire portfolio. Indeed, a substantial portion of customers leave their money at an institution for reasons other than rate. Firms must begin with an understanding of customer investment style, cash position and inflows and outflows between various cash products.

This wealth version of customer-level deposit scores allows for the overall optimization of marginal cost of funds by offering elastic clients the opportunity to seek higher-yielding deposit options, while also maintaining lower interest expense across the entire portfolio.

Without these customer-level analytics, wealth deposit managers will continue to struggle to compete with other off-balance sheet rate-based products and direct banks.

FIGURE 1: TRADITIONAL SWEEPS DON'T SERVE ALL CASH PURPOSES



Source: Novantas Analysis

Finally, wealth managers are attempting to steal market share from their retail counterparts by making a foray into cash management. These offerings are sometimes tied to reward credit cards or various discounts and bonuses for the addition of a checking account. While in theory this strategy makes sense, attempting to "out-Chase" Chase has proven difficult. (See Figure 2.)

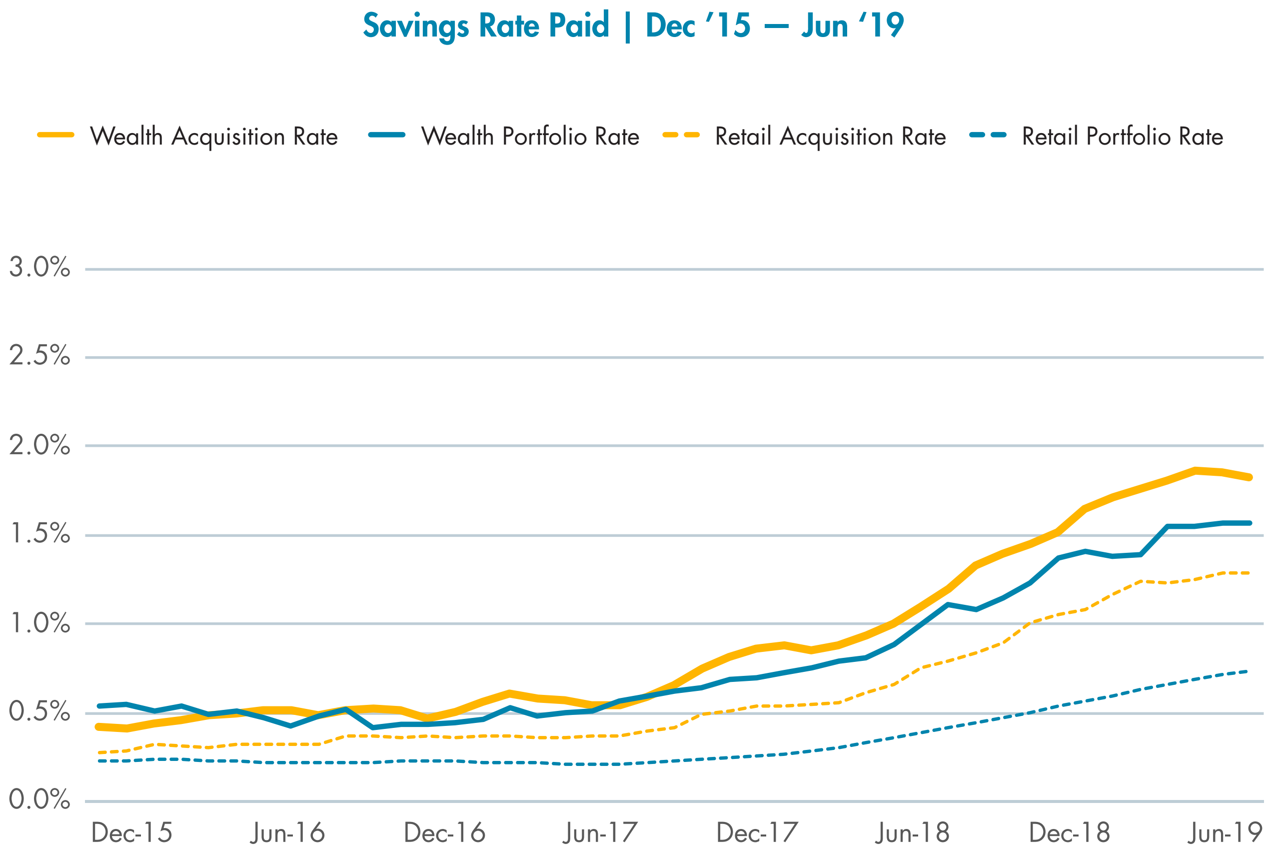
UNDERSTANDING THE CASH NEEDS OF WEALTH CUSTOMERS

Novantas believes banks must begin their journey now. There is no one-size-fits-all solution, meaning that a wealth division of large broker-dealers will need to employ different strategies than the private-bank division of a large regional bank that can rely on retail-bank deposits.

First, banks need to understand the various categories of cash "needs" and invest in enhanced analytics to understand the behaviors and motivations of their current client base. This goes beyond flows between on- and off-balance sheet products. Banks must learn how customers think about their cash and the importance of rate versus security behind customer movements of money. This enhanced understanding will prove important for future products and offers.

Wealth-management firms should use that analysis to assess their current product line-up to determine how additional products can improve balance acquisition and retention. The returns of potential investments should be based upon both the current and potential client bases. For instance, if promotional savings are offered, what percent of the balances will stay within the bank and how much will be converted to assets under management? And how do these ratios compare with the overall market, as well as top-quartile performers? If enhanced cash-management

FIGURE 2: RETAIL PORTFOLIO RATES LAG WEALTH PORTFOLIO RATES, BUT ACQUISITION RATES ARE CONVERGING



Source: Novantas Comparative Deposit Analytics (CDA) Database, Jun '19 | Includes 7 wealth LOB banks | Simple average used to protect participant anonymity | Portfolio and acquisition rates are calculated using 3-month moving average

products are introduced, what specific segments should be targeted? Which customers are under-served by the current product offerings?

The lack of such customer-level knowledge is already costing firms money. Novantas has found, for example, that many wealth-based clients have been overly conservative in their sweep FTP assumptions, allocating a higher percentage to float than is warranted by the data. Enhanced analytics will allow banks to revisit these assumptions and better manage interest-rate and liquidity risk. Once they have a better understanding of client balance flows and uses of cash, banks can revisit their rules for sweep deposit FTP.

Finally, given the nature of the wealth business, banks should begin the journey towards relationship-based pricing. Wealth mangers are at an advantage with the advisor-based relationship; they already have frequent discussions with customers regarding their current and future needs more frequently than their retail counterparts. Understanding these needs allows advisors to use price for the mutual benefit of both the firm and the customer. For instance, wealth managers can have deep discussions with their clients regarding event-based lending, such as mortgage and auto, when meeting to discuss cash needs for the coming year.

This relationship-based strategy allows wealth managers to reward their most loyal customers while also attracting new business. Understanding the current and potential value of this relationship is key for banks to attract and retain valuable customers.

Many wealth managers already have a keen sense of their customers' risk/return preferences and investment needs. It is time for the same textured understanding of their cash needs if bankers are to optimize deposits for themselves and these customers.

Michael Jordan
Principal, New York
mjordan@novantas.com

Adam Stockton
Director, New York
astockton@novantas.com