Today, most bankers have been so busy dealing with credit issues, compliance, and profitability that they don’t have fuel in their tank to act strategically. Effective bank leaders in this dynamic environment are unique. They see past the momentary issues into the future. They focus on what will matter as the current trends play out. High performance bank leaders seek out and seize opportunities to implement competitive strategies that empower their bankers to better serve customers and manage the most significant parts of the balance sheet.

Interest expense is historically the largest expense in banking. Today, while bankers worry about fees and operating expenses, the opportunity for substantial, durable financial earnings enhancement is readily available in an area that some bankers have overlooked—time deposits. Many bankers have been deceived into thinking that time deposits are innately expensive, obsolete, and undesirable, when in fact the traditional CD market represents a significant—and significantly underperforming—segment of the vast majority of banks.

“By Neil Stanley
Bank Performance Strategies

“The $2 trillion FDIC-insured CD market is too large to ignore without consequences.”
The Resilient Magnitude of the CD Funding Portfolio

While CD funding has declined in the past two years, June 2011 call report data reveals several interesting statistics:

- The average community bank (under $1 billion in assets) still carries slightly more than 43% of total deposits as time deposits
- More than two thousand of those banks carry more than half of their total deposits in time deposits
- Within that subset, the average concentration of CD funding is 60% of total deposits.

At the end of 2008 there were $2.8 trillion of FDIC-insured CDs. Even as a reduced component of the industry’s balance sheet compared to the past, the $2 trillion insured CD market is too large to ignore without consequences. In reality, CDs offer one of the few opportunities for banks to truly differentiate in a crowded competitive environment.

Challenge #1: The Level and Direction of Interest Rates

Recently, bankers have told me they have profitably reduced their CD funding. Presumably their focus is on lowering their current cost of funds while maintaining adequate liquidity. As long as interest rates only ever decline, this strategy will work to enhance profits and thereby franchise value.

But the issues with time deposits are not merely about liquidity. The primary purpose of “time” deposits is for the bank to properly fund fixed-rate term loans. In this world where interest rates will ultimately be determined by market forces, you can assure yourself that interest rates will remain low as long as individuals, businesses, and governments collectively have more supply of loanable funds than demand for loanable funds.

If you want to bet your bank that the collective supply of money will consistently overwhelm the demand and thereby support low interest rates for the next five years, purge your time deposit funding portfolio swiftly. If on the other hand, you recognize that the supply and demand of loanable funds has provided a fickle, temporary gift to bankers today in terms of low interest rates, how much CD funding should your bank have?

Challenge #2: Match Funding Fixed-Rate, Long-Term Loans

The appropriate amount of CD funding cannot be gauged by just looking at peers or a rule of thumb (40%, 20%, or 10%). It depends on how much fixed-rate term lending you are doing or asked to do. If you experience no demand for fixed-rate loans, by all means avoid fixed-rate funding. But, if you are granting fixed-rate loans and funding them without comparable term fixed-rate funding, your financial institution is playing a dangerous game with interest rate risk in the lowest interest rate environment of our lifetimes.

If your bank does not carry adequate CD funding, you could be playing a dangerous game with interest rate risk in the lowest interest rate environment of our lifetime.
Maybe caution toward interest rate risk keeps you from making properly-priced, fixed-rate term loans. If you had an efficient retail funding system that allowed you to create and maintain spread across the spectrum of maturities, what would be the opportunity? What is the magnitude of profitability and franchise value enhancement you are foregoing by passing on fixed rate loan opportunities because you doubt that you could properly fund them?

**Challenge #3: The Moment of Truth for Retail Bankers**

Through no fault of their own, many retail bankers don't have a complete understanding of the balance sheet and cost of funds. If bank leaders have silently decided that term deposits are innately expensive, obsolete, and undesirable, retail bankers who work with CD customers are between a rock and a hard place. It is the bank executive's responsibility—and opportunity—to lead their retail bankers to understand the value of the options embedded in longer-term CDs and how to display the value of CDs in dollars at maturity to their clients. We must teach them how to communicate confidently regardless of the rate. Along with flexible options, and competitive rates, we must give them tools to analyze the depositor's options in this market.

**Pricing and Net Interest Income Optimization**

By using simple but powerful tools, banks today can experience the best way to purge unprofitable and marginally profitable CDs while maximizing the retention of the most profitable. Recently a banker stated that he would lower the CD rates more, but it has just been too painful for the retail bankers to deliver the “bad news,” so he is trying to work the rates down slowly. Instead of fearing the market response, *progressive bankers today focus on “de-commoditizing” CDs* and give retail bankers a scalable and reliable process that helps their bank aggressively lower cost of funds.

**The Next Steps: Creating a Refined, Core Retail Deposit Strategy**

Solidifying your core deposit funding requires more than the same process that your retail bankers have used to sell CDs over the last twenty five years: handing out rate sheets and apologizing for the low rates. Bankers who go beyond the traditions and personal experiences that limit their visions today will find that they can produce real value for their customers and their financial institution. They will materially enhance the short-term performance and long-term franchise value of their institution with the following strategic solution.

The solution is based on a simple premise: Express value that goes beyond price alone by treating every customer as you would your own family members. Expand CD sales into a four-stage sales process:

1. Standard Term CDs
2. Promotional Specials
3. Customized CDs
4. Limited Edition Savings Accounts
Standard Term CDs and Promotional Specials provide the core defensive and offensive position for the majority of the CD business. However, they are inadequate to handle the unsatisfied depositors. For those more demanding customers, more refined steps in the process are needed. Customized CDs give bankers tools to consistently provide the most flexible choices and compare alternatives quickly and clearly.

One of the greatest values in a CD transaction is that it facilitates a legitimate and meaningful conversation between a customer and a personal banker. Consultative discussions that arise due to the third stage of the sales process provide one of the most complete views into a customer's financial situation. Customized CDs create an opportunity to sit down with a customer and talk about their financial goals, their personal portfolio, their mix of deposits and investments. When bankers are empowered to ask questions and provide responsive solutions, they can turn average customers into profitable ones, and they can create long-term value that will bring the bank through the present challenges into a new era of profitability and growth.

For the most demanding customers who expect the bank to match a competing offer, Limited Edition Savings becomes the key deposit retention device. This invitation-only account assures the depositor the ultimate in access to their money while retaining a CD level yield.

**Systematically Harvest the Best and Purge the Rest**

Strategic bankers see that the four stages of an effective CD sales process are like an efficient harvesting process that saves the precious grain while separating out the stems, stocks, and leaves, and blowing out the chaff. Bankers can fine tune the system to get and keep the desired volume and terms at the best possible price points.

Bankers who are looking to solve the earnings enhancement puzzle will find some of the most significant pieces if they look where very few others have been looking – their existing CD portfolio! bps

A successful CD system simultaneously accomplishes several goals that all bankers have:

- Lowers cost of funds in typical banks by at least 10 basis points
- Grows properly priced core retail deposits
- Mitigates interest rate risk by attracting and securing longer-term retail deposits
- Empowers retail and private bankers to sell consultatively
- Enables consistent governance of deposit price aggressiveness by senior management

To learn more about the comprehensive four-stage CD sales process contact Neil Stanley, President, Bank Performance Strategies, Neil@Bank-PS.com, (402) 699-9509.