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THREE THINGS TO KNOW
Before You Set Your Deposit Pricing

Discover what sets your deposit pricing and institution apart from the other available options across the financial spectrum.

nomis

The primary vehicle of near-term growth for banks is price. Price is king.

INTRODUCTION

In the United States there are approximately 10,000 banks and credit unions, each competing for wallet share, mind share, and market share in pursuit of efficiency and profitability. What sets your financial institution apart from the rest of the options across the financial spectrum?

If you are like many financial institutions answering this question, your immediate response was likely centered around service or people. The rest will respond with differentiation by brand, technology, branch and ATM footprint, technology, convenience, local knowledge, or specific type of expertise.

All the aforementioned strategic differentiators take years, if not decades, to build and defend in the mind of customers. Therein lies the conflict on which financial institutions, and specifically their leadership teams, are measured by on a quarterly and year-over-year basis. This matter of fact clearly identifies that the primary vehicle of near-term growth for banks is price. Price is king.

To size market opportunity and make better pricing decisions, banks need to move beyond oversimplified pricing schemas based primarily on a generic evaluation of competitor rates and on internal performance reports. Good pricing discipline begins by looking at the micro-market level, and incorporates an evaluation of consumers' rate sensitivity, a deeper view of market competition, and the supply of dollars available for acquisition in each market.

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WHY PRICE?

Price is the value exchange made between a financial institution and its customers. Depositors relinquish their hard-earned money for their bank or credit union to leverage as they see fit, and in exchange receive the safety of federal insurance, access, and usually some return on that money. However, pricing power is not equal among all players. Large national banks with a broad and dense physical network are price-makers that pay much less in rate than hometown credit unions or online institutions without any branch network. Some might say, "Price is what you pay when you lack convenience."

When it comes to price setting, product analysts and financial staff will evaluate relative market price position against a peer set of institutions (i.e., banks with a similar demographics, footprint, and business strategy). Extensive competitor analysis can be useful in determining a price point, but the research and reporting efforts are primarily diagnostic in nature and can only see what a competitor chooses to disclose publicly, which explains why promotional pricing is so difficult to ascertain. Additional price-determining analysis is focused internally, and often from the current point-in-time and looking backward. What was our growth rate? What did our competitors offer? What products matured, or will, based on previously determined maturity cycles? What is our alternative cost of borrowed and brokered funds? What do we think the Fed will do in their next meeting?

Most analytical work done in preparation for pricing decisions is not predictive and does not incorporate the individual behavioral characteristics of existing or target customers, and that is why the preponderance of institutions fail to optimally price market opportunities.

EFFECTIVE PRICING REQUIRES BETTER MARKET SCANNING

Before setting a price for any deposit product, banks first need to understand the landscape. Effective price setting begins with effective market scanning. Unfortunately, most market scanning is based on only a single series of data points centered on what the competition is paying for deposits. The monthly chore of scanning competitors' websites, browsing the aggregated rates provided by a third-party service, and then generating reams of internal reports is a recipe for sub-optimal price setting. That said, this practice is rampant in the industry.

For effective price setting and promotions management, focus on evaluating the following three criteria:

1. The available supply of deposit dollars with a target area.
2. The rate sensitivity of your addressable market.
3. The intensity (not just the rates!) of your direct competition.

RATE SENSITIVITY

If your meetings are filled with a bunch of executives sitting around a table talking about what people want, then you are headed down the wrong path. Markets are made up of individuals who have discreet and identifiable characteristics that alter their attractiveness as customers. The mix of the type of customers will change from market to market and in some areas, there will be a higher concentration of rate-sensitive individuals that will respond to rate offers. In other areas the concentration will be lower, thus aggressive rate offers should be directed at markets with higher rate sensitivity to maximize campaign yield.

When building a market scan, the process should begin by rigorously analyzing what geographies or populations are most likely to respond to a rate offer, based on concentration of rate-sensitive or rate-seeking individuals. Regrettably, most financial institutions either skip this step altogether, or they use limited data sets and make too many inferences.

DEPOSIT SUPPLY

While a particular market or population may have a high concentration of rate-sensitive consumers, if the population of that area is low and there are few dollars available, then that area or audience would become less attractive. For community institutions, this point is less relevant as they usually compete in just a handful of zip codes. For regional, super-regional, national, and online institutions, this step should be treated as non-optional.

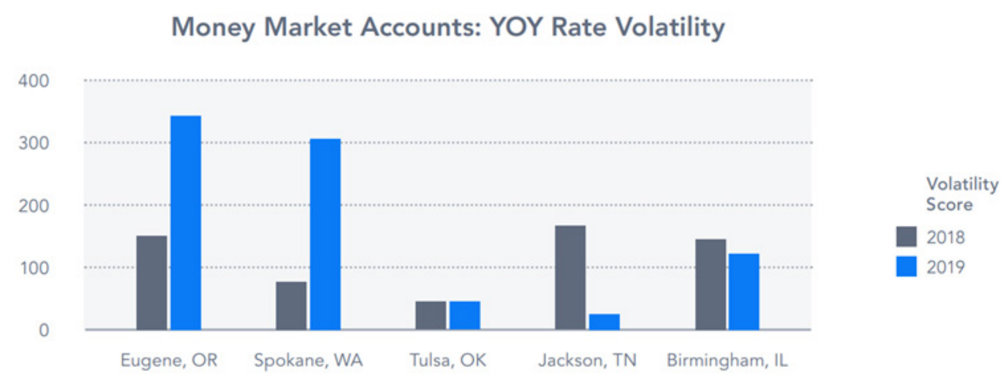
Third-party data from public and subscription-based services can provide some clues as to the deposit availability of a locality. There will be additional thought required as publicly available information from FDIC co-mingles retail consumer, small business, and commercial deposits within the branch view. NCUA data only gives deposits at the institution-level. Normalization mathematics will need to be applied to discount concentration of deposits at head office, and to spread institutional deposits across markets. Creating a view of deposit availability will help make better strategy decisions about pricing and promotional activity at the market level.

COMPETITIVE INTENSITY

Competition can be analyzed in different ways and will vary based on your unique business model. For traditional institutions, the count of financial institutions and the density of branches in each area will be a good proxy for the intensity of competition. Competitor rate research, including website browsing and secret shopping, are also useful. Additionally, capturing and analyzing the cost of keywords on Google by geography will help determine the overall willingness of your competitors to buy deposits in an area.

Understanding the density of competition in an area will help you understand pricing dynamics. Competition is not static, and when your financial institution publishes a rate, a promotion or an offer, your competitors will evaluate that offer and respond. More competitors, either unique financial institutions or coverage of branches from competing institutions, will drive faster and higher escalation in competitive responses. The clearest and fastest changing example is on online rate aggregator sites. As an online auction format, competitors are able to continuously jockey for position by manipulating rate and ad spend across varying geographies to maximize deposits gained per dollar spent.

In an ideal scenario, your best offers would go to areas that were less heavily contested. Additional metrics like rate change velocity, rate volatility (see sample chart below), and rate beta will help you determine whether a rate deployed within a specific market will be out-of-market faster than if you deploy the same rate elsewhere. Use thorough competitive analysis to uncover the areas where competition is less intense, but deposits and rate sensitivity are still high to ensure staying power in your rate offers.



PICK A CITY, ANY CITY

Traditional barriers to local and regional competition are falling rapidly. A financial institution's footprint used to be defined by the reach of its branch network. Now, any financial institution can compete nationally. Multiple regional banks have launched nationwide out-of-footprint digital offerings as means of expansion, and even credit union field of membership restrictions are hardly limiting any more.

So, let's assume you can compete anywhere. What cities would be most appealing? New York? Boston? San Francisco? Los Angeles? Honolulu? Miami? Any experienced banker could easily list the top 10 markets in the U.S., and will also be familiar with the dynamics of their hometown, but what about second- and third-tier cities? How might you compare Nashville against Tucson? Tacoma against Buffalo? Detroit against Tampa? For financial institutions competing across more than a few counties, the further from headquarters the harder it becomes to intuitively evaluate the attractiveness of a market.

If your institution competes locally or within a small region, this is an opportunity for your teams to deeply understand the rate sensitivity, deposit supply, and competition at a hyper-local level. For more far-reaching institutions, a roll up by county or MSA may be more appropriate.

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GETTING REAL

If you are still reading this, let's assume you agree with the theory outlined thus far, but how does one evaluate the rate sensitivity at the market or micro-market level? Even if your financial institution has deployed rate optimization software, those tools are primarily designed to evaluate the rate sensitivity and pricing strategy for customers that you already have. By nature, there is a selection bias within your customer base that may or may not represent the characteristics of customers in the broader market.

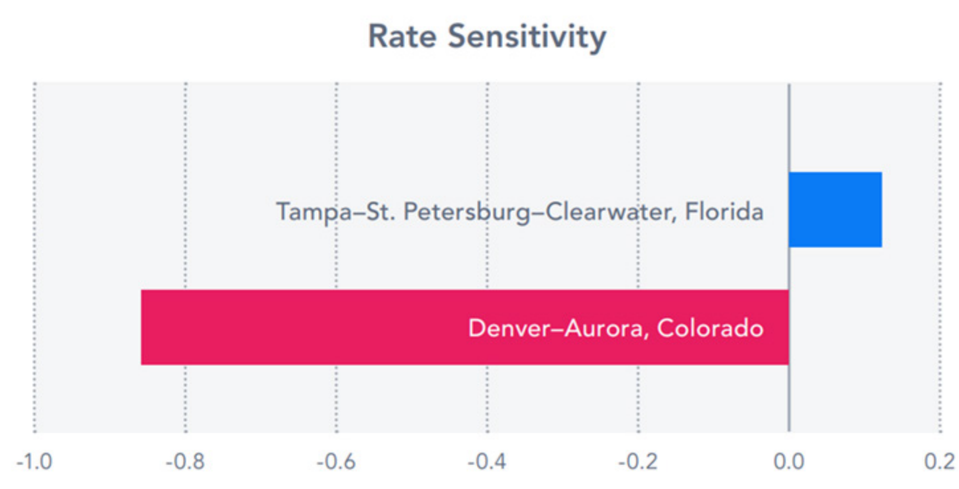
Evaluating rate sensitivity on only your existing customers is like taking a political poll at a political rally. The results are representative of a population, but not of the whole population.

Overcoming this requires combining billions of real financial observations from across geographies and demographics, then combining that data with public and proprietary data to create a unique view of every market in the U.S., across the three factors previously mentioned. While it sounds daunting, these tools already exist.

For demonstration purposes of this white paper, let's evaluate Tampa, Florida and Denver, Colorado—the 18th and 19th largest metro markets in the U.S. Each area has an approximate population of 3 million residents and a total deposit availability of approximately $100 billion. However, Denver has 112 unique financial institutions and 791 total branches in market, while Tampa has 77 unique institutions and 822 total branches. Said in other words, Denver has a far more fragmented market with smaller players and fewer branches. When we analyze the actual rate sensitivity of retail consumers in each market, there is a dramatic difference.

Using a scale where 0 is the national average for rate sensitivity, +1 is extremely rate sensitive, and -1 is extremely rate insensitive, Denver scores -0.864 versus Tampa at 0.115.

The conclusion? Denver is the clear choice for larger institutions that want to enter or expand into new markets without having to pay up on rates, but Tampa is more appealing for challenger institutions that want to gain share by focusing on rate.



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The ability to rapidly assess the viability of a specific market against a set of business strategies has implications for marketing, pricing, branch and retail strategies, and even M&A activity.

Now, let us analyze the performance of a regional bank that operates in the Midwest where we compare the rate sensitivity of a market (X-axis) against their average weighted deposit rates compared to market average (Y-axis). Each bubble represents one MSA/metro market. For this bank, green bubbles mean they are gaining market share, red bubbles mean they are losing market share.

Moving clockwise, the top right quadrant is the growth segment, meaning the bank is pricing above market in a rate-sensitive area. The bottom right is where we would expect a bank to lose market share (and this bank is doing just that), because they are underpriced in a rate sensitive market. In the bottom left, we expect the bank to be holding steady as they are priced under the market, but the area is less rate sensitive. Finally, in the top left quadrant, we see the bank is likely overpaying for deposits. This bank is gaining share, but since the market is not rate sensitive, the bank is spending too much on rate.

This 2x2 analysis will change for each financial institution depending on their geography and business strategy, but when comparing multiple banks using the same analysis there are clear winners and losers in the war for deposits.

CONCLUSION

Whether you are running a national charter, a regional bank, a local institution or a direct bank, the ability to better analyze the rate sensitivity, deposit supply, and the level of competition within a defined geography should be the center post of your strategic decision and price setting. Making informed, data-driven decisions about price setting and marketing/campaign activity will give your bank the edge in protecting margins and growing your book in the coming years.

ABOUT THE AUTHOR

Dustin Allen brings more than 15 years of FinTech, banking, and analysis expertise to his position as Senior Director of Consulting Services at Nomis Solutions. In his current role, Dustin leads an international team of SaaS consultants and data scientists to deliver greater value and customer success to a wide range of national, regional banks. Dustin's focus on data-driven price optimization, analytics, execution, and monitoring has enabled Nomis' client base to build a true competitive advantage through a more scientific and strategic approach to retail banking, resulting in a significant improvement in profitability, engagement, CSAT scores, and revenue growth totaling multi-billions of dollars.

ABOUT NOMIS SOLUTIONS

Nomis Solutions is a global, industry-leading pricing and profitability management solutions provider that delivers competitive intelligence to bankers and mortgage lenders to facilitate more advanced pricing strategies. The company's analytics platform and end-to-end pricing tools enable retail banks and mortgage lenders to achieve customer- and borrower-centric pricing backed by real-time, actionable data. The platform also supports banks and mortgage lenders in their understanding and anticipation of the evolving demands of customers and borrowers, competitors, and ever-changing market conditions. For more information, please visit www.nomissolutions.com.