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As Deposit War Heats Up Smart Pricing Is Vital

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By Anthony Malakian

Banks are falling in love all over again with consumer deposits; add to this newfound affection the industry's new entrants Goldman Sachs, Morgan Stanley and American Express - and what you have is an exceptionally competitive environment for deposits at the same time that consumers are more predisposed than ever to switch banks, thanks to the high-profile bank failures during the last year.

The winners of this deposit war are likely to be those banks that can incorporate pricing-and-profitability techniques, analysts say. At a very basic level, pricing and profitability optimization is understanding at a very granular, segmented level, what the price elasticity and demand is for different types of deposit products in different parts of the market, says Frank Rohde, vp of product development and chief marketing officer for San Bruno, CA-based vendor Nomis Solutions.

Banks are generally unwilling to talk about results of their pricing optimization efforts, though Rohde says that banks can generate five-to-ten basis points of incremental yield, or 10-to-15 percent increase in balance growth, while paying the same rate as before. Those results may not jump off the page, but that's for a reason, says Brent Lippman, CEO and co-founder of Scottsdale, AZ-based Response Analytics. "This is not radical stuff. If somebody comes in here and says I can make you a 100-point improvement, they're doing something that is too obvious and too dangerous to your image in the marketplace. This is all about subtle changes that go under the radar - that's very important."

It's not easy, though. The variables are mind-boggling. For example: you have different pricing channels (Internet, branch, call center); different markets (state, region or city); different accounts (standard vs. premium savings account, CDs, money market accounts); different terms (three months, 24 months or five year CDs); and different promotions to go along with those products.

"Very quickly, if you go through the complexity of all those products, you have hundreds, if not thousands, if not hundreds of thousands of pricing cells," Rohde says. "You can't solve for just one of those pricing cells, you have to solve for all of them simultaneously in order to maximize your net-interest margin or maximize the liabilities you're putting on the books. That's what makes it a hard, really, really complex mathematical problem that most banks - in fact, none of the banks - have really solved yet."

The problem is that due to the increased competitiveness in gathering deposits, most banks are looking for quick fixes, says Terry Moore, who leads global management firm Accenture's banking practice in North America. Most don't want to go through the time and expense of pricing optimization, much less worry about channel or product differentiation. It's far easier to simply price based solely on what your competitors are offering, he says.

But this push for quick fixes can hurt banks in the long run. "Right now there's an intense price competition for deposits to fund new lending, and I think that is affecting profitability negatively. It's not a sustainable model," Moore says. "They're raising pricing on CDs and other vehicles and that has a negative impact on profitability. There's only so long that you can utilize that strategy before you have serious viability concerns relative to earnings and profits."

Ellen Joyner, global financial services marketing manager for software-provider S.A.S., agrees with Moore that there hasn't been much thought behind pricing amongst banks. Rather, Joyner says, most banks are turning to fees to generate income. Not only is this punitive method unscientific, it makes customers angry and hurts deposit growth in the long run. Optimization allows for the customer to be rewarded while the bank saves on cost.

"Banks, typically and traditionally, do not have a really good handle on profitability," Joyner says. "There's a lot of foundational work to be done and this is a good time to do that because they're having to start and rethink their whole IT infrastructure anyway, to be more flexible in the future."