Managing Depositors AND Deposit Flows During the Economic Fallout of a Pandemic

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Keys to Managing Depositors

- The retailing tools of market segmentation and product differentiation are critical to minimize balance sheet cannibalization
- Start with a decile distribution for all organic deposit products and build a profile of large balance customers in order to estimate rate sensitivity and product needs
- Recognize that depositors will balance investment yield with liquidity and safety

Segmentation: Evaluate, Retain and Grow Relationship-Based Deposits

- Start with a decile distribution of balances for each product type to segment large balance customers vs. small balance customers.
- This is the first step in market segmentation and product differentiation!
- Identify large balance customers who drive the majority of your organic deposits; AND build a profile by answering the following questions:
  - How long have the balances been with you?
  - Has the product mix held by these customers changed?
  - What is the “share of wallet” of these large balance customers? How much of their deposit and loan balances do you control?
  - Do you have their primary transaction account… the key relationship driver?
  - Do you control their mobile banking relationship?
  - What are the demographics of your large balance customers?
  - For older customers, do you have relationships with household members?

Decile Distribution of Money Markets

Decile	# of Accounts	Balances	Averages	Medians	% of Total
1	455	92,400,280	203,078	159,961	51.4%
2	455	32,618,165	71,688	70,628	18.1%
3	455	19,252,318	42,313	41,328	10.7%
4	455	12,378,541	27,206	26,929	6.9%
5	455	8,501,929	18,686	18,714	4.7%
6	455	5,732,396	12,599	12,306	3.2%
7	455	4,038,110	8,875	9,007	2.2%
8	455	2,572,367	5,654	5,532	1.4%
9	455	1,561,438	3,432	3,401	0.9%
10	463	879,884	1,900	2,023	0.5%
	4,558	179,935,428	39,477	15,147	100.0%

Excludes 40 accounts with zero or negative balances

51.4% of balances
92,400,280 are in the top decile
455 accounts

50% of your depositors
2,283 hold 8.2%
of balances 14,784,195

The median reflects that half of your depositors
2,283 have balances of
15,147 or less

- 2 customers have balances >$1 million and total $3 million
- 88 customers have balances between $250k and $1 million and total $34 million
- 359 customers have balances between $100k and $250k and total $55 million

449 customers hold $92 million

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Managing Deposit Flows

- Develop competitive non-maturity deposit products to compete for high balance customers
- Implement marginal cost/savings analysis to evaluate the impact of shifting balances and rate sensitivity
- Adopt ALCO mantra: Fund your balance sheet at the lowest marginal cost
- Use FHLB advances strategically to lower your marginal cost of funds

Why Is Marginal Cost/Savings Analysis Important?

- It will evaluate how to fund your institution at the lowest <u>marginal</u> cost while managing your <u>average</u> cost of funds
- It is a decision-making tool to help maximize profitability
- It evaluates the true cost of pricing various deposit products based on assumptions of:
  - Rate sensitive vs. non-rate sensitive depositors
  - Retention of current balances
  - Changes in the mix of deposit types
  - Cost of raising new money
- It is measured by evaluating two different scenarios and by calculating the change in interest expense divided by the change in balances
- It will evaluate the benefits of combining wholesale funding with organic deposits

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Can Rates on Non-Maturity Deposits Be Lowered?

- Scenario:
  - Institution has a total of $500 million of non-maturity deposits (money markets, checking and savings)
  - Current weighted average cost is 25bp
  - Annualized interest expense is $1.250 million
- Can we lower rates across all products and reduce our weighted average cost to 15bp?

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Scenario 1: Can We Lower Rates and Retain Deposit Balances?

Product Group	Product Group	Current Balance	Current Rate	Current Int Exp	New Rate	Retain %	Total Forecast	Forecast Int Exp
Organic Deposits								
	Non-Maturity Deposits	500,000	0.25%	1,250	0.15%	100%	500,000	750
Proposed								
Totals:		500,000		1,250			500,000	750
Weighted Cost:			0.25%		0.15%			

	Current	Proposed	Change	Due to Rate Change	Due to Volume Change
Balance	500,000	500,000	0		
Weighted Cost of Deposits	0.25%	0.15%	-0.10%		
Interest Expense	1,250	750	-500	-500	0

Non-maturity deposits total $500 million at a weighted average cost of 0.25% and an annualized interest expense of $1.250 million. Lowering rates on average by 10bp to a weighted average cost of 0.15%, while retaining all balances, reduces interest expense to $750 thousand, an annualized savings of $500 thousand.

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Scenario 2: What Is the Marginal Benefit of Lowering Rates and Retaining Deposits?

Product Group	Product Group	Current Balance	Current Rate	Current Int Exp	New Rate	Retain %	Total Forecast	Forecast Int Exp
Organic Deposits								
	Non-Maturity Deposits	500,000	0.25%	1,250	0.15%	90%	450,000	675
Proposed								
Totals:		500,000		1,250			450,000	675
Weighted Cost:			0.25%		0.15%			

	Current	Proposed	Change	Due to Rate Change	Due to Volume Change
Balance	500,000	450,000	-50,000		
Weighted Cost of Deposits	0.25%	0.15%	-0.10%		
Interest Expense	1,250	675	-575	-500	-75
Gross Mgnl Savings of Reduced Deps			1.15%		

Marginal Cost or Savings = Change in Interest Expense Divided by Change in Balances

If we lose 10% of balances (retain 90%) by lowering the average cost to 0.15%, we retain $450 million at a total interest expense of $675 thousand, a savings of $575 thousand. This savings is a marginal benefit of 1.15% (negative $575 thousand change in interest expense divided by negative $50 million change in balances). It is interesting to note that 3- to 5-year advances cost between 58bp to 75bp right now.

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Marginal Savings

Original Balance (000s)	Current Wtg Ave Cost	Rates Reduced, New Wtg Ave Cost	Balance Pct Retained	Retained Balances (000s)	Change in Balances (000s)	Change in Interest Expense (000s)	Marginal Savings= Change in Interest Expense/Change in Balances
$500,000	0.25%	0.15%	100%	$500,000	n/a	($500)	Save $500k annualized
			90%	$450,000	($50,000)	($575)	1.15%
			80%	$400,000	($100,000)	($650)	0.65%
			70%	$350,000	($150,000)	($725)	0.48%
			60%	$300,000	($200,000)	($800)	0.40%
			50%	$250,000	($250,000)	($875)	0.35%

Scenario 2 on slide 9 reflected the retention of 90% of balances (a loss of $50 million balances) resulting in a marginal SAVINGS of 1.15% (-$575k/-$50m).

The additional examples above reflect the marginal savings for various assumptions of retained balances.

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Critical Takeaways and Considerations

- The retailing tools of market segmentation and product differentiation are critical to minimize balance sheet cannibalization.
- Start with a decile distribution for all organic deposit products and build a profile of large balance customers in order to estimate rate sensitivity and product needs.
- Optimize interest expense savings by evaluating the marginal benefit of lowering rates.
- Is your strategy to <u>retain</u> non-maturity deposits or to <u>grow</u> those balances?
- If you plan to grow deposits, do you have strategies for Elite high balance non-maturity products and Special CDs?
- Have you evaluated the marginal cost of using FHLB Advances?

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Strategic Financial Planning

and Strategic Deposit Analysis

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