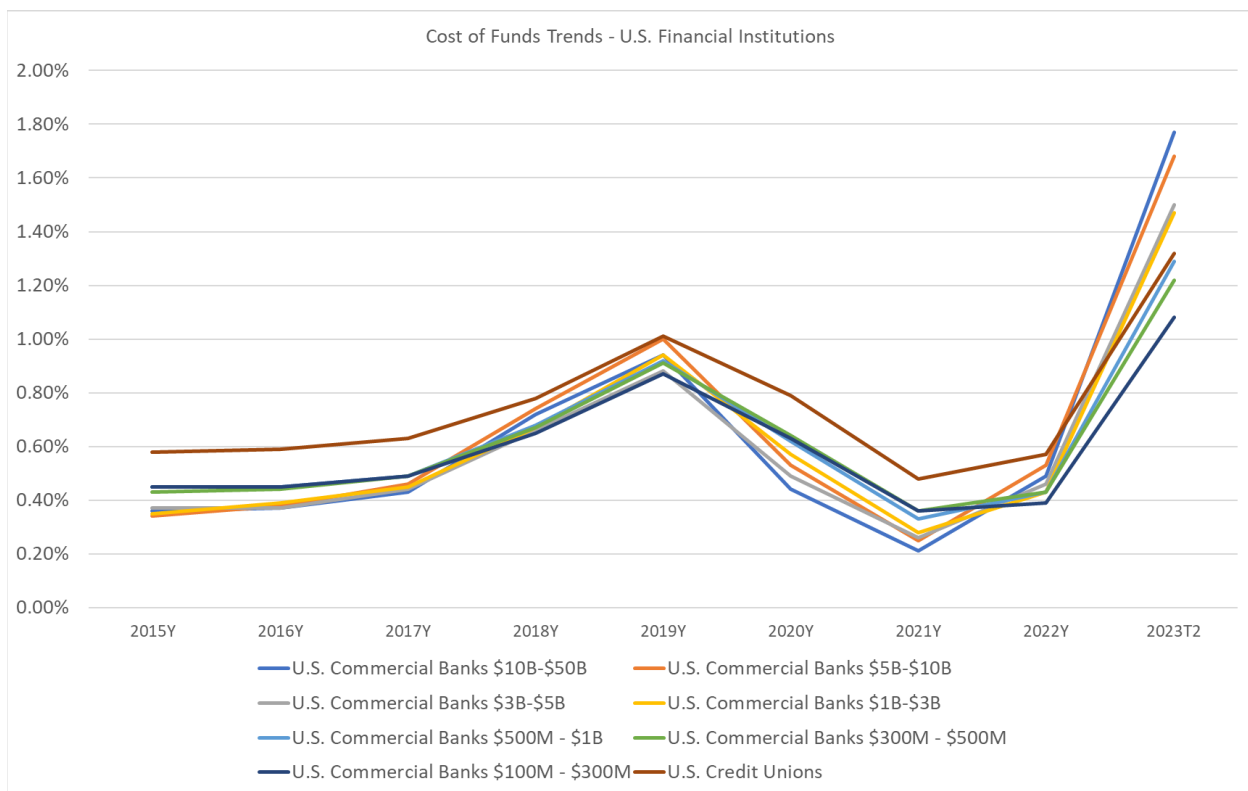


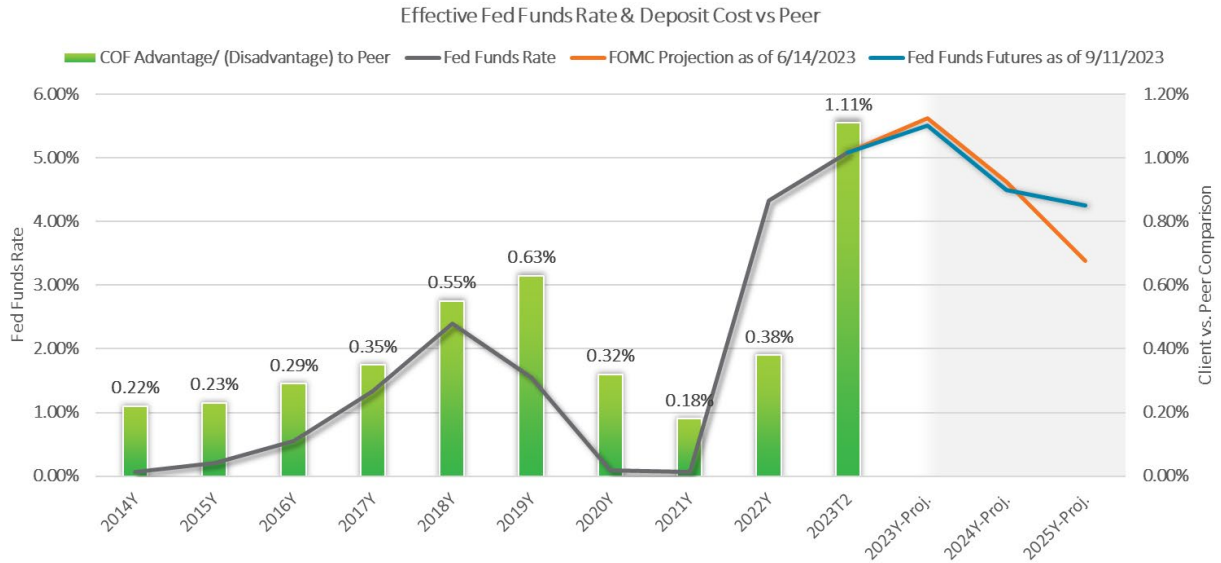
Under Pressure: Cost of Funds Strategies in a Rising Rate Environment

By Achim Griesel and Dr. Sean Payant

When rates were at record lows for long periods of time, the true value of low-cost funding may have faded into the background; however, low-cost core deposits continue to be the driver of long-term franchise value. Now, with rates continuing to rise – the one-year treasury is at 5.5% and the 10-year is close to 5% in November of 2023 – the importance of low-cost funding is once again at the forefront. A recent Jack Henry benchmark report stated that growing deposits was the #1 priority for banks and credit unions alike over the next two years. Rising Cost of Funds have become an issue in all segments of the industry.



The chart below is for a financial institution (FI) with strong low- and no-cost funding. In record low-rate environments, its cost-of-funds advantage over its peers was relatively small at 20-30bp. When rates started to rise from 2017 – 2019, it tripled to 60bp, and then dropped back during the pandemic and an extreme low interest-rate cycle. Over the past 18 months, in a rising rate environment, the value of strong low-cost funding really shows. The deposit cost advantage over its peers is now 1.11%. For a \$1 billion institution, that represents an \$11 million increase to the bottom line. Rate increases may slow, but it is very likely we will stay at the elevated rate environment and that cost-of-fund advantage is here to stay.



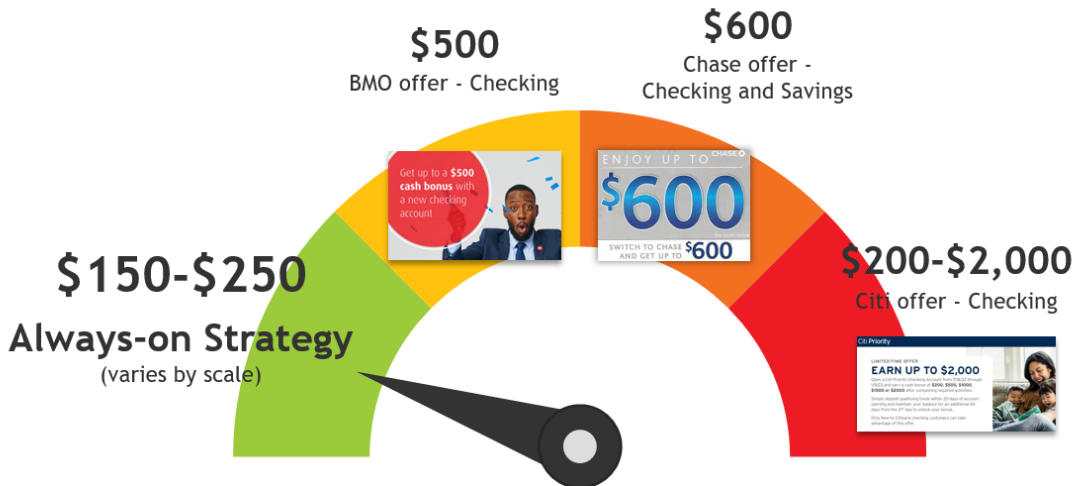
In addition, deposit growth stagnated in Q2 of 2022 and then started to decline in the second half of 2022. On the macro level, FDIC insured deposits have declined for 5 consecutive quarters for an overall decline of \$1.3 billion. A deeper dive into the deposit decline shows most of the decline happened in non-interest-bearing deposits. That decline was partially offset by growth in time and brokered deposits, putting even more pressure on funding cost. On the micro level, our data for consumer and business checking account deposit balances shows balances are down 10-20% from the beginning of 2022.

Large institutions are aware of the value created by low-cost deposits, and they have the budgets to target core relationships that drive these benefits. For example, Chase now has a \$900 offer for opening a checking and a savings account. BMO Harris pays up to \$500, and Citi has an offer of up to \$2,000 for relationships with extremely high balances.

In addition to the cost of the offer, these largest banks spend a significant amount of marketing dollars to gain new core relationships and the benefits that come with them. When a financial institution does not commit to an always-on marketing strategy, it must provide above market offers to “buy” new relationships.

Acquisition Cost

(there will be additional marketing cost for cash offers)



Community-based FIs cannot compete by following a similar strategy. Unlike their large competitors, they do not have the budgets for acquisition incentives of \$500+ or the expansive budgets associated with marketing to acquire these relationships at that cost.

Compared to community-based FIs, large banks generally have more products and services as well as marketing teams who dwarf their smaller competitors. Given this reality, what does a community-based FI need to do to thrive?

To grow low-cost deposit core relationships, it is essential you follow a disciplined approach:

Step One – Your Institution must have a Sales and Service Culture. Good products are the foundation of a sales and service culture. You cannot ask your teams to sell, or consumers to buy, inferior products. If you want to know if your institution has good products, ask your customer-facing employees; they can tell you how consumers respond. Equally important is ensuring your team members are well-trained, understand and believe in your products, and consistently execute your service expectations.

Step Two – Your Institution must be Strategic. Large institutions have the staffing and marketing budgets that allow them to frequently change offers, products marketed and/or desired prospects. For community-based FIs to compete, they must make data-driven, always-on marketing part of their core growth strategy. Your always-on marketing strategy supported by your sales and service culture will drive tangible results even when large banks are in periods of very high offers.

Step Three – Your Institution must be Aligned. Your FI's training and execution at the branch and through online channels must be aligned with your strategic marketing. Aligning marketing

and execution is what reduces the acquisition costs for new core relationships. Without this alignment, your FI is left trying to compete on the offer alone, making it expensive to match those large bank offers previously mentioned.

Step Four – Measure, Inspect and Reward! Any strategic initiative needs to be measured. Your core relationship growth strategy should have periodic – quarterly at least – goals. In addition, determine benchmarks to evaluate success. Inspect what you expect to ensure your sales and service standards are being consistently executed. Reward success! When your team members are fully aware of where they stand compared to their goals, it is possible to evaluate results and reward successes.

Growing core relationships to grow low-cost deposits should be of primary importance in any rate environment; however, it is paramount in the current rising rate environment. Ultimately, outperforming your peers by 100bp+ will be welcomed by your board and celebrated by your management team. When you strategically align your culture, products, and people, competing for core relationships becomes easier and the \$500+ offers from large banks become less effective. David will beat Goliath!

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