Rethinking Promotions to Build a Sustainable Deposit Portfolio

Introduction

Most banks rely on a healthy deposits portfolio to cost-effectively meet liquidity requirements. As Canadian banks compete more aggressively to get their share of consumer deposits, they've come to rely on promotional pricing to get an influx of volume. Not only does that approach seem to be losing effectiveness, it may be hurting banks in the long run.

The amount of money Canadians save has been on the decline since 1982, due in large part to falling interest rates. Statistics Canada reports that in Q3 2015, the average Canadian household only saved about 4.4% of its disposable income. At the same time, consumers' appetite for debt has increased. The ratio of household debt to disposable income reached a record high of 164% (i.e., $1.64 in debt for every dollar of disposable income) in December 2015.

Canadians' tendency to save less and borrow more means that banks are struggling to re-work their lopsided balance sheets. Reduced capital ratios threaten the banks' ability to sustain and grow their lending portfolios. Not only do banks need to attract more balances, they also have to ensure that customers maintain those balances over time. Without a stable base of deposits, banks simply won't have the liquidity to sustain lending for a reasonable period of time.

Unfortunately, low interest rates limit bankers' ability to attract more deposit dollars and still be profitable. Banks have resorted to often aggressive limited time promotional pricing to attract depositors, but that threatens to create a crisis in banking. For many banks that lead with promotions, temporary portfolio growth is offset by a resulting decline when the promotional rate expires or a new competitive offer hits the market, and the "hot" money takes off in pursuit of the next shiny deal.

Promotions are limiting the effective allocation of resources. Every opportunistic dollar that goes out the door represents an expensive investment that didn't pay off. The instability that results from these accounts turning over requires constant monitoring to ensure that there is enough capital to support the lending portfolio without resorting to more expensive funding sources.

What banks are beginning to learn is that the escalating use of broad promotions to meet growth goals is having the opposite effect on customer behavior. Instead of building or cementing relationships with customers, promotions are teaching customers to be promiscuous. In the long run, this ripple effect of portfolio volatility becomes damaging and destabilizing.

Despite the high price of relying on hot money, banks have difficulty breaking out of the promotional cycle. This dependency makes it difficult to build stable and sustainable volume growth in deposits, and banks will need to look at other ways to meet their capital requirements or risk having to reduce lending volumes. There is a cyclical danger of falling behind in liquid capital requirements if there is a sudden outflow of deposits. Yet even though these opportunistic deposits have little long-term value, the promotional premium increases internal expense invested in them.

But not every customer succumbs to the allure of competitive offers and moves their money to another institution. Some portion of the dollars resulting from promotions remains as a lasting part of the portfolio. And yet, the customers who are satisfied to leave their deposits in place often receive the same expensive promotional offers as the customers who are on the lookout for a better rate and are likely to move their funds as soon as a better deal is offered.

In working with banks on the issue of promotional pricing, Nomis has found that banks *can* decode customer behavior through scientific, data-driven segmentation and develop a far more effective paradigm for long-term balance and income growth. But this requires five critical capabilities:

1. Quantify a customer's price sensitivity in relation to your product features and services
2. Identify and behaviorally segment your loyal customers with sticky balances from the "hot money"
3. Predict a customer's relationship potential and their capacity to grow along with their propensity to maintain balances
4. Optimize and deliver tailored pricing and offers that are relevant to each customer segment
5. Forecast the impact of your strategies on long-term portfolio dynamics.

In-market tests have found that banks that harness these capabilities improve the volume of retained balances attained through promotions by 20-30% without incurring incremental interest expense. Their deposit portfolios grow more stable over time as the proportion of sticky balances increases by 10-20%. Ultimately, these banks are able to allocate interest expense and marketing spend more effectively to not only grow balances but also promote long-term stability and profitability.

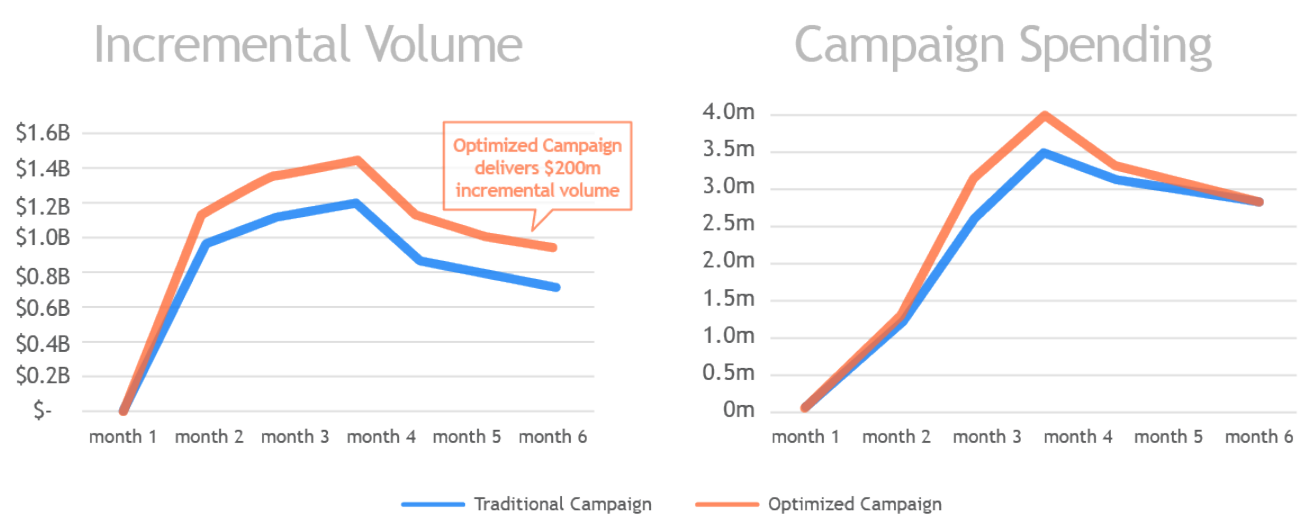

Figure 1 – *The optimized campaign delivers $200 million in incremental volume while having the same cumulative spending after 6 months.*

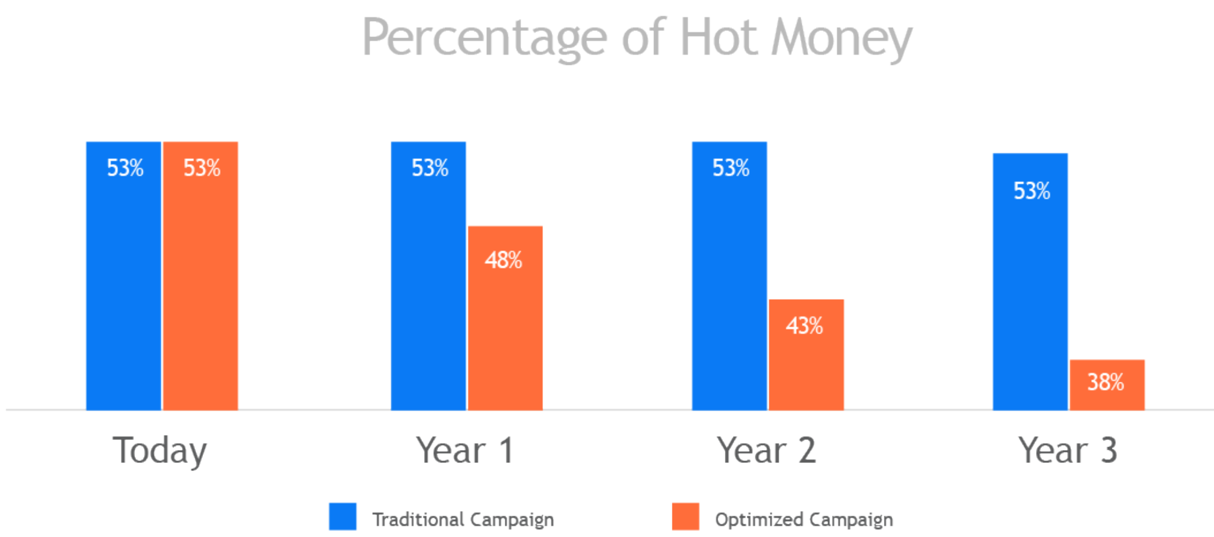

Figure 2 – *Campaign optimization can reduce the percentage of "hot money" in the portfolio over a 3-year planning horizon.*

Beyond Price Sensitivity: Predicting Consumer Behavior and Relationship Potential

For some time, banks have been using price sensitivity, the first capability on the list of critical enablers, to determine pricing and promotional strategies. While absolutely necessary, price sensitivity models alone are insufficient as they are often focused on short-term balance response. And that is where the next two capabilities become critical.

First, you need the ability to clearly identify and differentiate your loyal customers with sticky balances from those who are chasing rates, i.e., the "hot money." While traditional semi-static attributes of loyalty such as relationship breadth, depth, or tenure are useful, there is no substitute for actual, observed behavior. Big data techniques now enable deep, dynamic **behavioral segmentation** that can help banks understand and predict their customers' saving and investment behavior and determine a customer's response to promotions and their propensity to be a loyal saver or a rate chaser. The right behavioral segmentation framework also helps differentiate price sensitivity across the customer lifecycle – from acquisition to augmentation/diminishment to transitions to retention/renewal. This enables the development of the right strategies to drive customer response before, during, and after the promotional period.

Next, to get a full picture, a customer's expected behavior and propensity have to be married with a quantification of their true capacity to invest or, more broadly, their relationship potential. This almost always requires data beyond the bank's own and the ability to compile a complete picture of a customer's current and projected assets. Combined with life stage information, this can provide the bank with a predictive customer relationship lens to asses a customer's current capacity to invest, their future relationship potential and propensity across multiple products, their "off-bank" balances and holdings, and the bank's share-of-wallet with the customer.

When well executed, this triumvirate of predictive capabilities allows banks to identify customers who are not only likely to respond, but also have the means to do so and are likely to retain their balances in the long run. The fourth critical capability – the ability to design, optimize and deliver offers that align with each segment's price sensitivity and preferences – now comes into its own. Through informed decision-making, the bank is able to more efficiently allocate interest expense to the customers who have the greatest likelihood to help meet goals, be it growth, profitability, stability, or a combination.

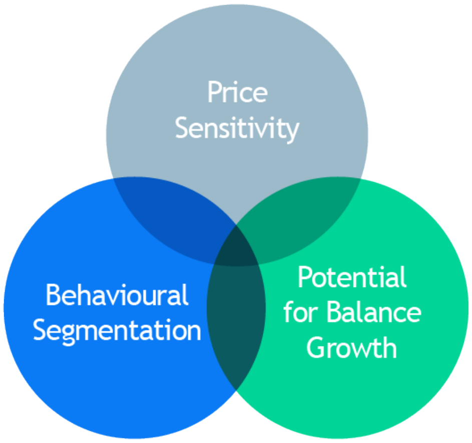

Figure 3 – *Price optimization and offer management powered by a holistic view of the customer outperforms first-generation approaches and solutions.*

Because market conditions and customer circumstances are dynamic, the data used in predictive customer analytics must be updated and refreshed frequently, models recalibrated, actions re-optimized, and strategies refined. Leading banks have realized that this requires a technology platform that can help operationalize this process end-to-end, delivering a closed-loop process that is continuously learning and improving.

Beyond Next Quarter: Long-term Forecasting to Ensure Sustainability

With the promotional targeting and optimized rates confirmed, banks can now leverage sophisticated forecasting capabilities to see beyond next month or next quarter. Best-in-class forecasting techniques can incorporate ongoing pricing and promotional strategies along with broader market, customer, and macro-economic dynamics to project deposit portfolio balance and net income month-over-month over longer horizons. By modeling various scenarios, the bank can examine the potential short- and medium-term impact of various actions.

As seen in Figure 4, sustained, targeted promotional strategies with continuous feedback and learning can drive significant, sustained, and cost-effective increases in portfolio balances. While some post-promotional run-off is unavoidable, the longer-term trend observed by Nomis customers is consistent and increasingly more stable growth.

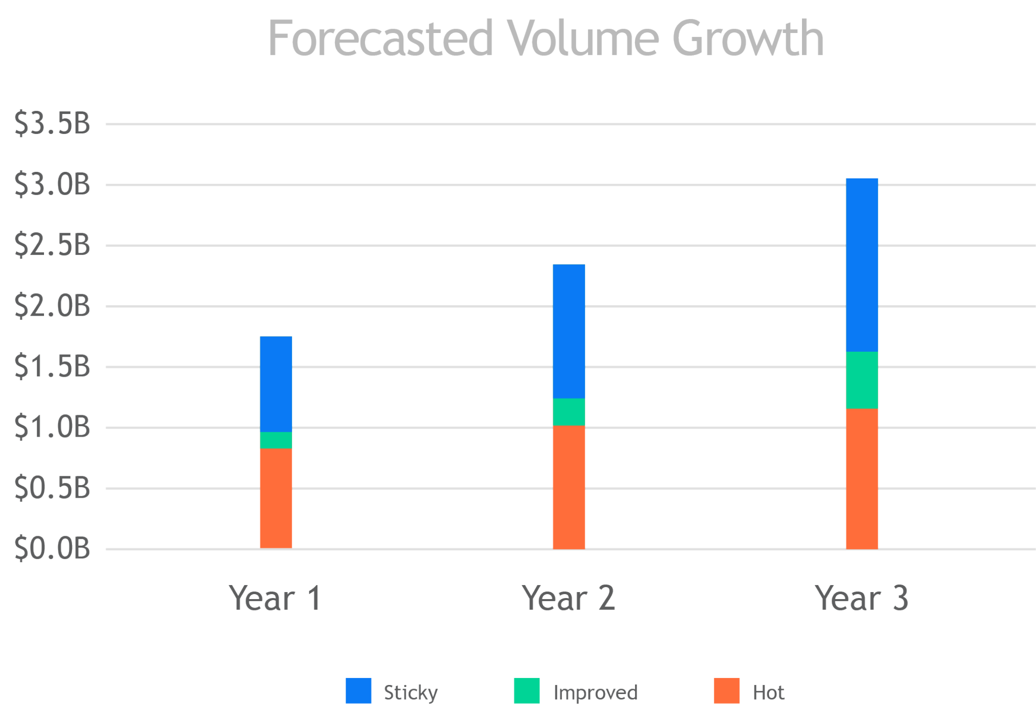

Figure 4 – *By utilizing the Nomis approach, banks are able to stabilize $500 million+ of new balances from hot money to sticky balances in a 3-year horizon, as shown in the "Improved" series.*

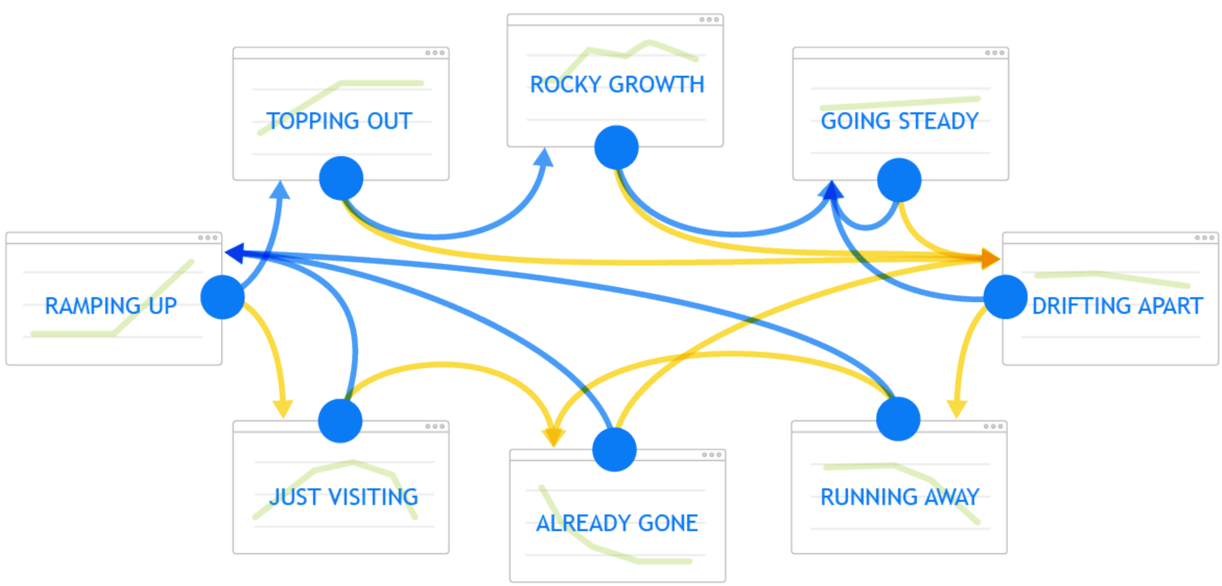

Figure 5 – *Nomis' intelligent segmentation, the Nomis Consumer Lens, can describe and predict the changes in consumer behaviors as they transition from one behavioral segment to another. This allows banks to evaluate ways to encourage more of the "good" behaviors.*

More effective promotional pricing is but one piece of the puzzle. Nomis is enabling leading banks of all sizes, globally, to deeply understand the financial lives of their customers and deliver the pricing, promotions and products offers - and ultimately the financial solutions - that not only resonate with their customers but are profitable for the bank. Powering this deep shift towards a win-win, real-time, science-driven approach to banking is Nomis' market-leading product suite, consisting of an intelligent segmentation engine, the Nomis Consumer Lens, its market-leading price optimization platform, the Nomis Price Optimizer and its multi-channel offer presentment solution, the Nomis Deal Manager.

Summary

It seems obvious that leveraging what is actually known about customers is key to designing successful targeted promotions, but, deprived of the right tools, turning vast amounts of data into actionable information is an overwhelming task. Further, economic factors, competitive pressures, and customer preferences can change almost without warning. A superior, purpose-built analytical, software approach allows banks to see trends early, consider options quickly, and respond faster.

Based on Nomis analyses of in-market tests, using the Nomis Consumer Lens and the Nomis Price Optimizer to drive targeted promotional offers can increase deposit volume by 20-30% alongside increases in stable deposits by an estimated 10-20% over three years.

But technology is only part of the equation; operational results are also critical. Without internal support for the project and guidance from expert consultants, important bank initiatives to change the status quo can fail miserably. Industry experience and focus are needed to guide the successful transition to pricing analytics.

Banks need efficient investment, stable balances, and sustainable growth to finance their operations. Assembling the right combination of data, technology, people, and processes to break free from simplistic or blanket approaches to promotional pricing can eliminate balance decay and deliver incremental growth.

About Nomis

Nomis is a fast-growing Fintech software company that combines cutting-edge Silicon Valley approaches to big data, advanced modeling, and deep analytics into the industry-leading price optimization SaaS software platform. We help large and medium-sized retail banks better understand their customers and grow their businesses. We help these banks deliver win-win products and pricing in an environment that is increasingly competitive and highly disruptive as interest rate increases begin. With experience in over 80 implementations, Nomis optimizes over $1 trillion in banking transactions annually and returns more than $300,000,000 to its customers every year.

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