

# The New Normalization: Three Keys to Successful Deposit Pricing Management



**React Quickly in a Dynamic  
Rate Environment**



**Be Prepared for  
New Regulatory Issues**



**Achieve a  
Pricing Process**

Financial institutions have an enormous challenge in front of them. Regulatory oversight is at an all-time high, the digital revolution has transformed how customers interact with their banks and the traditional brick-and-mortar approach to banking has been challenged by online-only direct banks. Deposit pricing is an area that is significantly impacted by all these changes and has received minimal attention from senior management in the last few years. However, as the rate environment normalizes, deposits are expected to get very competitive. A bank's pricing strategy and capabilities will be central to retaining necessary deposits. To be successful, banks need to anticipate how external factors — such as rate moves and regulatory changes — will affect the business, and revitalize focus in this critical area in order to edge out their competition.

## Moving Beyond Price Elasticity Models

Price elasticity has traditionally been the primary area of focus for deposit pricing teams. Analytically sophisticated organizations seek to develop statistical models that best describe their customers' sensitivities to deposit interest rates. This information is then used to set rates, forecast the corresponding deposits and understand the value of the pricing decision based on expected margin delivered. In today's environment, where more organizations seek to make data-driven decisions, elasticity models and optimization capabilities have become table stakes for deposit pricing solutions.

Looking beyond these basic capabilities, the next generation of deposit pricing solutions need to address the new concerns of pricing managers—namely:

1. React quickly in a dynamic rate environment to protect margins and balances.
2. Address new regulatory issues such as stress tests and LCR.
3. Achieve a well-managed pricing process with effective decision governance.

### React Quickly in a Dynamic Rate Environment

As the rate environment heats, it is paramount to understand the impact of rising rates on Funds Transfer Pricing (FTP), and the corresponding deposit rates. An organization that has a pre-evaluated arsenal of pricing strategies for different rate environment forecasts

will be ready to execute the optimal strategy with the fastest turnaround time. Developing this arsenal requires extensive and efficient collaboration with Treasury, which typically owns the forecasting of external rates. An effective deposit pricing solution should allow analytically fueled, technology-based interaction between business and treasury analysts, where various rate environment scenarios can be easily investigated. The need for collaboration between Treasury and other business stakeholders has never been higher, and this collaboration should be made seamless through the use of technology within deposit pricing solutions.

In addition to enabling collaboration between departments, an effective pricing solution must give you flexibility and speed in order to help you react quickly:

- **Automatic forecast updates:** An effective solution should allow

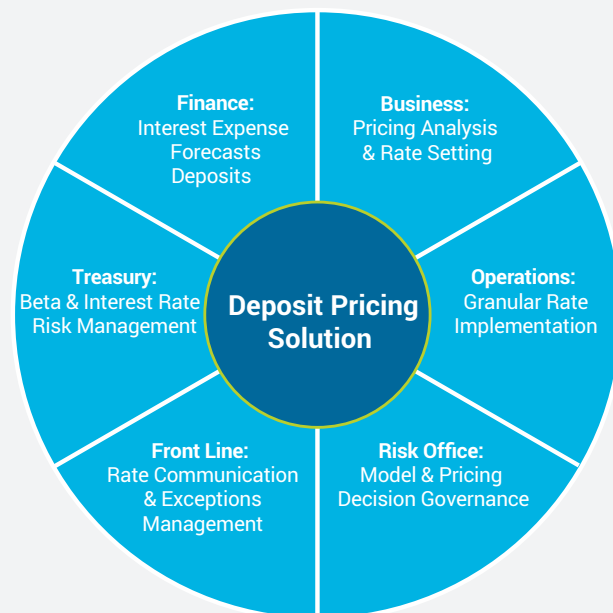
Treasury to autonomously update FTP and rate forecasts directly within the deposit pricing solution. Such a solution allows the business analyst to determine the impact of new FTPs and other macro-economic factors to the business-as-usual strategy.

- **Easy and fast re-optimization:** The ideal solution provides the necessary capability to perform a quick re-optimization. This provides the business with new pricing strategies that best meet corporate goals.
- **What-if analysis:** The solution should also provide necessary What-If analysis views. For example, what if the Fed’s “liftoff” rate is pushed out by a quarter? What if FTPs are off by 5 bps? A solution with such capabilities will provide business users a sound understanding of the impact to their portfolio and P&L, allowing them to react with faster turnaround time.

### Collaboration Between Groups Is Vital to Reacting Quickly

“One of the most common issues across firms is unclear or unsubstantiated assumptions. Loan and deposit pricing assumptions were, in many instances, not well documented nor adequately supported.”

—US Federal Reserve



## Making Stress Testing Less Stressful

### Leveraging technology for documentation trails and an automated review process



Stress test submissions now require significant resource investments from deposit pricing teams. Specifically, teams need a portfolio management solution that provides an accurate forecast for the stress test scenarios with complete documentation and controls of the inputs that lead to the forecast.

While robust elasticity models are a critical component of determining deposit portfolio behavior for the stress test scenarios, documentation of inputs and assumptions used, along with recordkeeping of necessary executive approvals, is even more critical. An effective deposit pricing solution should allow business users to enter the adverse and severe adverse scenarios as input. The solution utilizes previously built models to predict competitive behavior, seeks input on marketing and pricing strategy, and provides a robust forecast of the deposit portfolio for the requisite nine quarters.

Moreover, the solution should also automate the process of executive review and record the necessary approvals, and act as a single point of truth for assumptions, portfolio forecast, proof of review and approvals. Such a solution makes stress tests much less stressful.

## Be Prepared for New Regulatory Issues

Regulations within the financial services industry have typically focused on customer-facing policies – ensuring banks provide fair access to their services, fair fee policies, or appropriate

disclosure of terms and conditions. However, coming out of the financial crisis, banks are also being aggressively regulated on the internal health of their balance sheet. Paramount to these regulations is ensuring a bank has sufficient liquidity and capital to withstand a period of stress. These

regulations, manifested in stress tests, Basel committee rules and Liquidity Coverage Ratio (LCR), are now also impacting how banks set rates, develop deposit forecasts and manage the deposit portfolio. Now more than ever before, deposit businesses need to develop well-governed models and demonstrate well-managed pricing processes. Banks need the ability to grow and retain their “stable” deposits as defined by LCR rules, while also improving their margins. These regulatory changes have resulted in a need for a deposit pricing solution that delivers on growing stable deposits, growing margins, providing process automation, and documenting and governing decisions.

An effective pricing system should deliver technology-based solutions to capture and store reviews and approvals for effective auditability. This pricing system should also serve as a single point of truth for identifying the impact of adverse and severe adverse scenarios to the deposit portfolio within CCAR and DFAST. Such a system allows business analysts to focus on improving the business as opposed to developing needed infrastructure for regulatory compliance.

## Understanding the Impact of Liquidity Costs

### Basel III and LCR: More Than Just Checking the Box



Deposit pricing managers are increasingly engaged in issues pertaining to bank liquidity defined by new Basel III/ LCR rules, which increases the need to boost highly stable, less rate sensitive deposits at the bank. Stable deposits are defined as those having a deep relationship with the institution with lower likelihood of attrition during times of financial stress.

Given the focus on LCR, banks are over-indexing on setting rates that only seek relationship-based stable deposits. Paradoxically, the fastest path to deposit growth is through higher rates for large balance accounts, which are also rate sensitive. Therefore, it is imperative that deposit pricing managers effectively understand the impact of liquidity costs under the Basel III measures and include these costs in developing valuations for deposit pricing decisions.

An effective deposit pricing optimization solution identifies the stable and less stable components of the portfolio, incorporates elasticity models that predict the impact of pricing to those components and includes the cost of carrying less stable deposits in the optimization of pricing decisions. An ideal price optimization solution balances pricing across relationship/non-relationship deposits to enable interest revenue growth while also maintaining LCR-mandated volumes of relationship deposits.

### Achieving a Well-Managed Pricing Process

Identifying the right rates for the deposit portfolio through the use of elasticity models and optimization is the current best practice leveraged by deposit pricing managers. However, the role also requires effective review and documentation of the pricing decisions, accurate deployment of the approved rates, achieving successful audit reviews, and ensuring elasticity models are performing within defined governance thresholds. A breakdown in any of these activities can take away critical resources

from the pricing team that would ideally be using their time to evaluate pricing options rather than managing governance red-tape.

All too often, common methodologies for rate deployment such as emails and spreadsheets result in inaccurate rate implementation, dissatisfied customers and lack of transparency. Preparing pricing meeting decks with repetitive charts and resolving data issues can occupy multiple days of an analyst's time. Chasing down approvals for past decisions as part of an audit request can unnecessarily drain valuable resources. Ensuring models are performing

satisfactorily, implementing periodic reviews and obtaining risk office approvals have evolved into full-time analyst jobs.

An effective deposit pricing solution helps automate these tasks and significantly mitigates the risk of errors in the process. Through the use of technology, the creation of pricing options, the preparation of review materials, the approval and execution of decisions and the recordkeeping of past activity and model governance should be streamlined and automated. The right deposit pricing solution helps pricing teams function at a higher level of efficiency by automating the mundane tasks that currently occupy too much analyst time.

### How It Works

FICO® Optimization Solution for Deposit Pricing provides comprehensive deposit portfolio and product management. The solution incorporates analytically derived pricing strategies, model-based forecasting, customizable collaboration features and flexible workflow documentation that increase profitability while maintaining consistent policy-driven decisions.

FICO brings over 50 years of analytics excellence to bear on helping you develop customer-level price sensitivity models and understand pricing impact across lines of business. Powerful optimization features let you simultaneously optimize across all rate variables, perform what-if analyses and solve linear, non-linear and discrete pricing problems.

The analyst is able to orchestrate optimized pricing strategies by leveraging collaboration features meant to share vital information across groups, seamlessly and automatically. And by using built in documentation and workflow systems, the analyst is able to spend more time on strategy and less time on compliance management. FICO® Optimization Solution for Deposit Pricing is fully customizable, transparent and integrates with existing decision systems.

## Part of the FICO® Decision Management Suite

FICO offers a comprehensive suite of solutions for financial services institutions to help find, acquire, grow and manage customers. It includes the FICO® Decision Management Suite, an integrated set of analytics, decisioning and optimization products, complemented by integrated application development and productivity tools.

The FICO Decision Management Suite reduces implementation costs and total cost of ownership by connecting all the components necessary to build a profitable deposit pricing business. These include:

- Best-in-class rules creation, execution and lifecycle management
- Analytics capabilities to create predictive models from data
- Model management for ongoing model oversight and governance, including automated validations
- Sophisticated tools for creating and deploying optimization models
- User interface and workflow
- Reporting via interactive dashboards

FICO Optimization Solution for Deposit Pricing and the FICO Decision Management Suite can be delivered as either on-premises or cloud-based solutions.

## Two Examples

### How Banks Have Adopted FICO® Optimization Solution for Deposit Pricing

- **A fast-growing bank with a national footprint** selected FICO as their deposit pricing partner due to FICO's unparalleled software flexibility and proven analytic expertise. In light of current regulatory expectations, this organization valued FICO's ability to deliver a well-governed, auditable solution that includes easily configurable approvals workflow. FICO's market-leading ability to quickly adjust segmentation, add new products or relevant constraints, and perform true optimization across thousands of price points and segments was also deemed best-in-class.
- **A national UK online bank with deep brand recognition** selected FICO for pricing analytics across Deposits and Loans, after extensively reviewing several vendors. The organization recognized FICO's deep experience in the financial services industry across asset and liability products and decided to partner with FICO to bridge gaps in their price elasticity analytics. FICO's subject matter expertise in the area of deposit pricing, a deep understanding of the drivers of price elasticity models and strong domain knowledge on managing regulatory concerns such as LCR were the key factors in selecting FICO.

## For more information go to:

[www.fico.com/depositpricing](http://www.fico.com/depositpricing)



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