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## Wisely Pricing Deposits for Your Market in a Zero Interest Rate Environment

Credit unions face tightening margins and a competitive environment for deposits in this historically low interest rate environment. How can a credit union adjust pricing strategy to best fit their specific market conditions?

**‘Tumultuous’ is certainly one word that can be aptly used to describe 2008.** The deposit market was one of many areas which faced a dramatic shake-up over a short period of time. The financial services industry experienced widespread turmoil and extensive merger activity, the stock market cratered, and federal insurance limits were raised.

From June 2006 to September 2007, the Federal Reserve target rate was set at 5.25 percent. Once the negative effects of the subprime housing crisis began to fully emerge, the target rate began its precipitous decline, finally bottoming out on December 16th, 2008, when the target range for the federal funds rate was set at 0 to 25 bps, its lowest point in history. This monumental shift occurred in less than one year and three months, and the Federal Reserve has since acknowledged that this rate will remain at exceptionally low levels for quite some time.

Treasury yields also currently hover around historic lows with little expectation of rising in the short-term. Credit unions are actually faced with an environment where there is not a strong correlation between Treasury rates, and consumer rates, particularly with regard to deposits. Tightly focused deposit pricing strategy and ALM management is critical, as many credit unions work to strike a balance that meets their goals, their individual financial situation, and the needs of their members.

### Historic Nature of Deposit Flows

Historically, it becomes harder to grow deposits when the economy is expanding. Members gravitate to high rate CDs or seek higher returns in the stock market. Conversely, when the economy is contracting, members prefer liquidity and safety, and

credit unions can typically expect an increase in deposits, particularly in regular share and money market accounts.

Prior to 2008, our country last experienced its most recent economic downturn in 2001 when the dot-com bubble burst. Deposit growth for the credit union industry surged 14.9 percent during the year. In 2006, the U.S. economy had fully recovered, the stock market was growing, and the term “subprime mortgage” had yet to enter the public lexicon. Deposits only increased 4.2 percent in 2006, as many members turned to the red-hot stock market to pursue larger returns. As a dramatically poor year for the U.S. economy, 2008 saw credit union deposits grow 7.0 percent, the highest rate of growth in five years.

### Wise Deposit Pricing Strategy

Deposit growth is impacted by a variety of external factors that credit unions have no control over including interest rates, stock market performance, federal deposit insurance limits, and household savings rates. However, each credit union has the ability to determine how they choose to respond to their given environment. Evaluating a pricing strategy is an art, not a science, with credit unions weighing each of these factors carefully to implement the optimal approach. Ultimately, the goal of any credit union is to price their products and services intelligently, in such a manner that makes the most sense for their situation and membership. In the current environment, economic conditions vary dramatically from one locale to the next, which is why it is so important for credit unions to respond to local market conditions.

## A few questions to ask when evaluating your pricing strategy:

- **How often should your ALCO committee/standing committee meet to evaluate rates and strategy?**  
If you are paying more than FHLB pricing, what is the reason?
- **What are alternative borrowing rates for similar terms?**  
What are members benchmarking you against?  
Observe what the competition is paying and decide whether to match, surpass, or trail those rates.
- **Should we price more from a demand side perspective?**  
How does your member demand vary?  
Choose to be rate competitive on specific products and services, depending on what's most important to your members  
Consider demographic factors  
More emphasis on segmenting membership and understanding behavior
- **How can you effectively market and promote your efforts?**

**Different market conditions. Different goals. Different strategies.**

**Dried-up loan market? Time to cool things down.**

While the overall credit union industry has seen record loan volume in the last 12 months, several regions of the country are experiencing low demand for loans. If a credit union attracts deposits to higher yielding accounts in a zero interest rate environment but is unable to lend, they may lose money on every dollar deposited. In this situation, a credit union can de-emphasize deposit rates and instead emphasize the holistic benefits of membership to attract new members and core deposits while waiting on the lending market or rates to recover.

**Competitors are aggressively chasing deposits.**

Due to their intense need for funding after the collapse of secondary markets, many banks continue to aggressively pursue deposits. Credit unions in these markets often have to adopt a more aggressive pricing strategy if they wish to compete with these institutions for deposits. Credit unions can focus on offering a very competitive rate on one of their stickiest or most popular products and use it to anchor their promotion efforts. Some credit unions choose not compete on rates across the board, but instead use a tiered pricing system to hold on to their larger deposits.

**Your entire market is reeling.**

Some regions of the country, such as California and Florida, have been slammed harder and faster by the economic downturn than the rest. Not only has the lending market all but evaporated, but individuals simply don't seem to have money available to save. Credit unions in these markets may not have experienced a flight to safety after the stock

market tumbled, and may find that members are not particularly rate sensitive at this time. Some credit unions in these markets have focused on bringing in low-cost deposits, while others have chosen to draw attention to their institution by having an initial rate special on certificates.

**High loan demand? Bring those deposits in.**

Credit unions in portions of the country have experienced high loan demand, resulting from competitors dramatically tightening their underwriting standards, participation in the Invest in America auto lending program, or the refinancing boom that began when the Federal Reserve slashed rates back in December. Such credit unions continue to aggressively loan, and must fund these loans with an influx of deposits or borrowings.

Many of these institutions continue to price their deposits near the top of their market and may even implement a flagship product offering, such as a high-yield checking account that is coupled with member usage requirements to help offset the cost. Some credit unions may also choose to be rate competitive on specific products that are most demanded by their membership (e.g. offering a very competitive IRA because you are focusing on retirees). Such methods can be a way to dramatically differentiate your credit union from other institutions in your market.

Now that it appears the Federal Funds target rate will remain at historic lows for some time, and the U.S. economy will take awhile to recover, each credit union must adapt a sustainable pricing strategy that best allows them to take advantage of their particular market conditions. Allowing your strategy to actively respond to the community and specific member needs can only position your credit union to emerge from this tumultuous environment as a strong leader in your local market. ▲