



## Make Your Focus on Deposits Pay Off

It's time to apply the same rigor to deposit accounts as you do to credit accounts

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Deposits have been reestablished as the key driver of bank funding. Over a decade of third-party funding sources from the wholesale markets, brokered and foreign deposits, and liquidity leverage from the Federal Home Loan Banks has suddenly frozen up or is requiring capital and collateral at new levels. Banks are looking for strategic ways to grow, maintain and manage deposit customers for improved share of wallet, loyalty, greater net on funds and fee income.

Add the increase in incidence of fraud and the proposed changes to the Unfair and Deceptive Acts or Practices (UDAP) into the mix, and deposit management has never before reached these levels of complexity and challenge.

This paper examines:

- The use of scores, strategies and systems to automate and improve deposit decisions
- Three case studies of successful deposit management initiatives

*FICO's industry-leading solutions for credit management and fraud can be successfully applied to deposits as well. The principles in this paper can be put into action using these Decision Management applications.*

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### » Introduction

Managing deposits is much like managing cash flow. Financial Institutions receive deposits that are conditionally available back to the depositor on demand through various channels. Some of the cash flow is recognized as float, the credit you give the depositor from the time the deposit is made available to when you receive verified funds from the maker bank's account. Some funds need to be available in the form of cash stored in the vault for distribution to the ATM network and the branches.

*“As banks evaluate major strategic initiatives for 2009, especially those involving IT, the focus will be on capital preservation, increasing operational efficiencies, and establishing strategies to avoid future crises.”*

—TowerGroup, *2009 Top 10 Business Drivers, Strategic Responses, and IT Initiatives in Retail Banking*, Robert Hunt, Kathleen Khirallah and Tom Brogan, TowerGroup paper # V57:04R

Some cash is held in reserve as part of future forecasted demand. Much of the deposit dollars received go into solid risk asset decisions that create a margin or net of funds return. On this point, banks are naturally becoming more conservative. Arkadi Kuhlmann, chairman, president and CEO of ING Direct USA, was quoted in BAI Banking Strategies<sup>1</sup> saying, “If we cannot cover the mortgages with deposits, we *don't* take them.”

We are in this economic crisis in part because banks funded greater percentages of their lending activities from wholesale sources and moved more assets off balance, where the reserve requirements were lax or avoided.

It's time to regroup and rediscover the value and potential in effective, proactive management of the deposit portfolio. We'll now review scores, strategies and systems that will help you do this.

### » Scores that assess risk

At the center of deposit management strategies is predicting behavior. There are two common approaches to scoring deposit accounts. The first is a cycle-based behavior score that is refreshed on the statement cycle. This score predicts the probability that the deposit account or customer will achieve a particular aging on an overdraft. The performance period for this score is much shorter than those observed in credit scores. This score acts much like a credit score, and needs to be stable and reliable, a good measurement of true deposit risk that rank-orders the deposit portfolio accounts or customers. Credit scores also have an application in determining risk on new accounts. They can provide a strategic advantage in initial cross-sales and setting risk criteria prior to the aging of the behavior score.

The second score is transactional. This score is cumulative and recalculated as each transaction is presented either in real time at the point of contact or in batch through a back office operation. Developing this score requires that it not be overly reactive to individual transaction activity, but be focused on anomalies in expected account or customer behavior. This is the most common method used for detecting fraudulent transactions, and has recently been applied to risk-based decisions and activity-based cross-sales. A profile of the customer is accumulated over time and each incoming and outgoing transaction is compared with the expected profile on variability, velocity, location and other transaction-based elements.

Cycle-based behavior scores and transaction scores can be used in combination or individually based on the objective of the strategy.

<sup>1</sup> BAI Banking Strategies, January | February 2009

**» INSIGHTS****» Strategies that balance risk and growth**

Creating, testing and automating deposit strategies across the customer lifecycle can bring tremendous benefits. The key throughout—from account opening to forced closure or customer intervention to prevent closure—is to provide a positive and consistent customer experience. Strategies should include integration across channel, transaction type and product. Here are some of the recommended strategies:

**Marketing**

Cross-sell and upsell strategies can increase share of wallet while building customer loyalty. Activity-triggered cross-sell efforts can be implemented at the customer call centers, branch, ATM or online banking.

**Account opening**

When a new customer opens an account, authentication is usually the primary concern. However, savvy deposit managers realize that the account opening is an excellent opportunity to evaluate the credit risk and set shadow overdraft limits and daily ATM withdrawal limits, upgrade the customer to a premium product and cross-sell other products. A FICO® Score is the best measure of risk for this purpose.

**Customer management**

Once the account is established, risk-based and profit-based strategies help to provide “right-sized” risk management at the point of contact, uphold compliance and policies and support revenue generation. These strategies promote consistent customer treatment, and take the burden of decision-making off the customer-facing personnel, who are freed to offer a positive relationship and discuss available product offerings. Override of rules-based policies can be controlled and compliance achieved with defensible risk-based decisions.

Fee waivers can seriously erode deposit revenue when not managed properly. By automating a risk-based or value-based fee waiver strategy, you can focus on approving waivers for high-value customers and discouraging or blocking waivers on customers who merit the fee. These strategies could be of great value if the new UDAP statute is passed as currently proposed.

Strategies that reward debit card usage and increase signature interchange can promote customer confidence, and customers that choose signature over PIN can help generate interchange revenue if motivated by a targeted rewards program.

**Collections**

Risk-based strategies can help to mitigate collections volumes by preventing good customers from being moved to collections unnecessarily. At the same time, these strategies can allow the bank to accelerate identification of high-risk customers, automate balance set-off and direct customers to specific collection queues and letter messaging.

**Reporting**

Automation of risk-based decisions also supports compliance and generates reports for bank examiners. These reports also provide the framework for consistent communication to senior management and other constituents within the organization.

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**Testing**

Adopting a champion/challenger testing program for strategies can also improve results in deposit account management, just as it does in credit risk management. Challenger strategies for risk-based deposit hold can be tested against current rules-based decisions, to see how well they improve customer service and protect customers against unrecoverable reclamations or returned deposits. By fine-tuning strategies through controlled testing, you can achieve greater efficiency, reduce overrides, reduce losses and enhance the customer experience.

» **Systems that create agility**

One of the most challenging aspects of delivering strategies to the customer is the systems on which they are created. Often these systems are mainframe or server-based and require IT intervention to implement and test changes. This creates complications when a new strategy is needed immediately and the time to production is 3 to 6 months or longer in IT. Having a GUI interface and the ability for business users to test and implement strategies is critical to success.

Capacity and response time are also critical. Customers have a low tolerance for waiting for a response. In one time-motion study conducted at several branch locations, results showed the customer's tolerance for waiting was a total of 3 seconds. This needed to include the teller's response time as well. The optimal response time for the system to deliver the decision to the teller was 3 milliseconds. Delays in teller response longer than 3 seconds created customer frustration and sometimes led to confrontation.

» **Deposit strategy value proposition**

There are several ways to recognize a return on investment when creating deposit strategies. These are dependent on particular issues present in each individual bank.

Some of the more common areas that offer direct return include:

- Fee waiver decisions by mitigating justified fees and waiving fees for profitable customers
- Regulatory compliance by generating reports that support risk-based decisions
- New product offerings by segmenting and scoring customers that would benefit most from the offer
- Attrition mitigation and determining early, voluntary closure
- Fraud detection and intervention with second-factor authentication at the point of contact
- Pricing and cross-sales to create loyalty and improve profitability

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Deposit Account Decisions Can Be Improved and Automated

Account Origination	Customer Account Growth	Account/ Customer Management	Collections/ Recovery Management	Fraud	Portfolio Management
Origination	Segmentation	Holds	Collection strategies	First party	Cost containment
Authentication	Profitability / share of wallet strategies	Overdraft pay / no-pay	Retain most collectable accounts and manage OCAs	Victim fraud	Reserve estimation
New customer strategies	Cross-sell /upsell	Fee waivers	'Save the customer' strategies	Synthetic fraud	Alternative distribution channels
Daily limits	Customer service	Compliance		ID theft	
Shadow overdraft limits	Activity / change triggered cross-sell	Cashed Items		Account takeover	EWS
Customer value assessment	Marketing	ACH / Wires		Cross-channel	New products
Welcome strategies	Retention management	Bill payment / online banking		Cross-product transactional	Product convergence
		Debit card		Change initiated	Stress testing
				Insider fraud	Peer group analysis

Let's look at three success stories that bear out the results you can achieve by better management of deposit strategies.

» **Case study: improve the hold decision**

**Bank Description**

A tier one bank with over \$550 billion in assets and more than \$300 billion in domestic core deposits

**Challenge**

- Inconsistent customer treatment between channels and bank locations
- Increased losses due to ineffective deposit hold management
- High hold rates/unnecessary holds on good customers
- Regulation CC compliance violations
- Branch turnover affecting training, consistency and reliability of hold management

**Solutions Overview**

Automate the hold determination and length calculation based on risk for all points of deposit; allow for override capabilities when appropriate.

DDA account-level behavior scores were created and a Decision Management system was implemented that provided the holds determination for all points of deposit in the enterprise. Risk was assessed based on time on books, related accounts and balances, current and average balance, overdraft history and customer profitability. The decision was delivered to the point of

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contact in real time, with override capability based on the type of item(s), known maker and known customer. The override risk was accepted by the branch or override unit.

**Results**

- Hold rates reduced from approximately 22% to less than 0.5% providing exceptional customer service and market competition with no increase in operating loss.
- Automated hold length determination was based on credible risk measurements and Regulation CC requirements, and hold length compliance was consistently achieved.
- Customer experience was consistent throughout the enterprise
- Branch training was simplified and hold management was significantly improved.
- Override decisions at the branch were focused on the eligibility of the item, not the potential for customer risk
- The Decision Management system was rolled out to the ATM utilizing the memo hold system. Holds were either allowed to drop off or converted in processing to hard holds. Letters were automatically generated.

» **Case study: automate hold decisions**

**Bank Description**

A tier one bank with over \$29 billion in assets and more than \$19 billion in domestic core deposits

**Challenge**

- Improve transaction-based decisions for the demand deposit, interest and non-interest bearing deposits and other short-term lending product portfolios
- Create consistency in customer service across a large, geographically dispersed enterprise
- Automate the deposit hold determination to:
  - Improve the deposit efficiency ratio to better than 50%
  - Increase depositor fees 10–12%
  - Lower operation losses with a minimum 7.5% improvement

**Solutions Overview**

FICO installed a FICO® TRIAD® Customer Manager 8.2 decision platform to create a champion/ challenger application and improve the hold decision based on risk. TRIAD Customer Manager also allowed the bank to automate the hold length period based on Regulation CC requirements. In addition, transaction scores were developed for delivery in real time to the branch network.

**Results**

- Branch confidence in the hold decision based on risk was established
- Branch hold override rate was reduced by 17%
- Deposit hold rate was reduced to 3%
- Deposit holds were applied consistently across enterprise branches, based on measurable risk

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» **Case study: sharpen risk management**

**Bank Description**

A tier one bank with over \$550 billion in assets and more than \$300 billion in domestic core deposits

**Challenge**

- Inconsistent customer treatment in determining overdraft pay/no pay
- Increased collections costs and losses from judgmental decisions
- Fee income from overdraft pay decision lower than desired; lost fee opportunity
- Fee waivers not monitored
- Poor customer service from no-pay decisions on good (low-risk) customers

**Solutions Overview**

The overdraft pay/no pay determination was automated using DDA behavior scores and other tangible criteria to make consistent and sound overdraft payment decisions. Shadow limits were determined for each account, and overlimit behaviors management was developed. The decision was delivered in real time.

Risk and profit were used as base criteria in the fee waiver decision criteria and delivered to point of contact (e.g., customer service, branch, personal banker).

**Results**

- Pay rates were increased from <50% to 75%, improving both customer service and fee income
- Fee waivers were significantly reduced and targeted towards appropriate customers
- Customer service complaints were reduced
- Fee waiver inconsistency was minimized
- Overdraft pay strategies were risk-based and defensible

» **Summary**

The intense competition and scarcity of retail deposits have sparked new attention in management and growth. Deposit accounts can be proactively managed to provide greater net of funds, fees and cross sales profit. Deposit strategies can reliably provide an excellent and consistent customer experience while supporting regulatory compliance, risk management and protecting fee income. The ability to test new strategies and make changes, when needed, through interactive systems offers a strategic advantage to developing a stable and profitable deposit portfolio.

**To speak with a FICO representative about how to develop, test and apply deposit management strategies using Decision Management technology, email [info@fico.com](mailto:info@fico.com).**

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