

Q2 | precision**lender**

Chasing Deposits in a Liquidity Crisis





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Introduction

As interest rates have reached their highest mark in decades, banks and credit unions have had to do an about-face regarding their deposit strategies. Just one year ago, deposit growth was a non-conversation. Financial institutions were awash with liquidity and were content to let their deposit accounts earn a very low return without worrying about runoff. What a difference a year makes.

FIs have certainly felt some shaky ground so far in 2023, but not everyone has struggled the same. In fact, some FIs have had no problem growing their deposits in this financial environment. From September 2022 to April 2023, Q2 PrecisionLender clients' deposit portfolios showed that 40% of the FIs saw an increase in balances, approximately 40% saw a decrease in balances, and the remaining FIs saw no change. Which led us at Q2 to ask, "What are they doing differently?"

So we dug into our proprietary Q2 PrecisionLender data to find out. Q2 PrecisionLender is our leading commercial relationship pricing and profitability tool. It's used by more than 150 banks and credit unions from across the United States, ranging in size from small community banks to top 10 U.S. institutions. We looked at several FIs that had deposit growth during the time period—Deposit Expanders—and several that had deposit contraction—Deposit Contractors.

If we consider the Pareto Principle (also known as the 80/20 Rule) that specifies that 80% of consequences come from 20% of the causes, we can assert that the top-performing relationship managers (RMs) are driving most deposit growth. And by looking at the activity of those top RMs, we can determine several guiding behaviors for building liquidity. So we also looked at the activities of the top RMs in each of our FI groups, as well as reflected on the FI culture as a whole.

The sheer breadth and depth of data in Q2 PrecisionLender helps us paint a good picture of what's happening in the commercial banking industry, and it highlighted some important reasons some FIs are succeeding while some are struggling right now.

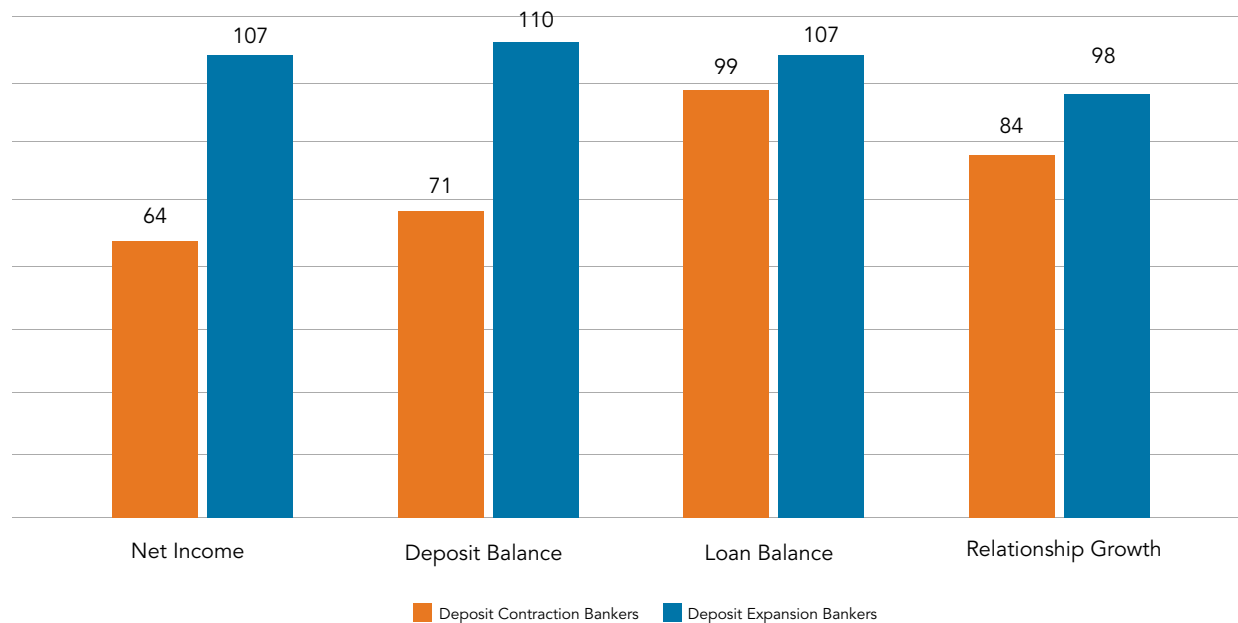
Leading the Pack: The Deposit Expanders

In analyzing FIs that experienced deposit growth from September 2022 to April 2023, we asked a fundamental question: Do betas drive deposit growth, or is there something more? Our research revealed two truths:

- The best RMs do not necessarily price up to attract deposits.
- The top deposit-gathering RMs are also the top performers in other measurements. In fact, if an FI's deposit pricing strategy focuses solely on rate paid, it may limit the potential of RMs.

By studying our Deposit Expanders, we found a successful deposit strategy is part of a broader pricing culture that provides leadership commitment, supports RM empowerment, fosters key behaviors, and provides appropriate measurement of outcomes.

Figure 1: Relationship Composition Change, Indexed to September 2022=100 as of April 2023

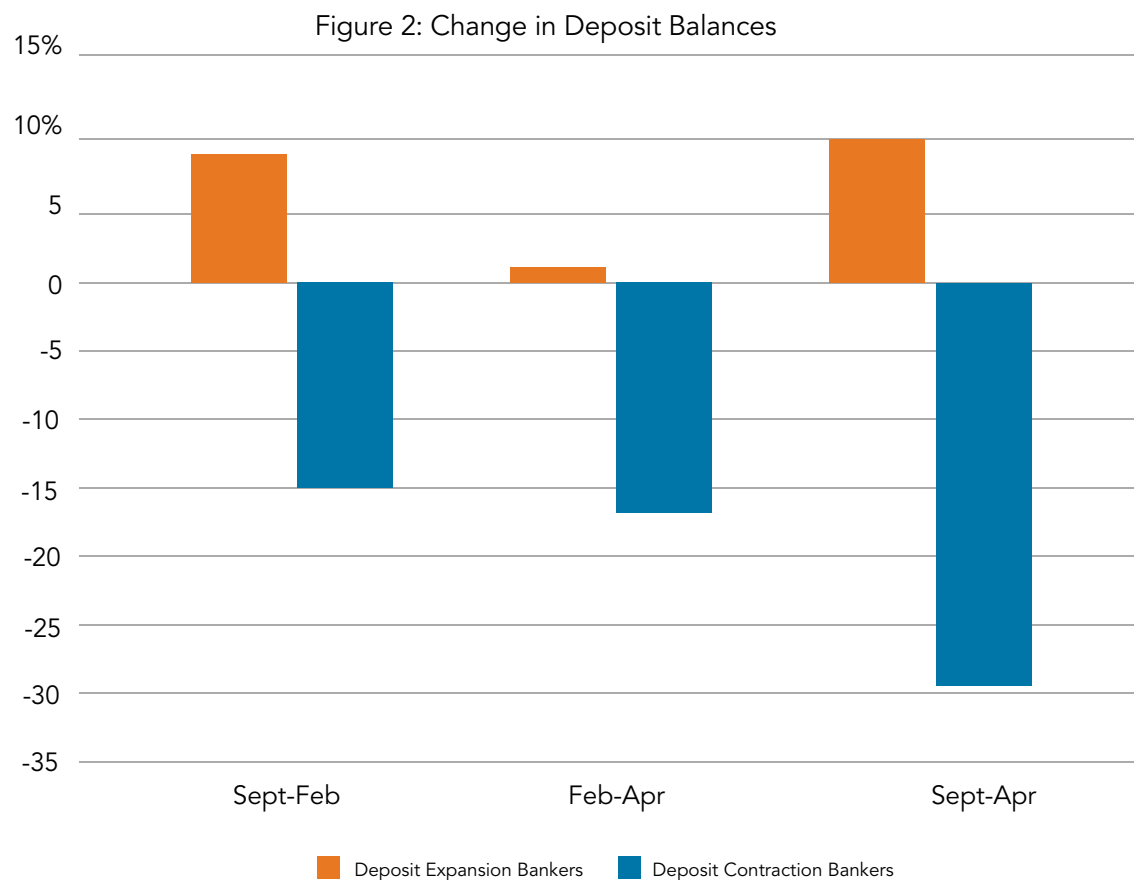


As seen in Figure 1, indexing key metrics such as net income, deposit balances, loan balances, and revenue growth to September 2022, we saw not just an increase in deposit balances but an increase in most

metrics over this timeframe. Given deposit growth at the line-of-business level, we found improvement in loan balances, improvement in net income, and growth in the size of the book of business.

Our analysis revealed that price (identified in this eBook as “rate paid”) is not the single driver that matters in deposit gathering. Results also indicate that the top RMs do not necessarily leverage price, and that the most successful deposit gatherers work in a culture that empowers them rather than hinders them.

Successful RMs continue to build their pricing muscles with increased activity over time, and they study the performance of that activity to continue to improve. As Figure 2 reveals, even though banking sector uncertainty stalled deposit growth in March-April, the Deposit Expanders maintained balances overall (up 1% for the two-month period). They also maintained their interest-bearing to non-interest-bearing mix at 45% and 55%, respectively, for the period.

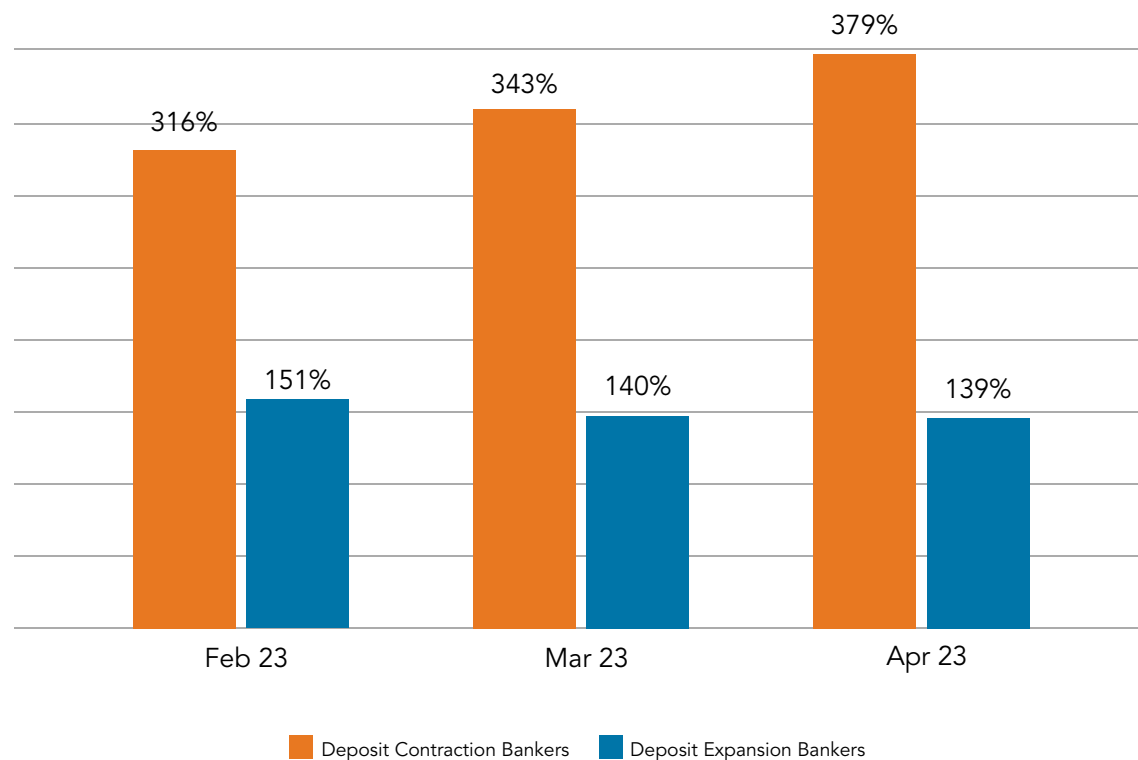


Trailing Behind: The Deposit Contractors

As it did for the Deposit Expanders, our research revealed some common themes for the Deposit Contractors: Poorly communicated approval processes and workflows inhibit RM empowerment, and focusing incentives on easy-to-reach loan targets can often discourage deposit conversations.

As seen in Figure 3, the transient nature of deposits has really exacerbated the loans-to-deposits ratio for these FIs. The existing interest-earning assets are consuming more and more liquidity from the rest of the organization. Meanwhile, the Deposit Expanders have generally maintained their degree of liquidity.

Figure 3: Loans-to-Deposits Ratios



The price sensitivity of the deposits and the underrepresentation of non-interest-bearing demand accounts frame the challenging environment these RMs face. The rate paid by the top RMs at the Deposit Contractor FIs is higher (2.28%) than the rest of the RMs (1.01%). Those RMs began from a higher deposit cost and moved relatively higher during the period. The Deposit Expanders demonstrated a very low beta by comparison.

Yet, the high rate paid by the Deposit Contractors did not stave off deposit attrition. These FIs saw erosion in deposit balances and net income, as well as relationship attrition. Loan balance composition held at par. It became clear that fewer deposit balances and relationships push total book performance lower, measured by a 20% decline (index value of 80) and also led to a nearly equivalent drop in net income.

The Deposit Contractors also have a substantial product mix disadvantage. We found a significant underrepresentation of non-interest-bearing deposit balances, at 2% compared to 55% for the Deposit Expanders.

Non-interest-bearing
deposit balances for
Deposit Expanders

55%

Compared with
Deposit Contractors

2%

Winning Strategies

By analyzing the practices of the Deposit Expanders and the Deposit Contractors among our Q2 PrecisionLender clients, we uncovered these winning strategies.

Deposit strategy is part of a broader pricing culture that provides **leadership commitment, supports banker empowerment, fosters key behaviors, and provides appropriate measurement of outcomes**. Recent interest rate hikes and curve term structure have opened the door for refinements in deposit valuation, leaving room for product and price specificity. On the flip side, poorly communicated processes and workflows—especially around approvals and exceptions—inhibit banker empowerment. Also, focusing incentives on easy-to-reach loan targets can often discourage deposit conversations. Deposit valuation goes beyond the ALM/Treasury value source of funding, and deposit rate/flight sensitivity can have harmful impacts on interest-earning assets and overall performance.

Actively consider liquidity premiums within the deposit valuation. Premiums are up about 100 bps since June 2022 by our proxy liquidity curve. Many FIs manage their own liquidity curves, and the overall trend has been upward. Recognizing liquidity producers and sources of funds may be separate measures within deposit valuation. Incentive compensation should consider the acquisition and retention of foundational operating accounts.

Managing the valuation in Q2 PrecisionLender is critical, as is timing and ease of change management to adapt to the current macroeconomic environment. Strategies to secure and expand core deposit operating accounts could not be more valuable. Wrapped into the consumption of services these accounts have is the offsetting measure of earnings credit rates. This is a dynamic environment in 2023 after a long period of stable ECR. ECR and service calculations are key in securing the operating account that works for the depositor.



Get Ahead With Q2 PrecisionLender

Equipping RMs—as well as other departments within the FI that have a vested interest in how commercial deals are structured—with the tools they need to make informed decisions is a critical component of the Deposit Expanders' success. Q2 PrecisionLender, along with the Andi® coaching tool and ancillary solutions such as Q2 Premium Treasury Pricing, provide FIs with the information they need to make solid pricing decisions that strengthen the whole relationship.

For example, the Deal Team feature in Q2 PrecisionLender (Figure 4) allows for specialty sales teams to collaborate with a customer-centric approach, enabling each team member to price within their line of business with a view into both the full opportunity (all FI services) and the total relationship.

Think of it like a triptych art medium that is made up of three canvas panels. One panel has all the credit, another panel has all the deposits, and the third has all the detailed off balance-sheet fee-based business, such as Treasury Services, Wealth, and Insurance. When placed side-by-side, you get a full picture of the relationship.

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Send To LOS | Print | Save | Delete | Close

Name: CLO - Working Capital Facility #3

Owner and Deal Team: Rollie Tillman

Relationship:

Current Scenario (2 of 2):

Add Commercial Installment

Amount:

Indicative Fixed Rate:

Payment Type:

Interest Options:

Maturity:

Amortization:

Edit Deal Team

Deal Team:

Name	Region
Rollie Tillman (Owner)	CL - Eastern
David Mendoza	Kentucky
Tom Gilchrist	North Carolina

Add Member / Transfer Ownership: Search...

Name	Region
Alejandro Rangel	Eastern
Alex Habet	Eastern

Figure 4: Deal Team Feature in Q2 PrecisionLender

Deposit Repricing in Q2 PrecisionLender, shown in Figure 5, enables the user to pull an existing account from a relationship and model a renegotiation of the expected balance and interest rate paid, allowing the user to manage deposit betas and protect the best customers in this competitive market.

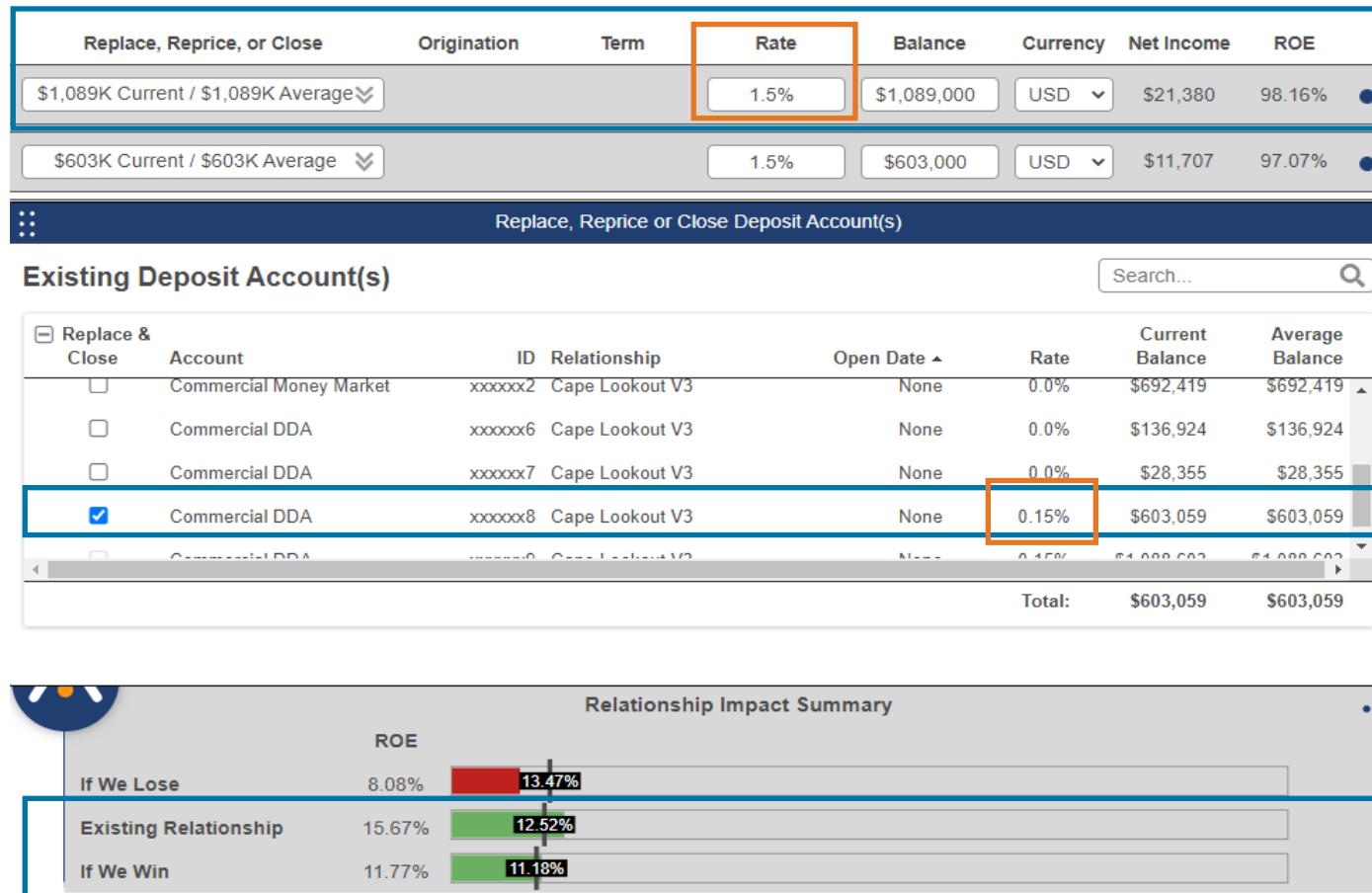
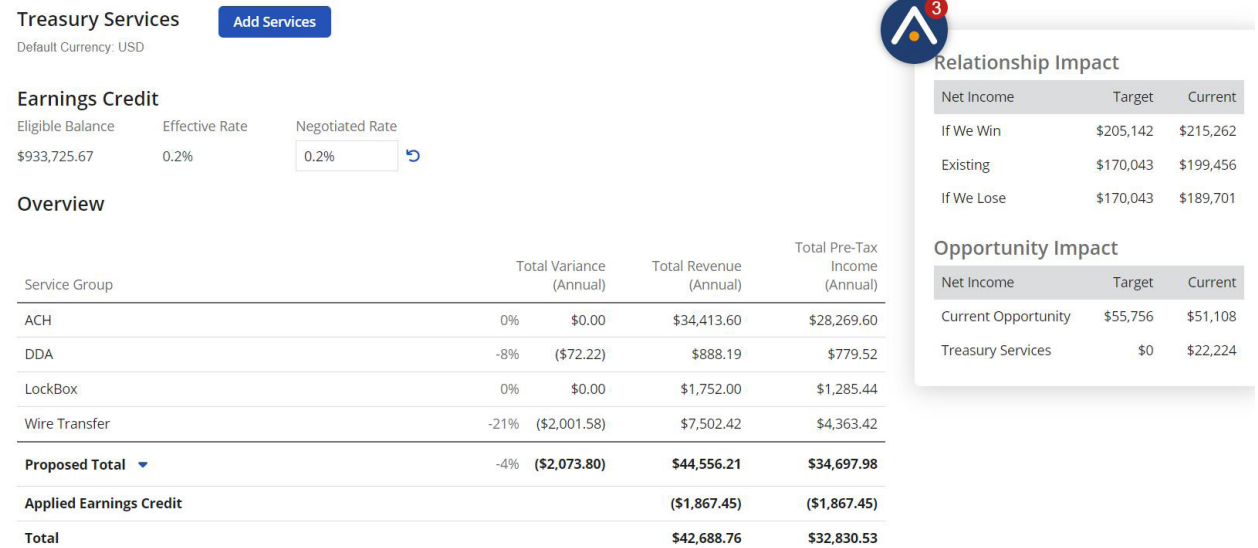


Figure 5: Deposit Repricing in Q2 PrecisionLender

Q2 Premium Treasury Pricing, our unified treasury pricing and relationship profitability solution designed for treasury officers, delivers a seamless experience across business units (Figure 6). This powerful tool helps FIs:

- Understand relationship profitability across all business units
- Align pricing partners to encourage referrals and collaboration
- Leverage contextual coaching and improve user experience

Figure 6: Q2 Premium Treasury Pricing



ACH

Service	Volume (Monthly)	Unit Price	Standard Unit Price	Variance (Annual)	Revenue (Annual)	Pre-Tax Income (Annual)
NEW - Per Batch Fee - G1131	21	\$8.00	\$8.00	0% \$0.00	\$2,016.00	\$1,512.00
NEW - Per Item Fee - G1121	2,000	Progressive	--	0% \$0.00	\$22,197.60	\$18,597.60
NEW - Return Item Fee - J1455	50	\$5.00	\$5.00	0% \$0.00	\$3,000.00	\$2,400.00
NEW - Reversal Fee - G1122	40	\$15.00	\$15.00	0% \$0.00	\$7,200.00	\$5,760.00
Total				\$0.00	\$34,413.60	\$28,269.60

DDA

Service	Volume (Monthly)	Unit Price	Standard Unit Price	Variance (Annual)	Revenue (Annual)	Pre-Tax Income (Annual)
At Risk - Checks Deposited - 91114	4,228.83	\$0.0094	\$0.01	-6% (\$30.45)	\$477.01	\$429.31
At Risk - Debits - 91115	36.17	\$0.02	\$0.05	-60% (\$13.02)	\$8.68	\$5.21
At Risk - Items Deposited - 91112	239.58	\$0.14	\$0.15	-7% (\$28.75)	\$402.50	\$345.00
Total				(\$72.22)	\$888.19	\$779.52

Q2 PrecisionLender is purposefully designed to enable non-technology-focused administrators to manage the configuration and ongoing assumption management quickly and easily, relieving the FI from using Information Technology or Operations resources, or having to hire a third-party vendor to manage the solution.

Deploying strategy at scale is critically important for a financial institution to be able to manage rapidly shifting economic environments, and make changes with agility. As Figure 7 shows, changing pricing configurations can be done with a simple click.

Figure 7: Q2 PrecisionLender Product Configuration

Product Configurations & Defaults

Operational & Market Risk Capital Allocation for Economic Capital:	<input type="text" value="2.0%"/>	of balance	+	<input type="text" value="0.0%"/>	of gross revenue
Operational & Market Risk Capital Allocation for Regulatory Capital:	<input type="text" value="2.0%"/>	of balance	+	<input type="text" value="0.0%"/>	of gross revenue
Use Net Interest Income as Revenue In Operational Risk Capital Calculations:	<input type="checkbox"/>				
Target ROE	<input type="text" value="0.0%"/>				
Float and Reserves:	<input type="text" value="4.0%"/>				
Use Deposit Float and Reserve in Eligible Balance for Earnings Credit Calculation	<input type="checkbox"/>				
Deposit Type:	<input type="text" value="Zero Interest Demand"/>				
Interest Income Calculation Method:	<input type="text" value="Transfer Duration"/>	▼	Duration:	<input type="text" value="60 months"/>	

Product Configurations & Defaults

Operational & Market Risk Capital Allocation for Economic Capital:	<input type="text" value="2.0%"/>	of balance	+	<input type="text" value="0.0%"/>	of gross revenue
Operational & Market Risk Capital Allocation for Regulatory Capital:	<input type="text" value="2.0%"/>	of balance	+	<input type="text" value="0.0%"/>	of gross revenue
Use Net Interest Income as Revenue In Operational Risk Capital Calculations:	<input type="checkbox"/>				
Target ROE	<input type="text" value="0.0%"/>				
Float and Reserves:	<input type="text" value="4.0%"/>				
Use Deposit Float and Reserve in Eligible Balance for Earnings Credit Calculation	<input type="checkbox"/>				
Deposit Type:	<input type="text" value="Zero Interest Demand"/>				
Interest Income Calculation Method:	<input type="text" value="Transfer Duration"/>	▼	Duration:	<input type="text" value="6 months"/>	

See Anything Familiar?

Chances are you may have seen a little of your FI in one of these groups. Whether your deposit balances are expanding or contracting, you should be looking to make some improvements to your deposit growth approach. We'd love to show you how Q2 PrecisionLender can help.

[Request a demo today!](#)

About Q2

Q2 is a financial experience company dedicated to providing digital banking and lending solutions to banks, credit unions, alternative finance, and fintech companies in the U.S. and internationally. Headquartered in Austin, Texas, Q2 has offices throughout the world and is publicly traded on the NYSE under the stock symbol Q TWO.

About PrecisionLender

Q2 | PrecisionLender is modernizing commercial banking. Our sales and negotiation solution empowers bankers with actionable, in-the-moment insights and coaching, so they win better deals and build strong, more profitable relationships. Andi®, PrecisionLender's virtual insights analyst, augments banker strengths and intelligence with the latest technology and data, delivering the best recommendations at exactly the right time. More than 12,000+ bankers at 200+ banks—ranging from \$1B to \$1T in assets—use our solution. Set your bank apart with Q2 | PrecisionLender's applied banking insights. Visit precisionlender.com to learn more.

For more information go to Q2.com or call (833) 444-3469.