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Loan and Deposit Strategy: **Managing the Great Squeeze**

A white paper from the CUNA Finance Council

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Executive Summary

Post-pandemic, the economy is entering a new phase unlike anything seen in decades. The nearest parallel to current conditions of rising rates and substantial inflation dates back to Ronald Reagan's first presidential term. Many finance leaders have no personal experience navigating the headwinds of high rates, changing appetite for loans and intense competition to attract and retain deposits. Meanwhile, low-priced loans issued in response to excess liquidity threaten long-term headaches. Lining up proper pricing and a solid strategy for the months and years to come will be crucial.

This paper will discuss:

- **Evolving** a playbook to deal with tight margins
- **Best strategies** for loan and deposit operations
- **How to think** about alternative funding options
- **Overcoming** organizational silos
- **The related effects** of pressure on non-interest income sources

Introduction

The back-to-back shocks of hot-and-heavy, cut-rate lending during the peak of the economic stimulus and the dramatic climb in the Federal funds rate can already be seen in the data. On an industry-wide level, net interest margin fell to 2.57% in 2022 according to CUNA Mutual Group analysis, the lowest rate on record. The news is not all bad as based on early signals the analysis does project a gradual recovery to 3.1% by 2026.

This is not simply a matter of suspending Friday cookouts or tweaking member dividends. Margin questions and the long-term answers to problems created by underwater investments and low-rate loans are of board-level concern. "If we don't tighten things up, boards are going to start asking about reducing benefits and reducing staff," said Julie Zink, CFO at Marshall Community CU ($306 million in assets and 14,800 members) in Marshall, Michigan.

Credit unions are historically slow to adjust pricing even in the face of familiar and well-understood relationships, such as depressed loan demand and increased demand for savings in a rising rate environment. "So we usually have our largest chunks of liquidity in the lowest point of the rate cycle, and that's flipped on its head when interest rates are rising and we don't increase our loan rates fast enough—or at all, like in 2022," said Andrew Okolski, director of credit union strategies, The Baker Group.

But correcting course will take more than pricing discipline. It will take the application of skills, tools and critical thinking which simply hasn't been demanded of most credit union leaders in a generation or longer. Multiple industry insiders interviewed for this white paper agreed that decades of near-zero Fed funds rates with little variation caused pricing discipline to atrophy among financial leaders. "A lot of the decision-making process kind of went away. Loan rates and deposit rates were all pretty much on autopilot, and it was a race to the bottom in terms of both," said Greg Tomaszewicz, vice president of financial strategies at The Baker Group. "And when the Fed came back so aggressively, there weren't good [pricing] systems in place."

Despite inflation and post-pandemic spending, CUNA Mutual Group analysis based on November 2022 industry data concluded that the average credit union member had an additional $2,609 in savings compared to the pre-pandemic comparable of November 2019. Based on increased spending and a low savings rate, CUNA Mutual Group analysis indicates that balance growth will continue to be slow, but climb from 2022's 3.5% to 6% in 2023. This is still below the 7% long-run average.

Learning to line up and properly price a wider range of liquidity options is not, then, about addressing a present withdrawal crisis. In fact, it's largely motivated by an over-reliance on a time-tested (some would prefer time-worn) method of building up deposits in a hurry. Caroline Vahrenkamp, advisor, market insights and advisory services at Filene Research Institute, is one of the vocal critics of CD specials. "The worst part is that the playbook run by 99 out of 100 credit unions—a CD special, then lending at a rate that's less than you could get in the marketplace—works," she said. "But it puts you in a hole for next time. And that hole is growing because only your older depositing members even know what a CD is."

When the familiar tool isn't the best

Near-zero interest rates meant that the spread between funding sources was usually narrow. This meant that innovation was neither richly rewarded nor strongly required. "For over a decade, you could get away with completely ignoring one side of the equation because the cost of funds was maybe 50 basis points," Okolski said. "The funding side of the equation has been such a non-event for most people for a long period of time, but that was shocked to life in a very aggressive way [by the Fed funds rise]."

The trouble with being complacent in easy times is that it can leave you flat-footed in a crisis. Many of the experts consulted for this white paper concurred that credit union leaders have not paid enough attention to the marginal cost of funds during the Fed tightening. "There's always some amount of hot money sloshing around the economy," said Jesse Schwamb, vice president of financial planning and analysis at Members 1st FCU ($6.9 billion in assets and 541,700 members) in Camp Hill, Pennsylvania. "But if that's all you use, then in times of financial or liquidity stress, there's nothing else to fall back on."

Those staying the course with the familiar specials are running into diminishing returns. Darling Consulting's analysis of institutional portfolios across its Deposits360 bank and credit union data suggests that upwards of 60% of recent CD portfolio growth is reallocation of existing non-maturity deposits to the certificates. "With CD specials up over 4%, you're starting to see cannibalization, and that's really going to have a negative impact on margin," said Joe Kennerson, managing director at Darling Consulting Group. "And with rising rates there will be a real struggle to grow non-maturity deposits, which we forecast to net-decrease on our current Fed trajectory."

This high cannibalization rate suggests that the true cost of specials is much higher than it appears at first glance. "If even one-half of a $10 million, 3% [special] was shifted from member checking or savings, then you only received $5 million in new money and the cost of that money was 6%, not 3%," said Robert Colvin, president and chief strategist of CU Capital Market Solutions. "This is why the marginal cost of funds issue is critically important to credit unions."

> " **The retirement savings in this country is now in the capital markets,** not in insured depositories. You're going to be fighting a losing battle."
>
> **ROBERT COLVIN,**
> **CU CAPITAL MARKET SOLUTIONS**

The fix, then, is to prepare sooner rather than later for a wider range of funds sources, not just with sources but a clear understanding of the pricing and long-term consequences of each. "One of the most challenging situations is when you suddenly realize liquidity is bare. If you haven't started preparing a year or six months prior, it becomes really difficult to manage," said Dave Brandt, executive vice president at ELGA CU ($1.4 billion in assets and 90,000 members) in Grand Blanc, Michigan. "That's why we have multiple sources of backup liquidity in place, so I can look at what makes the most sense for our balance sheet and our interest rate risk position."

And for those still reluctant to move away from the tried-and-true, ask how much that familiarity is worth to the credit union. "Why does it make sense to run a CD special, possibly repricing money you already had, for 40 basis points more than a Federal Home Loan Bank advance, for the same term?" Brandt said.

Whither the "Certificate of Deposit?"

Opinions vary about just how viable the staple certificate of deposit is. After decades of barely-there yields, the product simply has little resonance with younger savers. Vahrenkamp checked the numbers in a survey of established consumers in their thirties and the results were stunning. "I asked Millennials—with mortgages, jobs, families, the works—would you be interested in a certificate of deposit? And it was under 10%, an incredibly low number," Vahrenkamp said. "I also asked if they would be interested in a savings account where, if in exchange for locking in funds for one to three years, they received a rate as much as 10 times higher than a normal savings account rate, which is what a CD is. And 71% said they would love that."

Some leaders choose to keep the existing structure but are moving away from the outdated language. ELGA CD offers a youth-oriented savings product that acts like a CD behind the scenes but avoids the legacy terminology.

"We don't call it a 'certificate of deposit.' We just say that every year or every two years, the rate will change," Brandt said.

Others say that the rising rate environment creates opportunity and responsibility to educate members about savings options which were barely worth discussing in years past. "We want to be partners in building wealth together, but we should also understand that we should be the experts in that," Schwamb said. "We do have a responsibility to explain the depth and breadth and scope of products available and draw those lines between carrying a large balance in a checking account and looking at options and explaining what those options are."

Whatever the strategy, it's clear that credit unions are facing a very different landscape for savings. Retail awareness of options including I Bonds and US Treasuries, along with the option to make TreasuryDirect purchases has skyrocketed. And the dramatic growth in defined contribution retirement plans over the past few decades has shifted money that, before the rise of the IRA and 401(k), might have landed in certificates. "The dynamic has shifted. The long-term savings-and-retirement money has moved to insurance companies, pension funds and mutual funds," Colvin said. "That's what people think of as long-term savings, not putting money in long-term CDs."

With any name and with any price, the future demand for CDs has changed permanently. "A lot of these funds have become inaccessible. People are never going to take money [out of a brokerage account] and take it to your credit union to open a CD," Colvin said. "The retirement savings in this country is now in the capital markets, not in insured depositories. You're going to be fighting a losing battle."

Curbing the loan firehose

Credit unions awash in cash due to pandemic-era stimulus programs and the demand destruction of wide swaths of goods and services made what seemed like a rational decision at the time – they sold loans. A lot of loans. Many of them at very, very low interest rates.

As the economy re-opened and normalized, they kept lending. And when the Fed started to tighten, many kept lending without much mind paid to the steadily rising Fed funds rate, which pushed up the marginal cost of funds outside the existing (swollen) core deposit base. It has been all too common to hear credit union leaders lament in hindsight the day someone in their organization looked at their auto loan rate and the two-year Treasury rate and found little to no daylight in between. "We, like many places, experienced the somewhat-existential crisis of making lots of auto loans at relatively lower rates, and we had to come to terms with that," Schwamb said. "Leadership is seeing the need to return to first principles, make sure all of our pricing decisions are interrelated, especially in this strange confluence of rising rates, strong macroeconomic fundamentals and liquidity concerns."

> " **Dealerships will tell you immediately if you're the low rate** because your volumes double and triple!"
>
> **DAVE BRANDT, ELGA CU**

The imbalance should not have been so difficult to identify. "Dealerships will tell you immediately if you're the low rate because your volumes double and triple!" Brandt said.

To dig out of danger, ELGA CU charged the indirect auto channel higher rates than members for the first time. "Yes, it's [caused] a bit of pushback from dealers, but our non-member rate is still fair in the market, and our member rate represents the value we want to bring to membership," Brandt said. "And it helps change the volume because we're no longer getting all the loans!"

Some say that pricing correction is not enough and that credit unions need internal controls that specifically guide staff to lend in support of liquidity and concentration goals, avoiding rewarding and incentivizing unmarketable loans. "We can't do mortgages at a loss. No one gets paid if [the institution] doesn't get paid," said Charles McQueen, president and CEO of McQueen Financial Advisors. "In a commission-based job, you get paid well in the good years. It all nets out."

This course means shifting away from compensation based solely on origination volume, or controlling for volume by being more active about putting staff in margin-generating lines of business. Zink said that Marshall Community CU has both changed incentive structures and transitioned some mortgage staff into commercial lending to encourage higher-margin outcomes. “We need to put the loan team in a position to add healthy volume, with enough margin and spread to allow the deposit team to pay the rate they need to keep funding coming in,” Okolski said. “When their job is volume, you can end up 200 basis points below market. There’s a disconnect.”

McQueen thinks that despite some clear efforts in this area, credit unions are still underpricing their mortgages based on an assessment of incremental cost of funding. Starting with a 500 basis point cost of funds as of this writing, he recommends setting loan levels based on a true price should reflect these considerations, adjusting these benchmark values to reflect the true costs at the originating institution:

50 bp for servicing
50 bp for CECL considerations
100 bp for return-on-asset target margin
25 bp for commission

“So that’s 7.25%, and that’s the neutral rate. You won’t see loans grow dramatically but they won’t slow too much. If you have too many loans, go up. If you’ve got a lot of money to spend, go down. But you have to build up a process that looks at these incremental costs,” he says.

Closing the valve now can’t change the circumstances of loans issued a year ago, but the discipline should carry through to the next rate cycle. “That double-digit loan growth caused a liquidity crunch. With those lower rates the loans weren’t marketable, closing a potential avenue for liquidity,” Tomaszewicz said. “We need to look at this as an industry and get everyone on the same page. Changing volume leads to the greater benefit of the credit union in the long run.”

Why non-interest income pressures increase margin's importance

Pressure on non-interest income sources from members, competitors and government bodies only heightens the need for aggressive margin management. In particular, both interchange fees and NSF revenue are under heavy fire with courtesy pay/overdraft and late fees also coming under greater scrutiny and pressure. The results are already visible on the industry's balance sheets: Non-interest income is down 12.8% over the four quarters ending Q3 2022, according to NCUA data.

There are still non-interest income sources left to tap, particularly those which can be marketed as add-ons to existing loans. "Few people like dealing with car dealers, so credit unions offering things like extended warranties and other types of coverage is a way to cross-sell in a soft manner while providing members with products they can use and make them feel better," Tomaszewicz said.

Other financial services can be spun up or expanded to attract and retain new sources of revenue. "I like the insurance business; everyone needs insurance. But it's a tough one to do. And you can put an investment program in your lobby because especially as membership ages and grows, there will be revenue there," McQueen said. "Growing into those areas carefully can help offset some of your lost income from other areas."

But especially for smaller credit unions, the reliable diet of once-generous interchange fees can be difficult to replace. "Even if I sold insurance, and wealth management, and trust services, and other add-ons at a great clip, I'm still not going to come close in volume to the value of interchange income," Brandt. "So after you're optimized all those channels, you're still back to needing great margin management."

A revised playbook to deal with pricing imbalances

Pricing is a complex matter, but for a quick rule of thumb, consider that your pricing models may be inadequate to current challenges if your organization is not keenly tracking:

- **Your CU's** prices relative to market rates and spreads
- **Your** marginal cost of funds across multiple funding sources
- **The magnitude** of heightened credit risk as the economy is set to slow
- **The current** inverted Treasury yield curve and the inevitable reversion to the normal relationship between rates and term

Margin deserves additional attention but is only the beginning of a robust playbook. "Cost of funds versus your loan rate should be the first thing to look at, but you need to consider other expenses, everything from loan origination to chargeoffs," Tomaszewicz said. "And rarely have I seen institutions keep good tabs and have continuous discussions on how they're doing on pricing strategies, on their credit tiers and on their risk-based pricing contributing to profitability."

These assessments, ideally, should happen daily. "Even daily it's a challenge, given how fast interest rates are changing and risk profiles are changing," McQueen said.

Pricing on the deposit side is a particularly tricky business today because it's easy to overshoot on core deposit prices. (See "Buying high to sell low?" sidebar) Institutions should target CD rates very carefully to term needs and consider that seasonal effects are potent in the certificate market. "Try really hard not to have your specials mature in the first quarter because that's already a really competitive time for CDs," Brandt said.

Institutions also need to use finer measurements to understand when deposits are leaving (or never landing) due to non-competitive rates. Churn simply looks different in the digital age. Most lost opportunities lack the drama of account closures as they did in generations past.

Consumers are much more acclimated today to juggling accounts across several institutions, aided by digital conveniences and aggregator logins.

On the lending side, credit unions should consider whether fixed-rate products are as sound an avenue as they were during the long, stable, near-zero Fed funds era. This could mean a rethink of new issuance of fixed-rate credit cards in favor of variable-rate products. And speaking of variable-rate products, it's no coincidence that HELOCs are back in vogue. "Credit unions like them in a rising rate environment because they usually adjust every month, and we've measured a 50% growth in HELOC over the past year," said Steven Rick, CUNA Mutual Group chief economist. "It's literally off my charts."

Revising the playbook may feel like a fundamental shift away from the mission for credit unions which have taken pride in razor-thin margins and a commitment to efficiency. In these cases, think of a new focus on margin as an investment in sustainability. "A lot of smaller credit unions think that keeping share rates higher and loan rates lower is the way to benefit their members," Tomaszewicz said. "But at the end of the day, if the balance sheet's not growing and not healthy, we may not exist long enough to benefit that member."

Buying high to sell low?

According to NCUA's Q4 2022 summary of credit union and bank rates, credit unions continue to pay more for most deposits while charging less for most loans. On all CD products, ranging from 3 months to 5 years, credit unions paid from 16 bp (3 month) to 75 bp (5 year) more than banks. On money markets, interest checking, and regular savings the results were closer, with credit unions on average paying 40 bp on money markets to 31 bp at banks, but paying slightly lower rates than banks on checking (10 bp vs. 15 bp) and savings (14 bp vs. 22 bp) products.

When making changes in core deposit pricing, it's best not to make large moves all at once. Consider the competitive environment carefully: the national average for savings accounts is under 25 basis points as of March 2023, and the largest banks in the nation pay just one or two basis points. "Fintechs and online banks offer more, because they have to as people aren't used to banking with them," Colvin said. "Don't get too excited about raising savings rates, as most depositors are most interested in accessibility and convenience of funds. Focus on your CU's earnings, and compensate your members through attractive dividends."

On home equity loans and most mortgage products credit unions and banks were within 10 bp or less, but the CU average of 4.89% on a 1 year ARM notably undercuts the average bank rate of 5.4%. But for unsecured loans, credit cards, and both new and used car loans, credit unions undercut bank averages by greater than 100 bp in many cases:

Product	Credit union national average rate	Bank national average rate
Credit card, classic	11.96	13.34
Unsecured fixed rate, 36 mo	9.66	10.4
Used car, 48 mo	4.79	5.86
Used car, 36 mo	4.67	5.81
New car, 60 mo	4.47	5.53
New car, 48 mo	4.61	5.45

Source: NCUA

New benchmarks for new challenges

One of the most important tasks in this new era of heightened pricing challenge is to evaluate the current slate of rate benchmarks used by the institution and refresh or replace them when necessary. Rick notes that a common fix is to expand the usable range above and below a favored index. For example, a credit union which might have priced a money market in a spread 80-120 basis points above or below a three-month treasury might expand that range to 70-130 basis points plus or minus. "The inverted yield curve is really messing with all deposit pricing models," Rick said. "You might normally index off a three-month Treasury minus one percent, but the three-month Treasury has really shot up and it's going to push up the cost of your funds dramatically, especially if you're paying it on money that isn't rate-sensitive."

ELGA CU found as the mortgage market shifted that its rates were not keeping pace because its benchmark didn't accurately reflect the fast-changing circumstances. Some of its mortgages were under-market by as much as 150 basis points, which was sustainable in the short run because the institution planned to hold rather than sell them. To get back in line with the market, ELGA CU dropped its old benchmark based on secondary market rates and now builds its spreads based on the 10-year Treasury rate.

And even as nationwide data is easier than ever to obtain, some benchmark retooling should become more local. Where robust, formal data is difficult to obtain, eyes and ears on the ground can be invaluable. When University of Michigan CU merged with a Flint-market institution, pricing was imbalanced in the latter because the home market of Ann Arbor is different in meaningful ways. "Frontline team members belong in the meetings discussing changes to rates because they hear and see things on the frontline that add a lot of value," said Tom Kuslikis, vice president of accounting and finance at University of Michigan CU ($1.3 billion in assets and 115,800 members) in Ann Arbor, Michigan.

New tools and roles for a new era in pricing

Be sure to ask partners and processors to share their own data and analytical tools to help inform your pricing decisions. "Core processors have become better at providing performance data, so you can analyze and pinpoint performance across all of your credit tiers and against peers," Tomaszewicz said. "And when you can do that, you don't have to just raise all of your auto loan rates by 25 basis points; you can see exactly where your pricing strategy makes sense."

Members 1st FCU has increased the frequency and depth of its trend analysis and deep dives into inflows and outflows to inform pricing decisions. The charts today look much like equity technical analysis with a focus on rate-of-change indicators and not just direction but strength of moves in volume, pricing and demand. "It's giving us a better sense of what the real deposit elasticities and pricing sensitivities are so we can make decisions not from anecdotal evidence but from data, with high conviction and great comfort rather than reacting to markets and looking at competitive rates," Schwamb said.

As an alternative to higher deposit rates, consider introducing or expanding patronage dividends, which reward broad and stable relationships with special bonuses. Typical triggers include online account activity, higher volumes of debit card and electronic wallet transactions and participating in a spectrum of both deposit and loan products. "[As an industry] we've largely kept deposit rates low so that depositors really haven't benefited, but the bonus dividend is a better way of doing that," Tomaszewicz said.

Another alternative to higher core deposit rates are non-interest incentives like reward points. Partner programs exist to help even small credit unions implement and maintain rewards programs, but the sledding ahead looks tough because financial market disruptors play this game at a high level. Colvin points out that both Amazon and Walmart already offer in-store reward points on prepaid and/or debit card products and that Walmart has a massive advantage both in physical branch presence and sheer number of DDA accounts.

Rather than solving discrete problems on short-term products, step back and consider a new pricing playbook the beginning of a new statement of business goals. "Start with the five-year strategic plan – how fast you want to grow versus what you want earnings to be. That's the start of your pricing decisions," Rick said.

Consider meeting the new challenge with a new commitment to leadership focused specifically on deposit products.

"Most institutions have a VP or a chief lending officer who manages the lending side of the business. But most institutions do not have a similar figure on the deposit side," Vahrenkamp said. "Maybe deposits are run by marketing, or the CFO, or operations. And as a result we see lending decisions made without taking deposits into consideration at all until the CFO looks at the balance sheet."

(Over-)preparing for liquidity squeezes

Whether underwater investments, below-market loans, or just a wary eye on the inverted yield curve is putting your institution on alert for sources of funds, our sources were clear: Credit unions must have options beyond the core depositor to ensure adequate liquidity in the months ahead. "Credit unions can no longer rely on 10% of members providing 90% of deposits, which is what a lot do right now," Vahrenkamp said.

And aside from the concerns about overpaying for deposits, the fact is that in a rising rate environment, alternative sources can be competitive or even less expensive than the search for more core member deposits. "The largest benefits of non-member sources of liquidity, whether borrowing from FHLB, corporate borrowing, selling loan participations or non-member deposits, is that you have a set rate and zero risk of cannibalization," Okolski said.

Kennerson agreed. "If you're holding a lot of cash due to internal guidelines, or if your liquidity policy is very limited in terms of wholesale funding options, I think you really need to revisit," he said. "Yes, some of the wholesale short-term funding option costs don't look pleasant relative to what we were used to over the past 15 years. But a CD offering that isn't structured correctly could cost you double when you account for high levels of cannibalization."

"I'm over the hot money game, pulling in millions of dollars over two weeks, then all of it matures at the same time and it goes right back out the door," Zink said. To meet liquidity needs in recent months, she has instead chosen to sell off a minority of Marshall Community CU's investment portfolio, with wholesale funding still left on the table for possible future use.

To be comprehensively prepared for its ongoing $10 million average in monthly liquidity needs and to insulate against shocks, ELGA CU took several steps. A corporate credit union line of credit and investment portfolio are now among the liquidity options in play, and the institution recently increased by a factor of six the amount of mortgage loans pledged to FHLB. "In fact, we have at least three places we can go to and have up to $30 million deposited within a couple of hours," Brandt said.

Make a daily comparison of wholesale funding options including FHLB and brokered deposits in comparison with loan rates, and consider whether incentivizing more member savings through higher rates makes sense. Catching up with the membership through later rewards may be the stronger play. "If we can supplement with other sources to meet our liquidity needs and then put dividend checks in the hands of our members, then that's what we'll do," Schwamb said.

Learn about new or under-explored types of deposit products. Health savings accounts can add deposits at the margin as well as contribute non-interest income. Emerging sources of non-member deposits, including consolidated money market accounts, are growing in popularity for credit unions which qualify. ELGA CU, a CDFI and low-income-designated institution, uses both the consolidated money market and a variety of brokered CD partners for non-member deposits. "If we need longer money, we compare the Home Loan Bank versus Depository Trust Company (DTC)-eligible CD, and even sometimes our corporate credit union has a loan special that makes sense," Brandt said.

Be careful about over-concentrating on any one new source of funds. "Credit union borrowing [at wholesale] is up 220% over a year ago, which is incredible, and we've never seen anything like it in a 30-year period," Rick said. "They're going to have to sell investments below par to keep deposit drawers stocked if withdrawals start to exceed repayments."

Thoroughly explore wholesale options before turning to secondary capital markets for liquidity. "Secondary capital can be a wonderful thing, but it's meant to cure net worth issues with [otherwise] good, healthy, profitable growth," Okolski said. "It's not really designed to be a funding answer. But some people are out there paying 8% or more on secondary capital. It's one of the worries I have for the industry."

Catering to a new kind of saver

Even in an inflationary environment where members may be catching on with pandemic-deferred spending, there are still ways to bolster core deposits. It will require new discipline and messaging, and above all consistency. "It takes focus to ensure that every member has a checking account with you, that you have good penetration of your money market or savings, whichever your institution likes best," McQueen said. "And it takes hard work to make sure you've asked for additional deposits from all your members. This is a long term, years-long process."

Savers haven't had much to get excited about for over 20 years. The issue today is not that most credit unions are paying princely sums on regular or draft shares or money markets; those rates were well below 50 bp on average at year's end even as the federal funds rate pushed rapidly past 400 bp. But certificates are notably more generous at the average credit union than the average bank. And although the difference in lending rates has narrowed somewhat, credit unions continue to charge markedly less than banks for most non-mortgage loan products. (See "Buying high to sell low?" sidebar).

Credit unions are currently able to offer low rates on non-maturity products roughly in line with banks (see box) but Darling Consulting shared projections that on the expected Fed trajectory, costs on non-maturity deposit accounts will double over the near term. Nevertheless, leaders should avoid overcorrecting on deposit pricing based on the first few months of 2023 activity. Consider waiting until at least Q2 and Q3 are in the books before making a dramatic move. "Q1 will have tax returns and everything of that nature. Q2 and Q3 will be a good measurement of whether we are back to 'normal' or if there's a dreaded 'runoff,'" Okolski said.

Retaining and growing deposits today takes an expanded understanding of member behavior. Identify, based on demographics as well as balance patterns, which deposits specifically are at risk and create campaigns to shore those up. Understand flows between products, quantify cannibalization and think about targeting member communications more precisely than ever before.

Specifically, deposit pricing going forward needs to reflect an understanding of which deposits are truly core and will tolerate a low rate and which are going to rate shop. "There are more potentially volatile deposits, particularly high balances, members over the insurance limit, those with interest in higher-tier products and those with certificates set to mature soon," Tomaszewicz said. Know which need incentives and which will happily tolerate a below-market, margin-friendly rate.

Keeping in mind that an entire generation has come to adulthood at a time when savings was barely compensated, financial services leaders should look for innovation between youth products and high-end wealth management. Younger adults making their first financial strides don't have the same connection to traditional savings products as older generations, and the attractive yields today are not found in depositories. "I think we're all missing an opportunity in the middle. How can we serve someone who might want a $5,000 Treasury? A wealth management department doesn't really want to spend the time to sell a $5,000 Treasury," Brandt said.

Many deposit strategy improvements are unrelated to pricing. Credit unions can better compete without touching yield by making it easier to start or expand the relationship. Even the fintechs frequently win based not on price, but rather on convenience. Members 1st FCU recognized that friction was far more significant than yield.

“We had a large number of steps to open an account online. It was cumbersome with lots of hurdles,” Schwamb said.

A marketing and product development team worked on the problem, collapsing dozens of steps down to just three. This greatly speeds the enrollment and membership process without changing the underlying cost to acquire and service the member. “We know once you’re here, you’re going to be well-taken care of and be in our ecosystem,” Schwamb said. “But people have to be able to get to the point where they have a willingness to try.”

Reinforcing strategy with communication and consistency

Revised pricing strategy needs leadership from the top, with frequent communications and much broader involvement in discussions and execution than ever before. "It takes someone leading that conversation and pushing the focus to have everybody understand that all of our jobs are in balance sheet management," Schwamb said.

The credit union leaders making these decisions today recommend employing several different types of messaging based on the audience. Some tangible examples:

- **Discuss spreads with lending officers** by directly showing competitive market rates as well as showing the cost of funds.
- **Cite struggles faced by competitors,** such as Capital One's decision to reduce auto lending and directly cite unusually low credit union rates as a key motivator.
- **Explain the need for healthy margins** using tangible inventory and cost-of-goods-sold as an analogue.
- **Address dire predictions with information** about actual outcomes, either from the credit union's own past or from peer institutions. "Our indirect department was very worried that if we lifted rates, it would ruin relationships. It didn't ruin anything," Brandt said.

Repetition as well as multiple perspectives can help people with a range of perspectives and experience catch on. "It really changed the narrative to walk the lending team through our calculations, showing how our cost of funds went from 20 basis points to now paying 4.5% for FHLB advances after liquidity dried up," Kuslikis said.

Communications strategies also need to consider how much the workplace has changed since the last rising rate environment. "Today, all of our back-office folks are remote, so it's not as easy as walking down to the CEO's office to talk about pricing strategies," Kuslikis said. "We've had to be very diligent about communication, coordinating on text and emails and phone calls almost every day on rates, especially on the lending side."

Tomaszewicz said the time has come to completely reimagine the ALCO team, with more rapid turnover and representation from a wider range of functions to get more credit union employees invested and informed in the decision-making process and its impact on the organization. "ALCO is the biggest example of a silo in credit union operations, and so it falls victim to miscommunication," he said. "Traditionally the focus has been solely on the origination side of things. ALCO needs to focus on the whole picture, including long-term interest rate risks, and pursue prudent courses of action that loan officers may be hesitant to employ."

> “ **Especially for smaller credit unions,** there’s this idea that we have to get to a 100% loan-to-asset ratio; that’s how we know we’re doing our job.”
>
> **GREG TOMASZEWICZ, THE BAKER GROUP**

The strategy should include messaging that getting the right products into the market is not just about pricing but also includes asking for the business at the right times. “This can be tricky in the credit union space, where a lot of front-line employees don’t like the idea of cross-selling products; that’s thought of as being a bank activity,” Tomaszewicz said. “But you need those employees to offer information to the membership, especially to educate them across multiple types of deposits.”

Expect to need reinforcement time, and don’t be shocked when there’s backsliding. “We met with our loan officers; they all said they understood why we’re raising rates and what we need to do. Two days later, I got a request to match a 1.99% loan rate. And I’m still asked if we’ll match CD rates from the Bank of Puerto Rico!” Brandt said. “It has to be frequent with different voices and different stories.”

And leadership must be ready to put pricing decisions into place and hold the line. “I can’t tell you how many board meetings I’ve sat in where the organization wants to raise rates, but the people responsible for indirect lending scream and yell, and then the CFO doesn’t make a decision,” McQueen said. “As a leader you may upset people every day. You can explain why you’re upsetting them, why it’s the right thing for the organization and then you move forward.”

Conclusion

Few on today’s senior leadership team have been tested by a true rising rate environment with meaningful inflation. Past won’t necessarily be prologue, so use the data-driven tools of today to tackle the challenges. “Subscribe to rate surveys. Do statistical analysis on your own historical data to determine whether raising your rates brings new money in or results in cannibalization,” Rick said. “It’s like the old saying about driving without headlights. If you don’t have data, you’re just making decisions without knowing where you’re going.”

Schwamb agrees. “Why are people putting money where they’re putting it? What are their demands, their concerns? What do they need the money for?” he said. “We need to tease that out and discern underlying behaviors, not just slap a rate on something.”

Recognize that the long-term effects of changing demographics and competitive pressures can’t be addressed by margin alone. “An important way to keep net income strong will be to drive your expenses down and really drive efficiency,” Kuslikis said. “We’re going to need to keep the human element in some transactions, but robotic process automation and AI can help you turn out an auto loan much faster, and that’s going to help everyone stay competitive.”

And finally, walk the belief that adjusting pricing and—yes, even actively seeking larger margins—is not a betrayal of the credit union mission. “Especially for smaller credit unions, there’s this idea that we have to get to a 100% loan-to-asset ratio; that’s how we know we’re doing our job,” Tomaszewicz said. “That’s just not true anymore. We don’t need to overload our balance sheets. We can strike that balance, and we can end up performing better as a result.”

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