



Profitability Of Deposits And The Yield Curve

by [Steve Brown](#) Topics: [deposits](#), [customer profitability](#)

Summary: To understand the potential impact of the yield curve these days, we took a look at some results from our relationship profitability model used by hundreds of bankers nationwide.

Understanding curves of all sorts can be challenging or it can be relatively easy. After all, curves can be simple, compound, reverse, transition, spiral, sag, crest, parabola, cycloid, hyperbolic spiral and others. There are just all sorts of curves out there.

In banking, profit and performance can be rocked by market movement, so the yield curve is one of the most closely watched of all types of curves.

To understand the potential impact of the yield curve, we took a look at some results from our [relationship profitability model](#) used by hundreds of bankers nationwide.

As we conduct training on our profitability model, one of the most common questions bank users will ask us is how to calculate the profitability of deposits.

This is tricky because we all know there are up-front costs associated with opening an account, as well as ongoing maintenance. We also know some institutional costs are better shared by larger deposit volumes. So, for a deposit to be profitable, those costs (overhead) must be overcome by the reinvestment value of those balances.

Whether or not this is possible is related directly to the overhead costs of your bank, as well as the size of the deposit and interest rates. We have data that strongly supports the premise that there is a "floor" to overhead costs - those costs do not drop below a certain level, regardless of the deposit balance. So, smaller deposits can sometimes be more costly on their own.

Another important driver of the profitability of deposits relates to duration. Recall that duration measures the sensitivity of your assets or liabilities to changing interest rates.

One way to increase the profitability of deposit accounts is to keep your customers for a longer period of time. When a bank increases the depth of the relationship with a customer (i.e. increases the number of products that the customer has with your bank), it becomes far less convenient for them to leave.

Then, when competition becomes tougher, having more hooks into customers is in the end more profitable. Incremental increases in the profitability of deposit accounts come from features like internet banking, which can extend the expected life of the account by 6 to 8 months in one example. Add a debit card or ACH on those retail accounts and you can extend the life of a deposit too. That not only addresses duration, but also extends the length of time a customer will stay loyal, despite any change in rates. That makes these deposit customers the most profitable.

To win the fight of gathering and retaining deposits, know it never ends, so patience is critical. Remember that rates always move up or down, and customers are always fickle. So trial and error testing is just part of banking no matter the shape of any particular curve in question.

ECONOMY & RATES

Rates As Of: 08/08/2019 10:10AM (PDT)

Treasury	Yields	MTD Chg	YTD Chg
3M	2.02	-0.04	-0.34
6M	1.97	-0.10	-0.51
1Y	1.79	-0.19	-0.80
2Y	1.63	-0.24	-0.85
5Y	1.58	-0.25	-0.93
10Y	1.77	-0.25	-0.92
30Y	2.30	-0.23	-0.72
FF Market	FF Target	Fed Disc	
2.12	2.25	2.75	
SOFR	Prime	Unemp	
2.10	5.25	3.70	

[More Market Rates](#)

BANK NEWS

ATM Risk

Bank Director reports about 95% of ATMs in the US run on Windows 7 which will no longer be supported by Microsoft starting in January 2020.

CEO Thoughts

KPMG recently surveyed top US CEOs and found: 81% plan to pursue inorganic growth including M&A and strategic alliances; 77% believe that they could improve their understanding of their customers; 63% agree that over the next 3Ys they need to improve their innovation processes and execution.

Biz Customer

Bank of America research finds small business owners use the following technologies to communicate with their customers: email response to inquiries (63%), social media (37%), website feedback portal (27%) and newsletter updates (22%).

OUTSOURCED PROFITABILITY SOLUTION FOR YOU

Profitability FIT is an [outsourced relationship profitability solution](#) that combines a powerful pricing model with full-time advisory support. Contact us today for more information.

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