



DEPOSIT GROWTH

# INSIGHTS



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Banks face a challenging environment for deposit growth, despite a recent cut to the federal funds rate and expectations that rates will lower further by year-end. To maintain their profitability, banks are getting selective about deposit rates and putting relationship growth at the forefront of their strategies.

### KEY METRICS



49%

**49% of bank leaders said they paid incentives to bankers for growing deposit relationships.**

*Source: Bank Director's 2024 Compensation & Talent Survey*

79%



**79% of bank leaders reported increased concern about interest rate risk in 2024.**

*Source: Bank Director's 2024 Risk Survey*

### KEY TAKEAWAYS

- The banking industry is facing a tough environment for deposit growth; U.S. banks have seen net deposit outflows in all but two quarters since the Federal Reserve began raising interest rates in March 2022.
- Core deposits tend to be cheaper than brokered deposits or wholesale funding, making them key to bank profitability.
- Due to higher rates, consumers have shopped around for better returns on their deposits, easily moving their money to competing institutions.
- Some banks reward staff who grow deposit relationships as part of their overall incentive package.
- Other strategies include selectively raising deposit rates for particularly valuable clients or specializing in niches that tend to be large depositors.

**Since it was founded in 2005, Birmingham, Alabama-based ServisFirst Bancshares has rewarded its commercial bankers for growing deposit relationships, not just loans. The \$16 billion bank's leadership team made a decision on day one that they would fund the bank mainly through core deposits, rather than relying heavily on wholesale funds or brokered deposits.**

"We deem core deposits as one of the most critical – if not the most critical – factors in the franchise," says Chief Operating Officer Rodney Rushing.

Higher interest rates have created a tough deposit environment, with the effective federal funds rate topping 5% beginning in July 2023. Since the Federal Reserve's rate increases began in March 2022, the banking industry has experienced quarterly declines in deposits, with the exception of the fourth quarter of 2023 and the first quarter of 2024, according to the Federal Deposit Insurance Corp. Altogether, that adds up to a total loss of roughly \$1 trillion in deposits.

Not so at ServisFirst, which grew deposits by 8% year-over-year in the second quarter while holding deposit costs steady. That growth has come through emphasizing relationships as well as key in-market niches, something ServisFirst has in common with other banks seeking to grow deposits while managing costs.

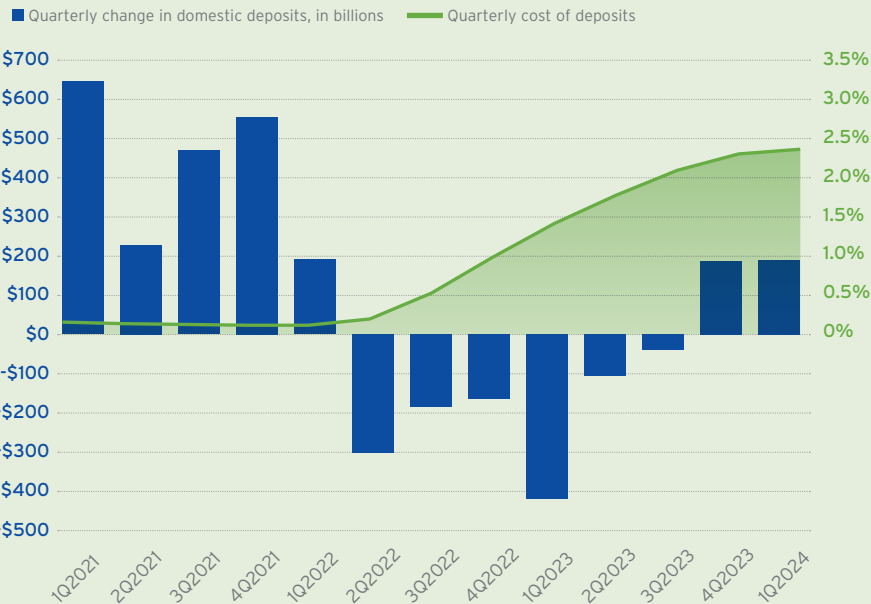
Deposit costs are admittedly higher at the bank compared with the industry average of 2.37% as of the first quarter, according to the FDIC. ServisFirst, a commercial bank with a significant correspondent banking business, tends to pay higher rates on deposits, averaging above 4% on interest-bearing deposits in 2024 through June 30.

ServisFirst's strategy includes specializing in client niches that tend to be "net depositors," such as churches, foundations and charities, says Rushing. "You have to offer a package of products to be able to compete in that space."

## Losing Deposits but Paying More

### Quarterly change in domestic deposits versus cost of deposits

Source: Federal Deposit Insurance Corp.



## Changing Consumer Behavior

Core deposits are key to bank profitability. They're usually cheaper than brokered deposits or wholesale funding. While the Fed cut the federal funds rate by 50 basis points in September and signaled its intention to lower rates further this year, it remains easier than ever for consumers to move their deposits if they don't like the rate they're earning.

"The consumer depositor has probably forever changed as far as expectations on rate and shopping for rate," says Dan Flaherty, managing director in the financial institutions group at Janney Montgomery Scott.

And while the Fed's recent rate cut should relieve upward pressure on deposit pricing, it could still be a while before banks see significant relief on funding costs.

"Unlike assets, deposit franchises take a long time to build," Flaherty says. "The deposit base will continue to drive value for banks going forward, whether they're

public or private, whether they want to be traded or they want to be sold. The value of deposits is critically important."

## Making Smart Decisions

Like ServisFirst, more banks are rewarding commercial bankers who grow deposit relationships. Almost half of respondents to Bank Director's 2024 Compensation & Talent Survey offered incentives to commercial bankers for bringing in new deposit relationships, compared to 42% a year earlier.

In some cases, bankers find it necessary to raise a client's deposit rate in order to keep that relationship and the deposits that come with it. But some banks have become more selective about those decisions — even if that means losing a depositor who's only there for the rate.

NBT Bancorp in Norwich, New York, built an internal tool to help its employees make better informed decisions on deposit pricing, says Scott Kingsley, CEO of the \$13.5 billion bank. The tool shows

bankers a profitability matrix for each client, providing a clearer picture of their relationship.

"If you had an institutional customer, like a college or university, you might offer them a slightly higher rate to keep their deposits on the balance sheet," he explains.

With more expected cuts from the Fed, Kingsley anticipates NBT will lower the interest rate paid on higher-yielding deposits by a bit more than 50 basis points. Though he expects some pushback from clients, he also believes long-time customers will generally understand that those rates would not be sustainable in the long term. "The discussion we've been having with our customers leading into this is that when rates come down, we'll have to follow suit and bring our rates down on our deposits," he says.

Specializing in certain niches may also translate into a competitive benefit. Roughly 10% of NBT's depositors are municipalities, which tend to hold larger balances in operating accounts and are often large employers.

As deposit growth comes to the forefront of banks' overall strategies, Flaherty reports seeing more banks add titles like chief deposit officer or chief treasury services officer. Banks have also made a concerted effort to ask customers for deposits when underwriting new lending business — for example, by offering a more favorable interest rate on loans to clients who also bring over deposits.

"Banks got away from that in the last decade," Flaherty observes, "and that's really come back."



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