

THE ART OF POSITIONING

## bancography

BRANCH PRODUCT RESEARCH BRAND

After years of deliberate balance sheet restraint and even contraction, many markets are seeing ample potential for growth in markets with robust commercial loan demand.

## Outlook 2019: Deposit and Demographic Trends

For our initial *Bancology* issue of 2019, we examine some of the trends in the banking environment overall and specifically in branching over the past several years, and the implications of those trends. The branch statistics that follow reflect FDIC and NCUA data releases as of June 30, 2018, the data on consumer balances reflect the Federal Reserve Board's December 2018 Flow of Funds Accounts tables, and the household and population counts reflect U.S. Census Bureau 2018 releases.

### Deposit Growth

At most institutions, the fundamental role of the branch network is to gather deposits, so deposit growth offers an apt starting point for discussing the current banking environment. From that perspective, last year's data raise alarms. Across all U.S. bank and credit union branches, retail and small business deposits grew by 3.3% over the past year, the lowest growth rate since 2014. Overall deposits (the prior total plus corporate and public funds balances) grew by 4.0%, the lowest pace since the trough of the recession in 2010. The lagging deposit growth rates may reflect competition from a robust stock market, fatigue at rates that — even after modest increases — remain near historic lows, unusually tepid real (versus nominal) wage growth given the low unemployment rate, and businesses drawing down

cash supplies for investment during a strong economic period. But that favorable economic environment has boosted loan demand, too, rendering deposit growth imperative to maintain safe liquidity levels.

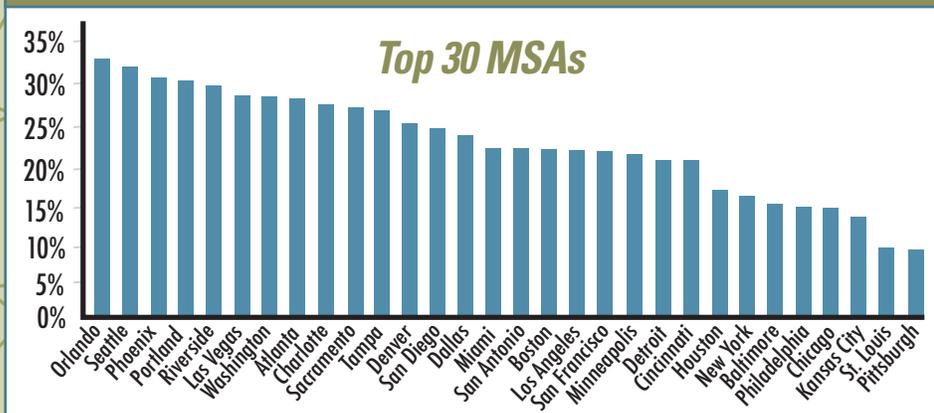
One immediately apparent impact of the historic low-rate environment is evident in the erosion of CDs from consumer deposit portfolios. In 2000, CDs comprised 42% of U.S. consumer deposits and as recently as 2008 consumers held 38% of their bank deposits in CDs. But the recession ushered in a precipitous decline in CD preferences, and by 2016 consumers had reallocated their balance sheets such that only 14% of their deposits were in CDs. The trend away from CDs finally reversed in 2017, inching upward to 15% that year and 16% in 2018, suggesting bankers may need to start paying greater attention to their competitive positioning for that product type than in recent years.

The trend of lower deposit growth occurred across the nation, with 26 of the 30 largest metros showing lower deposit growth rates in 2018 than in 2017. Performance varied across markets, with Orlando, Atlanta, and Washington DC posting deposit growth of more than 6% over the past year, even as growth lagged at 2% in St. Louis, New York, and Philadelphia. That noted, at the individual market level anomalous events can skew a one-year total, leaving a longer-term view more indicative. Over the past four years, Orlando showed the top deposit growth among the large metro peer group (as it did in the last year), with its deposit base growing at a 7.3% compound annual rate from 2014 to 2018. But the next-ranking markets differed from the one-year result, as four West Coast metros, Seattle, Phoenix, Portland, and Riverside, followed behind Orlando.

Although the Northeast corridor continues to host the greatest concentration of population in the U.S., Washington was the only metro in that region to rank above median in four-year deposit growth. Boston ranked slightly below median, while Baltimore, New York, and Philadelphia all ranked among the bottom-ten markets in deposit growth, each with four-year deposit CAGRs in the 3.0% - 3.5% range.

*(continued on page 2)*

### Deposit Change % (2014-2018)



Changes in consumer channel preferences have reduced in-branch transaction demand, allowing modest branch consolidations in recent years. However, a closer examination of recent branch closings confirms most are still targeting either overlapping branches or outlying offices carrying balances below profitability thresholds.

## Outlook 2019: Deposit and Demographic Trends *(continued from page 2)*

Credit unions showed stronger deposit growth than banks in recent years, increasing retail and small business deposits by 6% over the past year and at a 6.4% annual pace over the past four years. Within the bank side of the industry, large institutions, defined as those with assets greater than \$100B, posted 4.3% annual deposit growth from 2014 - 2018, compared to 3.7% for the less than \$1B and \$1B - \$20B tiers, and 2.8% in the \$20B - \$100B tier. The lesser performance in that lattermost tier may reflect the challenges of competing in a middle ground, without the absolute scale, scope, and efficiencies of the national banks but also without the single-market focus of a community bank.

### Consumer Loan Growth

Even as deposit growth waned, consumer loan demand continued to increase in the past year. Aggregate credit card balances reached a peak in 2008 and then declined sharply during the recessionary years, bottoming out in 2010 – 2011 before beginning a slow rebound. But in 2017 credit card balances surpassed the 2008 peak, and continued to rise, reaching record levels in 2018. Auto loans recovered more quickly, surpassing pre-recession levels in 2013 and rising each year thereafter, also reaching record levels in 2018. Offsetting that to some extent, home equity borrowing continued a pattern of erosion that started during the recession and has yet to abate; and aggregate home equity balances are less than half the level of 2008 (see Bancology July 2017 for more on this issue). The \$600B decline in home equity borrowing more than offset the combined increase in credit card and equity borrowing, so non-mortgage consumer borrowing remains below pre-recession levels; but an increase in mortgage loans in that period leaves aggregate consumer borrowing at an all-time high level.

### Branch Counts

2018 was the fifth consecutive year in which aggregate U.S. branch counts declined, and the eighth such year in the last nine (2013 showed a small increase in branch counts). Banks and credit unions combined to shed a net 1,700 branches over the past year, and 6,200 over the past four years. The four-year decline represents 6% contraction from 2014 levels, and the count of 105,000 branches nationwide sits 8% below the peak levels of 2010.

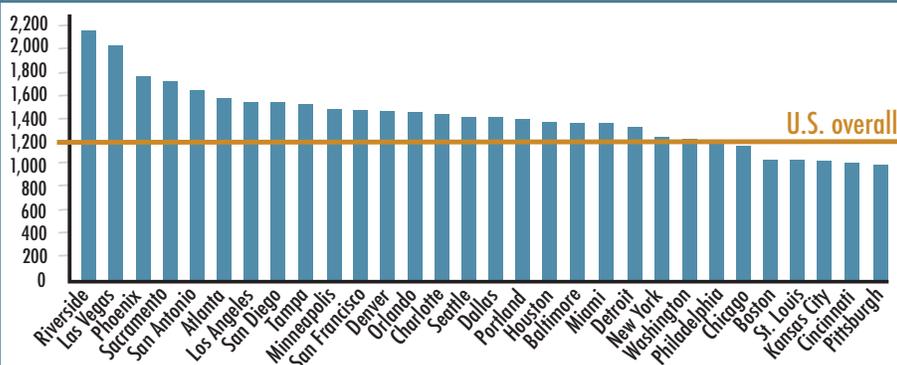
As with deposit growth, the pace of branch contraction varied across markets. Branch counts have declined in every one of the top 30 metros over the past year, but the declines ranged from severe to minimal. The Baltimore metro saw a 10% reduction in its branch counts over the past four years, while Chicago, Washington, Atlanta, and Sacramento experienced declines in the 8% - 10% range. In contrast, Boston's branch count declined by only 1% over the past four years, and San Diego, Charlotte, and Seattle saw contractions of only 2%. Of the 107 metros with 500,000 or more residents, all but three host fewer branches today than in 2014 (the Spokane, WA market added a single branch in that timeframe, while counts in Bakersfield, CA and Lancaster, PA remained unchanged).

The closures have yielded a less concentrated branching environment. Across the U.S., there is now one branch for every 1,180 households, compared to one for every 1,030 households four years ago. Branch concentration remains sharply higher in long-established Midwest and Northeast metros: Pittsburgh, Cincinnati, Kansas City, St. Louis, and Boston all contain one branch for every 1,000 households. In contrast, the Riverside and Las Vegas metros each show ratios of more than 2,000 households per branch; and Phoenix, Sacramento, and San Antonio show ratios of around 1,600 households per branch.

Note though, the branch count statistics are net changes, and thus do not fully show the magnitude of branch closures; but also do not imply a cessation of new-branch development. Rather, the 1,700-branch decline in the past year represents the net impact of about 2,500 branch closures, offset by 800 new-branch openings; and each of the past four years have seen 800 to 1,000 new branches open nationwide.

Although some banks undertook wholesale consolidations as either post-merger optimization exercises or as part of an institution-wide efficiency campaign, the last year's closures occurred mostly

### Branch Concentration: Households per Branch



## Attrition Case Study

In order to maintain long and prosperous client relationships, financial institutions invest heavily in their brand, people, training and distribution strategies. Yet customers still close their accounts and move to another institution. Attrition happens. But losing the account does not necessarily signal the end, as these customers may consider utilizing the institution again and recommending it to others. The institution needs to discover the reason for the closure request and determine if it can save the relationship, or at least assuage the customer to where they'd consider the bank for a future need.

Bancography worked with a \$2B community bank that posted excellent service quality and loyalty results in its customer satisfaction tracking studies. However, the bank experienced an attrition problem that was beginning to cause employee unrest. No one wanted to take responsibility for a customer needing to close an account. The front-line managers thought the tellers should

try to save the accounts, while also serving other customers. Yet the tellers, tasked with these dual roles, were unable to provide appropriate attention to account closures. The customer feedback from the attrition interviews supported this behavior, by revealing the front-line employees seldom asked why customers were closing their accounts, and almost none of them tried to prevent the closure.

The bank held focus groups with the tellers and their managers to discover how to navigate the situation. The discussions led to establishing the following policy. First, the teller would listen to the customer and show empathy and compassion. Then the teller would inform the customer they did not have the authority to close accounts but would escort them to someone who could. The goal was for the teller to calm the customer, followed by removing the customer from the teller line and/or lobby, making the customer feel appreciated and important. Further, separating a dissatisfied customer from

other customers removed the potential for negativity in the lobby.

The teller delivered the customer to a CSR, platform employee or branch manager charged with understanding and selling the various products and services offered. This employee could now attempt to avert the closure, but most importantly, further mitigate any dissatisfaction that may have prompted the close request.

This closure action plan quickly achieved success, while demonstrating excellent teamwork. Bancography shared this approach with other institutions, and they reported similar success.

Remember that saving or preventing an account closure is secondary to showing concern and empathy to the customer, which will lessen any pessimism; thus, reducing the likelihood of the lost customer displaying ill will toward the institution.

*For more information about Bancography's Attrition Studies, please contact us at (205) 251-6227 or [research@bancography.com](mailto:research@bancography.com)*

in low-risk situations. In 25% of the closures, the institution maintained another branch within one mile of the closing office; and in 50% of closures there was a surviving branch within two miles. Further, the average deposits of branches closed within one mile of a surviving branch approached \$38M, the same level for branches within 1 – 2 miles of a surviving branch. But that average declines in lockstep with distance; for example, the branches closed within 2 – 3 miles of a surviving branch averaged \$33M in deposits; at 4 – 5 miles, \$28M; by 10 miles or more, only \$21M. In sum, the farther removed from a surviving branch, the smaller the closed branches, as bankers understandably would risk only small deposit bases without a nearby option to ensure retention.

An additional result of recent mergers and closures is an increase in the concentration of branch ownership. The 10 largest banks in the U.S. by branch count now own 33% of all branches nationwide, and the 50 largest own

52% of all branches. Just 250 banks combine to own nearly 70% of all U.S. branches, and in each tier, these concentration levels are about two percentage points higher than four years ago. The credit union side of the industry remains less concentrated, with the 10 largest credit unions (again, by branch count) accounting for 6% of U.S. credit union branches, the 50 largest holding 14% of branches, and the 250 largest holding 35% of branches.

### Three Key Implications for 2019

After years of deliberate balance sheet restraint and even contraction, many markets are seeing ample potential for growth in markets with robust commercial loan demand. However, harvesting that asset growth opportunity without unduly compromising margins will prove challenging if the low deposit growth of 2018 persists. Increasing competition for deposit dollars at a time when the overall deposit pool is expanding only modestly will heighten the importance of relationship-building

skills to find and retain deposits, absent a default to price-based appeals that would threaten an institution's margins. Keep in mind, the discipline of negotiating rates with consumers is wholly unfamiliar to a generation of branch managers who started their careers after 2008; this group has never worked in an environment where rates on any instrument were sufficiently above zero to allow for meaningful differences among competing institutions.

The continuing shift in consumer borrowing preferences away from home equity lines and into instruments such as credit cards and auto loans presents challenges in that large banks (e.g., Chase, US Bank), specialty lenders (e.g., Discover, American Express), and captive finance companies hold outsized share in those markets; whereas traditional banks and credit unions hold much greater share in the still-shrinking home equity market. With most institutions selling the majority of consumer mortgages forward and off of the balance sheet, those that wish to maintain a balanced *(continued on page 4)*

# NEWS

Bancography will present  
 “The In-store Branch as Role  
 Model for the New Banking  
 Environment” at **FSI’s  
 National In-store  
 Banking Conference**  
 May 2 in Atlanta.

consumer/commercial divide in their loan portfolios must consider changes such as new portfolio mortgage products, indirect lending, in-house credit cards, or a premium home equity product that can capture significant share of a smaller market.

Changes in consumer channel preferences have reduced in-branch transaction demand, allowing modest branch consolidations in recent years. However, a closer examination of recent branch closings confirms most are still targeting either overlapping branches or outlying offices carrying balances below profitability thresholds; but not gambling on a proposition that consumers are willing to tolerate greatly reduced branch networks or substantially longer travel times to their offices.

Accordingly, even as electronic channels demand a greater share of the delivery network budget, bankers must act judiciously when seeking to find those funds at the expense of the traditional branch network. Closures should occur only at those branches close enough to surviving offices to forestall significant attrition, or at branches already draining profitability. Any more aggressive actions would risk creating a competitive disadvantage relative to institutions maintaining broad market coverage.

*The deposit growth and branch count statistics summarized in this article are available for any market in the U.S. To see how your market compares to these national trends, contact Bancography at [info@bancography.com](mailto:info@bancography.com).*

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