

Should I Run a CD Special or Issue Brokered CDs?

Asset Management Group, Inc. (AMG) is a wholly owned subsidiary of Country Club Bank and has been serving community banks since 1995. AMG offers a range of asset/liability management services designed to meet regulatory expectations while also managing risk and improving margins. Included with the standard monthly and quarterly risk reporting services provided by AMG is the Marginal Cost Report. This report is in Excel format, is unique to each client's data set and is updated each period with the client's most recent data. This report is available for download by the AMG client any time after their report is complete at AMG's secure web-based portal.

The Marginal Cost Report allows the bank to analyze the marginal cost of running a CD special. This worksheet requires the bank to make estimates of how much money could be raised by a special and the amount of funds that could shift from other maturity buckets to the special.

Exhibit 1 shows the original term of CD deposits, the current offering rate for that maturity bucket and the amount of \$\$'s rolling in that bucket in the next 3 months. The bank is considering a 12 month CD special at a 1.00% rate and expects to raise 140% of the \$13.9mm rolling within the next 3 months or an additional \$5.6mm. By running the special, the bank expects 20% of 6 month CDs rolling in the next 3 months (\$763,298) to migrate to the special as well as 20% of the 24 month CDs (\$412,776). Given these assumptions, the bank expects to raise net new money of \$4.4mm at an additional interest cost of \$70,336 which results in a Marginal Cost of the CD Special of 1.59%.

Exhibit 1

Current Position		Offering	\$'s Rolling	Interest	Base Case		Growth /	Add'l		
Product	New Mat	Rate	within 3 mos	Expense	Rate Chg	Retention	New Rate	Shrink	Int/Exp	
CD 1M	1 mos	0.15%	2,124,352	3,187	0.00%	100%	0.15%	0	0	
CD 2M	2 mos	0.00%	0	0	0.00%	100%	0.00%	0	0	
CD 3M	3 mos	0.20%	1,052,026	2,104	0.00%	100%	0.20%	0	0	
CD 6M	6 mos	0.32%	3,816,488	12,305	0.00%	80%	0.32%	(763,298)	(2,461)	
CD 9M	9 mos	0.35%	351,624	1,214	0.00%	100%	0.35%	0	0	
CD 12M	12 mos	0.85%	13,990,801	118,333	0.15%	140%	1.00%	5,596,320	76,714	
CD 18M	18 mos	0.85%	529,304	4,477	0.00%	100%	0.85%	0	0	
CD 24M	24 mos	0.95%	2,063,878	19,584	0.00%	80%	0.95%	(412,776)	(3,917)	
CD 30M	30 mos	0.95%	60,000	569	0.00%	100%	0.95%	0	0	
CD 36M	36 mos	1.34%	138,576	1,861	0.00%	100%	1.34%	0	0	
CD 48M	48 mos	1.24%	0	0	0.00%	100%	1.24%	0	0	
CD 60M	60 mos	1.48%	236,044	3,490	0.00%	100%	1.48%	0	0	
CDARS	12 mos	0.00%	0	0	0.00%	100%	0.00%	0	0	
Brk Non Call	12 mos	0.00%	0	0	0.00%	100%	0.00%	0	0	
Brkr Call/Step	12 mos	1.85%	0	0	0.00%	100%	1.85%	0	0	
Total CD's		12 mos	24,363,093	167,124				4,420,247	70,336	
								Marginal Cost of Time Deposits Strategy		1.59%

With alternative cost of funding from the FHLB for 1 year available at around 0.43% and brokered CD rates even lower, this does not look like the best strategy in the current market.

Exhibit 2 considers a more aggressive strategy where the bank runs a 14 month special at a 1.10% rate. Since this is a more aggressive special, the bank assumes that 40% of the 6 month bucket and 40% of the 24 month bucket will migrate to the special. The worksheet then solves for the amount of funds needed to be raised by the special to equal the net amount of funds raised in Exhibit 1. In this case, that amount is \$6.7mm coming in to the special to raise net new money of \$4.4mm. This special results in a Marginal Cost of the CD Special of 1.40%. This is better than the first special but still not attractive given alternative funding sources.

Exhibit 2

Current Position		Offering	\$'s Rolling	Interest	Best Special			Growth /	Add'l
Product	New Mat	Rate	within 3 mos	Expense	Rate Chg	Retention	New Rate	Shrink	Int/Exp
CD 1M	1 mos	0.15%	2,124,352	3,187	0.00%	100%	0.15%	0	0
CD 2M	2 mos	0.00%	0	0	0.00%	100%	0.00%	0	0
CD 3M	3 mos	0.20%	1,052,026	2,104	0.00%	100%	0.20%	0	0
CD 6M	6 mos	0.32%	3,816,488	12,305	0.00%	60%	0.32%	(1,526,595)	(4,922)
CD 9M	9 mos	0.35%	351,624	1,214	0.00%	100%	0.35%	0	0
CD 12M	12 mos	0.85%	13,990,801	118,333	0.00%	100%	0.85%	0	0
CD 18M	18 mos	0.85%	529,304	4,477	0.00%	100%	0.85%	0	0
CD 24M	24 mos	0.95%	2,063,878	19,584	0.00%	60%	0.95%	(825,551)	(7,834)
CD 30M	30 mos	0.95%	60,000	569	0.00%	100%	0.95%	0	0
CD 36M	36 mos	1.34%	138,576	1,861	0.00%	100%	1.34%	0	0
CD 48M	48 mos	1.24%	0	0	0.00%	100%	1.24%	0	0
CD 60M	60 mos	1.48%	236,044	3,490	0.00%	100%	1.48%	0	0
CDARS	12 mos	0.00%	0	0	0.00%	100%	0.00%	0	0
Brk Non Call	12 mos	0.00%	0	0	0.00%	100%	0.00%	0	0
Brkr Call/Step	12 mos	1.85%	0	0	0.00%	100%	1.85%	0	0
CD Special	14 mos	1.10%						6,772,393	74,496
Total CD's	12 mos	0.69%	24,363,093	167,124				4,420,247	61,741

Marginal Cost of Time Deposits Strategy **1.40%**

Exhibit 3 considers a defensive strategy where the bank just attempts to retain its current deposits. Using the same retention factors as Exhibit 2 and assuming the bank runs a special for 10 months at 0.75%, this Marginal Cost of CD Special would be 0.96%. Still not great given the alternative cost of funding currently in the market, but better than the more aggressive specials in the first two examples (Exhibits 1 and 2).

Summary

Given this banks current offering rates on CDs and where alternative cost of funding is available, one conclusion for this bank is to employ defensive strategies to retain the current deposit base and look to raise funds through the brokered CD market. Brokered CD rates for longer-term brokered CDs are around 0.55% for 5 years and 0.75% for 7 years, so for lower rates than where you can issue 1y CDs, you can lock in rates for 5-7 years. For just an additional 5 to 10 bps, you can issue them as callable. With rates at all-time lows, it makes sense to be defensive on CD specials to retain your current deposits and be more aggressive on extending liabilities by issuing long-term funding through the brokered CD market.

Exhibit 3

Current Position		Offering	\$'s Rolling	Interest	Defensive Special		Growth /	Add'l	
Product	New Mat	Rate	within 3 mos	Expense	Rate Chg	Retention	New Rate	Shrink	Int/Exp
CD 1M	1 mos	0.15%	2,124,352	3,187	0.00%	100%	0.15%	0	0
CD 2M	2 mos	0.00%	0	0	0.00%	100%	0.00%	0	0
CD 3M	3 mos	0.20%	1,052,026	2,104	0.00%	100%	0.20%	0	0
CD 6M	6 mos	0.32%	3,816,488	12,305	0.00%	60%	0.32%	(1,526,595)	(4,922)
CD 9M	9 mos	0.35%	351,624	1,214	0.00%	100%	0.35%	0	0
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CD 18M	18 mos	0.85%	529,304	4,477	0.00%	100%	0.85%	0	0
CD 24M	24 mos	0.95%	2,063,878	19,584	0.00%	60%	0.95%	(825,551)	(7,834)
CD 30M	30 mos	0.95%	60,000	569	0.00%	100%	0.95%	0	0
CD 36M	36 mos	1.34%	138,576	1,861	0.00%	100%	1.34%	0	0
CD 48M	48 mos	1.24%	0	0	0.00%	100%	1.24%	0	0
CD 60M	60 mos	1.48%	236,044	3,490	0.00%	100%	1.48%	0	0
CDARS	12 mos	0.00%	0	0	0.00%	100%	0.00%	0	0
Brk Non Call	12 mos	0.00%	0	0	0.00%	100%	0.00%	0	0
Brkr Call/Step	12 mos	1.85%	0	0	0.00%	100%	1.85%	0	0
CD Special	10 mos	0.75%						2,352,146	17,641
Total CD's	11 mos	0.69%	24,363,093	167,124				0	4,886
<i>Marginal Cost of Time Deposits Strategy</i>									0.96%

Please feel free to call AMG at 800-226-1923 if you have questions about these deposit pricing tools or our Asset Liability Reporting and Consulting Service in general. Also, contact your Capital Markets Group representative to discuss opportunities to issue long-term brokered CDs in this market.

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