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Financial Services Practice

Deposits: The top profitability lever for retail banks' CEOs

Sophisticated deposit management can help banks lower funding costs, improve liquidity, enhance customer loyalty, and boost margins.

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For about a decade and a half, attracting deposits wasn't a major concern for bank executives in Europe and North America. The era of low interest rates between 2008 and 2022 meant that depositors had fewer incentives to move their money to another bank. That began to change when central banks started raising rates in 2022 to combat inflation. Suddenly, there was a lot more competition for deposits, both within the traditional banking sector and from neobanks and fintechs.

On both sides of the Atlantic, 2022 marked a turning point for bank deposits' dynamics. After a long period of growth, deposits started to fall in North America and experienced slowing growth in Europe. According to the European Central Bank (ECB), household deposits in the eurozone increased just 1.2 percent in 2023 to €9.2 trillion—the slowest growth rate since the 2000s—as a widening gap between reference rates and deposit yields prompted consumers to seek out alternative savings options such as government bonds and money market funds.

Banks reacted by boosting the rates paid on deposits to secure financing and better compete with digital peers. The heightened price competition, coupled with decreasing liquidity coverage ratios and more challenging loan-to-deposit positions, came at a cost for European banks. Their deposit rates increased significantly: The weighted average yield on household deposits in the eurozone rose from just 0.7 percent in January 2023 to 1.5 percent by October 2024, according to a McKinsey analysis of ECB data.

In another twist for the banking sector, both the ECB and the US Federal Reserve cut rates in 2024 for the first time in several years, putting customer margins at risk. But even as interest rates fall, the competition for deposits is likely to remain tough as customers, particularly those who are digitally savvy and price sensitive, seek favorable returns on their savings.

What's next for banks? It is imperative that they raise the bar on deposit management to be able to optimize customer margins and maintain profitability levels in the new interest rate environment. Sophisticated deposit management can be a game changer, resulting in reduced funding costs, improved liquidity positions, enhanced customer loyalty, and higher long-term margins.

In this article, we first examine trends in the deposit market in the context of several years of rising rates that are now coming down again. Then, we offer a blueprint for sophisticated deposit management, focused on five key areas: strategy and value proposition, customer intelligence, personalized campaign execution, technology and data, and governance.

The new normal in the deposit market

Deposits remain a priority topic for banks. Although interest rates are falling and depositors understand their yields are coming down in tandem, banks have work to do to maintain profit margins amid heightened competition.

To help make that happen, banks are shifting their focus to three key areas in 2025:

- *Attracting customers to non-interest-bearing accounts.* Banks are striving to boost their account balances by bringing in new customers and retaining existing ones by reducing churn. Many banks are using targeted campaigns, such as cash back for salary deposits, or other benefits, such as bundles or preferential rates, to enhance these efforts. They are also improving customer onboarding and reviewing the process of moving customers' transactions from branches to digital channels to ensure competitiveness.

- *Managing term deposit renewals.* Term deposits lock up the customer's money for a certain period, usually in exchange for a higher interest rate; it's a different proposition than a checking or savings account. As many term deposits are now reaching maturity, banks are refining their strategies for renewing these deposits and giving depositors who appear likely to take their money elsewhere a rate that entices them to stay.

- *Exploring new opportunities.* Trade-offs between on-balance-sheet and off-balance-sheet funds are becoming relevant again. Some banks are looking into new avenues for growth and moving toward off-balance-sheet products in search of fee income, which is more resilient than net interest income (NII) to interest rate cycles.

More broadly, banks are navigating five trends in the deposit market: heightened consumer expectations, growing scrutiny from regulators and investors, the comeback of term deposits, the outsize success of banks seen as mobile leaders, and increasing competition from digital attackers.

Consumers' heightened demands are here to stay

These days, many consumers are digitally savvy and tend to use free online tools to compare offers, a trend likely to persist. In this context, banks are concentrating on three areas to address changing customer preferences and demands:

- *Making highly personalized offers.* By using machine learning, banks can better predict which customers are so attuned to the interest rate earned on their accounts that they are likely to move their money elsewhere if the rate is out of sync with competitors' offerings. These price sensitivity predictions allow frontline staff to offer better remuneration to retain this type of customer.

- *Rethinking product innovation.* Deposit products are evolving, offering greater flexibility with various maturities. Banks are also employing more aggressive and variable pricing and temporary rate boosts to attract new customers and cross-sell other products to them, such as credit cards and loans.

- *Upgrading customer experiences.* Banks are making things easier for customers, for example by making it possible to open an account instantly with an electronic-know-your-customer (e-KYC) process that allows for fully digital onboarding.

Growing scrutiny from regulators and investors

Stakeholders such as regulators and investors are increasing their scrutiny of bank deposits. Banking regulators' agenda for the next few years includes a focus on asset liability management, including interest rate risk in the banking book, which is the risk posed by interest rate movements that cause a mismatch between the rates that banks earn on loans and pay out on deposits.

Regulators are also watching for the risk of bank runs, given that digital banking and easy access to information via social media have facilitated their speed, size, and spread. For example, Silicon Valley Bank lost 85 percent of its deposits over two days in 2023, leading to its collapse. Conversely, in 2007, Northern Rock had much slower outflows, losing 20 percent of its deposits over four days.[1] The heightened threat of bank runs and the speed at which they can drain banks' funds reinforces the importance of deposit management.

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[1] *The 2023 banking turmoil and liquidity risk: A progress report*, Bank for International Settlements, October 2024.

Banks that rely on less stable deposits are naturally more vulnerable to deposit runs. Two forms of deposits that are less likely to flee are those fully covered by government deposit guarantees and operational deposits that the bank needs to have on hand to perform certain services for clients, such as clearing, custody, and cash management. To mitigate these risks, banks are taking five steps:

— They are adapting early warning indicator systems, which measure systemic and credit risks, by using AI to monitor and analyze social media posts to gauge public perception and flag negative sentiment.

— Banks are creating layered contingency funding strategies to ensure they have enough cash to continue operating during a crisis scenario.

— They are increasing asset liquidity, for example by paying off loans from the ECB's targeted longer-term refinancing operations (TLTROs), under which the central bank offers banks loans at a favorable cost to ensure that they lend to businesses and households. Banks can then use the collateral they get back, typically bonds, to support contingency funding strategies.

— Banks are using funds transfer pricing, a method of measuring how various assets and liabilities affect profitability, to steer deposit portfolios toward desired funding products and tenors.

— They are redesigning deposit products to increase stickiness of deposits and customers.

Investors in European banks are also increasingly focusing on deposit management. We analyzed how often investors and analysts raised this topic during the earnings presentations of publicly traded, Spain-based banks in the second quarter of 2024, and the results were striking: More than 40 percent of all questions addressed NII topics, such as deposit betas and sensitivity to interest rates.

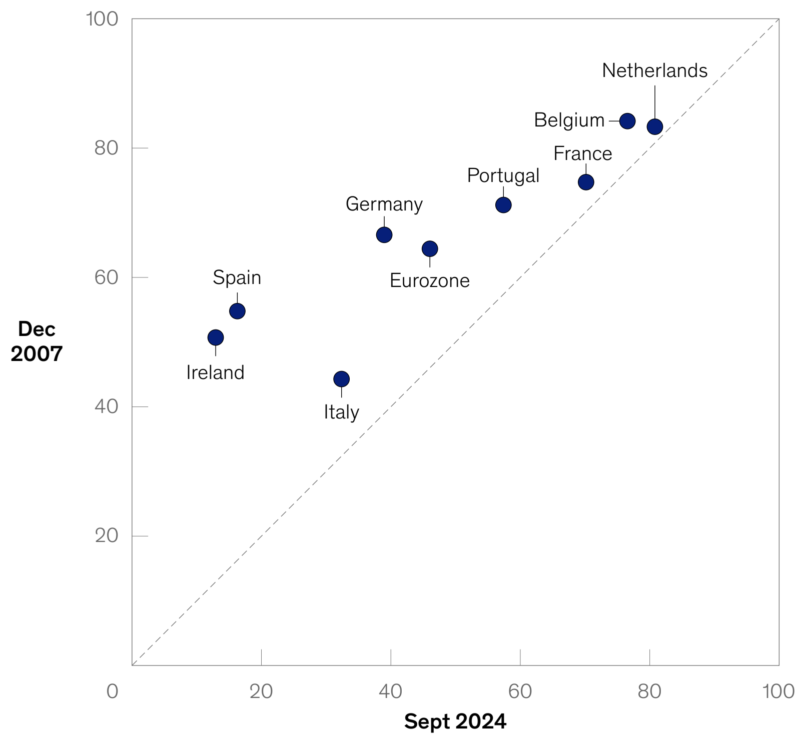
Term deposits make a comeback

European markets are experiencing a shift from overnight deposits, which can be withdrawn anytime, to term deposits, which can't. This shift has been widespread, driven mainly by banks increasing yields much faster for term deposits than for savings and current accounts. But there are regional differences: Our analyses show that the prevalence of term deposits in each market is converging to levels seen before the 2008 financial crisis (Exhibit 1). Markets close to the diagonal line in Exhibit 1 show similar prevalence of term deposits in 2007 and 2024. For example, Belgium, France, and the Netherlands had a high share of term deposits in 2007 and reached similar levels by the second quarter of 2024. Italy had a lower proportion of term deposits, at roughly 40 percent, and returned to that level in 2024. If the shift from overnight to term deposits continues, markets could reach or even surpass precrisis levels of term deposits.

Exhibit 1

The share of term deposits is moving toward levels seen in 2007, when interest rates were similar, though with some regional differences.

Term deposits[1] as a percentage of total deposits, Dec 2007 vs Sept 2024, %



[1]Term deposits include deposits with agreed maturity and deposits redeemable at notice as categorized by the European Central Bank.
Source: European Central Bank; McKinsey analysis

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Mobile leaders show outsize gains

Deposit account openings—such as savings accounts, checking or current accounts, and term deposits—have risen sharply across the board over the past few years, and banks that are seen as mobile leaders are experiencing outsize gains, according to Finalta by McKinsey. Finalta's analysis of data from more than 200 banks worldwide shows that in 2023, the banks opened 291 deposit accounts per 1,000 active customers, on average, up 17 percent from 2021 (Exhibit 2). A subset of banks seen as mobile leaders delivered even stronger results, with account openings rising to 381 per 1,000 active customers in 2023, up 35 percent from 2021. Mobile leaders have also significantly boosted the percentage of deposit accounts opened through digital channels (websites and mobile apps).

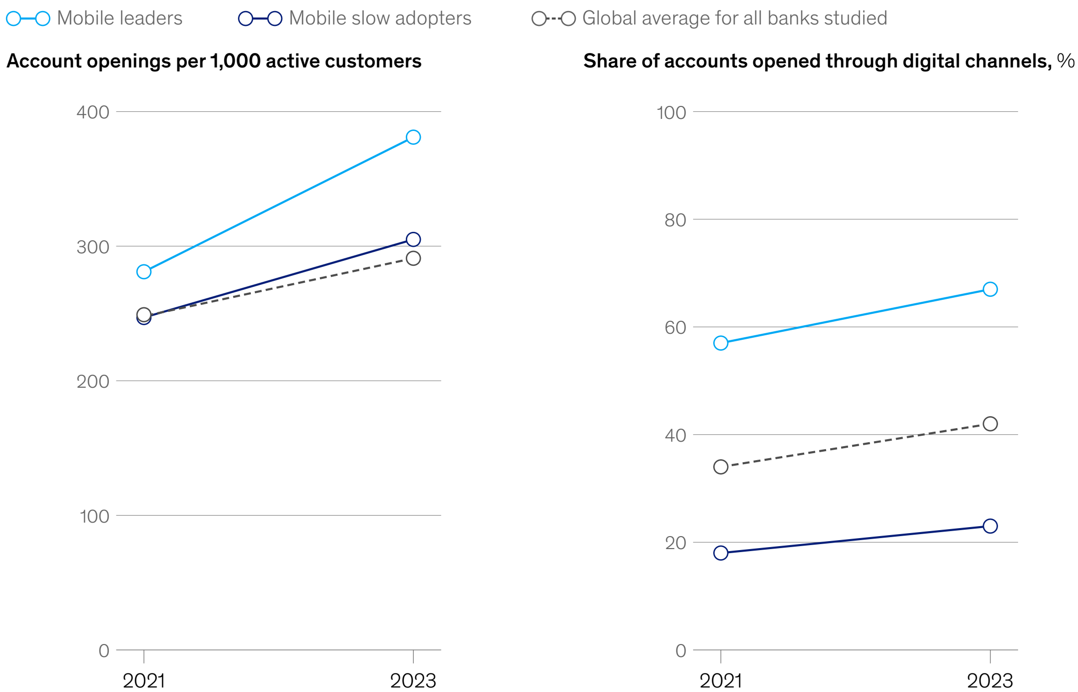
Example: Private bank successfully reaches the mass-affluent segment

A leading European private bank decided to venture into the mass-affluent segment, targeting individuals with investable assets of between €50,000 and €1 million, among others. The bank, historically very successful in its core markets and segments, launched into new markets with a subbrand and a new app to appeal to mass-affluent individuals, but struggled in the

Exhibit 2

Banks that are mobile leaders have seen faster growth in deposit account openings and accounts opened digitally.

Deposit account openings across all channels, by level of mobile adoption[1]



[1]Mobile leaders are the top 20 banks of more than 200 banks worldwide scored on mobile app adoption, engagement, sales, and functionality. Mobile slow adopters are the bottom 20 banks scored on the same metrics.
Source: Finalta by McKinsey

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beginning. In the first year, the bank spent more than €2 million on marketing to bring in fewer than 1,000 new customers. Its challenges included limited appeal to new customers because of a €2,000 investment threshold, implementation of marketing technology, marketing strategy for the new brand, and customer experience.

The bank redesigned its app to ensure its features and services aligned with this customer segment's expectations, simplifying and optimizing the user experience to make it easier for customers to navigate the app and complete financial tasks. A crucial factor for success was adjusting the barrier to entry for the new subbrand: The bank introduced a term deposit that functioned like a money market fund, with a much lower minimum investment. This allowed the bank to reach more clients faster, build trust and value, and then cross-sell them other investment products, such as funds. Within a year, the bank increased its customer base by more than 20,000 and attracted more than €1 billion in new assets under management. It is important to note that because the bank created a brand for this mass-affluent segment, the new business didn't dilute its core private bank brand.

Competition from digital attackers

The deposit market has witnessed an unprecedented shift as digital attackers seize the opportunity to break into new markets. Fintechs and neobanks such as Bunq, Monzo, N26, Revolut, and Starling are rapidly acquiring customers with attractive financial products and rates, using deposits to support their growth ambitions. Our analyses of deposit rates in the European Union and United Kingdom show that, on average, fintechs and neobanks are paying 40 to 90 bps more than traditional banks on fixed-term products and over 100 bps more on savings accounts and other overnight products.

These strategies are paying off in terms of balance growth. For instance, London-based Revolut launched in 2015, specializing in low-cost foreign exchange services; it is now one of Europe's biggest fintechs. In 2023, Revolut began offering money market funds across 22 European countries, and as of July 2024, balances in those accounts totaled £1.5 billion. Additionally, between 2022 and 2023, Revolut's total customer balances increased 38 percent to £18.2 billion.

Other fintechs, including California-based Robinhood and Berlin-based Trade Republic, are redefining the financial-services landscape by offering innovative savings and investment management options that come with seamless digital interfaces—and often higher returns than more established businesses. Trade Republic has expanded from its roots as a brokerage into high-yield savings accounts, further blurring the lines between banking and investing. Since January 2023, Trade Republic has been passing on the full ECB interest rate to its customers. Instead, Trade Republic makes money through trading fees as well as payments from market makers in exchange for routing trades to them.[2]

Meanwhile, online marketplaces such as Berlin-based Raisin are gaining traction, giving consumers access to a range of competitive deposit products from multiple institutions through a single platform. Smaller digital banks such as Bunq and Pibank are entering the fray with higher yields and fewer conditions.

A blueprint for sophisticated deposit management

In our experience, achieving distinctive deposit capabilities is a complex endeavor. How should banks approach the deposit challenge? Our blueprint shows they should focus on five key areas (table).

[2] Olaf Storbeck, "European Robinhood rival Trade Republic reports first profit," *Financial Times*, January 8, 2024.

Table

Best-in-class banks approach deposit management through these five areas.

Key focus area	Components of focus area
Strategy and target setting	• Making planning and budgeting more dynamic; moving faster on new strategies and ensuring targets are adequately cascaded down to channels
Customer intelligence	• Using models to predict which customers can bring in money from other institutions • Using models to understand customer behavior in response to pricing changes, including churn
Personalized campaign execution	• Differentiating communications and products to make offers targeted to microsegments of customers • Launching campaigns through channels including online banking, mobile apps, and physical branches and ensuring a superior customer experience
Technology and data	• Using transaction data to better understand customers; ensuring unified data sources across the bank; improving access to real-time data
Governance	• Integrating the finance and business functions; involving several areas of the bank in deposits

Next, we explore each area in greater detail.

Strategy and target setting

Banks should take a comprehensive approach to their strategy by considering not only the balance sheet as a whole but also their competitive position within each individual market segment or portfolio. This requires focusing on two key areas:

— *Making planning and budgeting more dynamic.* The past two years have shown that traditional budgeting doesn't allow banks to adapt quickly enough to changing interest rates. Consequently, banks have adopted rolling forecasts to adjust their deposit rate targets monthly. Best-in-class banks go a step further, considering information for various clusters of customers within each portfolio, based on their characteristics, and adjusting deposit rates accordingly. This level of granularity enables informed decisions at the management level. In the best-functioning banks, real-time simulators allow for the assessment of deposit rates' impact on churn and price sensitivity for each customer segment. For instance, banks could use machine learning to identify customers who are likely to move their funds to another institution and offer them a higher rate "below the line" (a rate personalized to that customer rather than available through the bank's main channels).

- *Moving faster on new strategies and updating business targets more frequently.* The increased dynamism in the planning and budgeting process also flows into commercial strategies, performance management, and incentive setting. Setting targets monthly, rather than quarterly, can help. Banks that move quickly to implement new strategies and define related targets tend to outperform their peers in balance growth and cost of funding optimization.

Customer intelligence

The deposit management strategy that leading banks are focusing on the most is the use of customer intelligence to offer personalization—such as in pricing, content, format, and channel. Data analytics and machine learning can enhance customer intelligence in the following areas:

- *Hidden affluence.* Technology can predict which customers are likely to bring in new money from other institutions. A robust hidden-affluence model identifies customers whose behaviors resemble those of existing affluent clients, indicating potential for both fund transfers and increased margins from fees and other banking and savings products sold to these customers.

- *Churn and price sensitivity.* Machine learning can identify which customers are likely to move their money out of their accounts, particularly as term deposits reach maturity or as pricing conditions change, for example, if a promotional rate expires. Similarly, data analytics can predict customer behavior in response to pricing changes. Such analysis requires either data on churn events to track customer behavior when alternative savings options are more appealing, or insights from the bank's previous promotional campaigns at various price points. One major challenge is the poor visibility banks have into their peers' pricing, given that banks offer many customers below-the-line yields that are higher than their published yields.

We have found that integrating customer intelligence into decision-making can reduce a bank's cost of funds by up to 10 percent for a constant volume of funds.

Example: Finding hidden affluence

Many banks have made it a priority to maintain stable balances in term deposits over the past year, even as many of these deposits have come up for renewal. A European retail bank developed a hidden-affluence model to predict which of its customers had funds at other

Integrating customer intelligence into decision-making can reduce a bank's cost of funds by up to 10 percent for a constant volume of funds.

institutions that could be transferred to the bank, boosting deposit volumes. By building a machine learning model to score its customer base, the bank was able to make personalized offers for term deposit renewals at various prices for different customer segments. The result? Tailored campaigns more than doubled the additional funds brought in compared with untargeted base campaigns with the same average cost of funds.

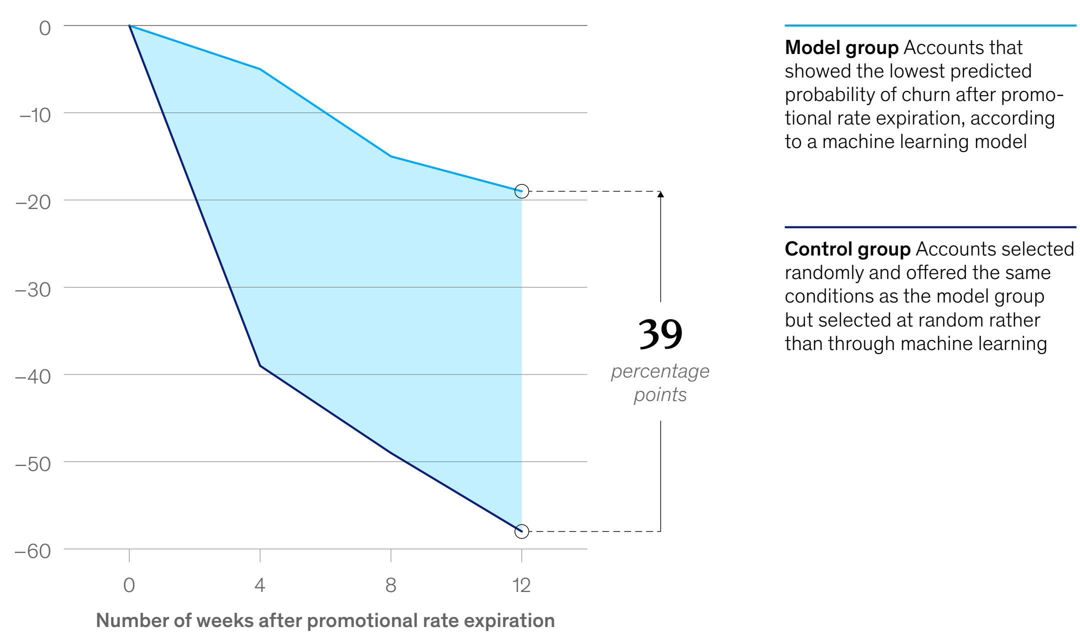
Example: Minimizing churn

As interest rates come down, banks have experienced challenges in lowering the yields on newly acquired customer deposits, particularly those with promotional offers and those that had experienced strong growth during times of rising rates. A bank built a model to predict churn when a new customer's promotional rate expired, and the interest rate on the account decreased to the base rate. By using machine learning, the bank was able to pinpoint which customers had the least propensity to leave when experiencing a change in yields. The bank made personalized offers to customers depending on how likely they were to leave, enabling it to significantly reduce churn. Balances in a model group of accounts with the lowest predicted probability of churn, accounting for 15 percent of all accounts with the expiration of a promotional rate, declined 19 percent after 12 weeks. That was a major improvement compared with a control group of accounts, in which balances fell 58 percent (Exhibit 3). Using this strategy allowed the bank to reduce its total interest expense by 11 percent with a minimal volume loss (less than 3 percent).

Exhibit 3

By using machine learning, a bank was able to identify the customers least likely to leave after their promotional rate expired.

Decline in account balances following promotional rate expiration, %



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Personalized campaign execution

Personalization is a common thread in successful deposit management strategies. Banks that increase personalization and focus on offers targeted to microsegments of customers, or even to individuals, tend to have higher balances and renewal rates at a more optimized cost.

Executing below-the-line campaigns by offering more favorable rates to select new customers can be done through both branch and digital channels, preventing a contagion effect to the back book, the rates for existing customers. This approach enhances customer engagement but also introduces operational complexities, such as managing diverse pricing structures for similar customer segments and ensuring consistent messaging about rates across channels. Consequently, banks must focus on customers who have the biggest effect on boosting the bank's NII or expanding its deposits to maintain operational efficiency while effectively addressing these challenges.

Technology and data

Improving internal data on deposits has been a priority for many banks, as the structure and quality of this data often fall short. Recent efforts have focused on three main objectives:

— *Using transaction data to better understand customers.* Machine learning can help banks comb through transaction data—including what customers are spending on and how much—to gain insights on customer behavior, even for customers who don't use the bank as their primary financial institution. While the quality of this data varies depending on factors such as consent levels, aggregating transaction data allows banks to predict which customers are likely to pull their money out and which customers likely have funds at other institutions that could be brought in with a targeted campaign.

— *Ensuring unified data sources enterprise-wide.* Banks typically have different data systems for their business units and their financial or treasury functions, given that these systems serve different purposes and are subject to different regulatory requirements. By standardizing these data sources, banks can ensure full alignment between business decisions and liquidity requirements.

— *Improving access to real-time data.* With real-time data on transactions, banks can quickly respond to customers' needs. Managing the operational complexities of millions of transactions can hinder banks from accessing real-time insights, yet the ability to tailor offers based on immediate customer activity can yield significant benefits. For example, if the bank notices that a customer is about to transfer funds to an account in their name at another institution, the bank can offer a savings account with an attractive rate to retain those deposits.

Beyond internal data, banks often struggle with obtaining high-quality data on competitor pricing, particularly for below-the-line offers. Best-in-class banks regularly collect and analyze data on their peers' deposit rates, by using, for example, web scraping tools to pull relevant data on published rates from competitors' websites, and by tasking employees or a third party to gather details about unpublished rates. Banks can use this data to conduct sensitivity analyses to understand how different market conditions and actions by competitors could affect their business.

Governance and operating models

Finally, banks will need to adapt their governance and operating models to become more agile in managing deposits, moving quickly to make decisions about deposit pricing, campaign launches, and product development.

While there is no standard recipe for success in setting up governance and operating models, several guiding principles have emerged from how best-in-class banks handle these challenges. The principles include the following:

— *Bridging the distance between finance and business divisions.* There is no winning formula for bringing finance and business closer together; banks have various ways to accomplish this task. Some banks create forums where teams from finance and business units can work together on deposit-related issues. Others embed finance-related roles within business units. Another strategy, common among digital banks, is to include specific deposit teams within the finance function.

— *Involving several areas of the bank in deposits.* Business teams are becoming more involved in critical deposit-related processes, taking part in pricing decisions and discussions about funding the bank’s operations, making sure that deposit strategies align with funding needs. In top-performing institutions, even processes traditionally addressed exclusively by business unit teams—such as product design, campaign launches, and customer segmentation—are developed collaboratively.

Banks face numerous challenges in managing deposits due to changing macroeconomic conditions and heightened consumer expectations. Nevertheless, advanced deposit management can transform their operations, bringing lower funding costs, stronger customer loyalty, and higher long-term profits. A comprehensive approach that involves collaboration across various parts of the bank is essential to excelling in deposit management, one of the largest opportunities for retail banks to improve their financial performance.

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