The Carfang Group

2021
The State of
Commercial Deposits (USD)

The Carfang Group
March 2021

Abstract: During 2020, commercial banks saw significant growth in USD commercial deposits.

Following the Covid-19 related shutdowns, companies rushed to add liquidity. Banks and money market funds experienced tsunami-like deposit and investment flows. This "surge" led to strained bank balance sheets with Basel III ratios and money fund liquidity ratios stretched as never before. After commercial paper markets froze, the Treasury and the Fed rushed to the scene with a number of programs to ease the stress and provide some regulatory relief.

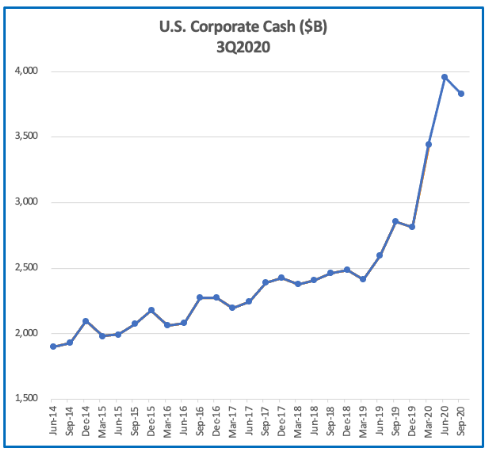
Entering 2021, bankers must now re-forecast and re-optimize their balance sheets. This whitepaper, based upon interviews with dozens of bankers and industry experts, explores how they will do that. Verbatim comments in the Appendix add further color to the analysis.

The Carfang Group specializes in consulting, writing, speaking, thought leadership and advocacy in the area of treasury management, payments, liquidity, fintech and banking. We know these areas intimately and bring unparalleled insights to our clients. Visit https://www.thecarfanggroup.com or email tony@thecarfanggroup.com.

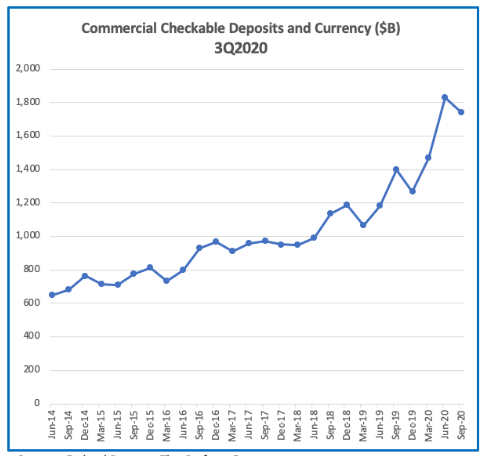
I. Background

The pandemic-driven flight to liquidity in 2020 led to a $1 trillion increase U.S. corporate liquidity, with the bulk of that finding its way to bank balance sheets. Bankers saw a 37% increase in commercial transaction deposits and currency and a 35% increase in commercial time and savings deposits. Money market fund assets, the other primary component of corporate liquidity surged 66%. Most of those assets and deposits remain in place today.

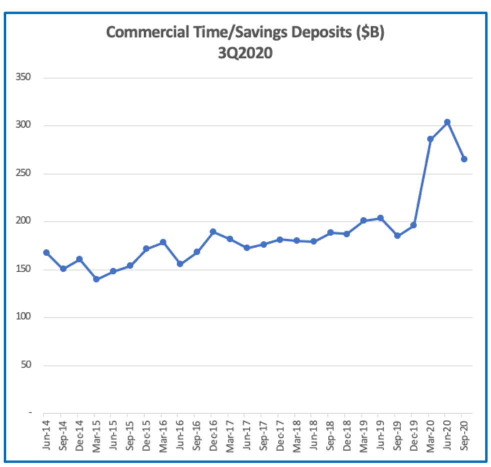
This "surge" created distortions which bankers must address in 2021. Total domestic USD deposits in the U.S. grew by 18% last year. However, commercial deposits, mostly uninsured transaction deposits, grew at nearly double that rate.



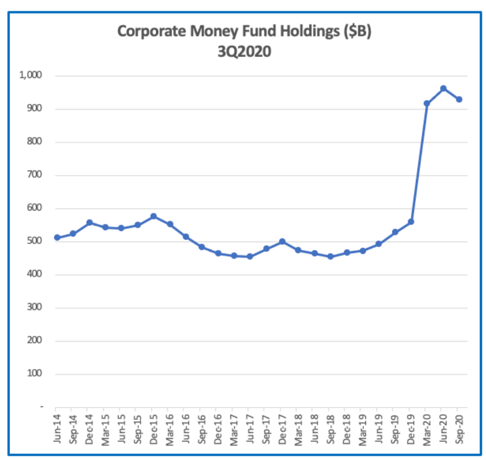
Source: Federal Reserve, The Carfang Group



Source: Federal Reserve, The Carfang Group



Source: Federal Reserve, The Carfang Group



Source: Federal Reserve, The Carfang Group

II. The Research

To help market participants understand how banks are adjusting to these balance sheet pressures and altering their deposit structures, The Carfang Group undertook a comprehensive research program. We conducted phone and written interviews with senior managers at thirty-nine large banks doing business in the U.S. In addition, we drew upon our Quarterly Corporate Cash research reports and recent Fed and FDIC statistics. We also received insights from leading industry experts. In all, we conducted fifty interviews.

From this analysis, we put forth the “2021 - The State of Commercial Deposits (USD)”.

For our interviews, bankers were divided into three peer groups:

- 19 US Banks with deposits greater than $100B
- 13 US Banks with deposits between $3B - $100B
- 7 Non-US Banks – foreign headquartered banks seeking US commercial deposits but with no US branch network.

We asked banks to share their outlook regarding five types of corporate deposits:

- Transaction deposits – sourced directly from customers or affiliates.
- Time/Savings deposits – sourced directly from customers or affiliates.
- MMF deposits - deposits placed by money market funds.
- FDIC - deposits sourced via external insured deposit programs.
- 3rd Party platforms - deposits sourced via third party platforms.

Then we probed about key economic and regulatory events that currently shape the view and could alter that view if they change.

- What potential regulatory events would change that outlook for you?
- What potential financial/economic policy developments would change that outlook?
- How do you believe the overall cost of deposits will change in 2021 for your peer group of banks?
- Is there any one particular deposit type that will become materially more significant for your peer group in 2021?

III. Overview Findings

Three key take-aways emerged from our analysis:

- Bankers expect transaction deposits to continue to increase but see all other deposit categories experiencing slight runoff.

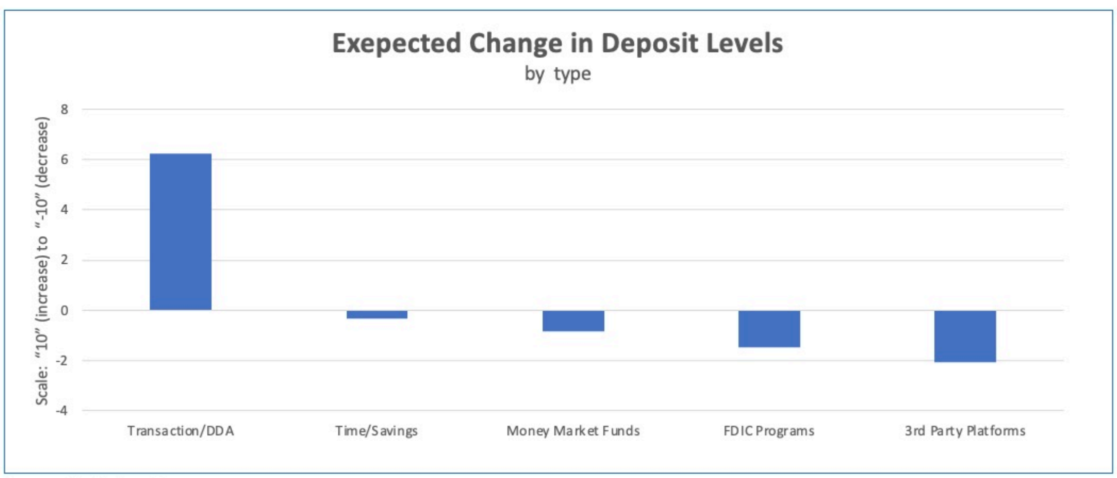
- Bankers are not in agreement about how their cost of funds will fare in 2021. The average outlook is for a slight decrease but there is wide variability.

- Most of the bankers interviewed cited several game changers which would alter their forecasts. As detailed in the Appendix, these will be the indicators to watch.

What follows in this section is a high-level view of each of these three points.

1) Bankers expect transaction deposits to continue to increase but see all other deposit categories experiencing slight runoff.

   The chart below highlights our interviewee expectations. For each deposit category, we scaled each response ranging from "+10" for an expected increase to "-10" for an expected decrease.



Source: The Carfang Group

Expected Change in Deposit Levels
by Deposit Type

	Transaction	Time/Sav	MMF	FDIC	3rd Party
Total	6.3	(0.3)	(0.9)	(1.5)	(2.1)
US > $100B	6.0	(1.9)	1.7	(5.4)	(2.8)
US < $100B	5.4	(2.9)	(4.5)	2.3	(0.9)
non US HQ	8.6	8.6	(2.1)	(0.7)	(2.1)

Note: Responses scaled ranging from "10" (increase) to "0" (flat) to "-10" (decrease)

Source: The Carfang Group

- US Banks >$100B see a sharp increase in transaction deposits and a large decrease in deposits source via insured deposit programs. In all other categories, they expect modest runoff.

- US Banks <$100B foresee a sharp increase in transaction deposits and a sharp decrease in deposits placed by money market fund. They expect a modest runoff in time/savings deposits and funds sourced vis 3rd party platforms partially offset by a slight increase in insured deposit programs.

- Non-US Banks see very strong increase in both transaction deposits and time/savings deposits.

Percentage of Banks
Expecting Change in Deposit Levels
by Deposit Type

	Transaction	Time/Sav	MMF	FDIC	3rd Party
Increase	76%	29%	23%	24%	15%
Flat	16%	37%	49%	32%	50%
Decrease	8%	34%	29%	44%	35%
Total	100%	100%	100%	100%	100%

Source: The Carfang Group

- This table shows the range of forecasts by our interviewees. For every deposit type, there are some banks expecting increases, deceases and no change.

- The overwhelming outlook, however, is that transaction deposits will continue their increase.

2) Bankers are not in agreement about how their cost of funds will fare in 2021. The average outlook is for a slight decrease but there is wide variability.

Cost of Funds

% of Banks Expecting Change

	Increase	Flat	Decrease	Total
US > $100B	28%	33%	39%	100%
US < $100B	31%	23%	46%	100%
non US HQ	14%	57%	29%	100%
Total	26%	34%	39%	100%

Source: The Carfang Group

39% of all participants expect their bank's cost of funds to decline in 2021 while more than a quarter expect their cost of funds to increase. In general, participants indicated that although they had some level of control over their deposit structure, they were largely at the mercy of the Fed's monetary policy.

3) Most of the bankers interviewed cited several game changers which would materially alter their forecasts. Many of these are discussed in the Appendix.

Many banks, especially the systemically important banks (GSIBs), would be constrained by the Supplemental Leverage Ratio (SLR) requirement. That was a dominant concern, not only for the GSIBs but for next tier banks that may be on the receiving end of deposits shed by GSIBs.

Additional key issues frequently cited include the following:

- Interest rate policy,
- Size and shape of additional Covid relief and stimulus,
- Speed of economic recovery,
- Basel III regulatory constraints,
- Pending regulatory guidance regarding brokered deposits,
- Loan demand,
- Possible additional money fund regulations, and
- Inflation.

For additional insights, we provide a sampling of interviewee verbatim comments in the Appendix.

IV Findings by Deposit Type

Except for transaction deposits, there are marked differences based upon the type of bank. These tables show the percentage distribution of responses by bank category for each deposit type.

1) Transaction deposits (+6.3)

Transaction Deposits

% of Banks Expecting Change

	Increase	Flat	Decrease	Total
US > $100B	78%	17%	6%	100%
US < $100B	69%	15%	15%	100%
non US HQ	86%	14%	0%	100%
Total	76%	16%	8%	100%

Source: The Carfang Group

76% of respondents expect an increase in transaction deposits in 2021. All three bank categories report a similarly high percentage. Only 8% of our interviewees expected to see a decrease in this category.

Interviewees noted that government stimulus spending, regardless of how effectively it works its way through the economy, will ultimately find its way on to bank balance sheets and mostly in transaction accounts.

Many bankers commented that in a low rate, flat yield curve environment, corporate treasurers have little incentive to tie up too much of their funds in longer-term interest-bearing deposits. However, they are quick to point out that could change quickly if rates rise, the yield curve steepens or inflation appears.

2) Time/Savings Deposits (-0.3)

Time/Savings Deposits

% of Banks Expecting Change

	Increase	Flat	Decrease	Total
US > $100B	22%	39%	39%	100%
US < $100B	8%	46%	46%	100%
non US HQ	86%	14%	0%	100%
Total	29%	37%	34%	100%

Source: The Carfang Group

The general expectation is that these deposit levels will be overall flat for the year. Nealy one third of respondents expect an increase, one third flat and one third expecting a decrease.

The only exceptions are non-US HQ banks which expect an increase in time/savings deposit levels.

3) Deposits from MMFs (-0.9)

Deposits from Money Funds

% of Banks Expecting Change

	Increase	Flat	Decrease	Total
US > $100B	39%	44%	17%	100%
US < $100B	10%	40%	50%	100%
non US HQ	0%	71%	29%	100%
Total	23%	49%	29%	100%

Source: The Carfang Group

Here we see a sharp contrast between the larger US banks and medium sized US banks. The patterns are mirror images of each other. 39% of US > $100B expect these deposits to increase while 17% expect a decrease. Conversely, only 10% of US < $100B expect an increase while 50% expect a decrease.

Following the March commercial paper freeze, assets flowed into government and treasury MMFs but out of prime MMFs. It is prime MMFs that invest in both commercial paper and bank deposits. If assets were to flow back into prime MMFs, we would likely see the fund managers increase their bank deposits. The largest banks expect to be the beneficiaries of this inflow.

4) Insured Deposit Programs (-1.5)

Deposits Sourced via FDIC Insured Deposit Programs
% of Banks Expecting Change

	Increase	Flat	Decrease	Total
US > $100B	9%	27%	64%	100%
US < $100B	50%	33%	17%	100%
non US HQ	13%	50%	38%	100%
Total	26%	35%	39%	100%

Source: The Carfang Group

Although the FDIC recently approved new rules on brokered deposits, interviewees expect deposits sourced through the programs to dip slightly. They came in at -1.5 on the plus 10, minus 10 scale. However, that masks a sharp contrast across our two US bank peer groups.

- 64% of US banks > $100B expect these deposits to decrease.
- 83% of US banks < $100B expect flat or increased levels.

5) 3rd Party Sourced Deposits (-2.1)

Deposits Sourced via 3rd Party Platforms
% of Banks Expecting Change

	Increase	Flat	Decrease	Total
US > $100B	19%	38%	44%	100%
US < $100B	9%	73%	18%	100%
non US HQ	14%	43%	43%	100%
Total	15%	50%	35%	100%

Source: The Carfang Group

65% of our participants expect deposits sourced via 3rd party platforms to remain flat or increase. Although most confirmed they are flush with cash and don't need to avail themselves of third parties, they raised two important factors :

- Convenience of 3rd party technology platforms from the client perspective, and
- The importance of being present on these platforms to gain experience in this emerging category.

VI Conclusions

Driven by the pandemic, commercial deposits are at unprecedented levels, up by over 35%. Corporate liquidity surged by more than $1 trillion and much of this ended up in bank deposit accounts.

Bankers expect that transaction deposits will continue to grow in 2021, even as they anticipate the pandemic will subside. To balance the transaction deposit growth, most see slight runoff in their other commercial deposit categories. They expect their overall cost of commercial deposits to decline slightly from their current historic lows.

Finally, there are many unknowns that cloud the outlook. Bankers will be watching carefully and adjusting the deposit strategies accordingly.

VII Acknowledgements

The Carfang Group wishes to thank the fifty senior bankers and industry experts who shared their insights and made this paper possible.

Appendix: Potential Game Changers

Bankers are facing great uncertainty as we enter 2021. They mentioned a wide range of issues which can be summarized in the following categories.

Supplementary Leverage Ratio.
Interest rate policy.
Size and shape of additional Covid relief and stimulus.
Speed of economic recovery.
Basel III regulatory constraints.
Pending regulatory guidance regarding brokered deposits.
Loan demand.
Possible additional money fund regulations.
Inflation.

Here are some of the comments direct from our interviewees.

Regulation

- “One potential regulatory event that could increase deposit balances for the (super) regional banks would be the Federal Reserve allowing the Supplemental Leverage Ratio relief implemented in 2020 to expire at the end of March. GSIBs would need to reduce leverage by either (i) issuing additional Tier 1 capital or (ii) pushing deposits off their balance sheet. If they opt for the latter option, then those balances could make their way to regional banks’ balance sheets.” US bank > $100B

- “GSIB and SLR will continue to be areas of focus that may impact the ability of larger banks to take on more deposits due to capital costs. ” US bank > $100B

- “If a regulatory decision were made to continue the current restrictions on share buybacks and or restrict dividends, banks would not be as capital constrained and might choose to be less concerned about increasing deposit books in the near term. Balance sheet optimization would not be as important. This is not an expected outcome. The industry expects the current restrictions on share buybacks to end in 2021. ” US bank > $100B

- “More liberal interpretations of the new FDIC guidance would cause us to change our deposit mix. ” US bank < $100B

- “Reclassification of deposit which are considered "core" would change my deposit forecast. ” US bank < $100B

- “LCR friendly balances, especially those tied to payment flow, fee revenue, and strategic client relationships, will be more important to financial institutions. Conversely, I think the industry will look to find a new home for LCR unfriendly deposits. The industry will likely look to keep such deposits in house but move them somewhere else such as a money market fund. ” US bank > $100B

- “Three areas I’m watching: Capacity limits at banks; FDIC rule revisions; Elimination of LIBOR. ” US bank < $100B

- “The two regulatory events would be (1)continuation of the existing SLR exemption beyond March 31st and (2) recalibration of GSIB.” US bank > $100B

- “Modifications to the capital buffer requirements under Tier 1 Leverage Ratio.” US bank > $100B

- "The market will find the new Bloomberg LIBOR replacement BSBY might gain traction. Perhaps a SOFR benchmarked floating deposit. " non-US HQ bank > $100B

- "If regulations changed to allow "non-banks" to take deposits, that could have a significant impact on our peer banks. We could see sizable run-off, especially if the new competitors had lower costs, especially regulatory infrastructure costs that all banks are required to have. " US bank < $100B

- "Regulation of digital / virtual assets for investment and as payment method and the balance sheet and capital treatment of same- which is not contemplated by regulation yet. " non-US HQ bank > $100B

- "Continued evolution of Basel IV and V- increased focus on operational risk may increase requirement for additional stable funding so drive price competition for same operating and longer-term balances. " non-US HQ bank > $100B

Monetary and fiscal policies

- “We remain attentive to any policy developments that might be enacted. We will watch the FED closely and react accordingly to navigate the ongoing financial/economic environment. COVID-19 is still the 800lb gorilla in the room, and we’re looking closely at those companies/segments that were most impacted in 2020 to begin a slow recovery as demand returns. ” US bank > $100B

- “Given the ongoing and forecasted continued depressed rate environment in addition to low loan demand, there is little anticipated change on the 2021 horizon for the cost of deposits. Banks will continue to seek opportunities to reduce overall deposit costs as much as possible, but the majority of rates have been brought down as low as possible for now. ” US bank > $100B

- “Our cost of deposits will be nearly the same or lower as recovery from Covid will not begin until late 2021; rates will still be low. ” US bank > $100B

- “FED rate changes and inflation would likely change the outlook, not to mention PPP & consumer stimulus payments. ” US bank < $100B

- “$1.9 T Stimulus package, tentatively scheduled for vote in March 2021 (my responses assume it is passed by April 1; Loan forgiveness: Material change in QE; Inflation. ” US bank > $100B

- “Interest rates, End to the Fed’s stimulus.” US bank > $100B

- “Tax increase / rising rates.” US bank > $100B

- “If interests rates run-up quickly, deposits often flow out to other investments as fewer deposits are needed to cover services via account analysis and there are other investment options.” US bank < $100B

- “With the short-term markets flush with liquidity—repo trading close to zero and well below levels of overnight bank/fed effective—the Fed might raise IOER and Fed Repo levels. ” non-US HQ bank > $100B

Importance of transaction deposits

- “The “transactional deposits” sourced directly from our clients that are tied to the operational business activities will continue to be the most significant and important deposit dollar types throughout the 2021 calendar year. ” US bank > $100B

- “Overall, the expected increase in money supply will drive deposits up, though this may be partially offset by the more sophisticated clients moving back into alternative investments types. ” US bank > $100B

- “There are some interesting categories of growth in deposits related to niche segments where there is alignment with certain fintech driven trends such as on-line deposit gathering supporting e-commerce applications, or funding needs related to niche loan funding which could increase time deposit spreads and demands for deposits within those eco-systems. ” US bank < $100B

- “Transaction deposits will remain top priority, but we believe deposit aggregators that have historically been considered brokered deposits, will potentially be a greater emphasis based on new FDIC guidance. ” US bank < $100B

- “I think banks will continue to look for normal operating deposits that happen naturally from operating business. Seeing some banks turning deposits away. ” US bank > $100B

- “Our peer group would prefer operating accounts/DDA rather than money markets, savings, CD’s. However, if banks need deposits, I can see a push in the I/B arena to get them. ” US bank < $100B

- “I don’t believe the level of surge deposits will dramatically flow out in the near term, at least until Q3 2021. ” US bank < $100B

- “Operating liabilities continue to be the golden source with an integrated proposition to rolling average deposits with 45+ rolling tenors to preserve liquidity operating quality and maturity transformation. ” non-US HQ bank > $100B

Third party platforms and technology

- “Winning cash business in this climate has nothing to do with yield and everything to do with technology. ”   US bank > $100B
- “Regarding deposits sourced via external insured deposit programs and third-party platforms, I did perceive some interest in such products given the outperformance in yield with some of them for much of 2020. ”   US bank > $100B
- “Referring to the question on third party platforms, regulators might encourage banks to do this and would likely cause this category of deposits to grow for our peer banks, but to shrink for smaller banks that might not be able to participate.”   US bank < $100B
- “Evergreen deposits. ”   US bank > $100B
- “We need to gain experience with these types of programs.” US bank < $100B
- “These platforms are an ideal vehicle that we can leverage and efficiently gather USD deposits. Although we don’t need deposits at this point, we do need to establish our presence.”   non-US HQ bank > $100B

Economic conditions

- “More aggressive economic expansion coupled with higher loan demand would potentially soak up the excess liquidity in banking system and drive greater need for balances than forecasted. Stronger economic expansion might be supported by a federal infrastructure program. ”   US bank < $100B

- “Certainly, a faster than expected pandemic recovery could drive increased borrowing, capital investment and a corresponding increase in yields on savings based on spreads on higher demand borrowing. ”   US bank < $100B

- “Inflation in the U.S. would alter our outlook.”   non-US HQ bank > $100B

- “Against the pandemic background, people are not spending as much as previously and so are increasing their savings. ”   non-US HQ bank > $100B

- “Until there is a true light at the end of the (Covid) tunnel, I don’t see deposit outflows, spending or loan growth returning to pre-pandemic levels. My view is this will most likely happen in Q3-Q4 of this year. ”   US bank < $100B

- If the economy does not rebound, clients/customers could have liquidity challenges and thus withdraw funds. ”   US bank < $100B

Cost of Funds

- “COF flat to decline. The decline will largely be due to cd portfolio’s maturing and the new rates being lower than the portfolio rates. I think most rate reductions on liquid account types have already occurred. ”   US bank < $100B

- “We cannot go much lower on interest rates we pay on deposits, but we and our peers will continue to manage our exception rates, so we can likely lower our portfolio cost by a few more basis points in 2021. ”   US bank < $100B

- “COF stable. Fed effective/Overnight Bank Funding Rate (OBFR) spread to Interest on Excess Reserves (IOER) expected to remain stable. ”   non-US HQ bank > $100B

- “Significant increase in bank regulation further raises costs of an asset base.” non-US HQ bank > $100B

- “Change in withholding tax between USA and other countries. ”   non-US HQ bank > $100B

- “Banks will continue to be scrutinized by analyst on their deposit costs and I don’t see that changing any time soon. ”   US bank > $100B

- “Flat to decrease. Until the Fed increases the EFF there is increasing pressure on FTP. ”   US bank > $100B

- “Costs will remain relatively flat as they can’t go much lower. The offset would be if there is a significant increase in demand for loans and banks need to gain deposits for funding, which could drive rates up. ”   US bank < $100B

- “The current and continued yield curve steepening that we have seen over the past few weeks —10 years up 50 bps will impact convexity, profile is not symmetric, when rates are higher , banks DO NOT need to hike deposit rates. ” non-US HQ

- “Will increase for USD operating liabilities and those deposits with a longer value date. ”   non-US HQ