ANALYZING DEPOSIT SOURCES AND MANAGING EXPECTATIONS DURING THE PANDEMIC

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The pandemic has brought to light the need to review deposit sources and manage depositor expectation. With massive monetary and fiscal stimulus, financial institutions are inundated with excess liquidity at rates near zero. In addition, political unrest coupled with the uncertainty from the pandemic continues to suppress loan growth and hamper economic recovery. Financial institutions are increasing reserves in anticipation of asset deterioration and loan losses stemming from the economic shutdown. As a result, regulators are closely monitoring the situation as we move into 2021 and want to see stress testing and contingency plans.

Controls and safeguards stemming from the Great Recession have put financial institutions on better footing to weather the storm of the pandemic. Yet, the pandemic is like nothing we have seen before, with severity and duration still uncertain. Financial institutions are required to develop clear funding strategies and incorporate stress scenarios ("the unexpected") with an ongoing focus on liquidity position. Currently, financial institutions are comfortable, from a funding standpoint, as they can access all the cheap money that they want through traditional channels. As a result, wholesale sources, such as listing services, FHLB advances and brokered deposits, are being furloughed for another day.

The concern, similar to the Great Recession, is that cheap funding will lead to complacent behavior resulting in concentrations. In the case of the pandemic, ongoing uncertainty is creating credit stress on assets and shorting duration and amount of depositor cash flows. How well do you know your depositors, both retail and wholesale, and how will they react in a stressed situation? Questions to ask and record:

1. What sources are you utilizing?
2. What percentage of their portfolio/budget do you have in deposits?
    a. How much of the portfolio reserve is not earmarked?
3. Who is your competition for various sources?
4. What situation(s) could have a negative impact on this source?
    a. What are their credit criteria?
5. Are your sources ready available and tested?
6. Are you able to defend their utilization of this source with your examiners?

The questions above are not inclusive, but provide a broad overview in which you can build depositor expectations based on a sound plan.

Currently, with everyone actively seeking to park money, it is tempting to take in large sums from known customers to meet primary needs. However, without a cash flow, the funds should not be considered stable and there is flight risk. For known customers, look at balances pre-pandemic compared to now and setup tier pricing and limits. Any balances over pre-pandemic levels should be priced to move off balance sheet. In addition, new depositors or funding sources should be at levels in which balances can be maintained (0-10% of depositor cash flow) with any excess priced to move off balance. By staying diversified and setting concentration limits based on depositor cash flow at the onset, this will help eliminate unexpected surprises during times of stress.

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network and PMA Securities where he oversees PMA Funding, a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities and Investment Advisor Representative with PMA Asset Management. Mr. Lutter has the following FINRA licenses with PMA Securities, LLC: Series 7, 24, 50, 53, 63, 65 and 99.

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