

Calming Depositor Angst at Community Banks

Corporate News: A Legal Update

By Daniel Spungen on April 17, 2023

The recent issues involving community and regional banks, such as Silicon Valley Bank, Signature Bank, and First Republic, have led depositors to flock to the larger banks, such as Chase.

Chase's CFO Jeremy Barnum, in Chase's earnings call last Friday, stated that Chase saw "significant new account opening activity and meaningful deposit and money market fund inflows" and they estimate that they "have retained approximately \$50 billion of these deposit inflows at quarter end." Barnum elaborated that these inflows reversed an intra-quarter trend of increased deposit outflows.

It's safe to assume that these new deposits came from smaller banks as a result of the recent bank failures, not interest rates. So to protect their deposit base, smaller banks need to message to the market that the funds of their deposit customers are safe and protected AND emphasize the advantages a local bank who knows its customers has over big banks.

There are a number of tools we have seen community banks use to help alleviate customer concerns resulting from the recent bank failures, including the ones below.

Federal Home Loan Bank System and Bank Term Funding Program

Both the Federal Home Loan Bank System and the Bank Term Funding Program offer secured lending programs to community banks to provide liquidity. The Federal Home Loan Bank System will lend cash to its members for short-term needs secured by assets of the bank, such as mortgage loans, small business loans, and government securities.

The Bank Term Funding Program was developed in response to the recent bank issues and allows banks to borrow money from the Federal Reserve. Banks that borrow under this program pledge assets such as U.S. Treasuries, U.S. agency securities, and U.S. agency mortgage-backed securities, as collateral for the loan. The Federal Reserve values these assets at par value and allows banks to borrow against their long-term securities without having to mark down their value or sell them at a loss.

Reciprocal Deposit Networks

Recently, more banks have been interested in engaging in reciprocal deposit relationships to provide additional measures to protect customer funds.

A reciprocal deposit relationship is a relationship between banks wherein a bank transfers the amount in an account in excess of the FDIC's \$250,000 limit to an account at a network bank so that the excess is eligible for FDIC insurance. It is a reciprocal relationship because in order to transfer customer funds to a network bank, a transferring bank would also be receiving customer funds from another bank to provide its customers with FDIC insurance.

This mechanism diversifies customer funds across multiple banks and allows for FDIC insurance eligibility for all customer funds while customers retain a relationship with one single bank. This is a very appealing option for community banks and its large deposit customers.

Account Titling

Banks can also assist customers in titling their accounts to maintain FDIC insurance when customers intend to hold more than \$250,000 at a single bank.

The FDIC provides \$250,000 account insurance to each separately titled account for a customer provided the accounts are titled correctly. For instance, if a customer holds one checking account and one corporate account at the same bank, each account would have \$250,000 FDIC insurance coverage for a total of \$500,000 in FDIC insurance coverage.

This is another straightforward option that will provide customers with the assurances they need to know that their funds are protected. Community banks can leverage their relationships with customers and proactively assist customers in titling their accounts to provide additional FDIC insurance coverage.

Providing these resources can help aid community banks in retaining customers and easing any concerns. The success of these resources is dependent upon their implementation and in times like these it can be wise to seek advice from trusted counsel.

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