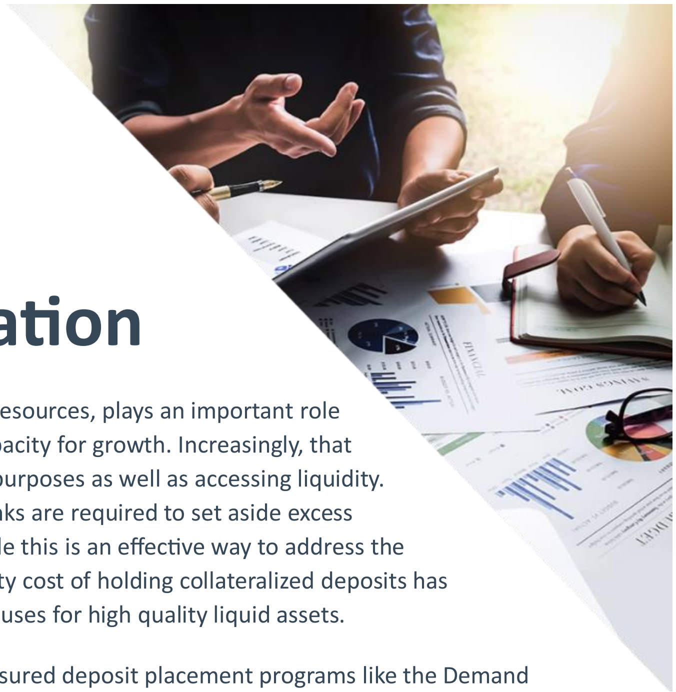
Unlocking Liquidity & Balance Sheet Optimization



In today's competitive banking landscape, the strategic allocation of resources, plays an important role in determining a financial institution's resilience, profitability, and capacity for growth. Increasingly, that includes the optimal use of collateral for regulatory and commercial purposes as well as accessing liquidity. For many traditional deposit relationships, such as municipalities, banks are required to set aside excess collateral to provide principal protection for uninsured balances. While this is an effective way to address the investment policy needs of their customers, the increasing opportunity cost of holding collateralized deposits has caused bank treasurers to seek alternatives given the other potential uses for high quality liquid assets.

One option available to banks is to shift collateralized deposits into insured deposit placement programs like the Demand Deposit Marketplace® ("DDM") program administered by R&T Deposit Solutions[1] ("R&T"). The DDM Program is an automated daily cash sweep program that provides a bank or other institution with the ability to send, receive or reciprocate deposits, providing a high level of flexibility and balance sheet management, while also enabling the institution to offer its customers access to an expanded level of FDIC insurance coverage on their deposits through a network of participating FDIC insured institutions[2]. Banks can participate as "send only", "receive only" or "reciprocal" institutions, with the ability to increase or decrease the level of deposits on their balance sheet at any time.

Flexibility:

By transitioning collateralized deposits into FDIC insured cash sweep programs, a bank can gain greater flexibility in managing its liquidity. Instead of tying up funds in collateralized assets, a bank can allocate those resources to areas that offer competitive rates of return[3] or better align with the bank's strategic objectives. This flexibility enables banks to respond more effectively to changing market conditions, regulatory requirements, and customer demands.

Diversity Funding Sources:

Channeling liquidity away from collateralized deposits allows banks to diversify their revenue streams by exploring alternative deposit opportunities. Whether it's investing in new market segments, funding innovative projects, or participating in strategic partnerships, banks can leverage their freed-up liquidity to pursue a broader range of income-generating activities. This diversification of liquidity not only enhances revenue potential but also can help mitigate risks associated with overreliance on traditional banking products and services (e.g., risk of uninsured deposits).

Cost Reduction:

Collateralized deposits often require administrative cost associated with managing and monitoring the underlying collateral, conducting valuations, and ensuring compliance with regulatory requirements. By reducing reliance on such deposits, a bank can streamline its operational processes, helping to provide cost savings. Additionally, freeing up liquidity can alleviate the need for additional funding sources, thereby reducing dependency on more expensive forms of financing, such as wholesale funding or interbank borrowing.

[1] Stable Custody Group II LLC ("Stable"), an affiliate of Reich & Tang Deposit Solutions, LLC d/b/a R&T Deposit Solutions, is the administrator of the DDM program.

[2] Access to FDIC insurance coverage is subject to the DDM program customer terms and conditions and FDIC laws and regulations, including pass through deposit insurance coverage requirements.

[3] The primary objective of the DDM program is to provide customers with convenient access to expanded FDIC insurance coverage on their funds (and not for investment enhancements, higher rates of returns or profits).

Strengthen Customer Relationships:

While collateralized deposits provide a sense of security for depositors, they also can be perceived as restrictive in terms of withdrawal flexibility or yield potential. By offering alternative deposit products where collateralization may not be required, banks can cater to a broader spectrum of customer preferences and needs. This enhances customer satisfaction and strengthens the bank's relationships with its client base, helping to drive long-term loyalty and retention.

Regulatory Requirements and Risk Management:

Reducing reliance on collateralized deposits also can help a bank manage its collateral regulatory requirements and help mitigate associated risks with collateral. Regulatory frameworks governing collateralized deposits often impose strict requirements on asset valuation, collateral adequacy, and reporting standards. By diversifying funding sources and reducing exposure to collateralized assets, a bank can reduce its collateral regulatory burdens and associated costs. Additionally, a more diversified funding base can enhance the bank's resilience to market shocks and systemic risks.

Rates:

FDIC insured cash sweep programs allow a bank to offer its customers competitive rates on their deposits[4], daily liquidity, the convenience of a single bank relationship, and access to an expanded level of FDIC deposit insurance coverage on its funds. These programs automatically sweep excess cash balances from customers' deposit accounts into interest-bearing deposit accounts across a network of participating banks, allowing sending banks the opportunity to offer their customers competitive interest rates. Unlike collateralized deposits, which may offer fixed or predetermined rates of return, cash sweep programs typically offer variable rates that are tied to prevailing market conditions. This flexibility enables a bank to capitalize on fluctuations in interest rates and optimize returns on its liquidity. For a bank that utilizes the reciprocal feature of the sweep program, the bank maintains control over the rate offered to its customers.

In conclusion, the benefits of reducing collateralized deposits and freeing up liquidity extend beyond immediate financial gains. A bank that embraces this strategic approach stands to gain enhanced flexibility, improved capital efficiency, diversified revenue streams, cost reductions, strengthened customer relationships, and less burdensome collateral regulatory requirements and risk management. As the banking landscape continues to evolve, optimizing liquidity will remain a cornerstone of sustainable growth and competitive advantage in the industry.

About R&T: Founded in 1974, R&T Deposit Solutions leverages deep industry expertise and a tech-enabled platform, to provide banks and wealth managers flexible cash sweep and deposit funding solutions.

[4] While rates obtained on funds placed into sweep programs may, under certain circumstances, outperform cash alternatives, such as money market funds, the primary objective of these programs is to provide convenient access to expanded FDIC insurance coverage on funds (and not for investment enhancements, or higher rates of returns or profits).

Contact **Emily Fox**, **efox@rnt.com** to learn more

Version MKT-156-001 – 04 April 2024