R&T Capital Insights

A view from Washington on the emerging issues shaping the banking and regulatory landscape.

Welcome to the second quarter edition of "View from Washington." This quarter has been particularly eventful, so let us delve into the key developments.

Republic First's Collapse

Republic First, a Pennsylvania-based bank with assets of $6 billion, succumbed to a trifecta of corporate governance failures, a declining mortgage business, and significant unrealized losses in its securities portfolio. This collapse provides the FDIC with a compelling argument for advancing its stringent Corporate Governance rule, which would elevate standards for board directors at banks with assets exceeding $10 billion.

This failure is likely to result in heightened scrutiny from examiners, particularly for banks with high ratios of uninsured deposits relative to their business models, concentrated commercial real estate portfolios, and significant securities depreciation.

Bottom Line

Market-sensitive liabilities can expedite a bank's failure and limit its ability to recover. Once negative attention from bank analysts or social media begins, the damage is often irrevocable.

Banks with substantial exposure to uninsured deposits should seize this moment to reassess their funding structures. The Demand Deposit Marketplace® (DDM®) program administered by R&T allows banks to leverage reciprocal features to meet their customers' FDIC deposit insurance needs while retaining valuable deposits. The DDM program also provides banks with the flexibility to adjust reciprocal deposit levels as needed to meet changing funding requirements.

Revisiting Liquidity Rules

Liquidity rule revisions are taking center stage, with proposals from the Federal Reserve expected this summer. Regulators and academics are focusing on addressing the root causes of bank failures in the spring of 2023, particularly the "run risk" associated with uninsured deposits. Enhancing regulatory responses to such risks could provide regulators with more time to resolve larger institutions without resorting to bailouts.

Former Fed Governors Tarullo and Stein, in their paper "Evolution of Banking in the 21st Century," argue for stricter regulatory requirements for uninsured deposits to mitigate the rapid runs seen last spring. They highlight the following statistics:

- **In Q4 1995, total deposits were 49% of GDP, with 20% uninsured.**
- **In Q3 2023, total deposits were 75% of GDP, with 39% uninsured.**

The bank failures of early 2023 underscored the vulnerability of banks to liquidity risk, exacerbated by the rapid growth of uninsured deposits and advancements in technology and social media, which have made bank runs more rapid and severe. For instance, on the eve of its failure, 94% of Silicon Valley Bank's (SVB) deposits were uninsured, and 25% of deposits were withdrawn in a single day, leading to its closure.

The former central bankers suggest that increasing deposit insurance is not the solution, as it would raise taxpayer exposure and reduce banks' incentives to manage risks. Instead, they recommend requiring banks with assets over $100 billion to secure their uninsured deposits by pre-positioning collateral, primarily in the form of short-term government securities, at the Federal Reserve.

Current Fed Governor Bowman, in her remarks "Bank Liquidity, Regulation, and the Fed's Role as Lender of Last Resort," urged caution in intervening in private markets and emphasized the importance of maintaining industry-standard access to liquidity beyond the Fed's tools for day-to-day liquidity management. She expects regulators to demand more rigorous testing of contingency funding facilities and ensure banks have multiple providers for critical functions in deposit and funding operations.

Solutions for Uncertain Times

Recent bank failures bolster the argument for revising liquidity rules to address the risks of uninsured deposits. Policymakers should explore private market solutions to mitigate "runnable liabilities," enabling banks to extend credit more confidently and support core business relationships instead of accumulating securities at the Federal Reserve.

At R&T Deposit Solutions, we offer clients flexible options to provide their customers with the security they seek during volatile times while meeting regulators' and investors' demands for greater deposit stability. Reciprocal deposits serve as a vital shock absorber during stress periods, as evidenced by New York Community Bancorp's 5% share increase following the announcement of over $18.7 billion in reciprocal deposit capacity.

Although Section 202 of the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act permits banks to engage in risk-reducing activities, many banks find the cap on reciprocal deposits challenging. Bank treasurers must navigate conflicting regulatory requirements to manage liquidity while adhering to statutory, regulatory, and supervisory mandates.

Former OCC Comptroller Brooks' proposal, which encourages the FDIC to promote the use of reciprocal deposit networks to reduce uninsured deposit exposure, remains relevant. Banks with high uninsured deposit ratios are likely to face additional regulatory scrutiny. Fortunately, regulators allow banks to convert a portion of their uninsured deposits into non-brokered (i.e., core) deposits using reciprocal deposit programs. Banks seeking a trusted provider for this crucial market-based solution can contact R&T at info@rnt.com. R&T's reciprocal deposit solutions help banks demonstrate deposit base stability, improve liquidity access, and manage uninsured deposits.

Looking Ahead

The upcoming liquidity proposals will significantly affect community and regional banks. It is crucial for banks to participate in this debate. With potential changes to the Fed lending program and deposit insurance coverage on the horizon, now is the time to recalibrate reciprocal deposit caps and review the supervisory treatment of reciprocal deposit networks.

Feedback or suggestions for future topics may be sent to me at: jcave@rnt.com

For further information about R&T's solutions, you may contact us at: info@rnt.com

Sources:
WSJ: Brian Brooks, M. Todd Henderson – 3/29/2023
Reuters: Manya Saini – 2/15/2024

Jason Cave
Strategic Advisor, R&T Deposit Solutions

About the Author:

Jason Cave has over 30 years of experience in public leadership, regulatory development, and financial institution stability. He previously held roles at the Federal Deposit Insurance Corporation ("FDIC") and Federal Housing Finance Agency ("FHFA"), helping to shape regulations that promote stability across banking, mortgage finance, and technology sectors.

At the FDIC, Jason led capital markets operations and the bank risk oversight program. In this role, he worked to deliver large-scale regulatory initiatives by collaborating with bankers, market participants, and regulators both in the U.S. and internationally. He also served as the FDIC's top representative on the Basel Committee on Banking Supervision for over a decade.

The opinions expressed in this commentary are my own and subject to change based on evolving market conditions, regulatory developments, and other factors. Readers should exercise caution and consider the suitability of any recommendations in the context of their own financial objectives and risk tolerance. I am committed to transparency and integrity and I encourage readers to conduct their own research and consult with a qualified financial advisor before making any financial or investment decisions.

About R&T Deposit Solutions

Founded in 1974, R&T Deposit Solutions provides deposit funding, liquidity management and securities-based lending programs to the financial services industry. Through its tech-enabled services, R&T helps banks, credit unions, broker-dealers, trust companies and wealth managers meet their unique cash sweep, deposit funding, and securities-based lending needs. As a recognized leader in the administration of deposit networks, the Demand Deposit Marketplace® (DDM®) program administered by R&T provides banks and other depository institutions access to billions of dollars in reciprocal deposits, and for their underlying customers, access to expanded levels of FDIC insurance coverage on their deposits through other participating banks in the program. R&T is a portfolio company with the majority interests owned by private equity firms, GTCR and Estancia Capital Partners. Both firms have partnered with R&T to expand its market presence and achieve sustained growth by further strengthening R&T's leadership team, expanding its product offerings and enhancing the firm's risk management and technology infrastructure.

Important Disclosures