The Bank Treasury Newsletter
The Chart Deck
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In This Month's Chart Deck

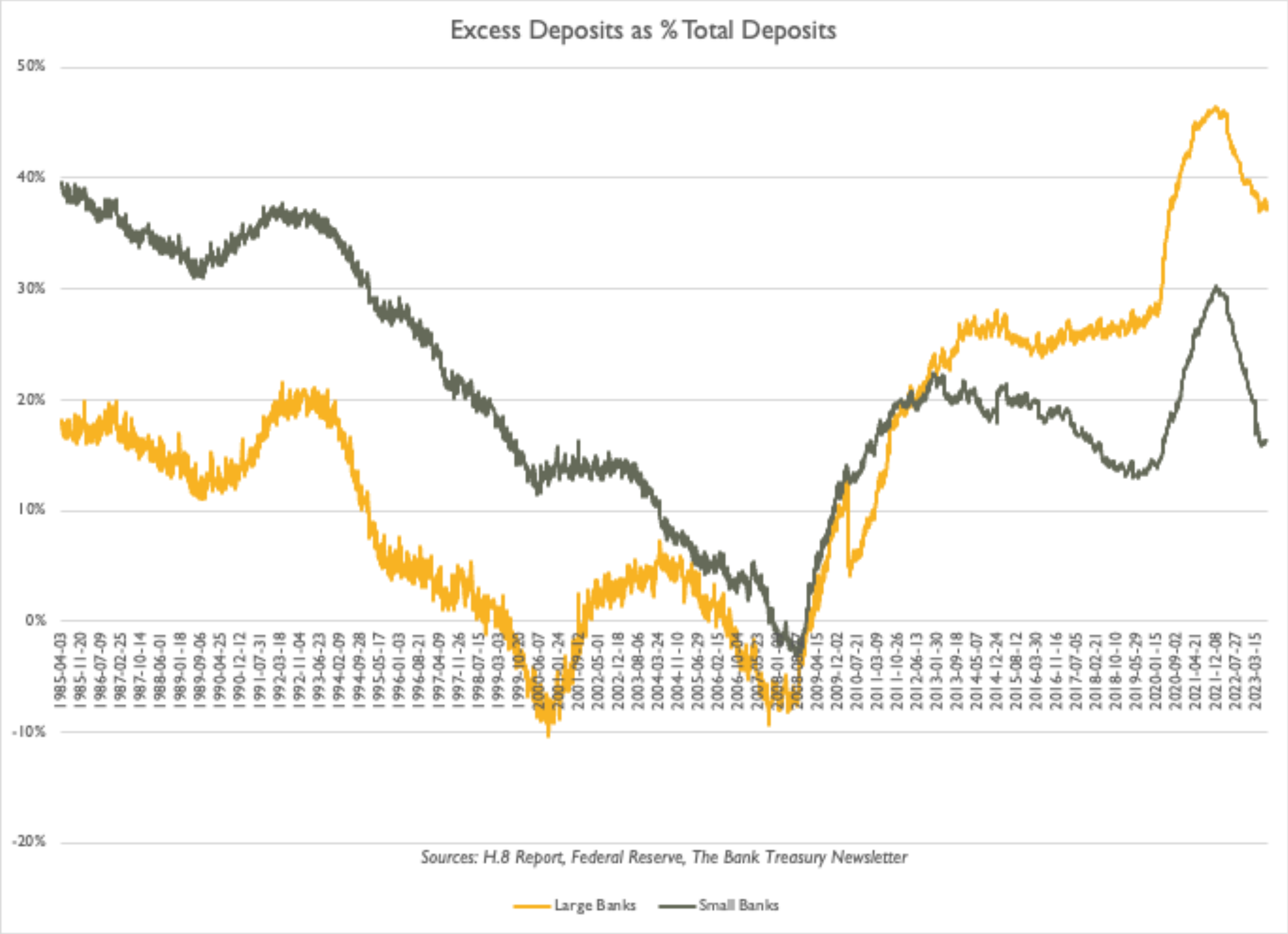
- Deposits are still trickling out of the banking industry into the money market funds or directly into Treasurys, while loans are still edging higher. Together these trends have wiped out $2 trillion of excess deposits since last year when the Fed began Quantitative Tightening (QT). Nevertheless, the industry is still sitting on nearly $5 trillion more deposits than loans. Slide 4 shows how the Fed's Large Bank and Small Bank peer groups swapped deposit profiles over the past 40 years, as the old money center banks had to borrow excess deposits from smaller regional and community banks, but now hold more excess deposits than their smaller peers. See this month's newsletter for more details.
- The composition of excess deposits is also changing. Money Market Deposit Accounts (MMDAs) fell, and time deposits increased in the last year (Slide 5), as consumers locked up their extra cash in bank CDs. Large depositors reduced their primary bank exposure risk in H1 2023, taking advantage of deposit networks to diversify their account balances. This reduced the size and number of uninsured deposit accounts that the industry reported at the end of Q2 2023 (Slide 6) in the wake of the failure of Silicon Valley Bank (SVB) and Signature Bank, New York (SBNY). Meanwhile, banks reported modestly lower levels of municipal deposits, an ongoing trend over the past year (Slide 7). To address their deposit outflows, the industry initially drew heavily on their advance lines, but in Q2 2023 let some of their drawn advance balances run down (Slide 8), the funding of which they replaced with brokered CDs (Slide 9).
- The proposed Basel 3 Endgame would eliminate the Accumulated Other Comprehensive Income (AOCI) opt-out provision that so called "Category III" and "Category IV" banks with total assets between $100 billion to $250 billion have been able to claim since Basel 3 capital rules were first implemented after the Global Financial Crisis (GFC). Slide 10 shows that the industry's AOCI headache is not going away anytime soon, especially for the banks in Category III and Category IV, in part because of the bond portfolio's concentration in negatively convex mortgage-backed securities (MBS) (Slide 11). Agency MBS holdings are between 9 and 17 points underwater, including what is carried in Available-for-Sale (AFS) and Held-to-Maturity (HTM) (Slide 12), using the fair value disclosures in the call reports.
- The Fed's balance sheet is extremely liability sensitive, as most of its "liabilities", including its Reverse Repo Facility (RRP) and bank reserve balances are overnight "funding" and its System Open Market Account (SOMA) portfolio on the asset-side consists of longer dated notes and bonds. A third of the SOMA portfolio consists of negatively convex Agency MBS which extended as the Fed raised rates in this cycle and caused its remittances to the U.S. Treasury to plunge into negative territory as the year has progressed (Slide 13).

List of Slides

- Excess Deposits as % of Total Deposits, *Sources: H.8 Report, Federal Reserve, The Bank Treasury Newsletter*
- CDs and MMDAs, *Sources: Call Reports, FIS FedFis, LLC., The Bank Treasury Newsletter*
- Deposit Accounts $250K+, Amount and Number of Accounts, *Sources: Call Reports, FIS, FedFis LLC., The Bank Treasury Newsletter*
- Municipal Deposits, *Sources: Call Reports, FIS, FedFis LLC., The Bank Treasury Newsletter*
- Advances, *Sources: Call Reports, FIS, FedFis LLC., The Bank Treasury Newsletter*
- Brokered Deposits, *Sources: Call Reports, FIS, FedFis LLC., The Bank Treasury Newsletter*
- AOCI (Tax Effected) as a Percent of Equity Excluding AOCI, *Sources: Call Reports, FIS FedFis, LLC., The Bank Treasury Newsletter*
- Mark-to-Market on Agency-Guaranteed CMOs and PTs In AFS and HTM, *Sources: Call Reports, FIS FedFis, LLC., The Bank Treasury Newsletter*
- Federal Reserve Remittances To The U.S. Treasury, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*

Deposit Outflows Hurt Smaller Bonks The Most

Over the last 18 months, excess deposits at regional and community banks were cut nearly in half, comparatively by twice as much compared to their larger peers.



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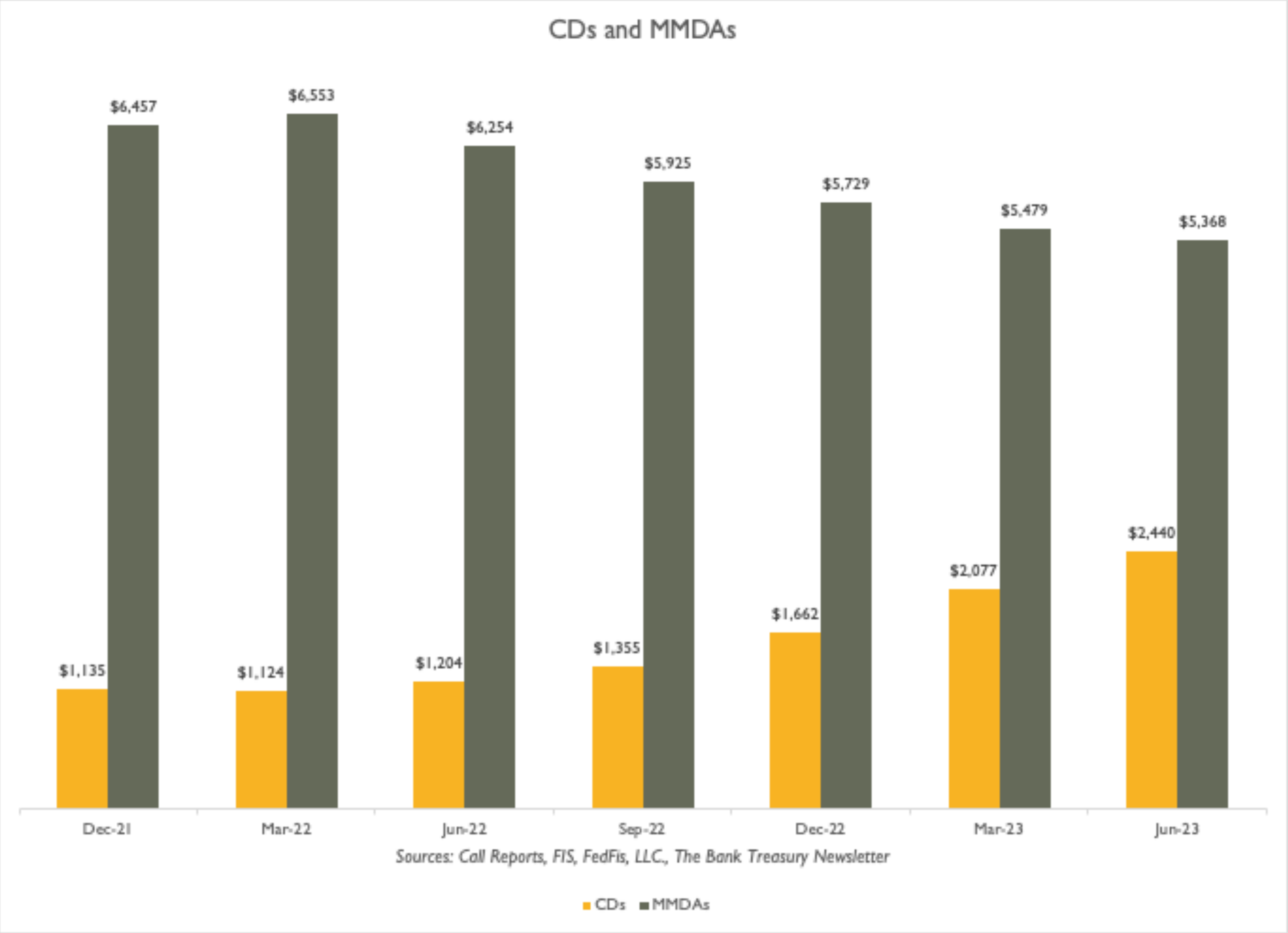
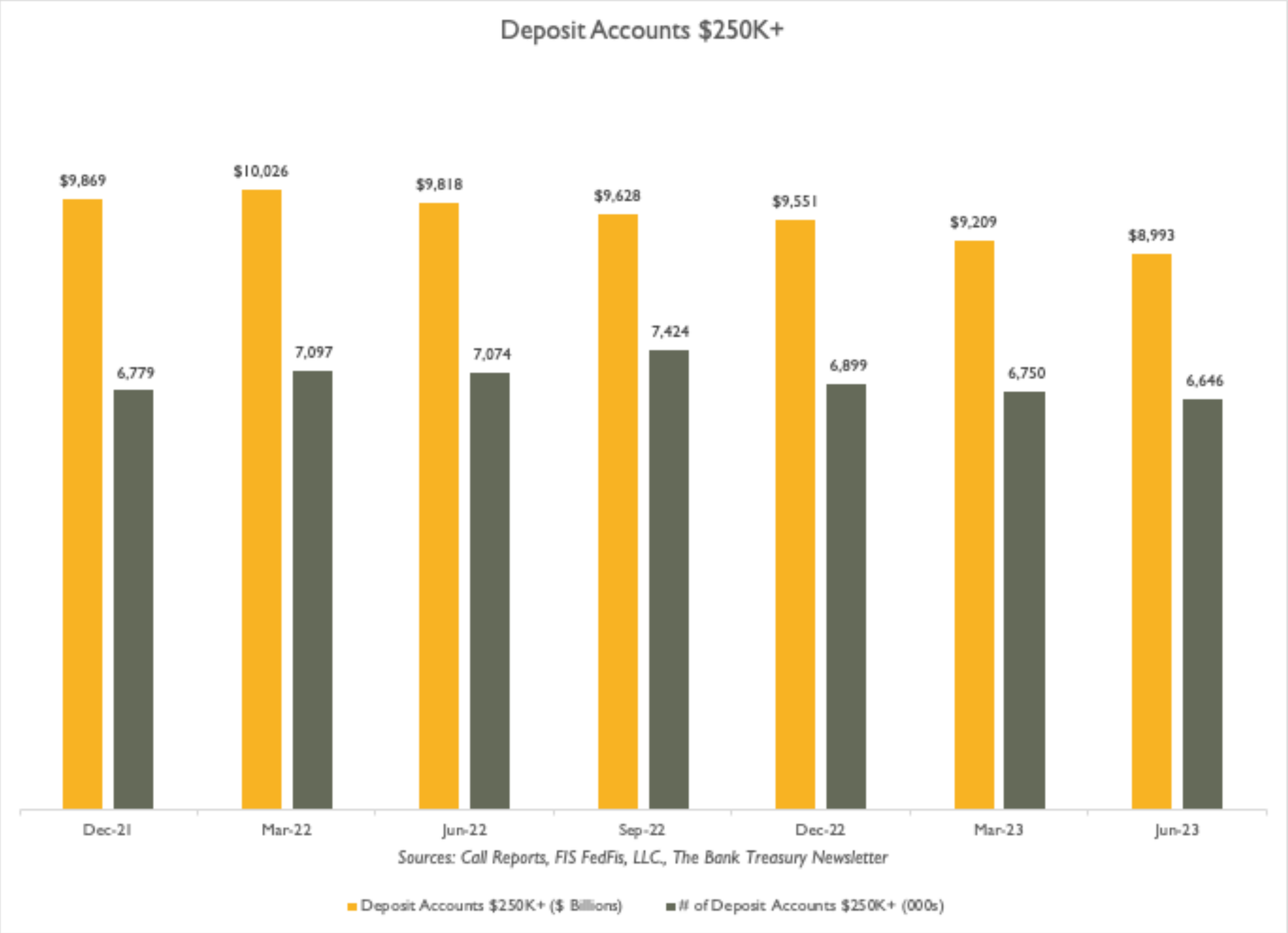
Out of MMDAs and into Time

MMDAs were introduced 40 years ago for banks to compete with money market funds as a non-time savings account. Today, MMDAs account for a third of total deposits in the system. They are a low-rate source of funding for banks. As rates increased this year, depositors shifted cash from their MMDAs into higher paying time deposits.



Modest Outflows: Large Depositors

The industry has nearly 1 million fewer large depositors since the end of September 2022, 0.25 million of which was in the wake of the SVB and SBNY failures last March.



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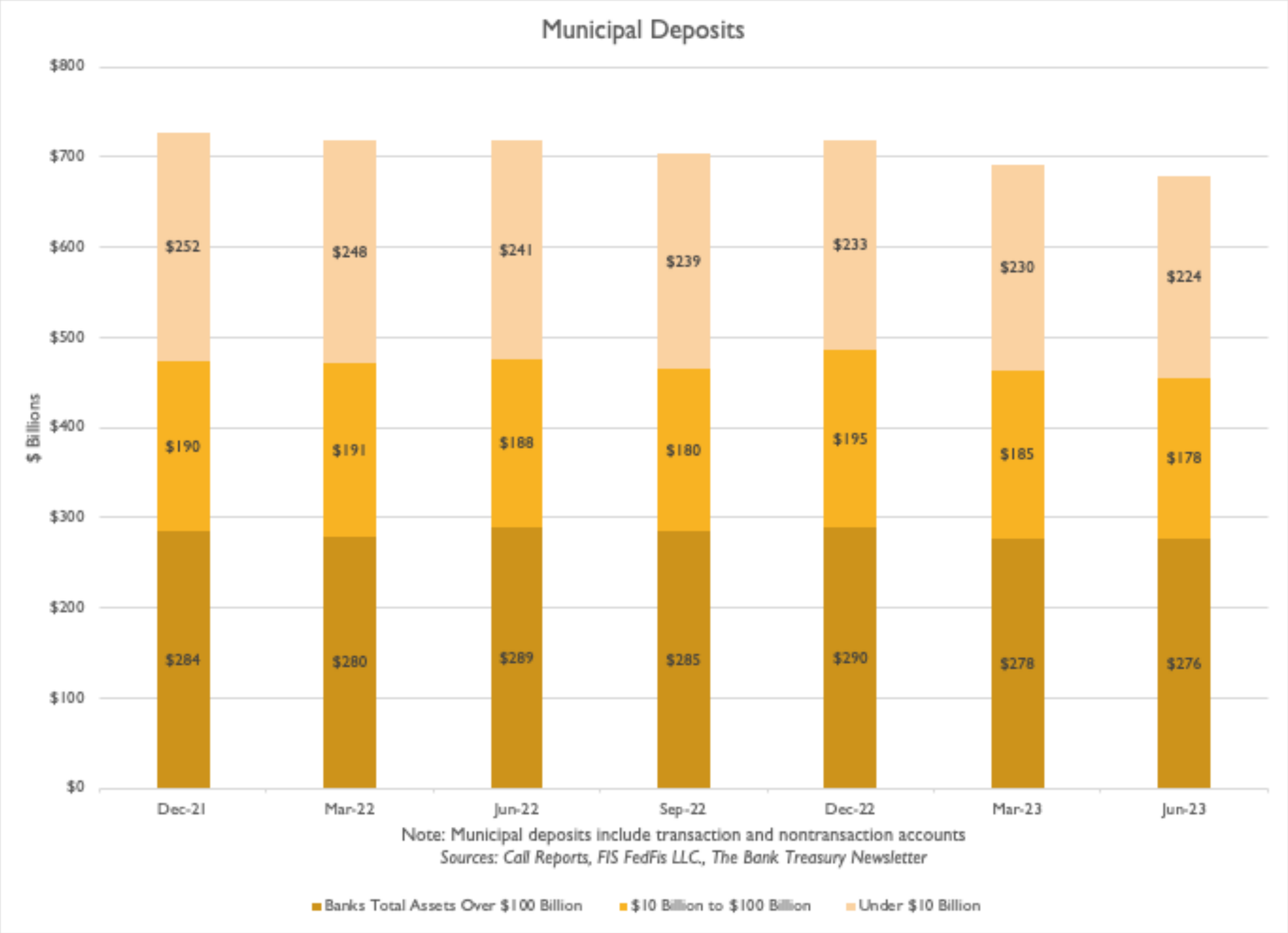
Modest Outflows: Muni Deposits

Municipal deposits fell at banks with total assets under $10 billion but balances remained generally stable at larger institutions.



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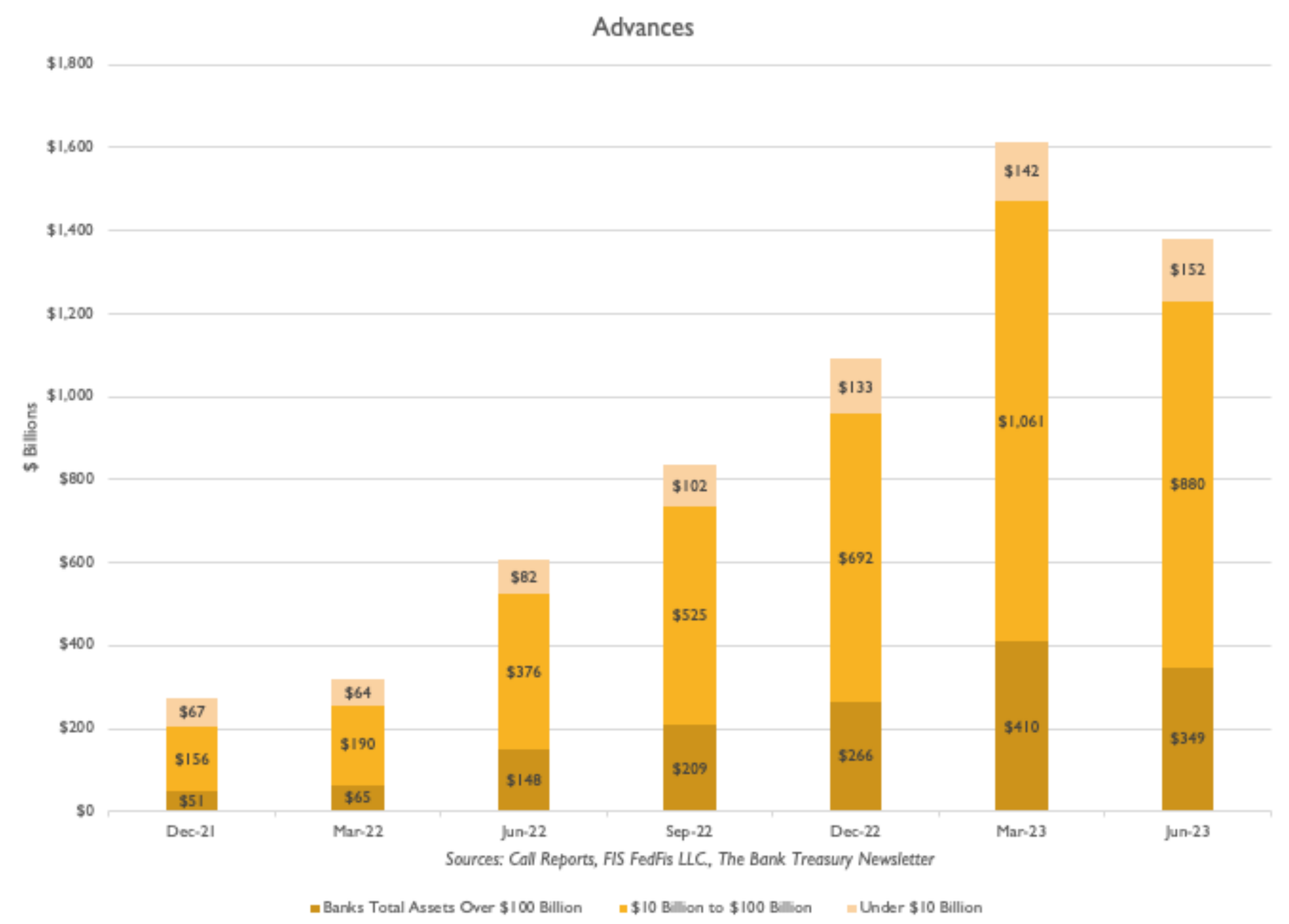
FHLB Advances Pay Down

The FHLBs remain a first line of defense for bank treasurers facing funding and liquidity pressures after SVB and SBNY failed last March, but as the "crisis" passed, bank treasurers began to let some of their drawn balances pay down.



Sources: Call Reports, FIS FedFis LLC., The Bank Treasury Newsletter

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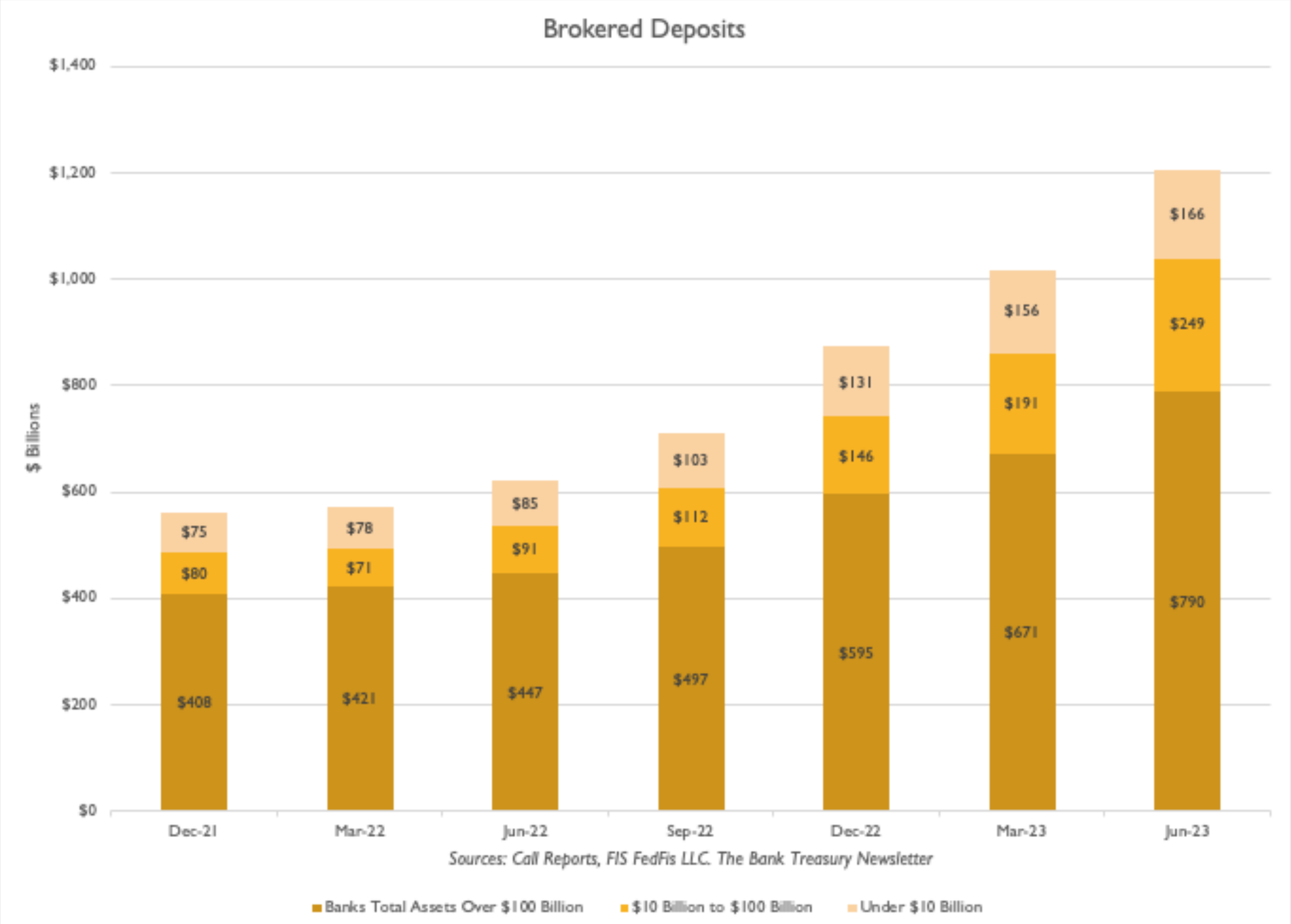
Brokered Deposits Replace Advances

A political campaign against the FHLBs, which have never lost a dime as collateral lenders to their members, criticizes them for their primary claim on the assets of a bank when it fails over the FDIC's claim as a receiver. But as the largest banks reduced their drawn advances in Q2 2023, they ramped up issuance in the brokered market, especially in the market for insured brokered CDs. Thus, the criticism could in fact increase insured deposits and might increase the cost to the FDIC when a large bank fails.



Sources: Call Reports, FIS FedFis LLC. The Bank Treasury Newsletter

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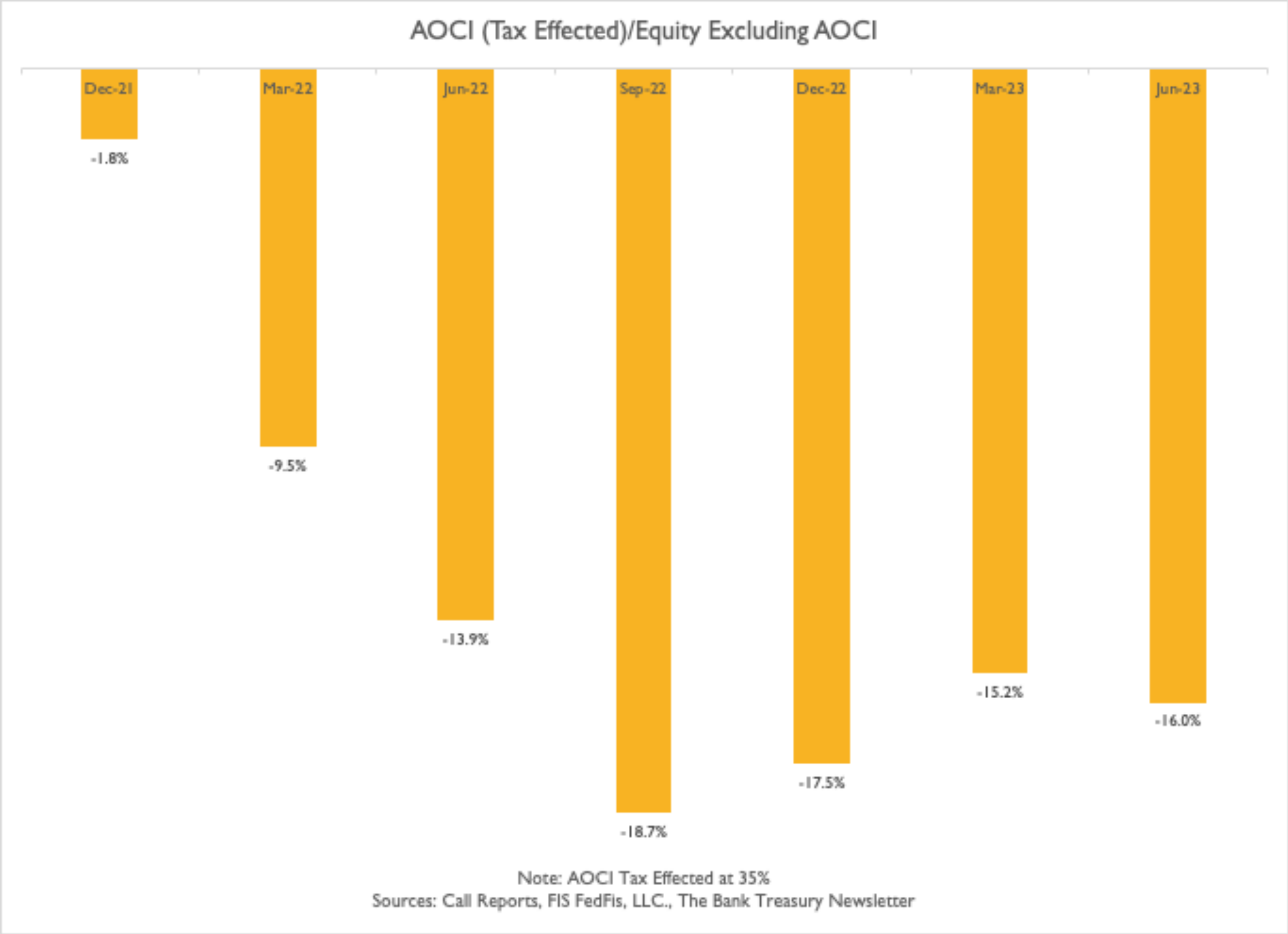
A Capital Hit That's Tough To Eat

The negative AOCI the average bank in the U.S. would have to realize if its bank treasurer wanted to sell underwater bonds right now is prohibitive without a large capital raise at the same time to cover the loss. Therefore, the practical strategy remains in place, to let underwater bonds amortize back to par value over time.



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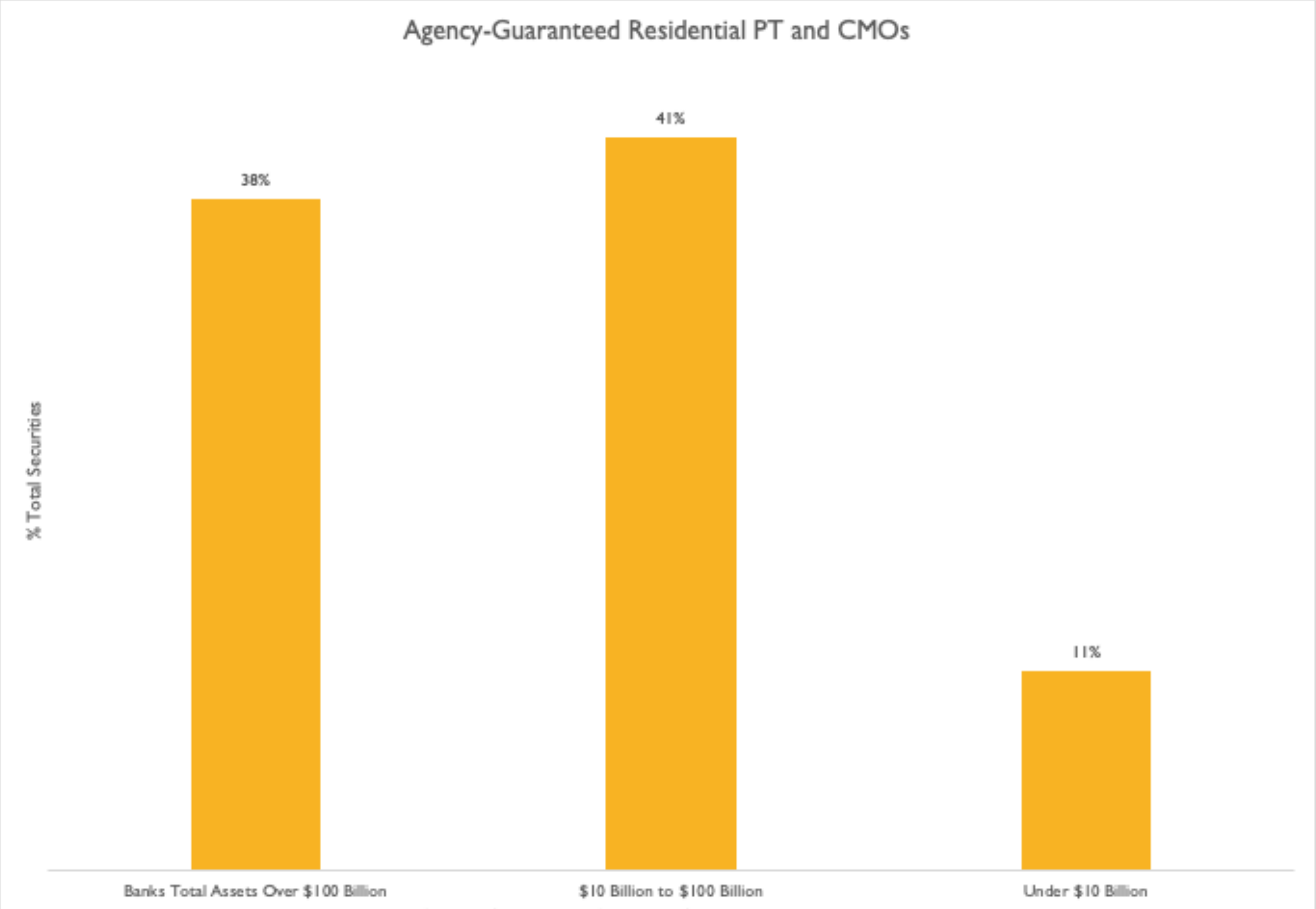
Residential Agency MBS Concentrations

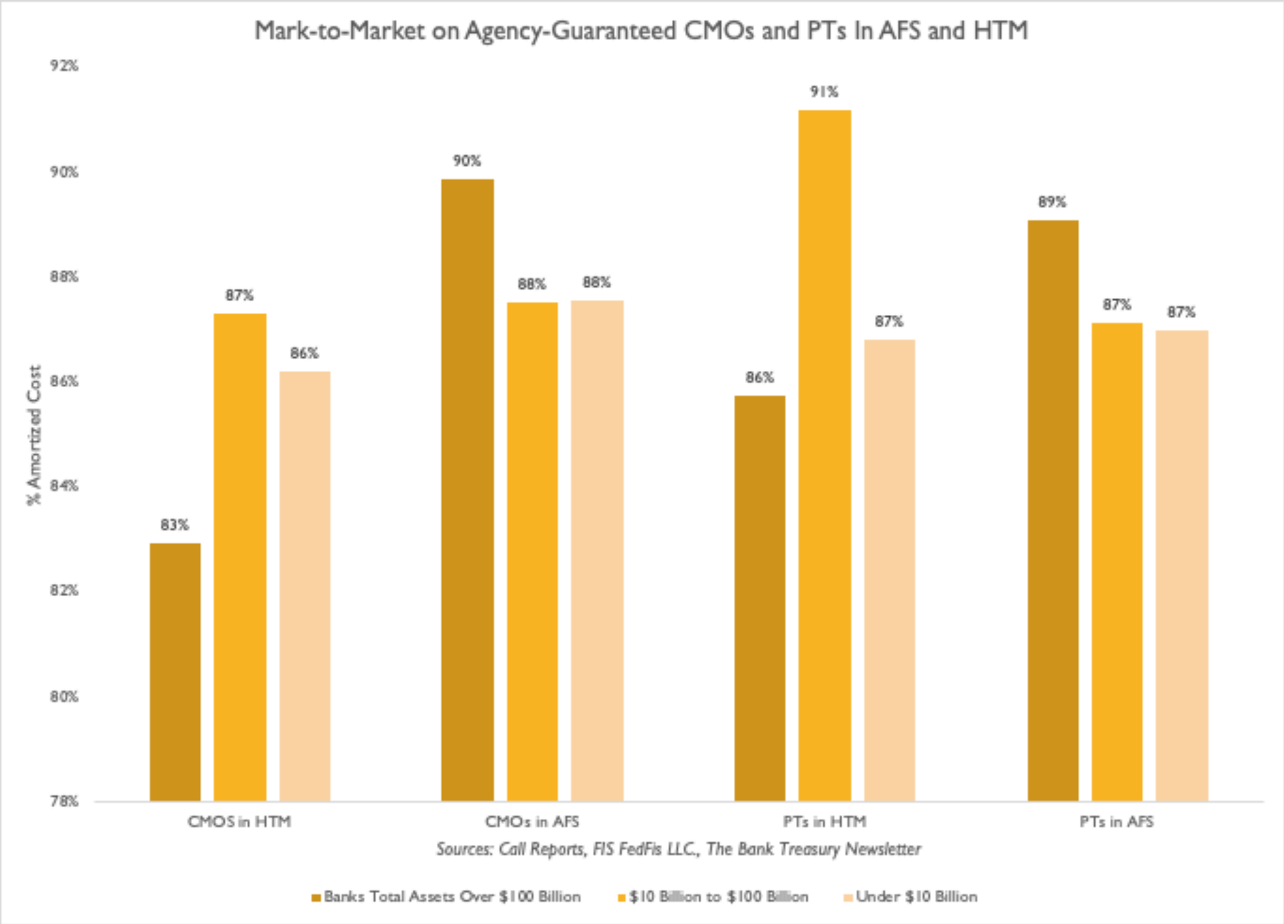
The problem with the run-off strategy to address negative AOCI is that the run-off of a bank's underwater bond portfolio could take a long time. Residential, Agency MBS, pass-throughs (PTs) and Collateralized Mortgage Obligations (CMOs), counting what the average bank holds in HTM and AFS, account for a significant chunk of the typical bank bond portfolio, especially at larger banks with total assets over $10 billion.



Sources: Call Reports, FIS FedFis, LLC., The Bank Treasury Newsletter

Bonds Deep Are Underwater

In less than two years, residential mortgage rates in the U.S. shot up between 3 to 4 points, and this month 30-year conforming is 7.2% and 15-year is 6.6%. Prior to April 2022, average mortgage rates were at least 2 points lower than they are today. Thus, a typical Agency MBS portfolio constructed over the last decade must be deeply underwater today. The ratio of the fair value of MBS to amortized cost is lower in HTM where bonds are not marked to market than in AFS where they are, reflecting the strategic accounting purpose of the HTM account in bank treasury strategies to shield capital from interest rate risk in the bond portfolio.



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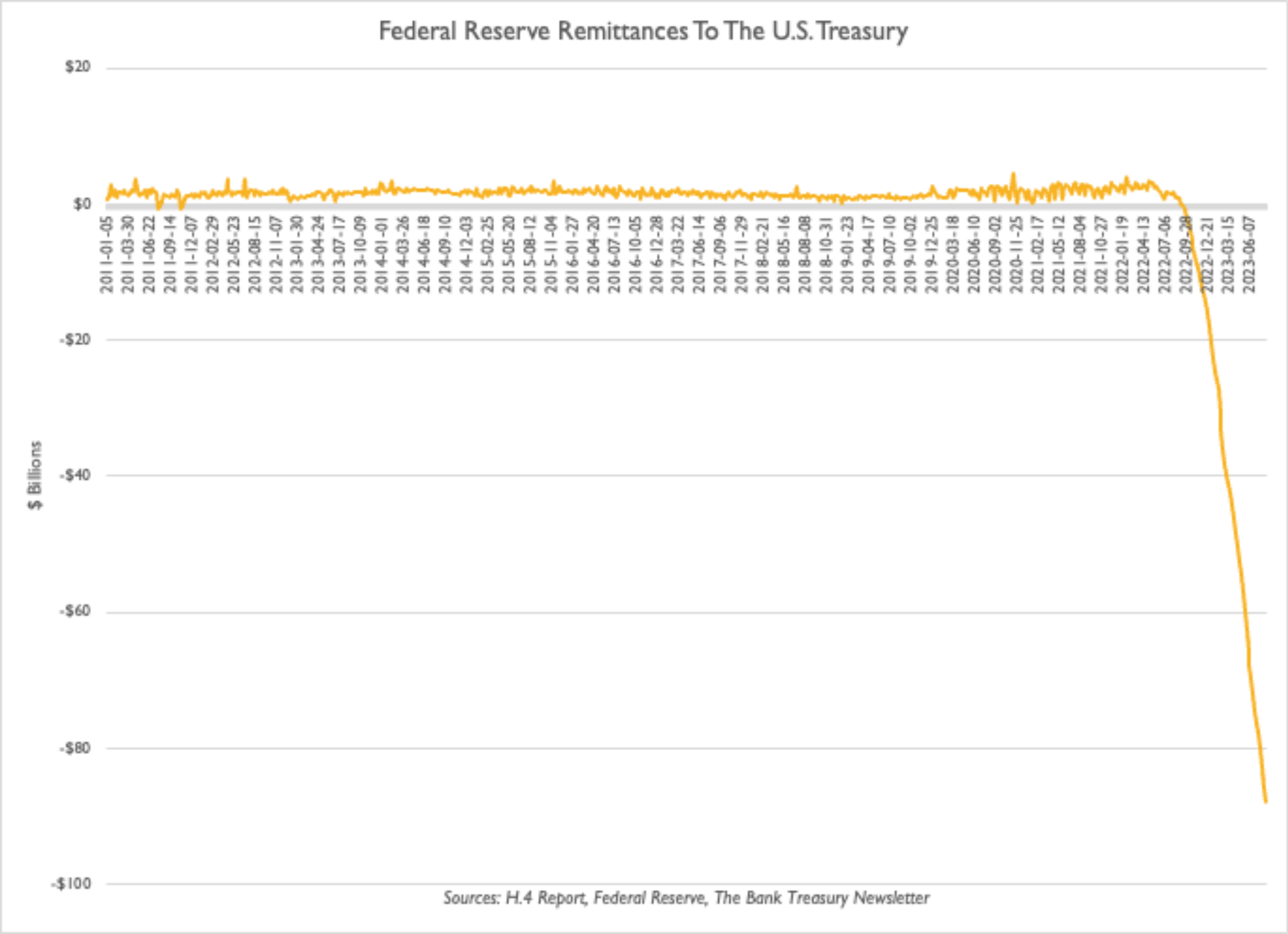
The Fed’s AOCI Problem

As with banks, the Fed’s SOMA portfolio, especially its portfolio of MBS, is deeply underwater. But since the Fed’s balance sheet is funded with overnight money, including the current 5.3% rate it pays on the RRP and the 5.4% rate it pays on bank reserve balances, its remittances to the Treasury have turned sharply negative, as the portfolio’s yield lags the rapidly increasing cost of its funding.



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