Coronavirus and Deposits: Shrink or Grow
by Charles B. Wendel

Earlier this week I lead a webinar on deposit gathering, a topic FIC has written about and worked on for years. Each time we present this webinar I make a few changes beforehand to update recent performance numbers, highlight new products, best practices, or other areas. This time was different. The former approach and PP seemed out of date and maybe irrelevant. While no one knows the impact of coronavirus on banking, it may change everything, including a bank's deposit appetite, at least for the near term.

Past webinars and project work have assumed that a bank wanted more deposits, and we would discuss how to grow deposits, using one or more of multiple channels, namely, the branch, relationship managers, specialized sales teams, the Internet, and more. But, today, do banks want more deposits? Given expected portfolio performance and appetite for lending, should banks be pursuing a deposit shrinking initiative?

Data provided by Bancography shows that in 2019 retail and small business deposits grew by 3.0% and overall deposits by 4.3%. This week, Precision Lender, working off a different data set than Bancography, wrote that DDA balances declined year-over-year from Q1 2019 to Q1 2020. More significant, they revealed that for the past two weeks overall balance levels rose 8%. That is not very surprising, given the amount of government payments, including PPP, and loan drawdowns parked in bank accounts.

Loan trackers, including Precision Lender, show that loan volumes are up this year as well, basically due to PPP and companies taking down their revolvers. Precision Lender's sample shows loan volume counts for the week ending 4/17 "at more than 3.7X the average from January and February." But, in their analysis non-PPP "business as usual" volume dropped 73%. You should go to their website for the full data, but across all business loan categories, "It's an across-the-board wipeout in volume, and the average loan size outside of PPP has also dropped dramatically."

At the moment many banks find themselves with higher deposit levels than expected and, other than PPP, reduced loan expectations and appetite. Unlike 2008-2009 some loan areas may experience systemic changes, impacting loan quality and growth opportunities for the foreseeable future. Recently, *the Real Deal* quoted the CEO of Morgan Stanley saying his firm could operate with "much less real estate", one in which "a lot of our employees will be at home." The reduced CRE needs of financial services companies, your own banks included, will also exist with many of your clients, potentially for years. Other than PPP and Main Street Fund lending, loan growth is unlikely and, perhaps, unwanted.

Banks are evaluating their portfolios and expecting increased losses. Some banks will need to retool their skills set to deepen their C&I capabilities. We assume that banks right now are conducting scenario planning and stress tests around their funding needs. Many will find that deposit requirements will be reduced in next three-six months and perhaps beyond.

Still, discipline around deposit gather remains essential and may be more important than ever. This time, though quality, rather than quantity takes strong precedence. By quality, we mean low cost or free deposits, as cost of funds plays a critical role in a low interest rate environment with rising loan losses and NIM under attack.

Banks that have succeeded in PPP lending have an easy place to start; if they have not done so already, they should be reaching out to obtain *all* the operating deposits of those borrowers. BTW, some banks have been gaining deposit share as they take business from banks where the banker has been MIA, not reaching out to help or even answer client calls. The industries in which banks have found low cost deposits may need to be revisited; some of them, such as professional services firms, may temporarily be cash constrained and become borrowers from a bank rather than, lenders of their funds to a bank.

If deposit needs are negative, the emphasis has to be on exiting high cost deposits ASAP. However, deposit needs will change, so strong communication to depositors explaining your change in appetite may help you reconnect with them later. Compensation also needs to be revisited with capturing only "free" deposits encouraged.

What will define winners in deposits (and other areas) going forward?

- Flexibility. No one knows whether we are heading over the next six months. You need to be able to change direction.
- Strong internal communication. Bankers need guidance.
- Quicker than usual decision-making. A small group of top management should be in regular discussions
- Deposit Czar or Czarina. Someone has to have the responsibility and authority to determine and implement policies.