



The past two decades have seen major changes in the financial services industry, with many new competitors entering the financial services industry. Growth in mutual funds, money market funds, and equity markets have lured core deposits away from banks. This shift of consumer funds has coincided with exceptionally strong loan demand over the past decade, causing loan-to-deposit ratios among banks to reach historic highs. As a result, community banks have turned to use a variety of alternative funding mechanisms, such as Federal Home Loan Bank advances, Fed funds, loan participations, repurchase agreements, brokered CDs, loan sales, banker's banks, and asset securitization.

As part of our continuing effort to address concerns about funding and liquidity issues, ABA recently surveyed subscribers of the *ABA Insider*. The purpose of the survey was to gain insight into the funding avenues that banks are starting to use, inquire about new ideas, and explore the degree of supervisory concern. The following is a summary of the four hundred and sixty-one institutions that responded to the survey.

In summary, we found:

- Eighty percent of respondents said that they are experiencing funding problems.
- The high cost of funds, intense competition and strong loan demand are the major funding challenges. Credit unions and the stock market are the primary competitors.
- Federal Home Loan Bank (FHLB) advances are the most popular "new" idea. This source was ranked as the most important source of funding for the near future.
- Credit union competition and FHLB advances transcended all asset and regional categories.
- Other sources for funding include marketing, product specials, loan securitization, brokered deposits and tiered money market accounts. A longer list of suggestions is provided below.
- Among the banks that cited funding problems, 22½ percent indicated that their examiners have criticized their funding mix.

In order to delve further into the funding issue, we separated the responses into both asset and regional classifications, but did not find any significant variation between the categories.

Funding Challenges

As to why the banks are experiencing funding pressures, the most frequent response was competition with credit unions (77 percent of respondents). In addition, banks with under \$100 million in assets noted limited funding available in their local communities (45 percent), while banks with over \$500 million in assets cited the stock market (88 percent) and competition from other banks (75 percent).

New Sources of Funds

Respondents cited a plethora of "new" ideas. It appears that many individual banks are experimenting with different funding techniques that are new to them, not necessarily new to the industry as a whole.

- FHLB advances are the number one "new" resource for banks of all sizes, cited by 55 percent of respondents.
- Deposit "specials" were cited by 40 percent of banks under \$500 million of assets.
- Banks with \$100-to-\$500 million of assets are relying more on brokered CDs and deposits.
- Small banks are using Internet deposit brokers, jumbo CD clearinghouses, and state CD programs.

A range of other ideas were cited, including:

- gathering deposits through internet brokers (e.g., through Express Data Corporation)
- IRAs and tax-deferred accounts
- borrowing from subsidiaries
- callable or no-penalty CDs
- CDs and money market accounts with rates tied to a market index
- CD specials
- targeting maturing CD accounts
- new deposit products; bundled accounts
- condo rental trust accounts
- courier service for commercial accounts
- credit union deposits
- loan sales to Farmer Mac
- federal funds borrowing agreement with neighboring banks
- federal funds pool between holding company banks
- loyalty rewards
- negotiated rates on municipal deposits
- adding branches
- “partners program”
- private deposit insurance
- performance incentives for deposit managers
- staff training
- “thrifty 50” account
- raising the \$100,000 deposit insurance limit, including for municipal deposits
- tiered interest-bearing checking accounts for municipal deposits

Supervisory Concerns

Among the banks that have funding difficulties, 22½ percent noted that their regulator was critical of their funding mix. The FDIC was cited by 48 percent of these banks; 32 percent cited their state regulator.¹ Survey respondents reported examiner criticism of:

- inadequate deposit growth and declining core funding;
- dependence on FHLB advances and brokered and large-denomination deposits;
- volatile and unpredictable non-core funding sources; and
- high and variable costs of non-core funding.

Some of the criticism was based on loans/deposits and other traditional liquidity measures. Some bankers were asked to set up policy limits on non-core funding and contingency plans.

¹ This result may not indicate that FDIC and state examiners are more critical of non-core funding than those from other agencies. The community banks surveyed disproportionately represent smaller banks that are supervised by the FDIC, Federal Reserve and state banking agencies.