# Has the Covid 19 Deposit Glut Forced a Rethink on Funds Transfer Pricing?

One of the consequences of Covid-19 is that, for months on end, a lot of people had a lot of money sitting in bank deposits, with no place else to go.

No foreign holidays, no live events, no visits to restaurants. Not even a drink in the pub. At the same time, quantitative easing to finance the cost of employee furloughs and other measures to support business has meant even more liquidity sloshing about.

It's almost the inverse of the situation during the liquidity crisis of 2008: instead of banks hunting for funding they've got a glut of deposits on their balance sheets. Just taking the UK as an example, the household savings ratio increased from 9.6% in Q1 2020 to 29% in Q2 2020; a record high.

Meanwhile, the practice of central banks aggressively cutting interest rates has put additional pressure on banks' net interest margins (NIM).

All of this has had an impact on fund transfer pricing (FTP) methodologies. How should the Treasury function in banks respond? As is well known, the Treasury department is essentially a bank within the bank. It buys funds from the liability business unit and sells them to the asset business unit at a rate that balances both the deposits and lending activities areas, in a way that is economically viable. In other words, the FTP rate is above what the bank pays to depositor clients, and less than what it charges creditor clients.

So far, so simple. Yet in practice the implementation, interpretation and management of the FTP framework can be complex at the best of times, and in the current scenario, requires some creative thinking. Suddenly, with the excess of deposits (liability business) the two have been thrown out of kilter.

On the deposits side, FTP normally acts as an incentive to increase the amounts of new deposits raised. But who needs such an incentive right now?

**What to do? Three strategies**

For banks that simply use FTP as a tool to allocate the liquidity cost, maybe the best solution is to do nothing, so long as the bank's business units are still economically viable. If, for example, the bank expects the current situation to be reversed sooner rather than later and can accommodate the excess deposits – particularly in cases where operational marginal cost for deposits is small – taking a small hit now might be a viable option.

On the other hand, where the glut is severely pressuring profitability, it may make sense to introduce different tiers in FTP. For example, to pay the standard FTP rate up to a certain threshold of funds raised and 0% for all amounts above. This could provide a great solution during this period of excessive liquidity. Treasury would define the thresholds and deposits team would be incentivized to reach the optimum return on their P&L.

Finally, should the bank be in a situation where it believes it will be able to deploy the excess deposits into lending in the medium term, Treasury can suggest steepening the FTP curve to create an incentive for the deposits team similar to a premium for longer maturities. This would be particularly effective if combined with a campaign to offer better prices for fixed term deposits for current clients of the bank. (This should of course not be aimed at new customers, as this would attract new deposits, piling more pressure on the liabilities business.)

At first glance, this third solution seems to add more interest expense. However, creating an alternative to shift non-maturing deposits into longer-term deposits may provide several positive impacts. These could include first, allowing Treasury to invest in longer-term high-quality liquid assets without maturity mismatch, second, reducing LCR and NSFR ratios and associated costs, and third, providing comfort that funding is locked in, and term lending can be executed without risk of deposit levels subsiding again.

This third option is rather more complex and demands more analysis, as it will impact the balance sheet structure and indicators such as liquidity gaps, hedging, and IRRBB amongst others.

But if done with success, it could result in higher NIM for the bank.

**Written by Moody's Analytics UK Limited**

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