

# TSI Says . . .

## Deregulation of Interest Restrictions on Deposit Accounts

A banking reform act will almost certainly become law in 1999. Different versions have already passed the House and Senate and are in the process of reconciliation.

The 108 largest U.S. banks reported total domestic deposits of \$1.72 trillion in December 1998. Of that total, \$455 billion, or 21%, was carried in non-interest bearing accounts, the remaining \$1.26 trillion in interest bearing accounts and instruments. Many banks, especially those catering to small and middle market businesses, rely on non-interest bearing deposits for balance sheet funding.

Legislation now in Congress may remove non-interest bearing deposits from the banking landscape as early as 2001. The press has focused attention on the "charter broadening" aspects of banking reform. It has said almost nothing about other reforms such as removing interest restrictions on what are called "demand" deposits. This latter reform could have a devastating impact on banking industry profitability and also on bank customers.

Suppose banks begin paying interest on currently non-interest bearing accounts. The rate paid on such accounts will likely approximate the yield on money market mutual funds, currently about 5%. Annual exposure for just the 108 largest banks would be about \$23 billion!

Two factors will determine how individual banks are impacted by the demise of non-interest bearing deposits.

- Each bank's ratio of non-interest bearing deposits to total domestic deposits.
- The degree to which banks are already paying *de facto* interest in the form of earnings credits.

Since there is no publicly available data about balance absorption via earnings credits, we can only speculate about this matter. We assume that between 20% and 70% of non-interest bearing deposits actually generate *de facto* compensation. Extrapolating from the FDIC data, banks with modest (20%) earnings credit offsets on their non-interest bearing balances will be impacted most.

For banks, the implications of reform are obvious: broader powers in exchange for higher operating costs in traditional business areas. Implications are less obvious for bank customers. Corporate Treasury managers, especially, should be studying their banks' funding structures to assess the likely impact of higher interest costs. Treasury managers should also be having conversations with their banks and within their own professional societies to better understand the implications of interest rate reform and to provide input into bank and industry planning processes in the 18 – 24 months before reform becomes effective.

*Treasury Strategies consults on global treasury management, payment systems, treasury performance and organization, and short-term liquidity.*

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