

# Out-of-market deposits helping small banks meet surge in loan requests

By

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Community banks are eager to make loans to help their small-business customers stay afloat while the economy remains shut down due to social distancing, but many face a significant hurdle: They don't have enough deposits on hand to meet loan demand.

As a result, small banks have been turning with more frequency to deposit placement firms like StoneCastle Partners in New York to help to secure the funding they need to offer bridge loans or participate in the federal government's emergency small-business loan program. In the last week, Farmers & Merchants Bank in Miamisburg, Ohio, has gone to its "absolute max" to draw \$18 million from StoneCastle so it can quickly get loans into the hands of business clients suffering from the economic shocks of the coronavirus outbreak, said CEO Shon Myers.

"And it's still not going to be near enough," Myers said in an interview Tuesday

StoneCastle gathers funds from municipalities and other large accountholders and, for a fee, parcels out the funds to its network of community bank clients.



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StoneCastle's banking clients have requested \$3 billion in deposit in the last three weeks, CEO Josh Siegel said in a recent interview, dwarfing what the firm would typically do in an entire quarter. The company's assets under administration, which represents the amount of deposits sent to community banks totaled nearly \$23 billion as of Tuesday, fueled in large part by March's growth alone.

"I've never seen this much accelerated growth that we've seen in the last few weeks," Siegel said.

Siegel said demand was first fueled by small businesses looking for bridge loans as social distancing policies were first being put into place across the U.S., and in recent days it's been driven by banks' desire to participate in the government's Paycheck Protection Program.

The SBA and the Treasury Department launched the PPP on Friday as a way to funnel \$349 billion through banks to small businesses to help the firms pay their employees and cover their expenses. Demand has been so overwhelming in the first few days that the Treasury Department is [asking Congress for another \\$250 billion for the program](#).

The program is expected to propel requests for deposits from StoneCastle "for the next few months," Siegel said.

This surge could increase calls for the Federal Deposit Insurance Corp. to ease restrictions on when banks can use out-of-market funds. The agency has long blamed the use of this quick cash for

fueling the kind of risky growth that leads to bank failures, but some argue that the deposits can be a critical resource in a crisis like the coronavirus pandemic.

In December, the FDIC [proposed a new rule](#) that would give banks more flexibility on raising funds and potentially exempting more companies under the definition of “deposit broker.” FDIC Chairman Jelena McWilliams [called on Congress](#) that month to give the agency more room to adapt its rules by revamping the underlying law governing brokered deposits that was passed three decades ago.

“Unless regulators and Congress get ahead of this, this will be another sad moment for community banks as they run into liquidity challenges,” Siegel said.

StoneCastle connects high-dollar depositors like municipalities and pension funds to place their accounts at different banks so that their funds are completely insured under the limit set by the FDIC. Community banks can receive these deposits for a fee and use them to fund their loans.

Promontory Interfinancial Network in Arlington, Va., helps carve large deposits up among multiple accounts with other banks in its network, giving smaller banks access to cash from customers that would usually go to bigger competitors. Promontory has seen increased requests for deposits since the economy began to shutter, but that demand was more driven by the billions of credit lines that have been tapped by corporations so far.

“Since early March, bank demand for deposit funding via our network has increased materially,” said Rob Blackwell, head of external affairs for Promontory. “However, to date this has been more due to banks needing to fund draw-downs on lines of credit and other borrowings as opposed to the new PPP program, which just launched on Friday.”

Not all bankers think it’s a good idea to be tapping outside deposits to meet funding needs.

Greg Morse, CEO of the \$295 million-asset Worthington National Bank in Arlington, Texas, said a new program coming from the Federal Reserve to buy the PPP loans from banks could curb some of the demand for deposits from outside brokers. Morse added that he felt it would still alarm regulators to turn to outside deposits as a source of funding even now.

“There is no substitution for homegrown deposits,” Morse said.

Myers at Farmers & Merchants Bank in Ohio said as local small businesses have heard their loans are going through, they have been inundated with applications. The Fed’s new program, he said, may not be helpful to small banks that don’t have the time to package the loans they make and sell them to the Fed.

“This is going to go so quick none of these options are going to happen quick enough to help us,” Myers said. “We are looking anywhere we can get funding.”