

## A DEEPER POOL OF FED FUNDS LIQUIDITY & SAFETY

by [Steve Brown](#)

Think about the last time you visited a swimming pool tightly packed with people. Every person in that pool has a varying level of swimming skill and some cannot swim at all. That

is why a lifeguard stands at the ready to assist. Before ever stepping foot onto a pool deck with that cool red buoy; the lifeguard has been thoroughly trained in rescue/safety techniques and had to pass a battery of tests. To the trained eye, lifeguards with more experience can also be easily spotted by their fast and

professional action when events dictate. While it may not seem

obvious, banks that wade into the daily Federal Funds market are

also taking risk without a highly trained lifeguard at their side that

is enforcing constant safety rules and regulations.

Take a moment and think about the events of the past couple

of weeks. Worldwide liquidity has locked up, central bankers

have flooded the system with liquidity adding volatility, Treasury

Bill yields have gone negative (because so many investors are

hiding in safety) due to heightened fear and some of our largest

financial services companies have been taken over or gone out

of business in a very short period of time. Without a doubt, we

have all seen how fast things can change in the market and how

quickly strong companies can literally go out of business. During

this time of heightened uncertainty, now more than ever, liquidity,

diversification and professionally trained experts are critical to

protect your daily Federal Funds investment.

This is a primary time to stop selling daily Federal Funds to

banks one at a time (after calling around randomly) and instead

move to a diversified and professionally managed "As Agent" pool like the one at Pacific Coast Bankers' Bank (PCBB). The pool has been around for nearly 12Ys, it is highly diversified, it is professionally managed and borrowers in the program must pass a litany of credit and performance

hurdles to get approved. Here is how it works. Community banks with excess funding open up an account at PCBB. Each day, whatever is in the account is automatically swept out and invested (on a pro-rata basis) in Federal Funds to banks that meet program requirements. Then, on the following day, the funds are redeposited back into the account, along with interest earned on the Federal funds investments from the prior day. The pattern then repeats and the community bank has total flexibility to move money in and out of the account based on its needs each day. The entire program sounds simple, but here are some things that may not be so obvious.

- First, the program is managed by a professional "lifeguard" that has traded Federal Funds for nearly 25Ys. That kind of training and experience ensures safety rules and regulations for the program are consistently followed.

- Next, the program is highly diversified. Each day, investments into the pool are spread across up to 30 different banks to ensure diversification is maintained. For example, let's say that for a particular day a given community bank leaves \$10mm in their account at PCBB. On that day, the funds are swept out and invested on a prorata basis to 20 different banks. That means for that specific day for that specific community bank, their \$10mm would have maximum exposure to any single upstream bank investor of only \$500k (e.g.  $\$10\text{mm} / 20 \text{ names} = \$500\text{k}$ ). If, on the other hand, the pool on that day were sold to 40 upstream banks, the community bank would have maximum individual exposure to each upstream bank of only \$250k (e.g.  $\$10\text{mm} / 30 \text{ names} = \$333.3\text{k}$ ). Investing in this manner

not only increases diversification, but reduces risk should any singular upstream bank fail for any reason.

- Being a "lifeguard" means you must also quickly react to changing conditions. When lightning strikes, lifeguards cannot let people keep swimming. In similar fashion, the "As Agent" program is actively managed throughout each day. That means just because a bank has passed the credit screens and qualified for the program does not mean they will receive any funding on a given day. Our "lifeguards" constantly monitor newswires, talk to institutional investors, review stock price movement, monitor credit default markets and take other steps to stay on top of risks forming around upstream counterparties. Lines can (and regularly are) suspended for any reason if the pool manager feels it is in the best interests of the investors.

Some community banks still call a handful of correspondent banks asking for the daily Federal Funds rate and investing one by one. While the process seems simple, it is not and conditions change constantly. If your bank is selling Federal Funds this way and not through a diversified pool, you are adding risk to the bank. Call or email us to get more information on the PCBB "As Agent" Federal Funds program and start diversifying your risk.

## **BANK NEWS**

### **Wow**

Since October, the S&P 500 index has erased 50% of the gains it captured during the 5Y bull market.

### **For Sale**

Experts predict Washington Mutual may be purchased by Wells, JPMorgan, Citigroup or Bank of America.

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