Top Strategies for Managing Liquidity in a Falling-Rate Environment

By H.D. Barkett, Senior Managing Director, Treasury Desk, IntraFi

With the Fed recently cutting rates by 50 basis points, bankers are rethinking their strategies for funding and liquidity management. Declining interest rates may tighten the spread between earning assets and liabilities, requiring bankers to adjust to the changing environment.

Here are three strategies bankers can leverage now to walk this tightrope.

1. **Examine and Reprice Short-Term Liabilities:** Falling rates will impact profitability. To counterbalance, banks will need to reprice a portion of their liabilities, reducing interest paid to some depositors. While some customer runoff will be inevitable, bankers should prudently consider their approach, as cutting rates too swiftly (or for too many customers) could lead to unexpectedly large losses in funding.

   Thoughtfully considering which classes of customer will see the first rate cuts (preserving higher rates for higher-value depositors), in conjunction with using short-term funding solutions, can help banks maintain desired funding and optimal liquidity levels. As an example, IntraFi's ICS® service can provide floating-rate, short-term funding that reprices quickly, enabling banks to take full advantage of falling rates and replace high-cost deposits that may leave because of rate changes. This can be done using ICS' One-Way Buy ® feature, through which banks can access floating-rate funding at select terms (from overnight to multiyear) without collateralization requirements.

2. **Assess Whether to Repay Long-Term, Fixed-Rate Liabilities:** Banks will also need to check their longer-term liabilities and decide if they are worth holding or paying off early and replacing them with shorter-term, lower-cost deposits. Fortunately, the math behind this decision is easy — bankers will just need to compare the prepayment penalty against the cost of continuing to pay above-market rates.

   For banks that make the decision to replace their longer-term liabilities with shorter-term funding, ICS One-Way Buy is a simple way to acquire floating-rate funding tied to an index of the bank's choice. Institutions that are looking to reduce the burden of longer-term liabilities but still desire fixed-rate funding may benefit from leveraging CDARS® One-Way Buy, which allows banks to acquire large blocks of fixed-rate, wholesale funding and mitigate margin compression — while paying a single, all-in rate with no transaction fees apart from the cost of funds.

3. **Pay Attention to Your Bank's Securities Portfolio:** The changing shape of the yield curve over the past two years has forced some institutions to take considerable losses, and, in 2023, even contributed to several notable bank failures. Most institutions have fortunately weathered the storm, though they may be holding on to unrealized losses. This latter group may be in luck — as rates decline, those once-underwater securities now have a chance to come up for air. Banks should monitor the yields of formerly upside-down bonds against the cost of funding.

These potentially recovered securities can be helpful to counterbalance any losses incurred in paying off long-term liabilities, offsetting at least some of the prepayment penalty.

These are far from the only considerations facing banks during a fundamental shift in rates, but by prioritizing these items, banks can act quickly to boost profitability during this period of change, setting themselves up for even greater success once rates settle. Solutions, such as IntraFi's ICS or CDARS services, can provide both short- and long-term wholesale funding alternatives, as well as deposit-gathering and liquidity management tools that banks can use in any rate environment.

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