

White Paper

Report of Findings: The Relationship between Remote Deposit Capture,
Capital Adequacy and Deposit Growth

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Report of Findings

In the banking industry, all eyes are on balance sheet health. Banks are focused on raising revenue and containing expense by growing deposits and reducing capital-related costs. Remote Deposit Capture (RDC) may be a way to achieve those objectives. Research suggests that banks with a remote deposit capture strategy experience greater growth in deposits while carrying less capital.

Many agree that the primary objective of bank capitalization is to offset business risk, yet banks frequently carry levels of market capital that well exceed regulatory minimums for capital adequacy. Banks have learned some hard lessons related to the balance sheet and the ability to quickly raise capital. So, in order to prevent barriers to credit due to under-capitalization, one response may be to over-capitalize to provide a cushion for risk management purposes or to fund activities. Certainly, banks must establish capital margins to mitigate unforeseen risk, but there are costs associated with reserve capital in terms of opportunity lost, funding expense and a diminished rate of return for bank investors.

As an alternative, banks can reduce the cost of idle and borrowed capital, as well as institutional risk, by funding as many activities as possible with deposits. Deposit growth will allow banks to reduce the need for borrowed capital and free up funds to create excess market capital.

So, what is the relationship between deposit growth and capital? To find out, Fiserv conducted a study in 2008 to determine whether RDC was a factor in deposit growth and if RDC banks carry less market capital.

Study Methodology

Fiserv gathered FDIC data from 1Q06 to 2Q08 for 8,796 institutions. From that group of banks, the 1,448 institutions with assets greater than \$1 billion that had reported for all of the 10 consecutive quarters were selected for the study. Using information obtained from Informa Research Services, Inc., RemoteDepositCapture.com and additional web-based research, 149 of the 1,448 banks were identified as having active RDC programs. And while it is possible that the sample may not include all banks within the asset parameters that offer RDC, the survey results do suggest a relationship between RDC use and market capital.

Please note that the study did not eliminate or isolate other variables or deposit growth strategies that may have had an impact on capital. The purpose of the study was to identify relationship trends rather than compile statistical data.

Fiserv further stratified the sample banks in order to identify any significant differences that might be related to asset size.

Study Findings

A fundamental indicator of a bank's financial strength is its Tier 1 capital, also referred to as core capital, which is comprised of equity capital and disclosed reserves. A fundamental indicator of bank's ability to manage asset risk is its Core Capital Adequacy Ratio (CCAR). To calculate CCAR, banks must first assign weights of zero, 20, 50, and 100 percent to assets based upon their relative credit risk. Banks then use the following formula to determine CCAR:

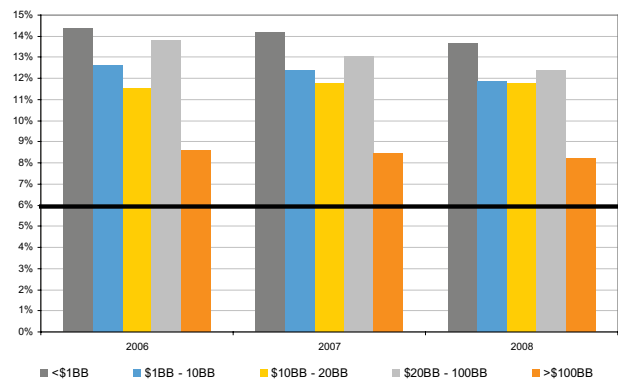
$$\text{Tier One Capital/Risk-weighted Assets} = \text{CCAR}$$

According to the FDIC, if the result of the equation is equal to or greater than six percent, a bank is said to be well capitalized, while a four percent ratio of risk-weighted assets to core capital is considered to be adequate. The capital banks retain in excess of a six percent margin generally represents market capital. Banks rely on market capital to fund projects and accommodate institutional risk policies. Similar to disposable income for a consumer, market capital is a key factor that creditors use to assess the credit-worthiness of banks. The higher the market capitalization, the better a bank is positioned to borrow.

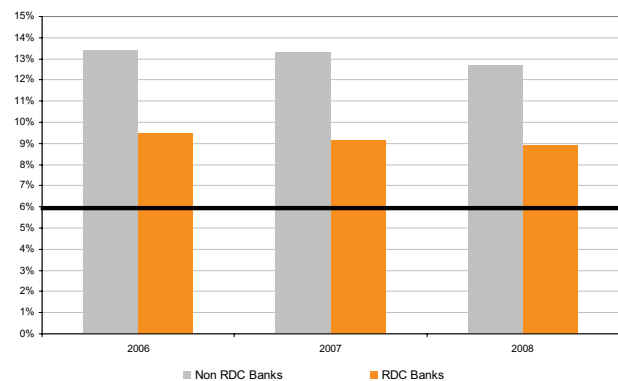
Banks with more than \$100 billion in assets had the smallest CCAR, maintaining a ratio of between eight and nine percent. At the same time, banks with assets

of less than \$1 billion maintained the highest CCAR of between 13 and 14 percent. This might suggest that there is an inverse relationship between asset size and capitalization. However, the asset classes of \$1 billion to \$10 billion, \$10 billion to \$20 billion and \$20 billion to \$100 billion did not vet that assumption. Therefore, there must be other factors involved.

Core Capital Adequacy Ratio by Asset Size



Core Capital Adequacy Ratio – RDC and Non-RDC Banks (Assets >\$1 BB)

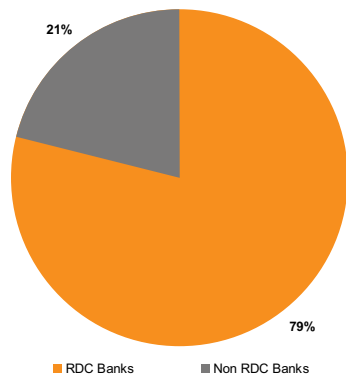


The study also compared capital held by banks with an RDC offering against banks that aren't offering RDC. For banks with assets greater than \$1 billion, those with RDC maintained lower levels of market capital. These banks also averaged a considerably lower CCAR than banks with assets less than \$1 billion. This may suggest

that banks offering RDC rely on deposits rather than borrowing to fund projects or provide additional cushion against risk.

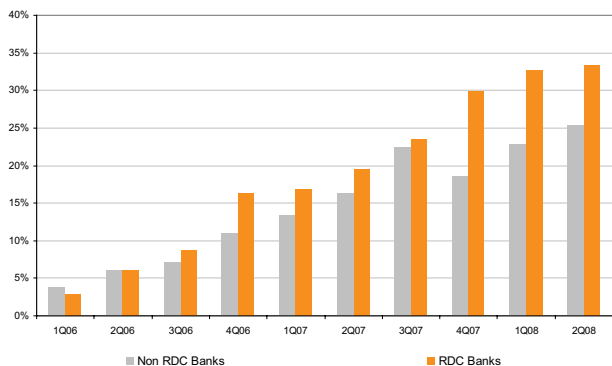
Fiserv also looked at the percentage of total deposits held by RDC banks versus non-RDC banks. By far, the majority of deposit volumes among institutions with more than \$1 billion in assets belong to banks with an RDC strategy.

2Q08 Deposit Distribution – RDC and Non-RDC Banks (Assets >\$1 BB)



For eight of the ten quarters studied, RDC banks, on average, also experienced a higher rate of deposit growth than banks that have yet to adopt RDC.

1Q06–2Q08 Deposit Growth – RDC and Non-RDC Banks (Assets >\$1 BB)



The research showed that 77 percent of the RDC banks had experienced deposit growth while 23 percent experienced a decline in deposits. In the case of banks with declining deposits, it is possible that the goal of deposit growth was subordinated by other objectives, including an increase in fee income, cost reduction or defense against competition.

Conclusion

While not a formal scientific study, the results of our research show that there are related trends involving RDC, CCAR and deposit growth. The findings do indicate that:

- RDC banks manage almost four times the deposit volumes of non-RDC banks
- RDC banks have experienced more deposit growth than non-RDC banks
- RDC banks maintain lower ratios of market capital than non-RDC banks

Fiserv believes that technology alone is not enough to grow deposits and lessen a bank’s need to borrow. What is required is a comprehensive strategy that not only includes an RDC platform, but also clearly articulates institutional directives to grow deposits and maintain capital. As the financial industry evolves in response to market pressures, deposit growth and the need for capital must be continually evaluated and corrections made to balance deposits and capital as needed.

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About Fiserv

Fiserv is the leading global provider of information management and electronic commerce systems for the financial services industry, driving innovation in Payments, Processing Services, Risk & Compliance, Customer & Channel Management, and Business Intelligence & Optimization. With solutions and expertise from Fiserv, you have the power to turn possibilities for managing risk, improving efficiency and growing your business into reality. The power within.



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