WORKING PAPER

Runs to Banks: The Role of Cash Sweeps During Market Downturns

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Sweep deposits from brokerage firms to banks vary inversely with the stock market. When the stock market declines, retail investors reduce risk and sell stocks, with the proceeds typically swept out of brokerage firms and into banks. This result holds for monthly data obtained from a large brokerage firm with affiliated banks and for estimated aggregate quarterly data for sweep deposits across banks. Overall, sweep deposits are a primary driver backing the inverse relation between total bank deposits and the stock market, and are not destabilizing, but instead stabilizing for banks as households reduce risk by converting stock to cash during periods of high stress. They also play a role in the bank lending channel by providing additional funds for loan commitments or credit lines during stressful periods. Absent the recent innovation of sweep deposits swept from brokerage firms to banks, client cash would reside on the balance sheets of brokerage firms and invested in short-dated Treasuries and comparable low-risk securities. Lastly, we find support for the deposits channel in monetary policy, namely that sweep deposits of brokerage clients have a high elasticity to the Federal Funds rate, holding the stock market constant.

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