RESEARCH BRIEF • DECEMBER 2025

Dynamic Competition for Sleepy Deposits

Based on BFI Working Paper No. 2025-128, "Dynamic Competition for Sleepy Deposits," by Mark L. Egan, Harvard University; Ali Hortaçsu, University of Chicago; Nathan A. Kaplan, Harvard University; Adi Sunderam, Harvard University; and Vincent Yao, Georgia State University

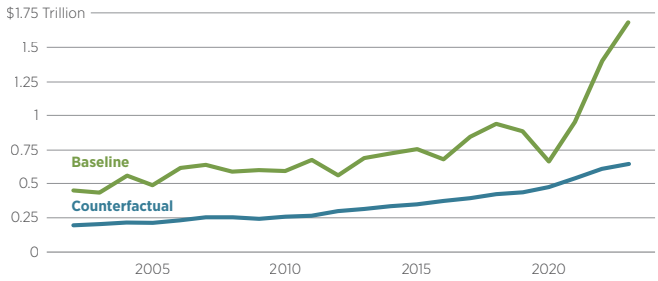
Most bank depositors rarely shop for better rates and stay with the same bank for nearly a decade, on average. This "sleepiness" accounts for more than half of banks' deposit franchise value while also creating stability in the banking system.

People tend to leave their money in the same bank account over long durations, even when they could earn more by moving it. This "sleepiness" is considered a critical feature of the banking sector, as it bolsters stability and allows banks to use deposit funds toward long-term loans. At the same time, regulators have scrutinized banks for not fully passing through interest rate increases to savers, even as they quickly raise lending rates. In this paper, the authors study the implications of sleepy deposits for bank competition, value, and financial stability in the US banking sector.

The authors begin by documenting depositor behavior using a novel dataset from Fiserv, a major financial technology company that processes accounts for banks and credit unions. The data cover 12 million deposit accounts from 89 financial institutions, tracking when accounts open and close, and why customers leave. They combine these data with detailed information on deposit volumes at every bank branch in America and weekly data on the interest rates banks offer. The authors document the following concerning depositors' shopping behaviors:

- Depositors rarely switch accounts. Ninety-four percent of depositors keep their bank account each year, consistent with estimates from practitioners. New accounts make up 5-15% of total accounts, implying that the average life of an account is 8-9 years.

Figure 1 · Total Deposit Franchise Value in the Banking Sector



Note: This figure shows time series of aggregate deposit franchise value under the authors' baseline estimates and under a counterfactual policy in which all depositors are always active.

- Less than 20% of account closures are a result of depositors shopping for better terms. The majority are driven by account inactivity, moving, and death.
- Turnover is higher among business and trust accounts compared to individual accounts. Larger accounts, measured by account balances, also appear to be more active. In contrast, accounts held by elderly individuals are less active. Somewhat surprisingly, accounts set up for online banking tend to experience less turnover. Part of this appears to be driven by moving, which is inherently a less important factor for online depositors.
- Sleepiness is negatively correlated with the lagged federal funds rate—people "wake up" (relatively speaking) when interest rates

increase. A one percentage point increase in the short rate reduces the fraction of depositors who are inactive by 0.4 percentage points.

To understand how this sleepiness shapes bank competition, the authors develop a model of the supply and demand for sleepy deposits. In the model, depositors are either "awake" (shopping for accounts) or "asleep" (staying put), and banks compete knowing that most customers will stay asleep for long stretches. Instead of constantly battling over every depositor with the best rates, banks face a dynamic choice: should they "invest" by offering attractive rates to attract new customers (knowing those customers will likely stick around for years), or "harvest" by offering meager rates to their existing sleepy customers (who probably won't bother switching)?

The model reveals the following:

- Sleepiness raises profit margins for banks. Average markups (the spread between what banks earn on loans and what they pay on deposits) would fall by 53% if all depositors were always actively shopping for new accounts.
- Sleepiness also makes markups procyclical, meaning they rise when interest rates rise. Average markups hover around 31 basis points when rates are near zero but jump to 127 basis points when short-term rates reach 5%. This is because when rates are high, banks with large market shares choose to "harvest" their sleepy depositors by keeping rates low.
- Dynamic competition eliminates the usual relationship between market concentration and markups. In a standard model, banks in concentrated markets would charge higher markups than banks in competitive markets. But with sleepy depositors, markups stay roughly constant regardless of concentration. In concentrated markets, dominant banks harvest their sleepy base with low rates, but this creates opportunities for smaller banks to compete aggressively for active shoppers.
- Sleepiness accounts for more than half of banks' deposit franchise value, roughly 58% on average.
- Banks with low-quality deposit services as well as banks with high marginal costs benefit most from sleepiness. Moving from the 25th to the 75th percentile of product quality decreases sleepiness dependence by about 10.4 percentage points, while moving from the 25th to the 75th percentile of marginal costs increases sleepiness dependence by about 3.4 percentage points. This is because sleepiness allows low-quality, high-cost banks to charge relatively high markups without losing too many depositors in the near-term.
- Sleepiness creates stability in the banking sector. For two large global banks in the US, the probability of default after the Federal Reserve's 2022-2023 hiking cycle would have increased to more than 20% in a counterfactual without sleepy depositors.

These findings carry important implications for bank regulation. Regulators in several countries, most notably the UK's Financial Conduct Authority (FCA), have sought to increase the extent to which banks pass through interest rates to their depositors. The authors' estimates suggest this would benefit depositors by raising the rates they earn by about 36 basis points. But it would come at substantial cost to financial stability, particularly during periods of monetary tightening. In this way, policymakers face a tradeoff between protecting depositors from low rates and maintaining a stable banking system.

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NO. 2025-128 · SEPTEMBER 2025

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