QwickRate Comments: The FDIC Study Report on Brokered and Core Deposits

by Shawn O'Brien, President

On July 8, 2011 the FDIC delivered a report to Congress containing the results of its study of core and brokered deposits. The study was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). In part, Dodd-Frank asked the FDIC to look at how it defines these types of deposits and how using the deposits might affect a bank's performance and losses to the Deposit Insurance Fund (DIF).

The FDIC researched this issue thoroughly. It considered statistical analysis, comments from the industry, and its own records to perform the study. After careful study, nothing has changed; the existing definitions for core and brokered deposits stand.

QwickRate remains a non-brokered deposit source.

However, even though the study is complete, and the results have been published, there's still a lot of confusion floating around the industry. This QwickViews article is designed to help you gain a clearer understanding. In it, we'll separate the facts from fiction…discuss what makes QwickRate different from other listing services…talk about how the FDIC evaluates deposits that banks obtain from all sources… and outline what those evaluations mean to you (especially at exam time).

SEPARATING THE TRUTH FROM FICTION

A mind-boggling amount of deliberate misinformation and misleading comments flooded the industry in the 18 months leading up to the FDIC's study report. Some of the myths grew out of speculation. Others were spread by people more interested in promoting their products or services rather than promoting the facts. And the confusion came from all corners. Early on, some brokers told banks that listing services such as QwickRate were losing (or would soon lose) their non-brokered status. Some even went so far as to publish a fictitious new term – "near-core" deposits – that the FDIC had never defined, used nor endorsed. And it still hasn't.

The "near-core" terminology appeared in a resource paper on liquidity management published by a national organization. The paper defined this hypothetical concept of "near-core" funding as all customer deposits that do not meet the definition of core funding, but normally raised as part of a core funding strategy from a bank's customers; generally include CDs over $250,000 and deposits gathered from local customers through reciprocal networks. The paper went on to define non-core funding as all liability-based sources of funding that are not part of a core funding plan; generally gathered from somewhere other than a bank's customers, including brokered CDs, rate board CDs, fed funds, etc.

The organization distributed this incorrect information before the FDIC presented its study to Congress. Obviously, the definitions promoted in this paper are not aligned with the FDIC's official conclusions. The FDIC study never mentions "near-core" funding. Instead, the agency confirms that reciprocal deposits are, without question, brokered deposits. And the non-core definition stated in the paper is inconsistent with existing UBPR definitions.

In its Advisory Opinion No. 03-03 (July 29, 2003) the FDIC addressed the activities of deposit placement networks, such as reciprocal networks, which facilitate the placement of excess funds for their member banks. In this opinion, the FDIC spoke specifically about the availability of "pass-through" insurance on these types of deposits. The agency did not address whether a bank in such a network, or the network's owner, qualifies as a deposit broker. In the FDIC's opinion, no dispute or question exists regarding the classification of a reciprocal network participant as a deposit broker since: (1) the bank participant admittedly places deposits belonging to its customers at other financial institutions; and (2) the stated purpose of the participant bank in placing those deposits is to obtain increased deposit insurance coverage for its customers. Thus, the bank satisfies the basic definition of "deposit broker".

Acting responsibly, reacting objectively

During the fact-finding phase of its study, the FDIC invited QwickRate and other industry representatives to participate in roundtable discussions, open meetings and written comments. Some of the organizations openly lobbied on behalf of their companies, promoting self-interest over the good of the industry.

While all this was going on, QwickRate has been cautious, proactive and responsible in explaining matters to our customers and the market. We maintained our position of 25 years, which is totally aligned with regulatory opinion:

- Non-brokered CD funding provides a diversified funding source that a bank can include in its liquidity plan.
- Direct CD deposits obtained through the QwickRate marketplace are non-brokered.

QwickRate has a long history of working with the regulatory agencies on behalf of community banks. On many occasions, we've requested the FDIC to issue official opinions that provide a clear understanding of the agency's position, so that institutions can incorporate this stable and valuable liquidity source with confidence. Over the years, we've clarified for the agency the various differences between consumer and institutional investors. We've also stressed how important it is for the FDIC to consider the behavior of investors that make prudent use of Internet listing services – and we've pointed out inaccurate assumptions that might exist among examiners.

These discussions have helped to further the FDIC's recognition that many types of non-brokered deposits, not just those obtained in a bank's local market, can be stable sources of funding. In fact, at least four of the FDIC Advisory Opinions cited in the study's discussion of listing services directly resulted from QwickRate's opinion requests and our interactions with the agency. The July 8, 2011 study report confirms, once again, that direct deposits from listing services – QwickRate included – will continue to be classified as a non-brokered deposit.

ALL DEPOSIT LISTING SERVICES ARE NOT ALIKE; HOW QWICKRATE IS DIFFERENT

The regulatory agencies describe a deposit listing service as a company that compiles information about the interest rates that insured financial institutions offer on deposits such as CDs. Internet-based listing services and some other automated services fit in this category.

QwickRate is different from all of them. And we're unique in several respects. For one thing, we've been serving the financial institution community for 25 years. That's a quarter of a century spent enhancing our marketplace, developing tools for our subscribers, and introducing better ways to make direct connections fast and efficient.

But here's the critical point: As the premier source for non-brokered funding and investing – with more than 3,000 active subscribers – our marketplace is limited to institutional investors only. No consumers are permitted. This business model is in stark contrast to other online Internet sites, and we've operated this way since day one. Why is that so important? Institutional investors have sizable funds to invest and typically invest an amount just under $250K in order for the CD to be covered by FDIC insurance. For their entire CD portfolio to be fully insured, these investors have no choice but to place CDs in multiple banks. This practice of institutions spreading their investments over many banks contrasts with the investment strategy of individual consumers, who may need to work with only one bank in order to secure full insurance coverage for their CD funds. Therefore, a bank issuing CDs through QwickRate benefits in significant ways. The bank can attract customers in QwickRate with less aggressive rates than it would have to offer in a highly competitive local market. In addition, the bank's cost of funds for deposits generated through QwickRate is typically lower than deposits from local customers.

QwickRate has controls in place to ensure that only direct institutional investors use its eContact function. As a result, an issuing bank knows with certainty that it's dealing directly, one-on-one with the investor – and that it's bringing in a non-brokered deposit with no third party involvement. These controls and qualification procedures make QwickRate different from most other listing services.

We've also built a wealth of other tools to help streamline the direct funding and investing process. In addition to automating communications, QwickRate provides reporting and tracking utilities that make it easy for banks to analyze deposits being generated in the marketplace. These are just some of the reasons issuers and investors alike log into QwickRate time and again to conduct their business online.

QwickRate deposits have all of the characteristics of a **stable, non-brokered** deposit

Our on-staff regulatory experts are another big factor in QwickRate's popularity. They're always standing by with guidance and support. You'll find the resources you need to work smarter and more efficiently, from a Risk Management Workbook to a Regulatory Examination Checklist... from national market CD funding policy templates to interpreting how FDIC opinions apply to QwickRate subscribers and national market funding.

As new regulatory changes come about, QwickRate continues to make it easier for our subscribers to comply with them. The new memorandum reporting item that was added to the Call Report last March is a perfect example. The FDIC is now asking for banks to quantify total listing service deposits. Our standard reports make it easy for banks to comply with this requirement as they diversify their funding mixes with non-brokered CDs. Examiners like to see banks take advantage of diverse funding sources, and the information you provide on the Call Report underscores QwickRate's role in facilitating stable and secure deposits.

This leads us to another point covered in the recent study…

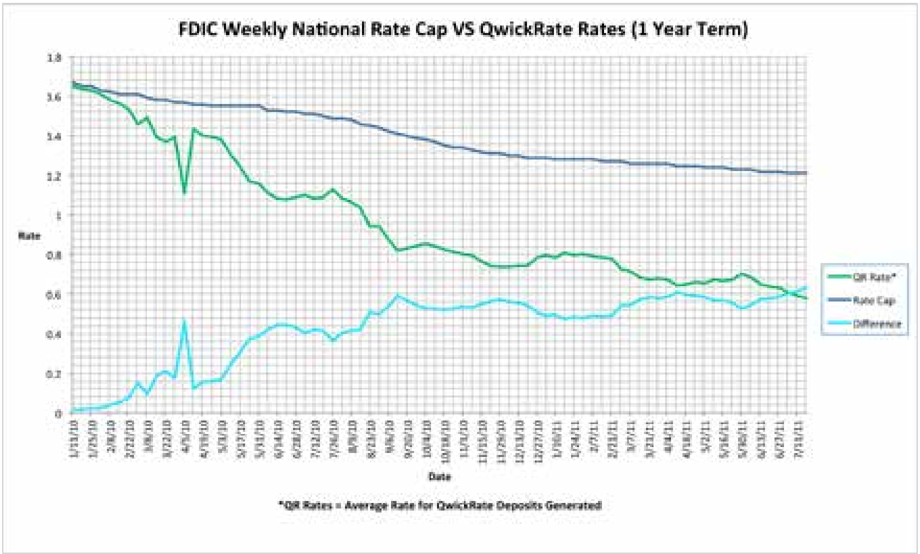
HOW THE FDIC EVALUATES DEPOSITS, AND WHAT THIS MEANS FOR YOU

In its report to Congress, the FDIC outlines five characteristics that are most useful in evaluating deposits and their potential impact on a bank's performance. Below we've listed these characteristics, why the FDIC considers them important, and facts that QwickRate believes you should know about our marketplace. Bottom line? QwickRate deposits have all of the characteristics of a stable, non-brokered deposit.

1. Interest rates relative to those offered by the rest of the industry

The FDIC notes that in order to pay high rates, a bank must invest in assets with even higher returns (if it is to earn a profit); generally speaking, the higher the potential return, the greater the risk. The interest rates a bank pays on its deposits can also have a significant effect on the stability or volatility of its deposit base.

- As the following graph illustrates, the average interest rates for deposits obtained in the QwickRate marketplace are well below the national rate cap.



- Last month, the rates for deposits placed on QwickRate averaged 63 bps below the FDIC Weekly Published Rate Cap for the 1-year term posted for July.
- Banks are not required to post high rates in order to attract investors in QwickRate. We always advise banks to bring in deposits slowly, to pre-fund their offerings, and to post their CD rates in the lower positions so they can pay less for the funds they receive.
- With proper planning and a carefully designed pre-funding strategy, CD issuers find that it isn't necessary to offer high rates in order to attract deposits in our marketplace. Our 25 years of experience shows that QwickRate's institutional investors place a high value on stability and insurance coverage.

2. Whether deposits can be gathered quickly in large quantities

The FDIC study states that deposits that can be gathered quickly in large quantities allow an institution to grow very quickly and invest in risky assets. In addition, these types of deposits may also present a liquidity problem: a deposit that can be gathered quickly in large quantities may, in some cases, leave the bank quickly in large quantities.

- Individual deposits are placed in the QwickRate marketplace in amounts of less than $250,000 and do not represent large investment blocks.
- Banks are never obligated to accept any deposit, and they may enter or leave the market at any time according to their own discretion.

3. ***The relationship between the depositor and the bank (or a bank's affiliate)*** *Page 51 of the FDIC study says, "To a certain extent, when a bank receives deposits because of a customer's relationship with an affiliate, that relationship may substitute for a relationship with the bank itself. However, this relationship is inherently more tenuous than a direct relationship between the bank and the customer, since it depends upon the continued success and business strategy of the affiliate, the customer's relationship with the affiliate, and the affiliate's willingness to continue to refer deposits to the bank."*

- Placements made through eContact and the QwickRate marketplace are direct, non-brokered transactions occurring between investor and the CD issuer. Issuing banks know with 100% certainty that deposits made through QwickRate's automated eContact tool are placed solely and only by qualified institutional investors. And the whole process is quick and easy.

4. ***Whether a deposit is insured or not***
Uninsured deposits can exacerbate liquidity problems at a weakened bank. The study explains that when a bank experiences financial deterioration, customers who hold deposits in excess of the deposit insurance coverage limit are likely to remove those deposits.

- All banks are required to be FDIC insured in order to post rates for deposits on QwickRate.
- QwickRate investors limit their placements to no more than $250,000, and QwickRate provides tools that help prevent an investor from placing more than one fully insured deposit with the same bank.
- Because all of the deposits placed by investors through QwickRate are insured, these CDs are less likely to leave the issuing bank should the bank experience financial deterioration. Therefore, less than well capitalized banks can be successful at generating deposits through the marketplace.

Placements made through **eContact** and the **QwickRate marketplace** are **direct, non-brokered transactions** occurring between investor and the CD issuer.

5. ***Remaining time to maturity***
This characteristic is an important evaluation factor to the FDIC because the duration of a deposit can present or mitigate the problem of a deposit leaving a bank for higher rates or when the bank is under stress.

- Banks are able to post rates in QwickRate for terms ranging from 7 days to 10 years with the 1-year term historically being the most popular term; however, our records show that the "greater than 3-year" term has been trending upward since January 2009.

- Institutional investors in QwickRate drive the activity in our marketplace. Past experience demonstrates that they tend to remain in the marketplace consistently and ladder the maturities of their investments as part of any ongoing liquidity management strategy.

In conclusion

Now that the study has been presented to Congress, what does it mean for community banks going forward? Will any legislative changes be enacted?

Of course, nobody can answer that with surety, but the FDIC has performed an exhaustive and comprehensive study based on statistical analysis, industry comments, and its own data. In the future, any proposed regulatory changes will reference this work and consider the FDIC's opinions.

In the wake of the financial crisis, and recognizing the prominent role that contingency funding plays in supporting the well-being of banks, the FDIC will continue to encourage banks to have diverse funding sources and will conduct more analysis of various types of liquidity sources, including listing services.

The comprehensive reports that QwickRate provides to our subscribers will help the FDIC in its analysis process, by illuminating both the quantity and quality of the deposit transactions generated in the marketplace. Your bank's records will shed light on the amount of activity consistently taking place in QwickRate. Your QwickRate reports include valuable details about your bank's activity, CD terms and interest rate position. The reports also provide the same details for the marketplace as a whole. This information will help you show examiners that QwickRate is a proven and reliably consistent source of stable deposits which can satisfy the bank's requirements for diverse liquidity sources.

If you have questions about funding opportunities available through QwickRate, and if we can help with anything else, please let us know. QwickRate is alive and well and ready to serve you. Plus our on-staff regulatory experts are always standing by with tools, guidance and answers to any compliance questions.

About QwickRate

QwickRate provides the premier Marketplace for non-brokered funding and investing. With more than 3,000 members, QwickRate offers community financial institutions a cost-effective way to gain direct access to a nationwide CD market to help proactively manage their primary and contingency liquidity needs. The company's online QwickAnalytics™ tool offers interactive research on all 6,000 U.S. banks, Bank & Peer Performance analysis and examiner-ready Regulatory Compliance reports. QwickRate, a Preferred Service Provider of The Independent Community Bankers of America (ICBA) is known for its exceptional customer service, which includes unlimited support and valuable on-staff regulatory guidance.

Call us at **800.285.8626** or schedule a walkthrough of the Marketplace at **www.bankliquiditysource.com**.

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