Risks Associated with a Bank's Dependence on Brokered and Above-Market Rate Deposits for Funding

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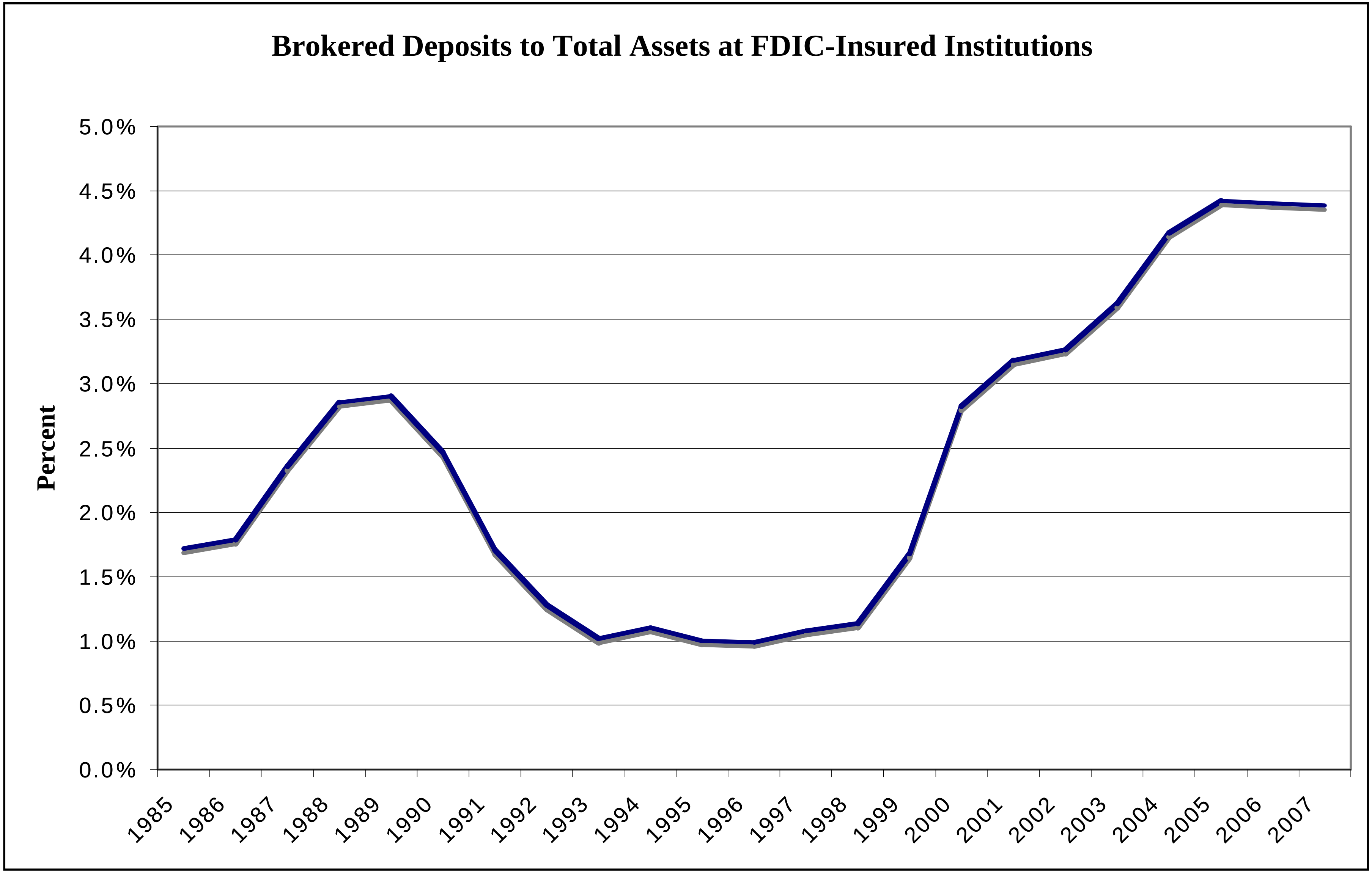
Disclosure

The following slide show is for educational purposes and should not be considered a legal opinion. This is intended to be a general overview and under certain circumstances exceptions to these rules may apply. Please review Part 337.6 of the FDIC Rules and Regulations for more detailed information on brokered and high rate deposit restrictions.

Brokered / High Rate Deposit Supervisory Concerns:

- They can be used for rapid growth which may result in less stringent underwriting
- Liquidity issues may develop
  - 337.6 restrictions
  - Deposit brokers' restrictions
  - S & S enforcement actions
- Interest rate risk may increase due to higher price sensitivity


Brokered Deposits to Total Assets at FDIC-Insured Institutions
Percent
5.0%
4.5%
4.0%
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
1985
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Interest Rate Restrictions

Basic Concept: Restrictions depend upon bank’s capital level. As condition deteriorates, restrictions become more severe. There are 4 main categories.

- Well capitalized institutions
- Adequately capitalized institutions with waivers to accept brokered deposits
- Adequately capitalized institutions without waivers to accept brokered deposits
- Undercapitalized institutions

What is Well Capitalized?

- Total Risk Based Capital – 10.0% or greater
- Tier 1 Risk Based Capital – 6.0% or greater
- Leverage Ratio – 5.0% or greater
- Not subject to a written agreement with a capital provision

Well Capitalized Institutions

- No Restrictions on the use of deposit brokers or on the rates they may pay

What is Adequately Capitalized?

- **Total Risk Based Capital – 8.0% or greater but less than 10%**
- **Tier 1 Risk Based Capital – 4.0% or greater but less than 6%**
- **Leverage Ratio – 4.0% greater but less than 5%***

*Can be 3% if the bank is rated a composite 1 and is not experiencing significant growth

Adequately Capitalized With a Waiver to Accept Brokered Deposits

Generally:

- Deposits <u>obtained through a broker </u>are limited to 75 basis points over 120% of the current yield on similar-maturity U.S. Treasury obligations
- All <u>internally generated deposits</u> are limited to 75 basis points over the effective yield paid on deposits of comparable size and maturity in the institution’s normal market area
- Additional restrictions apply in some circumstances

Sample Calculation – Rate Restrictions on Brokered Deposits

as of 09/02/08

1-year UST = 2.17%

X 1.2 = 2.604%

+ 0.75 = **3.354%**

Bankrate.com national average = **3.65%**

Sample Calculation – Rate Restrictions on Internally Generated Deposits

Bank A = 3.85%

Bank B = 2.00%

Bank C = 1.50%

Bank D = 1.25%

Average = 2.15%

The highest rate subject bank can offer is

2.15 + 0.75 = 2.90%

Adequately Capitalized Without a Waiver to Accept Brokered Deposits

- May not use a broker
- Rates on all deposits both within and outside an institution’s market area are limited to:
  - 75 basis points over the effective yield paid on deposits of comparable size and maturity in the institution’s normal market area.

What is Undercapitalized?

- **Total Risk Based Capital – less than 8.0% but greater than 6%**
- **Tier 1 Risk Based Capital – less than 4.0% but greater than 3%**
- **Leverage Ratio – less than 4.0% but greater than 3%**

Undercapitalized Institutions

- May not use a broker
- Rates are limited to the lower of:
  - 75 basis points over the prevailing effective yields on comparable-maturity deposits in the institution's normal market area, or
  - 75 basis points over the prevailing effective yields on comparable-maturity deposits in the market area in which the deposits are being solicited.

When is a Brokered Deposit Waiver Needed?

- Adequately Capitalized per section 29 of the FDI Act and Section 337.6 of the FDIC Rules and Regulations.
- Subject to a Formal Enforcement Action which includes a capital maintenance provision.

Brokered Deposit Waiver Requests

- Generally not to fund expansion
- Waiver time periods
- Plan to reduce dependency
- Precautionary requests

Waiver Requests

Applicants should submit a letter of application to the appropriate Regional Director. The letter should contain the following information:

- The time period for which the waiver is requested;
- A statement of the policy governing the use of brokered deposits in the institution’s overall funding and liquidity management program;
- The volume, rates, and maturities of the brokered deposits currently held during the waiver period sought, including internal limits on the terms, solicitation, and use of brokered deposits;
- Cost comparison of brokered deposits and other funding alternatives;

Waiver Request Continued

- Description of brokered deposit use in the institution’s lending and investment activities and asset growth plans;
- Procedures and practices used to solicit brokered deposits, including identification of the principal sources of such deposits;
- Management systems overseeing the solicitation, acceptance, and use of brokered deposits;
- Recent consolidated balance sheet and income statement; and
- Reasons the institution believes its acceptance, renewal, or rollover of brokered deposits would pose no undue risk.

The FDIC may request additional information at any time during the processing of the application.

Brokered Deposits and De Novo Institutions

Use of brokered deposits by an institution during the de novo period without prior notification to the FDIC can:

- Constitute a violation of the Order for Federal Deposit Insurance.
- Result in the assessment of civil money penalties against an institution or an institution affiliated party for violations of any condition imposed in writing by the FDIC in connection with its approval of an application.

Liquidity Risk Management Guidance (FDIC FIL 8-2008)

- Expectations for liquidity management at banks with brokered or high rate deposits:
  - CFPs
  - Pro Forma cash flow analysis
  - Stress test/ scenario analysis

- CFPs should outline reasonable funding alternatives

Liquidity Risk Management Guidance (FDIC FIL 8-2008)

Management expectations:

- Monitoring capital levels
- Understand brokers' restrictions
- Establish policy limits

Questions?