

January 22, 2009

MEMORANDUM TO: The Board of Directors

FROM: Mitchell L. Glassman, Director
Division of Resolutions and Receiverships

John V. Thomas
Acting General Counsel

SUBJECT: Final Rule on Processing Deposit Accounts in
the Event of an Insured Depository Institution Failure

Recommendation: That the Board of Directors approve the attached final rule and authorize its publication in the *Federal Register*.

Background

In July 2008, the FDIC issued an interim rule on the “Processing of Deposit Accounts in the Event of an Insured Depository Institution Failure” (“interim rule”). In summary, the interim rule: (1) articulated general principles underlying the FDIC’s existing and future practices and procedures for determining account balances in the event of an insured depository institution failure; (2) identified and defined the end-of-day *ledger balance* of the deposit or other liability account as the account balance the FDIC will use to make deposit insurance determinations in institution failures; (3) provided that, in an institution failure, the FDIC will use *cutoff* rules previously applied by the institution in establishing the end-of-day ledger balances for deposit insurance determination purposes, but noted the possibility that, if necessary, the FDIC might establish an *FDIC Cutoff Point* coinciding with the point at which the FDIC, as receiver, acts to stop deposit transactions which might result in creating new liabilities or extinguishing existing liabilities resulting from external transactions; (4) indicated how uncollected deposited checks and swept funds will be treated, for deposit insurance purposes, at failed institutions; and (5) imposed requirements, effective July 1, 2009, that insured depository institutions inform their sweep account customers of the nature of their swept funds and how those funds would be treated if the institution should fail.

We received four comments on the interim rule. Three of the comments were from banking industry trade associations and one was from a large commercial bank. The comments addressed the FDIC Cutoff Point, the treatment of swept funds and sweep account disclosures.

Recommended Final Rule

The staff recommends that the Board adopt a final rule largely unchanged from the interim rule, except that the preamble and the regulatory text provide examples of sweep accounts subject to the final rule and explain how the FDIC will treat each of those sweep arrangements in the event of an institution failure. The final rule also clarifies how the FDIC will treat repo sweeps in the event of an institution failure and slightly modifies the disclosure requirements for sweep products. The following is an explanation of how the draft final rule would differ from the interim rule.

The Treatment of Sweep Accounts at an Institution Failure

Guidelines and examples. The final rule specifies that the FDIC will use these guidelines in making claims determinations on swept funds when an institution fails:

- Ownership of the funds and the nature of the claim will be based on records established and maintained by the depository institution for that specific account or investment vehicle.
- Depositor-owned funds residing in a general ledger account as of the institution's end-of-day will be treated as a deposit for insurance purposes.
- The full amount of swept funds attributable to an individual customer residing in an omnibus or other commingled account as of the depository institution's normal end-of-day will be treated as belonging to that customer, regardless of any netting practices established by the depository institution.

The final rule discusses how these guidelines will be applied to: deposit-to-deposit sweeps, eurodollar and international banking facility sweeps, money market mutual fund sweeps, fed funds sweeps, holding company commercial paper sweeps and loan sweep accounts. These guidelines and their application to the various sweeps products are consistent with the discussion of sweep products in the interim rule.

Repo sweeps. The final rule provides a more expanded explanation than the interim rule of how we will treat funds swept in connection with repo sweeps. The final rule distinguishes between properly executed repo sweeps and ones that are not properly executed. It notes that, in properly executed repo sweep arrangements, as of the depository institution's normal end-of-day, the sweep customer either becomes the legal owner of identified assets (typically government securities) subject to a repurchase agreement or obtains a perfected security interest in those assets. The final rule provides that, in such cases, where the sweep customer either owns or possesses a perfected security interest in the identified securities, upon an institution failure, the FDIC will recognize the customer's ownership or security interest in the securities.

The final rule acknowledges that some institutions offer repo products that are not properly executed. In those situations, the sweep customer obtains neither an ownership

interest nor a perfected security interest in the applicable securities. (A common example is where a customer's swept funds rest (as of the institution's end-of-day) in an account in which a pool of securities are also transferred, but where the customer has neither an ownership interest nor a perfected security interest in any identified security(ies).) The final rule provides that, in such cases, upon an institution failure, the FDIC will treat the swept funds as if they had not left the deposit account from which they originated.

Disclosure requirements

The interim rule imposed certain disclosure requirements in connection with sweep accounts. The effective date of these requirements is July 1, 2009. In particular, institutions must prominently disclose in all sweep account contracts and account statements reflecting sweep account balances whether swept funds are *deposits* (as defined in 12 U.S.C. 1813(1)). If the funds are not deposits, the institution must further disclose the status such funds would have if the institution failed. In addition, the interim rule required that the disclosures be consistent with how the institution reports such funds on its Call Reports or Thrift Financial Reports.

In response to the comment that institutions already provide adequate disclosures to sweep account customers, the final rule indicates that no change to such preexisting disclosures would be required as long as they indicate: (1) whether the swept funds are *deposits*; and (2) if the swept funds are not deposits, how they would be treated if the institution should fail. Also, in response to the request for greater clarity regarding which sweep products would be subject to the disclosure requirements, the final rule specifies that the disclosure requirements would not apply to sweep accounts where: (1) transfers are within a single account (to a sub-account), such as with retail or reserve sweeps or (2) funds are moved between deposit accounts and the deposit insurance available to the customer is unchanged.

Staff agrees with the commenters who requested that the disclosure requirements not be overly prescriptive and not require specific language. Hence, the final rule does not impose specific disclosure language.

Despite a comment to the contrary, staff continues to believe that, in order for the disclosure requirements to be meaningful and effective, institutions must provide them in all new sweep account agreements, in all agreement renewals and on a periodic basis, but not less than annually. Thus, the final rule includes these requirements.

The FDIC agrees with the trade association that suggested flexibility in communicating the disclosure requirements to sweep customers. Hence, under the final rule, institutions need not modify their existing contracts with sweep customers, but are required to provide the disclosures in all new agreements and agreement renewals. Also, institutions may comply with the requirement for periodic disclosures through, for example, client letters, transaction confirmation statements or account statements. The requirement in

the interim rule that such disclosures be provided in account statements, therefore, is not part of the final rule.

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Attachments