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December 17, 2008

Robert E. Feldman  
Executive Secretary  
Attention: Comments  
Federal Deposit Insurance Corporation  
550 – 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

RIN: 3064-AD35

Dear Mr. Feldman:

We are submitting this letter on behalf of Charles Schwab & Co., Citigroup Inc., Morgan Stanley & Co., Raymond James Financial Inc., UBS Bank USA and UBS Financial Services Inc. (the "Firms") in response to a request for comments by the Federal Deposit Insurance Corporation ("FDIC") on a proposal to increase the deposit insurance premium assessment rates (the "Proposed Rule"). Each of the Firms controls one or more broker-dealers registered with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, and one or more depository institutions whose accounts are insured by the FDIC.

At each of the Firms, a broker-dealer offers to its clients a brokerage account feature in which the broker automatically invests, or "sweeps," excess funds in the client's brokerage account (a "Sweep Program") into deposit accounts at an affiliated depository institution (each a "Program Institution").<sup>1</sup> With certain exceptions discussed below, these deposits are reported as "brokered deposits" by the Program Institutions on their Call Reports or Thrift Financial Reports.

The Proposed Rule contains a "Brokered Deposit Adjustment" to the premium assessment that is intended to compensate the Deposit Insurance Fund for additional risk posed by the use of brokered deposits. The adjustment for Risk Category I institutions would be made if an insured institution's brokered deposits exceed 10% of its domestic deposits and its assets had increased by more than 20% during the prior four years. For Risk Category II, III and IV institutions, the adjustment would be made if brokered deposits exceed 10% of domestic deposits, irrespective of growth.

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<sup>1</sup> A sweep arrangement can be established by a broker-dealer with depository institutions that are affiliated with the broker-dealer and depository institutions that are not. Our comments in this letter are directed solely to sweep arrangements with depository institutions that are affiliated with a broker-dealer.

The FDIC's rationale for imposing a "Brokered Deposit Adjustment" to the premium assessments appears to rest on two assumptions. First, some recently failed institutions experienced rapid asset growth before failure and may have funded that growth with "brokered deposits." Second, the FDIC claims a "significant correlation" between rapid asset growth funded by brokered deposits and the probability of an institution's CAMELS rating being downgraded.<sup>2</sup> In addition to these assumptions, the FDIC characterizes brokered deposits as paying higher rates of interest.<sup>3</sup>

The Program Institutions in the Sweep Programs, which include insured institutions that rely primarily on deposits from Sweep Programs for their deposit funding, do not exhibit the characteristics noted by the FDIC in its rationale for the Brokered Deposit Adjustment and we are not aware of any history of risk related to the use of deposits obtained through similar sweep arrangements or of the failure of any insured institution that has participated in similar sweep arrangements. The deposits obtained through the Sweep Programs are a stable source of funding for the Program Institutions and are neither high rate nor rate sensitive. As further discussed below, we believe these deposits should be excluded from the definition of "brokered deposits" for purposes of the Proposed Rule.<sup>4</sup>

#### Description of the Sweep Programs

Most broker-dealers in the securities industry sweep excess cash, known as "free credit balances," in a customer's brokerage account into a liquid investment. Prior to 2000, most brokers swept customer funds into money market mutual funds. Since 2000, many broker-dealers have transitioned to sweep arrangements that sweep customer funds into deposit accounts at FDIC-insured institutions.

In the Sweep Programs, the broker-dealer sweeps funds into a money market deposit account ("MMDA") that is linked to a NOW account or other transaction account at a Program Institution. This account structure is utilized to permit customers with checkwriting, debit card and other transactional features on their brokerage accounts to utilize these features without being subject to transaction limitations under Federal Reserve Board's Regulation D (Reserves). Brokerage accounts with these transactional features, which are routinely offered in the securities industry, are referred to as "central asset accounts."

The broker-dealer establishes the deposit accounts on the books of the Program Institution in its name as agent and custodian for its customers. The manner of recordation complies with FDIC requirements for "pass-through" deposit insurance.<sup>5</sup> The broker-dealer

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<sup>2</sup> *Assessments, Notice of Proposed Rulemaking and Request for Comment*, 73 Fed.Reg. 61,560, 61,565 (Oct. 16, 2008).

<sup>3</sup> *Id.* at 61,571.

<sup>4</sup> While this letter is limited to deposits made through the Sweep Programs, it should not be read as implying that we agree with the assertions made by the FDIC concerning brokered deposits generally.

<sup>5</sup> 12 C.F.R. §330.5.

maintains records of the deposit accounts held by each of its customers and those records would be submitted to the FDIC in the event of the failure of the Program Institution.

Although the customer is informed of the Program Institutions at which deposit accounts will be established, the customer relationship is between the customer and the broker-dealer, not between the customer and the Program Institution. The Program Institution does not know the customers and never interacts with them. The broker-dealer, as agent for the customers, sends the customers periodic account statements of all assets held by the broker for the customer, including the deposit accounts, and year-end tax reporting statements (*i.e.*, IRS Form 1099). Since there may be tens of thousands of broker-dealer customers, the Program Institution does not incur the overhead (*e.g.*, customer relations, statements, tax reporting) associated with maintaining individual deposit accounts for direct depositors.

Funds placed by a broker-dealer with a Program Institution through a Sweep Program are stable, behaving like term funding. The excess cash in a customer's brokerage account is derived from interest payments and dividends on securities, sales of securities and funds deposited to the brokerage account by the customer. As funds flow into a customer's brokerage account they are automatically swept daily to the Program Institutions on an aggregate basis. As a result, funds are constantly flowing into the Program Institutions. Although aggregate withdrawals by customers also are made on a daily basis, the flow of daily aggregate deposits and withdrawals generally tend to offset one another. The result of this aggregate offsetting activity among the tens or hundreds of thousands of individual depositors usually participating in these programs is that the aggregate amount on deposit at Participating Institutions is predictable and stable.

While displaying the stability of term deposits, the deposits are priced as short-term liabilities. A Program Institution typically pays interest on a "tiered" basis. The tiering may be based on the value of customer assets, including deposits with the Participating Institution, held with the broker-dealer. Alternatively, the tiering may be based solely on the amount of a customer's deposits with the Participating Institution as determined by the broker-dealer. The rates vary among Sweep Programs, but typically do not exceed prevailing money market mutual fund rates at the highest tier, with no minimum or guaranteed rates in the lowest tier. The average rate is typically below the yield on money market mutual funds. Because of the minimal overhead (*e.g.*, no customer statements, tax reporting, personnel and other costs associated with branch offices) associated with the deposits, they are comparatively inexpensive to the Program Institution.

Data provided to us by the Program Institutions demonstrate that a decline in interest rates either in real terms or compared to standard indices, such as LIBOR, does not result in an outflow of funds from the Program Institutions.<sup>6</sup>

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<sup>6</sup> FDIC staff has informed us that any data included with the comment letter would be made available to the public. We would be pleased to share this data with the FDIC if it can be accomplished on a confidential basis.

A number of factors contribute to the stability of the deposits. As recognized by the federal securities regulators,<sup>7</sup> sweep arrangements are a service provided by a broker-dealer to its customers that permits the customer to earn interest while determining how to invest the funds or otherwise deploy the funds. Sweep arrangements, whether they offer deposit accounts or money market mutual funds, are not an investment end in themselves. They are not, therefore, viewed by customers in the same light as other investment products offered by the broker.

Customers select a broker-dealer because of their confidence in that broker. This confidence may result from the broker's reputation or "brand," a brand that may include a family of financial institutions, including the broker and its affiliated insured depository institutions. Though they have no direct legal relationship with a Program Institution, customers of the broker-dealer have a relationship with the family of financial companies that is functionally equivalent to being the customer of the Program Institutions. Deposits placed with the Program Institutions, therefore, are similar to so-called "core deposits" in that they are relationship-based, not rate based.

In addition, the Sweep Program may be the only investment option, or one of the few investment options, made available by a broker-dealer to its customers for sweeping excess cash in the customer's brokerage account. While other short-term money market investments (e.g., CDs) may be available as direct investments, the Program Institutions face little competition from other automatic investment options at the broker. Unlike brokered CD programs in which depository institutions seek funds in a national market, the Program Institutions are not competing with the banking industry at-large for deposits. The Program Institution's affiliated broker-dealer makes arrangements solely with the Program Institution to accept funds.

### Definition of "Brokered Deposit"

#### Regulatory Interpretations

For purposes of the Proposed Rule, the term "brokered deposit" has the meaning in the FDIC's regulations, including interpretive guidance thereunder. A brokered deposit is a deposit "obtained directly or indirectly from or through the mediation or assistance of a deposit broker."<sup>8</sup> A "deposit broker" is a person "engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured institutions...."<sup>9</sup> The regulations include an exemption for "an agent or nominee whose primary purpose is not the

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<sup>7</sup> See, e.g., Securities and Exchange Commission ("SEC"), *Notice to Broker-Dealers Concerning Interest-Bearing Free Credit Balances*, Exchange Act Release No. 34-18262 (Nov. 17, 1981) and Exchange Act Release No. 34-31558 (Dec. 3, 1992) (SEC approval of NASD Rule 2510(d)).

<sup>8</sup> 12 C.F.R. §337.6(a)(2).

<sup>9</sup> 12 C.F.R. §337.6(a)(5)(i)(A).

placement of funds with depository institutions.”<sup>10</sup> Pursuant to this exception, the FDIC has recognized that funds placed through certain sweep arrangements are not brokered deposits.<sup>11</sup>

The term “brokered deposit” is used in the Federal Deposit Insurance Act and in the FDIC’s regulations in connection with restrictions on the acceptance of such deposits by insured institutions that are not “well capitalized” (or “adequately capitalized,” if the institution receives a waiver from the FDIC). Neither the statute nor the regulations require the FDIC to utilize this term, or interpretations of this term, in assessing insurance premiums. In fact, the FDIC rejected the use of brokered deposits in determining risk in its current risk-based premium regulations.<sup>12</sup>

In 2005, the FDIC granted an exemption from the FDIC’s brokered deposit restrictions to insured institutions affiliated with a broker-dealer for deposits obtained through a sweep arrangement maintained by the broker-dealer for central asset accounts and IRAs. The FDIC based its exemption on the “primary purpose exception” in its regulations.<sup>13</sup>

The FDIC granted the exemption based on three characteristics of the program:

- (1) the excess cash from a customer’s brokerage account is swept to the depository institutions to facilitate the purchase and sale of securities;
- (2) the ratio of swept funds to total assets in the central asset accounts and IRAs should not exceed 10% on a monthly basis as verified by reports filed each month with the FDIC; and
- (3) the broker-dealer receives a flat “administrative fee” per brokerage account from the bank for performing certain services, such as recordkeeping and tax reporting, rather than a fee based on the amount of funds at the depository institution.

The exemption is specific to a certain sweep arrangement and the FDIC has not clarified the significance of any of the three factors in its analysis.

As set forth below, we are recommending that for purposes of the Proposed Rule Sweep Programs be excluded from the definition of brokered deposit based upon the economic behavior of these deposits, not technical legal interpretations of FDIC regulations.

#### Inconsistency of Application of Interpretive Guidance

Based upon regulatory reports and the experiences of several of the Firms with the federal bank regulatory agencies, it appears that some of the agencies are offering conflicting

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<sup>10</sup> 12 C.F.R. §337.6(a)(5)(ii)(I).

<sup>11</sup> FDIC Advisory Opinion 05-02 (February 3, 2005).

<sup>12</sup> *Assessments, Final Rule*, 71 Fed.Reg. 69,282, 69,287 (November 30, 2006).

<sup>13</sup> *Supra* note 11.

guidance regarding sweep arrangements that are fundamentally identical. Despite the existence of the single exemptive letter and its specific criteria, numerous depository institutions that participate in sweep arrangements are not reporting deposits obtained through these arrangements as “brokered.”

Clearly, this inconsistent application of FDIC regulations cannot be carried over to the premium assessments. The obvious result in the context of the Proposed Rule would be different insurance premiums for depository institutions engaged in identical deposit activities, where there exist no substantive differences between the programs (*e.g.*, all programs involve broker-dealers sweeping client account cash to affiliated insured depositories). Such inconsistent application of the premium assessments would impose significant costs on some depository institutions, while exempting other institutions from the Brokered Deposit Assessment in its entirety. This arbitrary application of the premium assessment to functionally equivalent deposit arrangements would render the premium assessment regulation void under law.

#### Economic Reality of the Sweep Programs

We believe that the case for excluding the Sweep Program deposits from the definition of “brokered deposits” is more persuasively based on the economic reality of these Sweep Programs than a technical legal interpretation of a statute or regulation. A Program Institution and its affiliated broker-dealer have shared financial interests that cause the deposits to be a stable source of funding for the Program Institution. The broker-dealer has promoted the Sweep Program to its customers, and specifically promoted the deposit of funds into its affiliated Program Institution or Institutions. Therefore, the likelihood of the termination of the Program Institution from the Sweep Program by the broker-dealer is remote. Although the Program Institution does not have a direct relationship with the broker-dealer’s customers, customers treat the funds deposited with a Program Institution through the Sweep Program in the same manner as they would treat funds at a depository institution at which they have directly established a savings account.

#### Regulatory Reporting

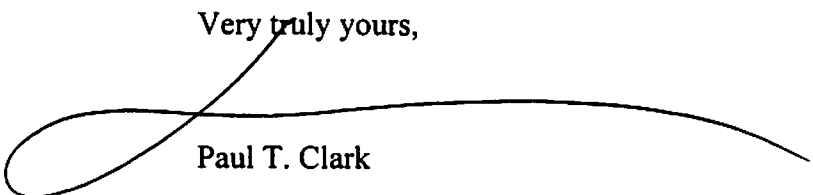
Regulatory reporting of brokered deposits does not currently distinguish between brokered CDs and brokered MMDA/NOW accounts. The FDIC has indicated that this could be a barrier to excluding sweep arrangements from the Brokered Deposit Adjustment.

We believe this problem can be easily remedied by permitting depository institutions to voluntarily file a supplement to their Call Report or Thrift Financial Report that provides relevant information about the sweep arrangement offered by an affiliated broker-dealer. If the depository institution verifies that the deposits are obtained from an affiliated broker-dealer under a sweep arrangement, the deposits would be excluded from the Brokered Deposit Adjustment.

Conclusion

For the reasons discussed above, we believe that deposits in the Sweep Programs should be excluded from the definition of “brokered deposits” for purposes of the Proposed Rule. The Program Institutions in the Sweep Programs do not exhibit the characteristics noted by the FDIC in its rationale for the Brokered Deposit Adjustment. The deposits obtained through the Sweep Programs are a stable source of funding for the Program Institutions, and are neither high rate nor rate sensitive. Further, we believe that excluding deposits obtained through functionally similar Sweep Programs from being “brokered deposits” for purposes of the Proposed Rule will avoid disparities and unfair treatment that could be caused by conflicting regulatory interpretations.

Very truly yours,



Paul T. Clark

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