

ANOVA

FINANCIAL CORPORATION

January 31, 2011

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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SECRETARY

Re: Federal Deposit Insurance Corporation Notice of Proposed Rulemaking, RIN 3064-AD66, Assessments, Large Bank Pricing; Assessments, Assessment Base and Rates

Dear Mr. Feldman:

Anova Financial Corporation ("ANOVA") is submitting this comment letter in response to the Notice of Proposed Rulemaking by the Federal Deposit Insurance Corporation (the "FDIC") with respect to Assessments, Large Bank Pricing, RIN 3064-AD66 (the "Notice"). Our comments focus on the proposed treatment of "brokered deposits" under the Notice and the requirements under Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act") that a study be conducted to address concerns arising in connection with the definitions of core deposits and brokered deposits.

ANOVA is a North Carolina corporation originally founded in 2003 to provide wholesale funding solutions for banks located principally in North Carolina. ANOVA has since expanded its operations to more than ten states. ANOVA provides services to our network of participating Insured Depository Institutions (IDIs) to enable them to attract stable deposits at cost-effective rates. ANOVA provides banks a low-cost stable wholesale funding solution (average retention >1 year) without collateral or credit limits and a high yielding treasury service as an alternative to Fed Funds for banks with excess liquidity that provides excess FDIC insurance coverage. In addition, through ANOVA's Reciprocal Exchange Deposit Program (see Exhibit "A") bank depositors can benefit from the same peace of mind knowing their accounts are also protected through excess FDIC insurance (balances >\$250,000). More than 50% of ANOVA's depositors are local governments who have benefitted particularly in these times of economic crisis knowing their accounts are fully FDIC insured, daily liquid, and earn a competitive yield over non-banking investment alternatives. ANOVA's deposit programs keep funds in the community banking system spurring economic growth in the local economy.

FDIC Deposit Insurance Assessment Rules – 12 C.F.R. Part 327

In October 2008, in response to the failure of a number of financial institutions and in anticipation of higher bank failure rates in 2009 and 2010, the FDIC established a restoration plan for the FDIC's Deposit Insurance Fund (the "DIF") and published a notice of proposed rulemaking to amend the FDIC's deposit insurance assessment regulations set forth in Part 327. After extending the comment period for the proposed rule and amending the proposed rule in response to received comments, the FDIC published its final rule (the "Final Rule") in the Federal Register on March 4, 2009, which Final Rule became effective on April 1, 2009.¹

¹ 75 Fed. Reg. 9525 (March 4, 2009).

The Final Rule introduces a new financial ratio that is designed to capture certain brokered deposits that are used to fund rapid asset growth. Excluded from this ratio are brokered deposits that an insured depository institution receives through a "deposit placement network on a reciprocal basis, such that (1) For any deposit received, the institution (as agent for depositors) places the same amount with other insured depository institutions through the network; and (2) each member of the network sets the interest rate to be paid on the entire amount of funds it places with other network members."² These types of deposits are defined to be "reciprocal deposits" under the Final Rule, and as set forth in 12 C.F.R. § 327.8(s). This ratio applies only under Risk Category I and does not apply to other brokered-deposit calculations for institutions in Risk Categories II, III and IV. In addition, this so-called "adjusted brokered deposit ratio" will affect "only those Risk Category I institutions whose total gross assets are more than 40 percent greater than they were four years previously, after adjusting for mergers and acquisition, . . . and whose brokered deposits (less reciprocal deposits) make up more than 10 percent of domestic deposits."³ The discussion in the Final Rule indicates that the FDIC was persuaded to exclude reciprocal deposits like those described in received comment letters from the adjusted brokered deposit ratio applicable to institutions in Risk Category I in part because the FDIC recognized that "reciprocal deposits may be a more stable source of funding for healthy banks than other types of brokered deposits and that they may not be as readily used to fund rapid asset growth."⁴

Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act pertains to Core vs. Brokered Deposit definitions and the FDIC's responsibility to redefine these definitions. The FDIC is required to submit to Congress no later than 1 year after the date of enactment of the Dodd-Frank Act a study that includes legislative recommendations, if any, to address concerns arising in connection with the definitions of core deposits and brokered deposits.

Section 1506 states the study will entail an evaluation of: (1) the definition of core deposits for the purpose of calculating the insurance premiums of banks; (2) the potential impact on the DIF of revising the definitions of brokered deposits and core deposits to better distinguish between them; (3) an assessment of the differences between core deposits and brokered deposits and their role in the economy and banking sector of the United States; (4) the potential stimulative effect on local economies of redefining core deposits; and (5) the competitive parity between large institutions and community banks that could result from redefining core deposits.

In response to the Section 1506 requirements and the precedent set as a result of the 12 C.F.R. § 327 effective 4/1/09 Final Rule ("Final Rule") exempting reciprocal deposits from the risk based brokered deposit assessment for Risk Category I Insured Depository Institutions (IDIs) we urge the FDIC to reconsider inclusion of reciprocal deposits in its definition of brokered deposits.

Currently reciprocal deposit services such as ANOVA's Reciprocal Exchange Deposit Program (REDP) and Promontory's Certificate of Deposit Account Registry System (CDARS) are included in the definition of brokered deposits. We contend that traditional brokered deposits involve a third-party deposit broker that acts as the agent for the depositor. Brokered deposits usually apply to large deposits with a certificate of deposit included. The broker pools these certificates of deposit and bargains them to financial institutions so that they can negotiate for a higher rate. Reciprocal deposit services, by contrast, involve no brokers, are initiated by the depository institution in which the initial deposit is made, and,

² *Id.* at page 9529.

³ *Id.* at page 9530.

⁴ *Id.* at page 9532.

most important, involve providing deposits matching the maturity, interest rate and other key terms and conditions of the original deposit back into the originating depository institution. Traditional brokered deposits are typically rate-driven, while reciprocal deposit services are security-driven. The discussion in the 4/1/09 Final Rule indicates that the FDIC was persuaded that "reciprocal deposits may be a more stable source of funding for healthy banks than other types of brokered deposits and that they may not be as readily used to fund rapid asset growth", and as a result the FDIC exempted them from the brokered deposit adjustment for Risk Category I IDIs.

Because the depositor is seeking safety for the entire amount on deposit, the deposit is likely to remain on deposit in the bank of initial deposit so long as full deposit insurance coverage can be provided. An alternative to a reciprocal deposit service is typically not a deposit broker, but collateralizing the account in excess of the deposit insurance limit, so that the entire amount on deposit remains secure. The notice of proposed rulemaking published in the November 24, 2010 Federal Register, where the FDIC proposed new Assessments, Assessment Base and Rates proposes to eliminate the adjustment for collateralized liabilities whereas it continues to impose a brokered deposit adjustment designed to compensate the deposit insurance fund for IDIs that rely heavily on brokered deposits.

Banks have found that reciprocal deposit services allow them to retain deposits that might otherwise seek an alternative deemed a safer haven. As a result, they increase the bank's lendable funds base and serve all the traditional functions of core deposits. Reciprocal deposits are stable funding sources that originate from banks and their depositors seeking the protection of other well capitalized banks to secure their FDIC insurance – clearly fulfilling ANOVA's claim of "Banks Supporting Banks". We believe that these reciprocal deposits should be properly classified as core deposits, and at a minimum, should be excluded from the definition of brokered deposits.

Conclusion

We concur with the feedback that was discussed during the 1/20/11 FDIC Advisory Committee Meeting for Community Banks Brokered Deposits/Core Funding Issues - <http://www.fdic.gov/communitybanking/agendaJAN2011.html> - by both the community bankers present as well as Melinda West, FDIC Chief, Policy & Program Development, Division of Risk Management and Diane Ellis, Deputy Director, Division of Insurance & Research that rather than Core vs Brokered Deposit categories a continuum categorization is preferable that assesses stability vs volatility through various characteristics such as:

- Customer Relationship
- Local Depositor
- Interest Rate
- Geographic Region
- Hot money source (Brokerage Sweeps)
- Direct Depositor vs Remote Depositor

If a weighted average was applied to the various characteristics this approach would provide a spectrum that would match risk to the DIF vs the outdated definitions of Core vs Brokered approach.

We contend that deposit sources like ANOVA's REDP and our Wholesale Funding Program which provide IDIs a stronger customer relationship, stable/high retention deposits, and market or below market rates are lower risk deposit sources than conventional stigmatized brokered and internet deposit sources and should be considered before a Final Rule is promulgated. We urge the FDIC to complete its study

under Section 1506 prior to publishing a Final Rule with respect to Assessments, Large Bank Pricing, RIN 3064-AD66.

Very truly yours,

A handwritten signature in dark ink, appearing to read "KB Winslow", written in a cursive style.

Kim B. Winslow
President/CEO
Anova Financial Corporation

Enclosures

cc: Martin J. Gruenberg, Vice Chairman of the FDIC
James D. White, Director of Anova Financial Corporation
Arthur H. Keeney, III, Director of Anova Financial Corporation

Exhibit "A"

ANOVA Reciprocal Exchange Deposit Program

One of ANOVA's principal product offerings is its Reciprocal Exchange Deposit Program[®] (the "REDP[®]" or the "ANOVA Product"). Through the REDP[®], depositors currently may deposit up to \$10 million through a reciprocal deposit arrangement involving a network of banks (the "ANOVA Network"), such that the full amount of the deposited funds receives federal deposit insurance protection, and the depositor benefits from liquidity that is not normally available through a more traditional brokered-deposit arrangement, such as the CDARS[®] deposit network established by Promontory Interfinancial Network, LLC ("Promontory").

Distribution of Deposits using ANOVA's REDP[®]

Under ANOVA's REDP[®], a bank deposit customer (each a "Depositor") establishes a deposit account (the "Originating Account") with the financial institution of its choice (the "Originating Bank"). The Originating Bank, as agent for the Depositor, engages ANOVA to assist the Depositor in placing funds deposited with the Originating Bank that exceed applicable FDIC deposit insurance coverage limits (currently \$250,000) in deposit accounts at other financial institutions that participate in the ANOVA Network (each a "Network Bank"). Under the REDP[®], a third-party custodian (the "Custodian") serves as a custodian for each Depositor and accepts each Depositor's excess funds for distribution and deposit among the Network Banks, with each Network Bank receiving for deposit no more than \$248,500 of the Depositor's funds. As discussed further herein, each Depositor's funds will be held in a Network Bank in an account (each a "Master Custodial Account") named "Anova Financial Corporation Agent fbo various Custodial Banks, Fiduciary, Custodian and Agent, Acting as Agent FBO various Depositors," that benefits from pass-through deposit insurance coverage in accordance with the requirements of 12 C.F.R. Part 330 as applicable to custodial account arrangements. The Network Banks establish the interest rates paid on funds deposited through the ANOVA Network. The participating Network Banks deposit funds of their customers throughout the ANOVA Network in a reciprocal manner, such that for each deposit received by a Network Bank from a Depositor, ANOVA assists the Network Bank in placing the same amount of the deposit for another Depositor at other Network Banks throughout the ANOVA Network. Thus, each Network Bank receives the benefit of deposits placed through the REDP[®] and from other ANOVA deposit sources.

Key Features of the REDP[®] for Depositors

Each Master Custodial Account will be a NOW account (as defined in 12 U.S.C. § 1832(a)) or a money market deposit account ("MMDA") as defined under Federal Reserve Regulation D, 12 C.F.R. Part 204, "Regulation D"), as opposed to a certificate of deposit ("CD") as is typically used in Promontory's CDARS[®] deposit product. Although each Master Custodial Account is and will be subject to the withdrawal and transfer limitations and other rules and restrictions of Regulation D applicable to MMDAs and NOW accounts,¹ ANOVA is able to give each Depositor access to such Depositor's funds without imposing on the Depositor any early withdrawal fees, penalties or time commitments that are associated with CDs. Depositors can withdraw funds from the ANOVA Network typically with one business day's notice. Depositors receive interest on funds placed through the ANOVA Network at a fixed rate

¹ Under Regulation D, NOW accounts are transaction accounts (but not demand deposits) and MMDAs are time deposits. On each of these accounts, the depository bank has the ability to reserve the right to require the depositor to provide seven days advance notice of withdrawal. Unlike CDs, however, NOW accounts and MMDAs do not have stated maturity dates or other withdrawal restrictions, such as early termination penalties.

of interest based on the Depositor's total balances placed through the ANOVA Network.² Interest accrues daily and is payable monthly, and the interest rates earned on deposited funds may change monthly with at least one business day's advance notice. The Depositors pay no set-up fees or licensing fees to use the REDP[®], but fees may apply to online services and transfers to and from the Originating Account initiated by Depositors using ANOVA's online banking program.³ Depositors have the ability to access information about and initiate transactions involving their excess funds on deposit throughout the ANOVA Network using ANOVA's online electronic funds transfer service software, and transfers between the Originating Account and the ANOVA Network Banks typically are affected within twenty-four hours.

Key Features of the REDP[®] for Network Banks

Network Banks benefit from their participation in the ANOVA Network and placing deposits through the REDP[®] for their Depositors in a number of ways.

- Network Banks retain direct relationships with their Depositors who desire to place funds using the REDP[®] while providing Depositors with full FDIC insurance coverage for their deposited funds.
- As a result of the reciprocal nature of the deposits, an equivalent amount of funds that are transferred from the Originating Account to other Network Banks are in turn deposited with the Originating Bank on a dollar-for-dollar basis. As a result, the total value of the deposit into the Originating Account remains with the Originating Bank, who is able to use the funds for its lending operations and liquidity needs.
- Rates are set by the participating banks and are typically at or below local market rates.
- Network Banks do not have to satisfy surety, bonding or other underwriting requirements or pay surety, broker or other fees to participate in the ANOVA Network.
- ANOVA does not require Network Banks to establish or maintain compensating balances, credit limits or collateral in connection with their participation in the ANOVA Network.
- As with their Depositors, Network Banks do not pay set-up fees, transaction costs or licensing fees.
- Funds placed with Network Banks are stable over one-to-three year time frames and more closely resemble core deposits as opposed to brokered deposits. For example, an analysis of wholesale funds deposited throughout the ANOVA Network over the last three years shows an average account balance of 96.7% in 2009, 95.77% in 2008, and 89.50% in 2007.

² As of February 2010, funds deposited through the Anova Network earn interest at rates of at least 0.42% per annum, depending on the amount deposited.

³ Currently Anova does not charge any fees for these services but Anova reserves the right to modify this practice in the future.

Application of Part 327 Definition of "Reciprocal Deposits" to Deposits Placed through ANOVA's REDP[®]

Looking at the plain language of the definition of reciprocal deposits, deposits placed through the ANOVA REDP[®] fall squarely within that definition and should be accorded treatment as reciprocal deposits for purposes of Part 327 and the "adjusted brokered deposit ratio." Under the REDP[®], deposits are placed through the ANOVA Network on a reciprocal basis, for each deposit received by a Network Bank, the same amount is placed by the Network Bank with other Network Banks. Furthermore, each Network Bank sets the interest rate paid on funds it places with other members of the ANOVA Network.⁴

We recognize, though, that the FDIC, in promulgating the Final Rule, may not have considered many reciprocal deposit products and may not have considered as part of its analysis whether the nature of the reciprocal deposit account was relevant to the definition. Although Promontory is not referenced in the Final Rule, we understand that most of the comment letters received by the FDIC related to reciprocal deposits and their treatment under the Final Rule related to deposits placed on a reciprocal basis through Promontory's CDARS[®] deposit network. ANOVA is not affiliated in any way with Promontory, but we understand that Promontory's reciprocal deposit product operates in a manner that is very similar to ANOVA's REDP[®], except that deposits placed through the CDARS[®] deposit network are deposited into CDs instead of NOW accounts or MMDAs.⁵ The only readily apparent difference between deposits placed through ANOVA's REDP[®] and deposits placed through Promontory's CDARS[®] deposit network is the nature of the deposit account into which the deposits are placed.

Under Regulation D, CDs and MMDAs both are time deposits; however, unlike MMDAs, CDs have minimum maturities of at least seven days, have a stated contractual maturity date and contractually preclude a depositor from withdrawing the funds prior to maturity without incurring a penalty. NOW accounts are transaction accounts under Regulation D and have no stated minimum or maximum maturity. The fact that CDs have a stated contractual maturity could suggest that CDs may have longer deposit time frames than MMDAs or NOW accounts; however, we understand that CDs utilized throughout the CDARS[®] deposit network frequently have maturities of thirty, sixty or ninety days, which time frames are significantly shorter than the deposit retention rates experienced by Network Banks for deposits placed through the ANOVA REDP[®]. Although we have no data on the retention rates experienced by banks that participate in the CDARS[®] deposit network, ANOVA believes that deposit retention rates

⁴ Network Banks primarily set their rates by adopting Anova's posted monthly program rate (the "Anova Rate"), which may then be modified and adjusted on a month-to-month basis going forward. Network Bank's are not contractually bound to pay the Anova Rate to depositors. While Anova will pay the Anova rate to Network Banks each month, the Network Banks have full authority and ability to set a different rate for any depositor based on independent business considerations. In other words, a Network Bank may choose to pay a higher or lower rate to its Depositor than the Anova Rate that it receives from Anova. For example, a Network Bank may decide to offer a rate higher than the Anova Rate for a particular deposit product that it promoting, and conversely may pay a rate lower than the Anova Rate on certain deposit products on which it does not place as great an emphasis. In practice, this result has been borne out, as Network Banks set rates independently from the Anova Rate for a wide variety of business considerations.

⁵ The discussion in the Final Rule contains a reference, for example, to customers who use reciprocal deposit networks tend to keep their deposits at the same institution when the deposit matures. *See id.*

experienced by ANOVA's Network Banks are at least as favorable as the retention rates for deposits placed through the CDARS[®] deposit network. Accordingly, the fact that deposits placed through ANOVA's REDP[®] may be placed into NOW Accounts or MMDAs, as opposed to CDs, does not give rise to a substantive distinction between the ANOVA Network and Promontory's CDARS[®] network.

Neither the FDIC's discussion as set forth in the Final Rule, nor the definition of "reciprocal deposit" as set forth in 12 C.F.R. § 327.8(s), requires, suggests or implies that reciprocal deposits are required to be time deposits, and Part 327 contains no prohibition against reciprocal deposits being transaction accounts. Given the "stickiness" of deposits placed through the ANOVA REDP[®], including those placed into NOW accounts as opposed to MMDAs, and the relatively short maturities that may apply to CDs that already have been recognized as being acceptable for use in connection with reciprocal deposits, there is no apparent policy reason for treating reciprocal deposits held in transaction accounts or MMDAs any differently from reciprocal deposits held in CDs.