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September 23, 2009

Jennifer J. Johnson  
Secretary  
Board of Governors of the  
Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

Re: Consolidated Reports of Condition and Income, 7100-0036

Dear Ms. Johnson:

On behalf of clients of our Firm that are “deposit brokers” pursuant to regulations of the Federal Deposit Insurance Corporation (“FDIC”), we are submitting comments on proposed revisions to the Consolidated Reports of Condition and Income (Call Reports) required to be filed quarterly by state chartered non-member banks, state chartered member banks and national banks. We are specifically writing to comment on the proposal to require banks to report interest expense and quarterly averages for both “fully insured brokered time deposits” and “other brokered time deposits.”

The Agencies cite two objectives for the proposed collection of interest expense data. First, the FDIC recently adopted a revised rule pursuant to 12 CFR 337.6 that establishes a national rate for deposits to determine whether depository institutions that are less than “well capitalized” are accepting “brokered deposits” by offering rates of interest that significantly exceed the national average.<sup>1</sup> Second, the Agencies cite the need to evaluate the impact of brokered time deposits on bank funding costs.

While we fully support the collection of relevant information by the Agencies, we believe that the proposal would not provide meaningful data to the Agencies unless additional changes are made to the Call Report. The Call Report currently does not require reporting of deposits obtained in the national deposit market other than deposits obtained through deposit brokers. For example, deposits obtained via the internet or through deposit “listing services,” two alternative means for banks to access the national deposit market without using a deposit

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<sup>1</sup> A “deposit broker” includes an insured depository institution that is not well capitalized that solicits deposits by offering rates of interest on such deposits that are “significantly higher” than rates of interest in such institution’s normal market area. 12 CFR 337.6(a)(5)(iii).

broker, are not separately reported on the Call Report. The Agencies, therefore, cannot meet their first objective of determining the national rates for time deposits. Further, the diversity of brokered time deposit products, and the lack of data concerning the true cost to banks of deposit gathering and maintenance, prevents the Agencies from achieving their second objective.

### Background

The term “brokered deposit” is a technical legal definition adopted by Congress in 1989 as part of the Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”).<sup>2</sup> As applied to well capitalized banks, the definition is not based on the economic characteristics of a deposit (*e.g.*, rate, term, *etc.*).<sup>3</sup> Rather, a brokered deposit is a deposit “obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.” A “deposit broker” is defined broadly to include a person “engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties . . .”<sup>4</sup>

Brokered deposits need not take any particular form. A brokered deposit can be a time deposit or a savings deposit. It can be established by the depositor directly with a bank or held by the depositor through an agent.<sup>5</sup> It can be certificated or uncertificated.

Although the FDIC has generally taken a broad view of the definition of “deposit broker,” the FDIC has granted exemptive relief to a number of arrangements that provide services similar to those provided by deposit brokers, including so-called “listing services.” Basically, a listing service permits banks to advertise available interest rates on deposits along with contact information for the bank to allow an interested depositor to arrange to make a deposit. When adopting the definition of “deposit broker” in FIRREA, the Senate amended the legislation to remove a proposed exclusion of such services from the definition.<sup>6</sup> Despite Congressional intent, the FDIC has granted exemptive relief to services that meet certain requirements,<sup>7</sup> permitting banks to raise deposits in a national market through an intermediary without reporting the deposits as “brokered.”

In addition to listing services, banks can readily raise deposits in the national deposit market using the internet or through other national advertising without having such deposits characterized as “brokered.”

Although the Agencies do not currently collect separate information on the amount of listing service or internet deposits, the significance of such deposits as a funding alternative for banks is increasingly apparent.

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<sup>2</sup> P.L. 101-73 (August 9, 1989).

<sup>3</sup> *But see* fn. 1, *supra*.

<sup>4</sup> 12 USC 1831f(g)(1)(A); 12 CFR 337.6(a)(5).

<sup>5</sup> For example, time deposits purchased through a securities broker are held through The Depository Trust Company. Time deposits purchased through the CDARS service are held through The Bank of New York Mellon.

<sup>6</sup> *See* CONG.REC. 84266, *et seq.* (daily ed., April 19, 1989) (Amendment No. 58 to S.774, the Financial Institutions Reform, Recovery and Enforcement Act).

<sup>7</sup> *See* FDIC Advisory Opinion 04-04 (July 28, 2004), which sets forth the FDIC’s criteria for determining whether a listing service meets the definition of a “deposit broker.”

- In a March 3, 2009 Financial Institution Letter,<sup>8</sup> the FDIC included internet deposits in a list of “non-core” deposits.<sup>9</sup>
- On June 4, 2009, the FDIC, at the urging of the American Bankers Association, requested that Ally Bank lower the rates on deposits solicited over the internet because the high rates were affecting the rate structure in local deposit markets, a clear concession that depositors look to deposit rates offered over the internet as a reference point for rates in local markets.<sup>10</sup>
- One listing service disclosed to the New York Times that in May 2009 it raised \$1.6 billion in deposits for banks.<sup>11</sup>
- In a number of recent bank failures, healthy banks assuming the deposits of a failed bank have declined to assume brokered, internet and similar deposits, indicating that such deposits were deemed economically equivalent by the assuming banks.<sup>12</sup>

In addition, our clients regularly report to us that banks are willing to pay higher rates for listing service deposits than for deposits sourced through a deposit broker that must be reported as brokered deposits on a Call Report. This trend has accelerated since the FDIC’s adoption in March of this year of the brokered deposit adjustment to FDIC insurance premiums. For example, during the week of September 14, 2009 the following rates were offered:

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<sup>8</sup> FIL-13-2009 (March 3, 2009). The FDIC has characterized brokered deposits and certain other funding sources as “volatile.” The basis for this characterization, particularly with respect to brokered time deposits, is unclear. In a time deposit, a depositor commits to keep funds on deposit at a bank for a fixed period of time, subject to rights of early withdrawal that may be limited and applicable penalties. The term on brokered time deposits can frequently be in excess of one year and a deposit broker has no right or authority to request a withdrawal of funds without a direction from the depositor that is consistent with the terms of the time deposit. In contrast, funds held in transaction accounts can be withdrawn on demand or short notice. The percentage of deposits in failed banks that are brokered deposits at the time of failure is frequently affected by the fact that funds in transaction accounts have been withdrawn by depositors prior to failure. The FDIC acknowledged the risk of deposit runs from transaction accounts by its adoption of the Transaction Account Guaranty Program.

<sup>9</sup> The term “core deposit” is defined by what are *not* core deposits, rather than by defining what *are* core deposits. See FFIEC’s User’s Guide for the Uniform Bank Performance Report. No affirmative definition of this term exists.

<sup>10</sup> Ron Lieber, *FDIC is Watching as a Bank Sets Rates*, N.Y. TIMES, June 13, 2009.

<sup>11</sup> Eric Lipton and Andrew Martin, *For Banks, Wads of Cash and Loads of Trouble*, N.Y. TIMES, July 4, 2009, at A1. The company advertises itself as being “fully compliant with the FDIC as a non-brokered Direct Deposit CD listing service” and states that the deposits obtained through the service are “core deposits.” It also states that it is “much more than just a rate listing service.” See QwikRate.com.

<sup>12</sup> See, e.g., Schedule 2.1(a) (Excluded Deposit Liability Accounts) to the Purchase and Assumption Agreement between the FDIC and Kitsap Bank dated May 8, 2009 in connection with the failure of Westsound Bank in Bremerton, Washington.

<u>CD Maturity</u>	<u>Listing Service</u> <sup>13</sup>	<u>Brokers</u> <sup>14</sup>
3-month	1.095%	.70%
6-month	1.525%	.70%
1 year	1.925%	1.10%

In other words, banks are willing to pay a premium for deposits that are not reported as “brokered.”

#### Proposed Reporting Requirements

We believe the Agencies should obtain relevant and useful information from banks and agree that meaningful rate information about brokered deposits could be useful to the Agencies for various regulatory purposes. However, brokered deposits are merely one component of the national deposit market, a market whose total size is unknown to the Agencies or the public.

Collecting data on the interest expenses of brokered time deposits will not assist the FDIC in determining a national rate on deposits. In addition to being historic rather than current data, it will not reflect interest expenses associated with the use of the funding sources most likely to be accessed by banks that cannot accept deposits from a deposit broker: the internet and listing services. Unless data on these funding sources can be isolated and the interest expenses properly allocated to these sources, the brokered deposit data is more likely misleading than illuminating in determining the interest rates required to be paid by banks to raise deposits in the national market.

In addition to the lack of data about internet and listing service deposits, data on the interest expenses related to brokered time deposits will be misleading if additional factors are not taken into account.

First, a growing portion of the brokered time deposit market is comprised of so-called “structured CDs.” These CDs pay interest on the basis of the performance of an index, such as the S&P 500, the Dow Jones, *etc.* The CDs generally have maturities of five years or more. While a nominal interest rate may be paid during the term of the CD, interest is typically paid at maturity. A bank’s interest expense in any quarter would be influenced by the percentage of its total brokered time deposits that are structured. A bank with a significant amount of structured CDs would have low interest expense in quarters in which the CDs pay little or no interest. The quarters in which the CDs mature would have arbitrarily high interest expense.

Second, interest expense is not the sole cost of gathering and maintaining deposits. Deposits raised through a bank branch cost the bank more than the interest expense.

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<sup>13</sup> Average of the top 10 rates in each CD maturity listed on a major listing service; does not include fees to the listing service.

<sup>14</sup> Survey of Seward & Kissel broker-dealer clients; includes fees to the brokers.

The bank must cover overhead expenses, including rent, advertising, staff, *etc.* In addition, the bank pays for customer communications, including statements and sending IRS Form 1099. These expenses are estimated to cost a bank between 90 and 150 basis points.<sup>15</sup>

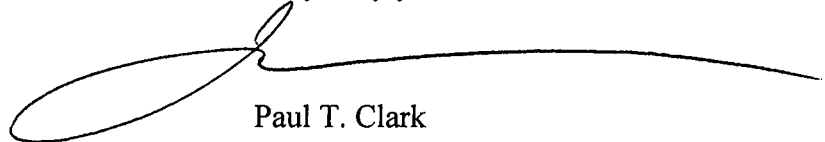
In contrast, banks obtaining deposits through a deposit brokerage arrangement that establishes the deposit through an agent (*e.g.*, DTC) do not incur these overhead costs. The broker incurs the marketing and depositor communication costs, including sending customer statements and Form 1099 disclosure. Banks pay deposit brokers a fee, but that fee is substantially less than 90 basis points.<sup>16</sup>

### Conclusion

As set forth above, we do not believe the proposed Call Report amendments will provide the Agencies with accurate or meaningful information. We believe that the Agencies should reconsider the information that they require concerning the national deposit market and the cost of deposit funding to banks. This reconsideration should be comprehensive and should identify the various sources of deposit funding and their related costs. The Agencies should also consider whether public comment should be solicited on a definition of “core deposit,” or whether such term is itself meaningful.

Absent an analysis of the true cost of gathering and maintaining deposits as suggested above, raw data on the interest expense of brokered time deposits is likely to be used to support pre-conceived notions about brokered time deposits, rather than providing much-needed clarity about the costs of deposit funding.

Very truly yours,

A handwritten signature in black ink, consisting of a large, stylized loop followed by a long, horizontal, slightly wavy line extending to the right.

Paul T. Clark

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<sup>15</sup> See comment letter of Paul T. Clark, Esq., Seward & Kissel LLP, dated December 17, 2008, in connection with the FDIC's proposed rulemaking regarding deposit insurance assessments, published at 73 Fed.Reg. 61,560 (October 16, 2008) (RIN 3064-AD35), at p. 7.

<sup>16</sup> Securities brokers charge a standard fee of 25 basis points annualized.