A Case for Brokered Deposits

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Over the past decade, following the financial crisis, low interest rates and investor risk aversion fueled large core deposit balances across the banking industry. As interest rates have risen, most banks are starting to re-evaluate their deposit funding models. With increased competition, technological changes and greater loan demand, banks are seeking out new deposit sources to achieve their strategic goals. With these challenges and opportunities, it is time to rethink the stigma of wholesale funding. When used appropriately, wholesale funding can be an effective and stable source of deposit funding.

As a refresher, the Great Recession of 2008 brought on the need for regulatory review of how banks fund their balance sheets. Through Congressional action (The Dodd Frank Wall Street Reform and Consumer Protection Act), the FDIC was required to conduct a study on the effects of brokered deposits. The "Core and Brokered Deposit" study focused on the role of brokered deposits in the lead up to the Great Recession. The common theme was that troubled banks were not utilizing diversified funding sources and were over-reliant on brokered deposits. This enabled rapid loan growth in higher risk assets. The rapid deterioration of asset value (sub-prime housing crisis), coupled with the depth of the recession and the dislocation of interbank lending exposed the vulnerability of the banking system. The theme coming out of this study was that ALL wholesale/brokered deposits were considered "hot money," which in times of stress can fuel instability.

A major concern with this line of thinking is that it takes a "one-size fits all" approach. The primary focus has been on the "brokered deposit," and not as much on the source, the "deposit broker." There are numerous sources that a bank can take advantage of when receiving brokered deposits and they are not all the same. A few examples of brokered deposit sources include Referral Services, Broker-Dealers, Money Managers, etc. These are considered brokered deposits, but behave differently. For example, in the case of referral services, they typically match advisors or depositors with banks. They have a limited relationship with the underlying depositor, thus possess limited knowledge on the depositors investment policy, deposit stability or the impact of stressed situations on the deposits. This differs greatly from that of a Money Manager. The Money Manager is usually involved in establishing a cash flow plan with the depositor, then implementing it based on investment objectives.

Brokered deposits can be a good complement to traditional funding when utilized in a prudent manner. This starts by taking the time to understand the source behind the deposit. Prior to participating in the brokered deposit market, an operating plan/template should be constructed outlining rules of engagement, specifically covering the various sources and types of brokered funding, such as:

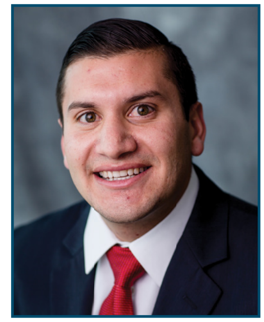
- When should brokered funding be utilized?
- Establishment of concentration limits
- Defining the relationship of the deposit broker to the depositor

The deposit broker needs to be vetted to determine their role in the deposit process and ongoing relationship. The more clarity provided at the onset of engagement will help eliminate unexpected surprises during times of stress All in all, brokered funding is an integral part of the deposit market place. It provides stability and fills the voids created during times of volatility in the local depositor base.

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network, Inc. and PMA Securities, Inc. where he oversees PMA Funding., a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 50, 53, 63, 65 and 99.

About Todd A. Terrazas



Todd joined PMA Financial Network, Inc. in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing financial institution partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.