



Excess Deposit Bond – Old is New Again (Part II)

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Mark Twain famously said “*History doesn’t repeat itself, but it does rhyme.*” For an old collateralization instrument often used before the financial crisis, Excess Deposit Bonds (EDB), this rings true. Opportunities to utilize this type of product are reappearing amongst the banking community. Like Mark Twain’s quote suggests, today’s Excess Deposit Bonds are similar to the past, but come with subtle nuances.

An Excess Deposit Bond is a guarantee from an insurance provider that a financial institution will perform its obligation to the depositor. Should the financial institution default in its obligation to the depositor, the EDB will be “drawn” upon and the insurance provider will make the depositor whole in principal and interest through default.

Since the 2008 Great Recession, securitization options have been reduced to Letters of Credit, Pledged Securities, FDIC Insurance and/or reciprocal deposits. Each process has unique features which require an understanding of associated costs, operational resources, functionality restrictions and regulatory classification. The reappearance of EDBs will provide bankers with an additional securitization option when participating in deposits that require collateral. However, just like current securitization options, it is important to be cognizant of all tangible and intangible costs.

Insurance providers issuing Excess Deposit Bonds will charge a premium on the deposit being placed, usually ranging from 20 basis points and up on an annualized basis. The cost may vary depending on a number of factors: program size, credit quality, duration, etc. It is important to ask your insurance broker or the underwriter about the cost associated with your bond and various factors that may influence it. Due to the impacts of the financial crisis, EDB providers are mitigating risk through shorter durations and smaller program sizes.

The utilization of EDBs will require modification to existing operational functions. Banks will have to identify which depositors require additional securitization, and if EDBs are a viable form of securitization. When applying for an EDB, a basic application is submitted to your insurance broker. The insurance broker then works with the insurance underwriter to issue a bond based on terms of the deposit and the credit worthiness of the financial institution. This process is much like requesting an FHLB letter of credit.

Functionally, Excess Deposit Bonds are one of the more efficient sources of securitization. Unlike some forms, EDBs do not experience market price fluctuations, settlement date limitations and third-party custody requirements. With an EDB, the application through issuance can be achieved in a single day at a set value.



In today's regulatory environment, banks have had little to be optimistic about. Thankfully, Excess Deposit Bonds can provide banks with an opportunity instead of a challenge. Through the EDB utilization process, a bank frees up securities or resources at the FHLB that might otherwise have become encumbered. This can have many positive effects for a bank; increasing liquidity or preserving resources.

Overall, EDBs are a welcome re-addition to the options of securitization. This tool provides banks with an opportunity to attract deposits that they typically wouldn't, due to securitization requirements. Furthermore, if used effectively, EDBs can provide regulatory relief. On the surface, EDBs seem more expensive than other forms of securitization; but when factoring in operational cost, functionality and regulatory diversification, they become a competitive alternative. In the case of EDBs, old is in fact new again.

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 banks 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, 53, 63, 65 and 99.

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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 bank 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.

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