



Not All Brokered Deposit Sources Are the Same

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The Great Recession of 2008 brought on the need for regulatory review of how banks are funding 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 deposits¹. The “Core and Brokered Deposit” study focused on the role of brokered deposits in the lead up to the Great Recession. The common theme: troubled banks were not utilizing diversified funding sources and were over-reliant on brokered deposits which fueled 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.

Since the crisis, additional controls/safeguards have been implemented through modified deposit assessments, new regulatory requirements and increased stress testing. Regulators require a bank’s Board of Directors to become more involved in the establishment and execution of both primary and contingency funding plans. One take away from the crisis was that bank’s Boards were not actively engaged enough in the development and ongoing execution of liquidity. Post crisis, banks are required to develop clear funding strategies and incorporate stress scenarios (“the unexpected”) with an ongoing focus on liquidity position. Regulators are requiring banks to build primary funding plans with a focus on utilizing traditional funding sources. Other wholesale sources, such as listing services, FHLB advances and reciprocal and brokered deposits, can be utilized to compliment the primary funding plan and provide diversification as part of a bank’s contingency plan.

With the gradual return of loan growth and the need for wholesale funding, questions are arising around the issue of brokered deposits and deposit brokers. Specifically, banks are looking for clarification on what constitutes a brokered deposit and a deposit broker. In January 2015, the FDIC published an FAQ to address these questions². The FAQ created further debate and confusion amongst the financial community regarding the issue. On April 22, 2015, the FDIC posted a Q&A section to further define the situation seeking industry input into issues that still were in need of clarification³.

The conversation has since moved to the topic of what constitutes a deposit broker. Until recent, the primary focus has been on “the brokered deposit,” and not as much the source, “the deposit broker.” Depending on the relationship with the depositor, the source may have an influence how the depositor reacts in various stressed situations. Three questions to ask when considering using a deposit broker are:

1. Do you understand your funding source?
2. What situation(s) could have a negative impact on this source?
3. Are you able to defend the utilization of this source with your examiners?



Listed below are examples of brokered deposit sources:

- Referral Services – Commonly referred to as a broker's broker, typically matches advisors (aka. money managers, trusts, escrows, etc.) or depositor with banks. There is usually limited to no direct relationship with the end depositor. Thus, they possess limited knowledge of depositor's investment policy, deposit stability and/or the impact of stressed situations on the deposits.
- Broker-Dealer – Underwrites DTC deliverable certificates of deposit for issuing bank. The Broker-Dealer then sells shares of the certificate/issue to retail and wholesale clients. The issuing bank does not have a direct relationship with the end depositor. The certificate is held in a street account through a custodian for the benefit of the depositor. Also, the certificate can continually be bought and sold throughout the life of the term. The certificate typically cannot be redeemed prior to maturity without death or adjudication. In stressed situations, the active certificates remain stable, but new/replacement issues can become expensive and even unattainable.
- Money Managers - Have a direct relationship with the depositor and with the bank. The Money Manager possesses a good understanding of the depositor's investment policy, deposit stability and the impact of stressed situations on deposit availability. The Money Manager may even apply additional credit standards or concentration limits beyond that of the investment policy of the depositor.

The examples above are not inclusive, but provide a broad overview to consider. Brokered deposits can be a good complement to traditional funding, but it is critical that banks 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:

- 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.

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1. Core and Brokered Deposit Study as Mandated by Section 1506 of the Dodd Frank Wall Street Reform and Consumer Protection Act: January 3, 2013, <https://www.fdic.gov/regulations/reform/coredeposits.html>
 2. Guidance on Identifying, Accepting, and Reporting Brokered Deposits: January 5, 2015, <https://www.fdic.gov/news/news/financial/2015/fil15002.html>
 3. Industry Call Regarding Guidance on Identifying, Accepting, and Reporting Brokered Deposits: April 21, 2015, <https://www.fdic.gov/news/news/financial/2015/fil15017.html>



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