Brokered Deposits

Thinking Through Funding Choice

When looking for fuel to sustain or rev up a loan engine, institutions look primarily to two types of funding – deposits or wholesale borrowings. Just as there are different sources for wholesale funding, there are different sources for deposits. Core retail deposits bring an undeniable value to an institution. Brokered Deposits become part of total deposits, but are they providing the same value and are they always the best choice?

According to the FDIC's definition[1], brokered deposits are defined broadly as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker." A deposit broker is then defined as "any person engaged in the business of placing deposits, or facilitating the placement of deposits, or facilitating the placement of deposits with insured depository institutions..."

There are many reasons why individuals place their deposits with a broker instead of directly with a financial institution. The most common reasons are 1) help in finding the best rate and 2) help in splitting up large balances to have full FDIC insurance coverage. Because of this, brokered accounts should immediately be classified as rate-sensitive since rate is a primary decision criterion. When an institution accepts brokered deposits, it often pays more than it pays its community depositors for like-term deposits, often times at significant premiums to local deposits. The higher rate is typically necessary to attract these deposits because the depositors are more rate-sensitive in nature. It seems somewhat counterintuitive that an institution will pay more to depositors who offer no cross-selling opportunities, have no loyalty to the institution and are more rate sensitive than core depositors, but that is often the reality.

As mentioned in the American Banker article,[2] "*Warning, Not too Early to Worry About a Liquidity Crunch*", brokered deposits have increased from 6.57% of total industry deposits in 2015 to 7.23% at Dec. 31, 2017 according to BankRegData.com. Regulators are sympathetic to banks' challenges in retaining core deposits in a rising-rate environment, but they have recently raised caution flags about becoming too reliant on brokered or promotion-driven deposits that could quickly flee to the highest bidder or move elsewhere if the U.S. economy begins to cool.

To better understand the nature of brokered deposits and to compare them to other funding alternatives, we offer the following questions for consideration:

- What is the stability of the funding? The renewal rate for brokered CDs may be significantly lower than retail CDs.

[1] **https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf**

[2] **https://www.americanbanker.com/news/warning-not-too-early-to-worry-about-a-liquidity-crunch**

- Can the depositor redeem early?
- How long does it take to acquire the funds? In many brokerage situations, it takes time to find depositors that meet your term and price needs and there may be "best efforts" covenants.
- Are you able to get the specific terms that best fit your needs? Are you able to obtain longer maturities or specific maturity dates that fit your asset/liability needs?
- Would funding that includes optionality, such as call features, best fit your funding needs?
- How will my regulator perceive significant levels of brokered deposits? Will it affect liquidity concerns due to the unknown amounts that will be sustained?
- How well capitalized is my institution?
    - Is my institution "well capitalized"? Per FDIC regulation, if not, there will be monitoring, approvals needed, and restrictions regarding the level of brokered deposits.[3]
    - Is my institution "adequately capitalized"? Per FDIC regulation noted above, a waiver must be obtained and, at the time that such deposit is accepted, renewed or rolled over, and the rate cannot exceed the national rate by more than 75 basis points.
    - Is my institution "undercapitalized"? Per FDIC regulation, you will not be permitted to issue new brokered deposits.
- Is the issuance of brokered deposits impacting my FDIC premiums?
    - If your institution is considered a "Large & Highly Complex Institution" per FDIC[4] (ex: greater than $10 billion in assets)? If so, an adjustment, or increase, could be made to your FDIC premiums.

Funding should be evaluated based on the economic value it provides, the profitable lending capacity it generates, and whether it meets overall balance sheet management.

FHLBank Indianapolis advances:
• Reliable • Can be tailored to specific terms up to 10 years • Can be structured with call features • Cannot be withdrawn, unless structured as putable • Available same day

When acquiring fuel to power your institution, choose the partner that is reliable, consistent, and there to provide you tailored solutions to meet your funding needs.

For additional assistance in analyzing funding strategies, contact FHLBank Indianapolis Member Services 800.442.2568 or memberservices@fhlbi.com

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[3] **https://www.fdic.gov/regulations/laws/rules/2000-5900.html**

[4] **https://www.fdic.gov/deposit/insurance/assessments/risk.html**