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Washington, DC 20036

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**Edward L. Yingling**  
President and CEO  
Phone: 202-663-5328  
Fax: 202-663-7533  
E-mail: eyinglin@aba.com

July 29, 2008

The Honorable Sheila Bair  
Chairman  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429-9990

Dear Chairman Bair:

The American Bankers Association<sup>1</sup> would appreciate the FDIC clarifying the status of deposits obtained through the Certificate of Deposit Account Registry Service (CDARS) offered by Promontory Interfinancial Network, LLC. The CDARS product enables a single bank to offer up to \$50 million in FDIC insurance per customer. This has become an important source of liquidity for many of our members and a valuable resource for depositors who, in ever greater numbers, are seeking the safety offered by insured depository institutions. Several of our members expressed concern at a recent ABA conference that the law governing brokered deposits as applied to CDARS has the potential to unnecessarily and inappropriately restrict the use of CDARS to the detriment of banks, depositors, and our economy as a whole.

In a CDARS “reciprocal” transaction,<sup>2</sup> deposits are divided into amounts under \$100,000 (making the full amount eligible for FDIC insurance coverage) and spread

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<sup>1</sup> The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

<sup>2</sup> Promontory also offers “one-way” transactions. In a “one-way sell” transaction everything is the same as with a reciprocal transaction except that the customer's bank chooses not to receive matching funds from other network members. Banks engage in these transactions to maximize the use of “excess” deposits on their books and to avoid turning valuable customers away. Banks also may engage in “one-way buy” transactions in order to obtain wholesale funding. While an argument may be made that the safeguards imposed by Promontory make it appropriate for one-way transactions to receive the same treatment as is requested in the body of this letter, the focus of this letter is on the CDARS reciprocal transactions.

among other banks that are members of the Promontory Network. In return, the originating bank receives exactly the same amount of deposits from other banks, thus winding up with an amount equal to its customer's original deposit on its books. Customers receive FDIC coverage from many banks but have a relationship with only one. Each bank sets the interest rate it offers to its customers and retains full control over the customer relationship. The customer's personal information remains private and is not shared with other banks in the network (other than the one bank that handles issuance, custody, settlement, and recordkeeping).

CDARS reciprocal deposits exhibit the characteristics of core funding. These deposits are "sticky," having an average reinvestment rate of 87%.<sup>3</sup> And the cost of funds for these deposits is below the cost of typical brokered deposits, with CDARS reciprocal costs averaging 40 basis points cheaper than a bank's comparable costs for typical brokered deposits. In short, customers enter into CDARS reciprocal transactions to increase deposit insurance and maintain the relationship with their bank in contrast to customers using classic brokered deposits to increase yield.

The expanded insurance coverage that a bank is able to offer through CDARS deposits has proven very effective in helping banks develop business from customers with large deposits. This provides an excellent opportunity for a bank to grow a stable, low-cost source of deposits while spreading risk throughout the system. It also has proven effective in calming large depositors who are made jittery by alarmist, irresponsible media stories about bank failures.

It is our understanding that the FDIC considers CDARS deposits to be subject to the law governing brokered deposits.<sup>4</sup> A number of our members have told us that they have been criticized for an over-reliance on brokered deposits notwithstanding the fact that most (if not all) of the deposits were obtained through CDARS reciprocal transactions. For the reasons outlined above, we believe this is inconsistent with the intent of a statute that was enacted to minimize the risks that arise when a bank that is not well capitalized relies on volatile funding. Technology has developed in ways that were not contemplated when the law was enacted in 1989. Thus, we believe it would be appropriate for the FDIC to apply the statute in a way that recognizes that certain deposits function as core deposits even though there is an intermediary between the depositor and the institution that issues a CD.

If the FDIC remains of the view that the CDARS deposits are "brokered" for purposes of the statute, we believe that your agency should recognize the very real differences between CDARS reciprocal deposits and typical brokered deposits in your examination of banks and in your consideration of waivers for adequately capitalized banks to accept brokered deposits. Absent a concern about the

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<sup>3</sup> All data concerning the reinvestment rates and costs of CDARS reciprocals deposits have been provided by Promontory.

<sup>4</sup> 12 U.S.C. 1831f, as implemented by 12 CFR 337.6.

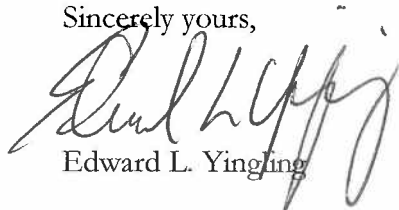
reinvestment rates or excessively high yields being paid to attract deposits, a bank should not be criticized for relying on CDARS reciprocal transactions, and requests for waivers to engage in such transactions should be granted. Moreover, we urge the FDIC to recognize the need for a prompt consideration of waiver requests in situations where a bank that uses CDARS becomes adequately capitalized. Delays can adversely affect customer relationships and disrupt the bank's operations.

Ironically, a bank can avoid being criticized for an over-reliance on brokered deposits by not offering CDARS, but in so doing it either will chase off good customers or increase exposure to truly volatile funding. For instance –

- Perhaps the customer will elect to invest funds in an uninsured non-bank product. This would lead to fewer deposits entering the banking system, thereby reducing the availability of funds for depository institutions to lend.
- Or perhaps, due to a relationship the customer has with the bank, the customer will elect to deposit a sum that exceeds available insurance limits. While long-standing customer relationships may lead to an initial decision to place uninsured deposits with a bank, such deposits often leave quickly when rumors spread about problems, either about that bank or about the banking system broadly speaking. Thus, rather than minimizing the exposure to volatile deposits, the current rule would produce just the opposite result in this scenario.
- A third option is that the customer who otherwise would have made a large deposit in a bank that offered CDARS may spread deposits around several banks by using a deposit broker. This would increase volatility throughout the system as those deposits chase yields at institutions that have no other relationship with the depositor.
- Restricting the use of CDARS reciprocal deposits will force a bank that needs additional liquidity to obtain it elsewhere. This may result in a diminished franchise value for the bank as the bank turns to non-core sources of funding.

We believe these adverse outcomes can be avoided by your agency clarifying that, as a general matter, it will not criticize a bank for relying on brokered deposits if the deposits at issue were obtained through CDARS reciprocal transactions. We also request that you clarify that, also as a general matter, it will grant waivers to adequately capitalized banks who wish to use CDARS reciprocal deposits and that the FDIC will respond to waiver requests as promptly as possible so as to minimize any disruption to the requesting bank's customers or operations. We appreciate your attention to this matter.

Sincerely yours,



Edward L. Yingling