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Recent Changes In FDIC Deposit Insurance Impact Sweep Accounts

Corporate treasurers and CFOs should carefully consider the impact on sweep accounts of recent changes in the FDIC's deposit insurance programs. These changes may frustrate a common goal for sweep accounts: achieving a high effective yield on a fully-insured account. Failure to account for recent changes could leave funds unprotected by FDIC insurance in the event of a bank failure.

Here is the problem: Under the FDIC's Temporary Liquidity Guarantee Program, non-interest or low-interest transaction accounts may have unlimited deposit insurance, but newly instituted rules for the processing of sweep accounts in the event of a bank failure may prevent the funds in these accounts from receiving this coverage.

On October 14, 2008, the FDIC announced unlimited deposit insurance for non-interest or low-interest transaction accounts (these accounts pay less than 50 basis points annually). The idea was to discourage the transfer of these accounts from small and middle-size banks to larger banks that were, in practice, too big to fail. This program has now been extended beyond its initial 30-day period to December 31, 2009, but participating banks must pay a fee for the insurance. Banks had an opportunity to opt out of the program as of December 5, 2008. The FDIC is expected to post on its website a list of institutions that have done so.

Effective August 18, 2008, a new FDIC rule addressed the processing of sweep accounts in connection with bank failures. The rule uses (for the most part) the end-of-day account balance in computing deposit insurance coverage and for the application of the depositor preference rule on liquidation. It also distinguishes between internal and external sweeps. Automated internal sweeps are deemed to have been completed as of the earlier of the bank's normal cut-off time or the end of the day of the bank failure. External sweeps, however, will not be completed unless the funds have actually left the institution before the earlier of the normal cut-off time or the time the FDIC has designated as its take-over time, which is usually the end of the day of the failure.

Thus, a corporate treasurer or CFO could find, in the event of a bank failure, that an external sweep will not have been completed. This may leave funds in excess of the deposit insurance amount in the transaction account. This is no problem if the account qualifies for unlimited deposit insurance. It is a problem if the account is high yielding and does not qualify for unlimited deposit insurance. Then the account will be insured only to a maximum of the applicable

FDIC insurance amount (currently $250,000). As a result, some treasurers may want to forego yield in exchange for unlimited insurance.

Similarly, another corporate treasurer may find that, after an internal sweep, which will usually always be deemed to be completed by the end of day of the bank failure, funds are swept from a lower yielding transaction account for which there is unlimited deposit insurance into a higher yielding overnight account for which there is only limited insurance. Again, some treasurers may want to forego yield for unlimited insurance.

Yet another corporate treasurer may have planned that each day, pursuant to a sweep arrangement, funds will be swept into a security subject to a daily repurchase agreement, or funds will be swept into an account at a money market fund (with a reverse sweep in the morning), or funds will be swept into a high yielding Eurodollar account at a foreign branch (with a daily reverse sweep planned). Once the sweeps are accomplished, the ownership of these investments usually would not be disturbed in the event of a bank failure (and the investments are not deposits for the purpose of deposit insurance). Under the new FDIC sweep procedures, however, in the event of a bank failure, such external sweeps will not be considered complete if, as of the earlier of the normal cut-off time or time of the FDIC takeover, the funds have not left the institution. If the original transaction account does not qualify for unlimited deposit insurance, the result again may be that some funds are uninsured.

The lack of widespread understanding of the impact of these processing procedures led the FDIC to adopt a new disclosure requirement for financial institutions, which becomes effective July 1, 2009. Under this requirement, financial institutions must disclose to their customers the deposit insurance implications of sweep accounts.

In light of this situation, corporate treasurers and CFOs should:

- Consult with their bankers concerning the implications of the rules regarding bank closures and sweep accounts, paying special attention to the sweep account disclosures as they become available;
- Pay careful attention to the mechanics and timing of external sweeps;
- Ask if their bank is participating in the unlimited insurance program. Some treasurers may insist their bankers institute sweep arrangements, like those involving internal sweeps, which have predictable results in the event of a bank failure; and
- Decide whether, in the current environment, it makes sense to forgo the increased yield associated with a sweep arrangement in order to have the certainty of unlimited FDIC insurance for a transaction account — provided the bank is participating in the Temporary Liquidity Guarantee Program for unlimited deposit insurance for transaction accounts.