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Chase Yields or Remain Conservative? FDIC Changes Impact Deposit Choices

Last fall's economic crisis influenced many corporations to steer their short-term cash into the most conservative deposit options. Today, with growing confidence in the US banking system, firms are now considering other choices, such as foregoing Federal Deposit Insurance Corporation (FDIC) protection in order to eliminate costs and seek higher yields.

To make such liquidity management decisions, companies need to understand new developments in FDIC insurance coverage and costs and how these changes, as well as their appetite for risk, may affect their depository allocations.

Depository Options

1. Risk-averse corporations may opt to maintain all or most of their balances in FDIC-insured accounts. These include non-interest bearing transaction accounts that offer newly enhanced protections for increased balance levels (described further below) and other conservative vehicles (e.g., money market accounts or certificates of deposit).

   In May, Congress approved extending the FDIC program that increases deposit insurance limits on deposits at insured institutions up to $250,000 per depositor through December 31, 2013.

2. Other corporations may prefer to obtain greater yields by foregoing FDIC protections by placing some of their balances in non-insured products such as overnight sweeps or mutual funds with a stable banking partner.

Each path has its tradeoff. For example, the value a corporation can earn in today's low interest rate environment may not generate the earnings credits needed to maintain an FDIC-insured account and offset today's higher insurance-related account fees.

Corporations must understand how their accounts are insured so they can weigh the benefits of this increased insurance against the direct and indirect costs.

Calculating FDIC Fees
Basic Assessment. Beginning with the second quarter 2009 balances, the FDIC moved to a risk-based system for calculating fees. The FDIC initial base assessment rate now ranges between 12 basis points (bps) for low-risk category banks like Deutsche Bank Trust Company Americas (DBTCA) to as high as 45 bps for institutions with the highest risk

classification. It is not certain how banks with higher risk profiles will handle increased risk-based charges on their clients' account analysis statements.

Temporary Liquidity Guarantee Program (TLGP). In late 2008, the FDIC enacted TLGP to provide unlimited FDIC insurance for non-interest bearing transaction accounts. Most FDIC insured banks (including DBTCA) participate in the program. The cost to banks is an annualized 10 bps assessment on non-interest bearing transaction accounts exceeding the $250,000 deposit insurance limit.

Special Assessment. In May 2009, the FDIC enacted a Special Assessment as an emergency measure to replenish the deposit insurance fund. The Special Assessment is based on the lower of 10 bps times deposits levied or 5 bps against assets (minus Tier 1 capital).

The FDIC has the authority to levy two additional assessments before the year's end if the deposit insurance fund needs to be further replenished. Depending on individual bank policies, this cost may be passed on to the client.

Costs. Like some of its competitors, DBTCA passes through FDIC-assessed fees by posting them to clients' invoices or account analysis statements.

For example, in second quarter 2009, DBTCA invoices and account analysis statements reflected an annualized 12 bps pass-through charge for the basic assessment and 10 bps per annum for TLGP coverage (when applicable). DBTCA also charged for the FDIC's Special Assessment starting in July. In the low rate interest environment that currently exists, where fed funds and T-bills are averaging under 25 bps, earnings credits are not keeping pace with these costs.

Extra Protection Worth the Cost?

In combination, when passed through to customers, these FDIC assessments represent increases over what corporations experienced last year. However, these fees correlate to the actual cost for guaranteed FDIC protection. For some businesses, the costs are worth it because they want their deposits guaranteed. Companies that are less risk averse, however, have the option of moving their deposits into products such as uninsured overnight sweeps that don't have a related FDIC insurance cost.

What You Can Control

To complement what the FDIC is doing to help stabilize and restore confidence in the bank system, corporations can help themselves by assessing the strength and stability of the banks with which they do business.

As your financial partner, Deutsche Bank is committed to presenting you with all your options. This means helping you understand the FDIC-insured protection programs, working through strategies that might minimize your costs and determining the best cash management alternatives for your corporation. Contact your Deutsche Bank representative to learn more.