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WASHINGTON

New Pitch: Deposit Insurance Sharing

■ BY ROB BLACKWELL

WASHINGTON — Several prominent ex-regulators are set to unveil a network this week designed to maximize federal coverage of deposits at small and midsize banks and make it easier for them to compete for the accounts of businesses, municipalities, and wealthy individuals.

Its creators, led by former Comptroller of the Currency Eugene Ludwig and former Federal Reserve Board Vice Chairman Alan Blinder, said their marketing pitches have been well received by banks that still have long-term concerns about liquidity, even though deposits have soared in the last couple years.

Community banks have unsuccessfully lobbied Congress to raise the coverage limit above \$100,000 per account, and in the process they have helped stall broader deposit insurance reform.

The new service represents a private-sector approach that could recast the policy debate.

In theory, at least, the Promontory Interfinancial Network offers bankers an opportunity to sell certificates of deposit as large as customers want, and have them fully insured by the federal government. Network executives say it will give community banks an inexpensive source of stable, long-term funding and help them improve service.

"I remember, as I traveled around the country as comptroller, if there was any-

thing I constantly heard from community and regional banks, it was the importance of funding," said Mr. Ludwig, the network's chairman and chief executive officer. "I heard



Ludwig: Now banks "can raise funds with an interest rate coincident with their lending."

that again and again and again, and how they were hard-pressed to fulfill all the needs they had to make loans. ... They can now raise funds with an interest rate that is more coincident with their lending, and they can cement relationships with the very customers with whom they want to cement relationships."

Here is how it works: Member banks can put their customers' funds in CDs for up to \$100,000 at another Federal Deposit Insurance Corp. insured institution. In return, the banks would expect to receive an equal amount of funds from other members.

For example, a bank in California could take a CD from a customer for \$300,000 and send \$100,000 each to banks in New York and North Carolina. In return, the California bank would receive \$200,000 from other banks on the network that were engaged in similar transactions.

Thus, a customer's money is held by as many institutions as it takes to ensure that the CD is fully guaranteed by the FDIC, but the customer will have to deal with only one bank, and the originating bank would get the same amount of funding as it would if it kept the full deposit.

The network also allows customers to receive the originating banks' interest rate for the entire amount deposited. To continue the example, the bank in California may pay 2.5% on its CDs, while its partner in New York might only pay 2%. To compensate, the California institution would send a 0.5% "bridge payment" to the New York bank.

Mr. Ludwig said the network will charge three types of fees: one for online access to the system and train bank personnel on how to use it; one for banks that fall short

of minimum use requirements; and a small fee on each transaction. Both the installation and the minimum usage fees would be determined by a bank's asset size, and the transaction fee would be between 2.5 and 12.5 basis points, depending on the CD's maturity rate, he said.

Promontory already has a version of the system up and running. Early last month the network ran a successful test and then brought it online for approximately 80 participating banks. Starting this week it plans to start advertising a "Certificate of Deposit Account Registry" service, available to any institution that may legally accept brokered deposits.

The early response has been positive. Earl McVicker, the chairman and president of \$262-million asset Central Bank and Trust Co. in Hutchinson, Kan., said that the transactions his bank has run on the network have gone smoothly and that he is eagerly anticipating more banks joining it.

"This service has tremendous potential, depending on the utilization by banks and their customers," he said in an interview last week. "It will give us the opportunity to grow our core deposits. By using the exchange service, we will be able to obtain more large deposits in our own community and effectively have more dollars to lend within the community."

Mr. McVicker and other banking industry representatives said they expect the bulk of the deposits raised through the program to come from retirees, municipalities, and small businesses that have until now spread their money around at multiple institutions to keep it insured.

Promontory is hoping the network will

take off in the coming weeks as banks learn more about it, and it has assembled an industry Who's Who to serve as its board of directors. In addition to the founders — Mr. Ludwig, Mr. Blinder, and Mark Jacobsen, a former chief of staff for both the OCC and the FDIC — the board includes several current bankers and former regulators.

They include James M. Culberson Jr., the chairman emeritus of the First National Bank and Trust in Asheboro, N.C., and a former president of the American Bankers Association; J. Michael Shepherd, the executive vice president and general counsel of Bank of New York Co.; former Sen. Warren B. Rudman; L. William Seidman, a chief commentator on CNBC and a former FDIC chairman; and former Fed Governor Edward W. Kelley Jr.

Former FDIC Chairman William Isaac heads the advisory committee.

Industry representatives say that all those names will give the network credibility.

"This is not someone off the street with a new idea," said Thad Woodard, the president of the North Carolina Bankers Association, who was briefed on the system. "These are proven industry leaders in whom bankers will have immediate confidence."

But it remains to be seen how policymakers will react. The network could affect the deposit insurance reform debate in several ways. Once enough banks join, it could bring in a significant amount of new insured deposits, and that could lower the Bank Insurance Fund's ratio of federal reserves to insured deposits below its current 1.25%. If the ratio falls below that mark, banks could face premiums for the first time since 1996.

However, Mr. Blinder said that was unlikely. Most of the money that community banks would receive would likely come from deposits at other financial institutions — such as large ones that already offer higher insurance limits, he said.

"If you use realistic numbers for this, we can't imagine this moves the BIF by any sizable amount," Mr. Blinder said. "If it does, we will be stunned by the volume."

FDIC Chairman Don Powell said that his agency will watch the network as it develops, but he does not have any immediate concerns about it.

"New deposits coming into the banking industry is not anything we are concerned about," Mr. Powell said. "It means the industry is healthy — the industry has to be funded. The deposits help economic conditions at banks who can take that money and loan it out."

The Promontory network may also affect the debate over coverage increases, particularly separate hikes for individual retirement accounts and municipal deposits. At least one lawmaker who has been pushing such increases said he was impressed.

"Especially in the area of municipal deposits, this product has the potential to free up significant amounts of capital for lending in our local communities," Sen. Tim Johnson, D-S.D., a sponsor of deposit insurance reform legislation, said Friday.

But Mr. Powell said that it did not change his support for raising coverage for IRAs or indexing it for inflation and that he did not think it would affect the debate. "This is just another thing that is happening in the marketplace." ■

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