What Are Reciprocal Deposits and Why Do They Matter?

Reciprocal deposits are deposits that a bank receives through a deposit placement network in return for placing a matching amount of deposits at other network banks.¹

Perhaps the easiest way to explain reciprocal deposits is by providing an example.

While there are a number of providers, the leading reciprocal deposit placement network in the United States is operated by Promontory Interfinancial Network, LLC, which invented reciprocal deposits and which offers two of the nation’s largest reciprocal deposit placement services: Insured Cash Sweep® and CDARS®.

Nationwide, thousands of banks offer these services to safety-conscious customers who want to make their large deposits eligible for FDIC insurance beyond the traditional $250,000 per insured bank, per depositor (technically, for each account ownership category). The Insured Cash Sweep, or ICS®, service provides access to FDIC insurance through demand deposit accounts and money market deposit accounts, while the CDARS service provides that access through CDs. The safety-conscious customer is often

¹ FDIC regulations currently define reciprocal deposits as deposits that a bank receives on a reciprocal basis such that, for any deposit received, the bank places the same amount with other banks in the network and sets the rate at which interest is paid to the customer on the entire amount of funds that it places at those other banks. See 12 CFR § 327.8(q). Most state laws expressly permit the use of reciprocal deposits by public entities, and they define reciprocal deposits in similar ways, generally adding that the maturities, if any, of the deposits placed and received, as well as the amounts, must match.
a business, nonprofit entity, government organization (such as a city and county treasurer or a public school district), or other depositor that would otherwise

- make a large deposit in a large money-center bank, rather than a community bank (foregoing access to FDIC insurance for most of the deposit and relying on large rating agencies, like Standard & Poor’s and Fitch, and then tracking the ratings over time);

- require that a bank collateralize or otherwise secure the deposit with Treasuries or other ultra-safe, highly liquid government securities (an added cost for the bank and one that could lead to the customer receiving a lower interest rate if the bank adjusts its rate to compensate for the added cost it incurs); or

- manually split its large deposit among multiple banks, maintaining relationships with each (which requires negotiating different interest rates, signing multiple agreements, receiving multiple statements, etc.).

Insured Cash Sweep and CDARS are popular services because they enable safety-conscious customers to access multi-million-dollar FDIC insurance through a single bank relationship. Bank customers enjoy peace of mind and the convenience of working through one institution. Participating banks enjoy the ability to grow relationships and deposits from a local customer base without losing either to larger, too-big-to-fail institutions; without the added costs or tracking burdens associated with ongoing collateralization requirements; and with the ability to turn around and lend these relatively low-cost funds locally. At the end of the day, it’s a win-win for banks and their customers.

The leading reciprocal deposit placement network in the United States is operated by Promontory Interfinancial Network, LLC.

But how this all comes together matters. How do services, like Insured Cash Sweep and CDARS, work?

The mechanics of different reciprocal deposit services vary. With Insured Cash Sweep and CDARS, a participating bank can offer access to FDIC insurance beyond $250,000 because its customer’s original deposit can be split into smaller increments—each below the standard FDIC insurance maximum—and placed into deposit accounts at a large number of other banks. This process enables a customer to access coverage from many banks while working directly with just one (and, generally, receiving just one regular statement per service utilized).
So why would a bank agree to take Insured Cash Sweep or CDARS deposits from another bank, essentially helping that other bank?

Because it is doing the same thing with its customers and sending an equal amount of customer deposits to other banks (generally with help from a sophisticated matching engine that connects participating banks with each other based on different variables, such as the total amount of a customer’s deposit). Exchanges occur on a dollar-for-dollar basis so that each participating bank comes out whole. In other words, each participating bank reciprocates—thus, the term reciprocal deposits.

Currently, reciprocal deposits, like those just described, are considered brokered deposits—deposits arriving at a bank through a third party—and, thus, deposits believed to be less stable than those organically generated by a bank.

However, reciprocal deposits differ from traditional brokered deposits. Traditional brokered deposits include deposits that arrive at a bank through a deposit broker with a customer who is chasing high rates in exchange for a large deposit and who is located outside of the high-rate bank’s main geographic area. Traditional brokered deposits are often considered less stable because they are likely to come from a customer who has no real affinity for the bank and who may take the money and run if a different bank comes along and offers a higher rate (either in general or at maturity, as applicable).

Reciprocal deposits tend to be based on a true, locally based bank-customer relationship and are generally associated with stability.

- For example, reciprocal deposits placed through CDARS behave much like core deposits in that the funds are very “sticky” and come with valuable relationships. Data, collected over more than a decade, show that CDARS customers reinvest approximately 80% of the time and generally are “core” customers who are often less rate-sensitive.²

². Through 9/30/17. Promontory Interfinancial Network calculates the reinvestment rate by determining whether a particular customer’s funds were reinvested within 28 days of maturity.
Insured Cash Sweep deposits behave in a similar fashion; banks typically see less than 2% of accounts liquidated in any given month, even as total accounts and balances steadily increase.\(^3\)

So, one can argue that reciprocal deposits are brokered in name, but behave much like a bank’s core deposits.

Indeed, the FDIC affirmed that reciprocal deposits, such as those available through ICS and CDARS, should be viewed and treated more favorably than traditional brokered deposits. The FDIC, in its *Study on Core Deposits and Brokered Deposits*, reiterated that “there should be no particular stigma attached to the acceptance of brokered deposits per se and that the proper use of such deposits should not be discouraged.”\(^4\) In the same study, the FDIC stated that it “has recognized for some time in the examination process that reciprocal deposits may be more stable than other brokered deposits if the originating institution has developed a relationship with the depositor and the interest rate is not above market.”\(^5\) In addition, the FDIC confirmed that the use of reciprocal deposits has not been shown to contribute to a bank’s likelihood of default or loss given default.\(^6\)

Additionally, in its white paper, *An Incremental Approach to Financial Regulation*, the Conference of State Bank Supervisors (CSBS) recommended that the brokered deposit designation for reciprocal deposits be eliminated. CSBS noted that reciprocal deposits help banks access low-cost funding responsibly, attract new accounts, maintain their relationships with customers, and responsibly share risk with a network of other banks.\(^7\)

Reciprocal deposits help banks do more for local communities.

By using reciprocal deposits, banks can help customers of all types—including businesses (large and small), nonprofits, municipalities, financial advisors, and even individuals—to safeguard their funds, while at the same time attracting locally priced, large-dollar deposits, the full amount of which can be used to make loans locally. This helps communities across the United States.

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3. Calculated for each of the twelve months preceding 7/31/17. The ICS Reciprocal account closure rate for a given month is the number of reciprocal accounts closed during the month as a percentage of the total number of reciprocal accounts at the beginning of the month. The number of reciprocal accounts closed during the month is the number of non-zero-balance reciprocal accounts withdrawn to zero dollars during the month and not returned to a non-zero-balance during the month or the subsequent two months.


5. Ibid., p. 54.

6. Ibid., p. 45.

Reciprocal deposits enable a community bank to offer its local customer access to millions of dollars of deposit insurance coverage, while the bank at the same time receives the full amount of the customer’s deposit for lending within the local community. As a result, reciprocal deposits empower community banks both to attract and retain valuable local customer relationships and to obtain a stable and cost-effective source of funds to serve the community’s credit needs.

Of note, the ability to offer reciprocal deposits can be critically important to banks located in disadvantaged/underserved communities, as these banks tend to rely more heavily on the ability to offer large-dollar access to FDIC insurance to attract deposits from socially responsible investors. This money can then be used to fund local lending initiatives (e.g., infrastructure improvements, low-income housing, education, and other important activities) that otherwise might not take place.

See how one local bank is making a difference in its community.

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