# Supporting Statement

## Processing of Deposit Accounts in the Event of an Insured Depository Institution Failure -SWEEP Accounts

INTRODUCTION

The FDIC is adopting a final rule establishing the FDIC's practices for determining deposit and other liability account balances at a failed insured depository institution. Except as noted, the FDIC practices defined in the final rule represent a continuation of long-standing FDIC procedures in processing such balances at a failed depository institution. The final rule also imposes certain disclosure requirements in connection with sweep accounts. The final rule replaces the FDIC's interim rule on this subject and applies to all insured depository institutions.

Upon the failure of an FDIC-insured depository institution, the FDIC must determine the total insured amount for each depositor. 12 U.S.C. § 1821(f). To make this determination, the FDIC must ascertain the balances of all deposit accounts owned by the same depositor in the same ownership capacity at a failed institution as of the day of failure. A deposit account balance can be affected by transactions presented during the day. A customer, a third party or the depository institution can initiate a deposit account transaction. All depository institutions process and post these deposit account transactions according to a predetermined set of rules to determine whether to include a deposit account transaction either in that day's end-of-day ledger balances or in a subsequent day's balances. These rules establish cutoff times that vary by institution and by type of deposit account transaction--for example, check clearing, Fedwire, ATM, and teller transactions. Institutions post transactions initiated before the respective cutoff time as part of that day's business and generally post transactions initiated after the cutoff time the following business day. Further, institutions automatically execute prearranged ``sweep'' instructions affecting deposit and other liability balances at various points throughout the day. The cutoff rules for posting deposit account transactions and the prearranged automated instructions define the end-of-day balance for each deposit account on any given business day.

In the past, the FDIC usually took over an institution as receiver after it had closed on a Friday.  For institutions with a few branches in one state, deposit account transactions for the day were completed and determining account balances on that day was relatively straightforward. The growth of interstate banking and branching over the past two decades and the increasing complexity of bank products and practices (such as sweep accounts) has made the determination of end-of-day account balances on the day of closing much more complicated.  In July 2008, the FDIC issued an interim rule on the ``Processing of Deposit Accounts in the Event of an Insured Depository Institution Failure'' (``interim rule'').  Generally, the interim rule established practices for determining deposit and other liability account balances at a failed insured depository institution. Concurrent with the adoption of the interim rule, the FDIC issued a related final

Rule, the Large Bank Modernization Rule, requiring the largest insured depository institutions to adopt mechanisms that would, in the event of the institution's failure: provide the FDIC with standard deposit account and other customer information; and allow the FDIC, as receiver, to place and release holds on liability accounts, including deposits.

## A. JUSTIFICATION

### 1. Circumstances and Need

*Circumstances.*

The interim rule would require, subject to an extended delayed effective date, depository institutions offering sweep products to disclose whether the swept funds are deposits for insurance purposes and, if not, how these funds would be treated in the event of failure.

*Need for a Rule.*

The FDIC is concerned that the treatment of swept funds in the event of failure is not clearly understood by sweep customers. A better understanding of this treatment by sweep customers is important to avoid misconceptions that may arise in the event of failure. While many institutions currently provide some disclosures to sweep customers, the FDIC believes the significance of the consequences to depositors of some sweep transactions necessitates consistent disclosures by institutions providing sweep services. In this context, it is particularly important for institutions to disclose to sweep customers that the completion of some sweep transactions may result in their funds being subject to treatment as general creditor claims.

*Limitations of current processes.*

Currently, there are no affirmative, consistent disclosure requirements regarding the insured status of sweep accounts.

*Delayed Implementation*

Insured depository institutions have until July 1, 2009, to fully implement the disclosure requirements.

### 2. Use of Information Collected

The disclosures this rule would require are important because the completion of some sweep transactions may result in customers' funds being subject to treatment as general creditor claims. A better understanding of this treatment by sweep customers is important to avoid misconceptions which may arise in the event of a failure.

3. Use of Technology to Reduce Burden

Not applicable.

4. Efforts to identify duplication

Not applicable.

5. Minimizing Burden on Small Entities

The final rule imposes a disclosure requirement on all insured depository institutions offering one or more sweep account products. This requirement is subject to an extended delayed effective date to allow the FDIC to consider specific comments on the disclosure requirement before insured depository institutions must comply with it. Preliminarily, the FDIC believes the disclosure requirement in the interim rule will not have a substantial impact on a substantial number of small banking organizations, mainly because such entities are much less likely than larger insured depository institution to offer sweep-account products. Such products are typically offered by insured depository institutions serving large commercial and institutional customers.

6. Consequences of Less Frequent Collections

Not applicable.

7. Special Circumstances

None.

8. Consultation with Persons outside the FDIC

The FDIC received four comments in response to the Interim rule. Three of the comments were from banking industry trade associations and one was from a large commercial bank. The comments addressed the FDIC Cutoff Point, the treatment of swept funds, and sweep account disclosures. Through this Final rule, the FDIC is soliciting comments regarding the disclosure requirements applicable to sweep accounts.

In response to the comment that institutions already provide adequate disclosures to sweep account customers, the final rule indicates that no change to such preexisting disclosures would be required as long as they indicate: (1) whether the swept funds are *deposits*; and (2) if the swept funds are not deposits, how they would be treated if the institution should fail. Also, in response to the request for greater clarity regarding which sweep products would be subject to the disclosure requirements, the final rule specifies that the disclosure requirements would not apply to sweep accounts where: (1) transfers are within a single account (to a sub-account), such as with retail or reserve sweeps or (2) funds are moved between deposit accounts and the deposit insurance available to the customer is unchanged.

The FDIC agrees with the commenters who requested that the disclosure requirements not be overly prescriptive and not require specific language. Hence, the final rule does not impose specific disclosure language.

Despite one comment to the contrary, staff continues to believe that, in order for the disclosure requirements to be meaningful and effective, institutions must provide them in all new sweep account agreements, in all agreement renewals, and on a periodic basis, but not less than annually. Thus, the final rule includes these requirements.

The FDIC agrees with the trade association that suggested flexibility in communicating the disclosure requirements to sweep customers. Hence, under the final rule, institutions need not modify their existing contracts with sweep customers, but are required to provide the disclosures in all new agreements and agreement renewals. Also, institutions may comply with the requirement for periodic disclosures through, for example, client letters, transaction confirmation statements, or account statements. The requirement in the interim rule that such disclosures be provided in account statements, therefore, is not part of the final rule.

9. Payment or Gift to Respondents

No payments are made to respondents.

10. Confidentiality

No individual bank or customer information will be made available outside the FDIC.

11. Questions of a sensitive nature

No questions of a sensitive nature are involved.

12. Estimate of Annualized Burden

*Estimated Number of Respondents*: 1,170 to 1,970.
*Estimated time per response:* 25 – 43 hours per respondent.
*Estimated Total Annual burden:* 28,870 – 84,400 hours.

*Background/General Description of Collection:* The interim rule contains collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 et seq.) ("PRA"). In particular, the interim rule requires, subject to an extended delayed effective date, depository institutions offering sweep products to disclose whether the swept funds are deposits for insurance purposes and, if not, how these funds would be treated in the event of failure.

*Estimated costs*: Compliance with the disclosure requirement will require insured depository institutions offering sweep products, which do not currently provide adequate disclosures, to modify their sweep account documentation, including customer account statements, to include new language indicating whether swept funds are a deposit for insurance purposes and, if not, how such funds would be treated in the event of failure. Further, additional documentation may be provided to sweep customers as part of a statement mailing on a one-time basis. Implementation cost will be mitigated by the delayed effective date of this requirement. Sweep account documents must be reprinted periodically in any case, and the cost of including the disclosure requirement should be minimal. Further, most insured depository institutions already make certain disclosures to customers, and the new requirements would simply replace these disclosures. After implementation, on-going cost should be negligible. Future printings of sweep account documentation will have to be conducted in any case to replenish stock, and the disclosure requirement should not add to the cost of such printings given its brief nature. Customer account statements would continue to be provided according to normal business practices. Further, staff training must be conducted periodically, and the disclosure requirement should not materially add to the length or complexity of this training.

13. <u>Capital Start-up and Operation /Maintenance Costs</u>

Implementation costs will vary based on the size, nature and scope of the depository institutions sweep programs. It is estimated that compliance costs for the very largest and super-regional banking organizations are between $25,000 and $50,000 while smaller regional organizations were placed at $10,000 to $20,000. Other large organizations (those with at least $2 billion in total assets) were assigned a cost estimate of $1,500 to $3,000. Costs for community banks were estimated to be between $1,000 and $2,000. Under these assumptions, the overall disclosure costs are estimated to be between $1.73 million and $3.46 million at the lower end of the number of institutions believed to be engaging in sweep operations (1,170). If as many as 1,970 depository institutions maintain sweep operations the total costs are estimated to range between $2.53 million and $5.06 million.

14. <u>Annualized cost to the Federal Government</u>

None.

15. Reason for Change in burden

Not applicable.

16. Publication

74 FR 5797 (Feb. 2, 2009)

17. Display of Expiration Date

Not applicable.

18. Exceptions to certification

No exceptions.

## B. STATISTICAL METHODS

Not applicable.