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FDIC Sweep Account Disclosure Rules Final Rule / Executive Summary

The FDIC issued a final rule on February 2, 2009 addressing the agency's determination of deposit account balances at banks placed into receivership. Effective July 1, 2009, the final rule significantly impacts certain types of sweep accounts at all FDIC insured institutions and has generated a great deal of industry discussion and confusion. The FDIC is in the process of finalizing a set of Frequently Asked Questions which we expect will address many of the outstanding issues. In the meantime, we have summarized the current thinking on the sweep account disclosure rules below.

Sweep Disclosures

BEGINNING JULY 1, 2009, ALL CONTRACTS WITH NEW AND RENEWING SWEEP CUSTOMERS MUST INCLUDE NEW SWEEP DISCLOSURES.

BY AUGUST 29, 2009, ALL EXISTING SWEEP CUSTOMERS MUST BE GIVEN NEW SWEEP DISCLOSURES.

ANNUAL DISCLOSURES ARE ALSO REQUIRED.

- **Sweep Accounts Requiring New Disclosures.** The disclosure requirements in the final rule apply to pre-arranged, automated sweep arrangements involving the bank's transfer of funds from a customer's deposit account to another account or investment vehicle held at the bank or another institution. The two most common sweep products requiring new disclosures are **sweep repurchase agreements** and **sweeps into mutual funds**. New disclosures are **not** required, for example, for sweep accounts where transfers are within a single account or a sub-account, typically zero-balance accounts and reserve sweeps.
- **Content of Sweep Disclosures.** Banks must disclose to their sweep customers whether their swept funds are deposit accounts under applicable FDIC statutes and, if not, what the status of the funds would be in the event that the bank failed. For example, banks must disclose whether their sweep customers would have the status of a general creditor or secured creditor with respect to their swept funds upon failure of the bank.
- **Disclosure Deadlines.** The disclosures must be included in the bank's contracts with new sweep customers beginning July 1, 2009. **As a consequence, your bank should not enter into a new sweep agreement or renew an existing sweep agreement without including the required disclosures.** Please contact us if you have any questions regarding the required disclosures.

By August 29, 2009, the disclosures must be provided to your existing sweep customers in the form of a letter or included on trade confirmations or periodic statements. The final rule also requires that the disclosures be given to all of your sweep customers on an annual basis, thereafter. Existing contracts need not be amended to include the new disclosures.

Initial Considerations

Mutual Fund Sweeps

- **Operational Considerations.** Disclosures required for mutual fund sweeps are considerably more complex, given the distinctions the FDIC makes between different types of mutual fund sweeps: (i) those that are same-day versus next-day; (ii) those sweeps for which the mutual fund maintains a deposit account

at the bank versus those where funds are swept to an omnibus account; and (iii) those that are reliant on wire transfers between the bank and the mutual fund.

- **Action Steps.** You will need to carefully review your bank’s mutual fund sweeps to determine how they work and what you need to disclose to your customers.

Sweep Repos and the Perfection Issue

- **The Issue.** The FDIC now requires banks to “properly execute” sweep repos or disclose to customers that the swept funds will be considered deposits in the event of bank failure. What constitutes “proper execution” has raised numerous issues dealing with control of the securities and the concept of perfection.
- **Typical Sweep Repurchase Agreements and Perfection.** In a typical overnight sweep repurchase arrangement, the bank grants a security interest in the assets (usually, U.S. Treasury securities) that are being sold to its customer. The final rule provides that the FDIC, as receiver, will only execute a sweep transaction upon failure of a bank if, under the bank’s sweep repurchase agreement, its customer becomes the legal owner of the securities or obtains a perfected security interest in the securities. Perfection of a security interest in U.S. Treasury securities is accomplished when “control” over the securities is transferred to the bank’s customer. In the case of hold in custody sweep arrangements where the U. S. Treasury securities are held by a custodian bank and the repo selling bank is the agent of the customer in executing the repo, transfer of control to the bank’s customer would seem to require acknowledgment by the custodian bank of the customer’s interest in the securities. It has been our experience that custodian banks are reluctant to take on this additional responsibility.
- **FDIC Clarification.** We have discussed this issue with the FDIC and expect the agency’s upcoming Frequently Asked Questions to soften the requirement that a customer’s security interest be perfected. We anticipate that the FDIC will instead recognize as adequate (i) a provision in the bank’s governing sweep repurchase agreement designating the bank as the customer’s agent with respect to the U.S. Treasury securities, and (ii) a statement that the bank will not substitute U.S. Treasury securities that have been pledged to its customer. On point (ii), we also expect that the FDIC’s Frequently Asked Questions will permit banks, as a temporary measure, to include a waiver on their transaction confirmations of any rights of substitution they may have under their existing sweep repurchase agreements. Because the security interest effected in this manner does not appear to be otherwise “perfected” under the Uniform Commercial Code, a bank should not represent in the sweep repo agreement that it will attain a perfected security interest for the customer.
- **Action Steps.** You need to carefully review your bank’s sweep repurchase documents to make sure that, in addition to the newly-required disclosures, they also address this critical issue. Please contact us if you would like us to review your sweep repurchase agreements.

Future Updates

We will continue to provide you with additional information on this evolving matter and the FDIC’s Frequently Asked Questions following their issuance.

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