

BARACK FERRAZZANO

Financial Institutions Group

FDIC Sweep Account Disclosure Rules Update

As an update to our June 29, 2009 Client Action Alert on the FDIC's sweep account disclosure rules, we wanted to advise you that on Monday, July 6th, the agency issued its much-anticipated Frequently Asked Questions (FIL-39-2009) in response to the many industry inquiries it received. You can access the Frequently Asked Questions at the following address:

<http://www.fdic.gov/news/news/financial/2009/fi09039.html>

The Frequently Asked Questions, for the most part, confirmed the FDIC's informal guidance as summarized in our earlier Client Action Alert. The Frequently Asked Questions, however, also elaborated on the final rule in several unexpected ways, as described below.

Deposit-to-Deposit Sweeps

AUTOMATIC SWEEPS BETWEEN DEPOSIT ACCOUNTS HELD IN DIFFERENT OWNERSHIP CATEGORIES DO NOT TRIGGER THE NEW DISCLOSURE REQUIREMENTS.

- **The Issue: Change in FDIC Insurance Status.** A surprise in the Frequently Asked Questions was a statement to the effect that the sweep disclosures were required when the sweep resulted in a change in insured status. Our concern was that the automatic sweep of funds between an **individually**-owned demand deposit account and a **jointly**-owned money market deposit account, for example, may result in a change in insurance coverage and trigger the disclosures. This is because, under the FDIC's general rules, a depositor's individual accounts are aggregated and separately insured from the same depositor's interests in joint accounts which are also aggregated and separately insured. Depending on a customer's overall deposit profile, sweeps between individual and joint accounts could result in an increase or a decrease in the customer's FDIC insurance coverage.
- **The FDIC's Clarification.** We have been informally advised by the FDIC, however, that a change in insurance coverage resulting from a sweep between individual and joint deposit accounts is **not** intended to trigger the new disclosures required under the final rule. The FDIC advised us that it intended the disclosures to apply to possible future products developed by the industry that might involve sweeps from one account to another where a customer loses his or her insurance coverage.

Mutual Fund Sweeps

BEGINNING JULY 1, 2009, FUNDS SWEEPED INTO AN OMNIBUS ACCOUNT FOR NEXT-DAY TRANSFER TO A MUTUAL FUND MUST BE REPORTED AS DEPOSITS ON YOUR CALL REPORT OR THRIFT FINANCIAL REPORT.

- **Next-Day Sweeps.** As we described in our earlier Client Action Alert, mutual fund sweep products can vary considerably in their operational characteristics. For example, some banks may review a customer's deposit account balance mid-afternoon each business day and, at the end of that same day, transfer funds from the customer's account directly to the mutual fund selected by the customer. Other banks may review

a customer's deposit account balance at the end of each business day and, based on the end-of-day balance, transfer funds into an omnibus holding account for transfer the following day to a mutual fund selected by its customer. Under the final rule, if the bank holding this latter type of next-day sweep arrangement is placed into receivership, the FDIC will not execute the transfer of funds to the mutual fund. Instead, the money will be treated as if it never left the customer's deposit account.

- **Call Reports and Thrift Financial Reports.** The FDIC's Frequently Asked Questions clarify that banks must report funds that are due to be transferred by the bank on a next-day basis from an omnibus holding account as deposits on the bank's Call Report or Thrift Financial Report.

Sweep Repos and Substitution of Collateral

EXISTING SWEEP REPO AGREEMENTS DO NOT NEED TO BE AMENDED TO REMOVE THE BANK'S RIGHT TO SUBSTITUTE SECURITIES IF A WAIVER IS INCLUDED IN TRADE CONFIRMATIONS.

- **Temporary Measure Made Final.** As we described in our earlier Client Alert, a bank seeking to "properly execute" a sweep repo agreement in accordance with the final rule, in part, must not have the right to substitute securities it has pledged as collateral under the agreement. Initially, the FDIC informally advised that, as a temporary measure prior to a bank's amendment of its sweep repo agreements with its existing customers, it was sufficient for a bank to include a waiver of any right to substitute pledged securities on its trade confirmations given to those customers. The Frequently Asked Questions clarify that a bank need not amend its sweep repo agreements with existing customers to remove any right of substitution as long as the bank continually provides a waiver of such right on its trade confirmations. Keep in mind, however, that a bank may still need to amend its agreements with its existing customers to include a provision stating that the bank is acting as the customer's agent with respect to the pledged securities and will act on the customer's orders in the event of default.

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Please contact John E. Freechack (312) 984-3223; Karol K. Sparks (312) 984-4186; John M. Geiringer (312) 984-3217; W. Alison Huszar (312) 629-7349, or another member of the group if you have any questions or would like additional information concerning this Alert.

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