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Cause or effect?

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Brokered deposits, frequently pointed to as a key cause of bank failures in the growing stack of reports on the subject, seem destined to dwindle in popularity.

In fact, banks everywhere are moving back to traditional core deposits, oftentimes at the suggestion of regulators, industry observers and analysts told SNL. Still, they added, the funding source itself should not shoulder the blame for poor lending choices, as brokered deposits at times make good business sense.

"It is [brokered deposits] basically a product, that, if used correctly, it's fine," Rick Weiss, an analyst at Janney Montgomery Scott LLC, told SNL. It's when that product is abused that banks get themselves into trouble, he added.

Among new banks — which the FDIC noted in its move to [extend](#) the de novo period were overrepresented in the growing ranks of failed institutions — brokered deposits at times held a certain allure. After all, for any bank wanting to grow, and fast, they served a purpose.

"A lot of banks that opened up wanted to grow really fast overnight, and it was easy to just go out and fill up your tank with brokered deposits, and then ... we could go out and make lots and lots of real quick loans," said Lee Bradley, a managing director at financial advisory firm Compass Point Research & Trading LLC.

"It was kind of a cause and an effect," Bradley told SNL. "You could say, well, they had such easy access to brokered deposits, that ... it made them more aggressive in going out and wanting to put the money work, but I don't think you can blame the brokered deposit. It was just an ingredient."

An SNL analysis of existing banks found de novos with slightly higher percentages of brokered deposits than banks overall, though the percentage for both groups jumped when looking at failed institutions. Indeed, failed banks of all types are statistically more likely to have brokered deposits, analysts and industry observers agreed, though they also are more likely to have delved into certain other riskier strategies.

Bank group	Average* brokered deposits/ total deposits (%)
Banks failed since 2008 [^]	36.69
De Novo banks failed since 2008 [^]	17.00
All current banks *	6.23
All current De Novo banks *	8.54

Data based on regulatory filings.
[^] As of the last filing period before failure.
 * As of March 31.
 * Calculated as the summation of brokered deposits at banks included divided by the summation of their total deposits.
 Source: SNL Financial

In its rationale for extending the de novo supervisory period, the FDIC noted certain "common elements" to failed de novo banks, including rapid growth, loan concentrations, weak risk management and an over-reliance on volatile funding sources, including brokered deposits. These causes often appear in the audit reports on other bank failures as well.

At Mesa, Ariz.-based [Towne Bank of Arizona](#), one of the most recent de novo [failures](#), brokered deposits represented about 23% of the institution's total deposits at closing. Looking back at

the de novo's history, however, an SNL analysis found that brokered deposits spiked from 8% to nearly 70% in the third quarter of 2006, while the bank made most of its loans in construction and land development and commercial real estate. Arizona, of course, became one of the worst-hit areas when the U.S. real estate markets went bust.

"There is a clear trend that we've seen from the banks that have failed in that they utilized brokered CDs to then fund loans that were in some shape or form related to the housing market," Terry McEvoy, an analyst at

Oppenheimer & Co. told SNL.

Looking ahead, analysts and industry observers said new regulatory pressure to reduce brokered deposits will likely lead to slower growth for banks over the next few years, which, in turn, also will lead to less of a need for brokered deposits, as banks typically turn to brokered deposits to grow when loan demand exceeds core deposit growth.

For existing de novos, that means a longer road to profitability, Bradley told SNL. "You're just going to burn through more capital. You're not going to be able to gear up and be a high performing bank overnight," he said. In the meantime, some of the older de novos that loaded up on brokered deposits and real estate loans just before the market bottomed still may be on their way to a crash.

Bradley characterized new regulatory pressure to lower brokered deposits as a "speed bump" of sorts on the road to loan growth, effectively slowing down the institutions that otherwise would have liked to race ahead. "It's probably a good thing," Bradley told SNL, adding that one of the strengths of community banks historically has always been a strong core deposit base.

The risk, however, is that regulatory pressure to reduce brokered deposits will go too far, a shift that Donald Musso, president and CEO of the financial institutions consulting firm FinPro Inc., said he fears already is happening. "I'm hopeful that they kind of remove these high level umbrella rules and bring it back down to a case-by-case basis," Musso told SNL. "It ought to be they go institution-by-institution and say, 'are you effectively using the funding, or not?'" One way to do this would be to require institutions to spell out their plans for the uses and limits to brokered and other wholesale funding sources in contingency funding plans the regulators then could approve or deny, Musso said.

And while interest in brokered deposits may fall in the near-term, rising loan demand could leave banks looking for alternative funding sources in the future, McEvoy told SNL. "In a more normal environment, it does seem like your traditional banks will have loan demand in excess of local deposit generation ... this is one way for banks to fill that gap," the analyst said.

Brokered deposits at De Novo banks failed since 2008

Company	City, state	Date of failure	Brokered deposits/ total deposits (%)
Pinehurst Bank	Saint Paul, MN	05/21/10	0.00
Towne Bank of Arizona	Mesa, AZ	05/07/10	22.72
Champion Bank	Saint Louis, MO	04/30/10	3.73
Wheatland Bank	Naperville, IL	04/23/10	8.58
AmericanFirst Bank	Clermont, FL	04/16/10	6.00
Century Security Bank	Johns Creek, GA	03/19/10	11.44
Old Southern Bank	Orlando, FL	03/12/10	0.00
LibertyPointe Bank	New York, NY	03/11/10	7.29
Carson River Community Bank	Carson City, NV	02/26/10	10.50
Marco Community Bank	Marco Island, FL	02/19/10	2.59
RockBridge Commercial Bank	Atlanta, GA	12/18/09	29.75
Commerce Bank of Southwest Florida	Fort Myers, FL	11/20/09	14.16
Pacific Coast National Bank	San Clemente, CA	11/13/09	7.76
Hillcrest Bank Florida	Naples, FL	10/23/09	9.75
Riverview Community Bank	Otsego, MN	10/23/09	2.54
American United Bank	Lawrenceville, GA	10/23/09	0.00
Brickwell Community Bank	Woodbury, MN	09/11/09	7.34
First Coweta Bank	Newnan, GA	08/21/09	10.83
Community Bank of Arizona	Phoenix, AZ	08/14/09	13.78
Integrity Bank	Jupiter, FL	07/31/09	10.46
Security Bank of Gwinnett County	Suwanee, GA	07/24/09	35.33
Security Bank of North Fulton	Alpharetta, GA	07/24/09	20.28
Waterford Village Bank	Williamsville, NY	07/24/09	0.00
Millennium State Bank of Texas	Dallas, TX	07/02/09	0.00
Community Bank of West Georgia	Villa Rica, GA	06/26/09	28.60
Mirae Bank	Los Angeles, CA	06/26/09	20.97
MetroPacific Bank	Irvine, CA	06/26/09	7.87
Citizens Community Bank	Ridgewood, NJ	05/01/09	0.00
American Southern Bank	Kennesaw, GA	04/24/09	50.08
Freedom Bank of Georgia	Commerce, GA	03/06/09	0.00
Pinnacle Bank of Oregon	Beaverton, OR	02/13/09	0.00
MagnetBank	Salt Lake City, UT	01/30/09	99.85
Freedom Bank	Bradenton, FL	10/31/08	10.28
Alpha Bank & Trust	Alpharetta, GA	10/24/08	2.95
Main Street Bank	Northville, MI	10/10/08	47.43
First Priority Bank	Bradenton, FL	08/01/08	2.75
Average*			17.00

Data based on the last regulatory filing before the failure of each bank.

Includes De Novo commercial banks, savings banks and savings institutions that failed since Jan. 1, 2008, and operated for less than seven years.

* Calculated as the summation of brokered deposits at banks included divided by the summation of their total deposits.

Sources: SNL Financial and the FDIC