# DODD-FRANK WALL STREET REFORM LAW WILL HAVE A MAJOR AND LASTING IMPACT ON ACCOUNT ANALYSIS

**BANNOCKBURN, Ill. – July 15, 2010** – Today the U.S. Senate passed H.R. 4173, the Dodd-Frank Wall Street Reform And Consumer Protection Act ("Act"), putting it only a signature away from changing account analysis forever. Buried within the Act's headline-grabbing financial reforms are five sections that will result in increased FDIC fees for both banks and their commercial customers as well as allow banks to pay hard interest on corporate demand deposit accounts. Both banks and corporations should prepare now for these major changes to their account analysis operations.

Regarding FDIC fees, the Act requires the FDIC to increase its coverage of insured deposits by $150,000 *and* increase its reserve ratio, which is the percentage of those insured deposits that it must keep on hand. To fund more of an increased liability, the FDIC will almost certainly have to raise the fees it charges member banks. As a result, insured banks should be prepared to evaluate how best to pass these increased fees onto their customers, who, like the banks, should be ready for higher fees. And while corporate treasurers should also be prepared to check the appropriateness of their fees, the Act changes the way FDIC fees are calculated, making it impossible to determine one's "fair share". Subsequently, treasurers will want to track and compare their FDIC fees on a cost per insured dollar basis to assess appropriateness and find the most competitive rates.

The other major change brought about by the Act will be the Fed's repeal of Regulation Q – the prohibition of interest on commercial demand deposit accounts. While banks will still be able to pay soft interest in the form of earnings credits, this change opens up the door to two new compensation models: hard interest only, and a combination of both hard and soft interest. Banks, as well as corporations, will need to carefully evaluate which model is best for their particular situation.

Considering the Act's impact on FDIC fees and compensation models, both banks and corporations need to take a careful look at their account analysis approaches today. At minimum, banks will need to determine how to maximize profitability while minimizing customer impact. In this exercise, some banks will be limited by outmoded technology while others will take advantage of advanced billing engines to analyze and offer multiple fee and compensation scenarios. Corporations, on the other hand, need to start tracking their FDIC fees immediately to establish a baseline ahead of the Act's changes. Moving forward, treasurers will want to compare their fees to this history as well as to other banks to enhance their negotiating power. Additionally, corporate treasurers will want to evaluate the different compensation models created by the Act keeping their respective tax and liquidity implications in mind. Like their banking partners, corporations will benefit from advanced software that helps automate these labor intensive tasks.

To learn more about the Dodd-Frank Wall Street Reform and Consumer Protection Act's impact on account analysis, please read the detailed coverage below or contact The Weiland Financial Group, Inc. at info@weiland-wfg.com or 847-735-0577.

Sections 331, 334, 335, & 343 – FDIC Fees are Almost Certain to Rise

Title III of the Act authorizes the FDIC to make four important changes to the way FDIC fees are calculated that will result in higher FDIC fees for both banks and their corporate customers. Banks must decide how they will pass these higher fees onto customers while corporate treasurers must be prepared to analyze and compare these higher fees to minimize their expenses.

*Assessment base changed*

Effective upon enactment, **Section 331** empowers the FDIC to redefine the deposit insurance assessment base from a bank's adjusted deposit liabilities to an institution's average consolidated totals assets less the sum of its average tangible equity. This change will increase the assessment base for larger institutions while lowering it for smaller ones, which are typically more reliant upon deposits. Initially this will result in higher FDIC fees for larger institutions (and their customers) as they adjust their business plans away from more costly non-deposit funding sources. Ultimately though, the increased competition for deposits generated by this shift should drive interest rates higher, nullifying the savings first realized by smaller banks. These increased interest rates have additional significance due to the Act's impact on Regulation Q, which is discussed in greater detail below.

In addition to higher FDIC fees for large institutions and their customers, the change in the assessment base will further separate the relationship between a commercial customer's FDIC fees and the actual coverage they are receiving. While a bank's FDIC fees are based on its assets, the actual insurance coverage its purchasing covers its customers' deposits – which will not directly correlate to its adjusted assessment base. Subsequently, it will be impossible for a bank to translate the price of this insurance down to its customers on a one-to-one basis and similarly impossible for corporations to determine if they are getting what they paid for. Subsequently, the assessment base change makes the analysis and bank-to-bank comparison of FDIC fees all the more important for corporate treasurers.

*Reserve ratio increased*

Effective upon enactment, **Section 334** authorizes the FDIC to increase the federally mandated reserve ratio from 1.15 percent of the estimated total assessment base to 1.35 percent; requires the FDIC to reach this new ratio by September 30, 2020; mandates that the FDIC must offset the effect of this 20 basis point increase on institutions with total consolidated assets of less than $10 billion; and also instructs the FDIC to remove the reserve ratio cap, previously set at 1.5 percent.

The 20 basis point increase in the reserve ratio will force the FDIC to almost immediately increase its fees and significantly raises the likelihood of future special assessments like the one imposed September 30, 2009. As of June 2010, the Deposit Insurance Fund (DIF) was $20 billion in the red. With a uniform rate increase of 3 basis points already planned for January 1, 2011, the FDIC still did not expect to achieve the *old* ratio of 1.15 until the first quarter of 2017 – and that was assuming the "temporary" $250,000 coverage limit would expire as planned, which it will not. Seeing that the reserve ratio is now set 20 basis points higher than before and that the $250,000 coverage limit has been made permanent, the FDIC will have to act aggressively to not only get out of the red, but also reach its new funding target by 2020.

Reaching the 2020 funding target will be made all the more difficult by the Act's offset requirement which forces the FDIC to offset the 20 basis point increase in the reserve ratio for banks with assets less than $10 billion. While it remains to be seen how the FDIC will implement this provision, the practical impact of Section 334 is that the FDIC will have a smaller base of banks from which it must collect more fees. Subsequently, institutions with assets over $10 billion will experience significantly higher FDIC fees that will inevitably be passed onto their corporate customers.

Importantly, Section 334 also empowers the FDIC to eliminate the 1.5 percent hard cap on the reserve ratio. In the past, the FDIC was required to pay a dividend to insured institutions if and when the DIF exceed 1.5 percent of the total assessment base. But now that the FDIC has unrestricted authority to set a target reserve ratio above 1.5 percent without limit, higher FDIC fees are a real long term possibility.

*Deposit insurance increased*

Effective upon enactment, **Section 335** authorizes the FDIC to permanently increase the insured deposit amount per depositor from $100,000 to $250,000 for all insured institutions. This increase applies retroactively as well to any institution for which the FDIC was appointed as receiver or conservator on or after January 1, 2008 and before October 3, 2008. This permanent increase lowers the DIF's real reserve ratio (equal to DIF divided by insured deposits) and thus increases the cost required to attain the new required reserve ratio of 1.35. This will make it much more difficult for the FDIC to reach the 1.35 ratio by 2020 and will result in higher FDIC fees for banks and their customers.

*Unlimited coverage for noninterest accounts extended*

Effective December 31, 2010, **Section 343** will extend the unlimited insurance of noninterest transaction accounts currently afforded by the Transaction Account Guarantee Program (TAGP) for an additional two years, until December 31, 2012. Unlike TAGP, this unlimited insurance does not cover NOW accounts and participation is mandatory for all banks. Some bank customers will welcome the additional security this section affords, but like the additional coverage authorized by Section 335, this insurance comes at a price. How that price is paid remains to be seen as the Act prohibits the FDIC from charging a separate premium for this coverage, as was done with TAGP. Subsequently, standard FDIC assessments are likely to rise even higher and, for bank customers who will almost surely be the ones to pay them, become far less transparent. Customers of banks that opted out of TAGP will experience especially large fee increases as their banks are now forced to participate in this unlimited coverage.

Importantly, the repeal of Regulation Q, which is discussed in greater detail below, will likely decrease the balances held in noninterest accounts, mitigating some of the impact created by this section. But because the FDIC cannot charge a line item for this unlimited coverage, corporate treasurers will not be able to calculate the cost of this coverage, and thus have a difficult time choosing between interest bearing accounts with only $250,000 of insurance coverage and noninterest bearing account with unlimited coverage.

*Other considerations*

As there are no rules or guidelines on how banks charge customers for FDIC fees, both banks and corporations must pay special attention to their account analysis statements going forward, be they on the generation or analysis side of them.

Some banks will *try* to collect customer fees equal to those they pay the FDIC while others will charge customers a premium or grant a discount. Try is the operative word here because it will be mathematically impossible for banks to determine each customer's "fair share" of FDIC fees on a one-to-one basis – the best they will be able to do is approximate. Subsequently, banks must carefully decide how they will pass FDIC fees through to their customers and whether they will charge a premium or discount.

Corporations, on the other hand, must carefully track their FDIC fees and compare them to other banks on a price per insured dollar basis. Like everything else on your account analysis statement, FDIC fees are negotiable – but only knowledgeable customers secure discounts. Automated bank fee analysis software is a critical companion when analyzing, tracking, comparing, and budgeting your FDIC fees as well as all your other bank fee and balance data.

Section 627: Regulation Q Slated for Repeal

Effective one year after enactment, Title VI, **Section 627** of the Act authorizes the Federal Reserve Bank to repeal Regulation Q which prohibits the payment of interest on demand deposits. Regulation Q was established in the 1930's in response to the Great Depression, but over time, bankers devised a way around it by compensating noninterest accounts with earnings credits – a type of non-taxable, soft interest that can only be used to offset service charges. And while banks may continue to compensate customers with earnings credits, Regulation Q's repeal will also allow banks to pay commercial customers in hard interest – a change that will transform the banking industry, corporate cash management, and account analysis forever.

*Impact on banking industry*

Once banks are able to offer hard interest on demand deposit accounts, they will be in a better position to compete with nonbank financial institutions for deposits. Additionally, banks will be able to attract deposits away from foreign banks to which many US-based companies have turned for safe, interest bearing accounts. But in order to attract and maintain these deposits, banks will have to compete by offering higher interest rates thus introducing a new expense – an expense that will likely be offset with higher transaction fees.

As oversees banks and nonbank financial institutions face more competition, small banks will see the biggest wins. Smaller banks typically lack the dividend-yielding investment vehicles required to attract large commercial customers, but now that they will be allowed to offer more competitive returns without taking on the cost of more complex products, they are in a great position to win customers from larger banks – banks already disadvantaged by the disproportionate impact of the assessment base change and DIF funding provision previously discussed. Nevertheless, small banks will have to answer the same question faced by their larger competitors – how do we fund this new expense?

*Impact on corporate cash management*

On its face, the repeal of Regulation Q appears to be a huge win for corporate cash managers…and in many ways it is. Corporations will finally earn hard interest on their demand deposits. And even though rates are low now, they will eventually rise – especially as larger

institutions compete for deposits as a result of the assessment base change, as discussed earlier. With the ability to earn hard interest, cash managers will no longer have to spend time transferring money from noninterest accounts to interest bearing ones or establishing complex account structures using sweeps and oversees accounts. The rationalization of account structures will also reduce the financial burden of account maintenance fees and transaction fees required to optimize balances under the current regime.

Smaller corporations will especially benefit from Section 627 as they have traditionally lacked the resources possessed by larger companies to mitigate the impact of Regulation Q. And while these smaller corporations will still lack access to many of the advanced investment vehicles and cash management strategies used by larger companies, at least they will be able to earn a return on their previously idle balances.

But for both large and small companies, these new advantages will come at a cost. In order to fund demand deposit interest, banks will have to increase their transaction fees. If higher bank fees offset the gains made from the newly permitted interest, Section 627 could be a financial wash. Only the informed cash manager will be able to assess the full impact of Regulation Q's repeal, which is why practitioners should prepare now by evaluating their account structures, short-term investments, bank fees, and account analysis processes.

*Impact on account analysis*

As mentioned above, the repeal of Regulation Q will likely result in a higher bank fees – even if the total cost of specific charges, like account maintenance fees, goes down. Still, the more momentous impact of Section 627 will be on the balances section of your statement.

After the repeal of Regulation Q, three compensation models are likely to emerge. First off, because banks will not be required to provide hard interest, some may choose to maintain the status quo and continue to pay soft earnings credits. Other banks may continue to pay soft interest on that portion of the balance required to offset customer service charges and then pay hard interest on any excess balances. Finally, some banks may choose to pay only hard interest on the entire balance. Banks must use their account analysis systems to compare the different scenarios and determine which approach or approaches are best suited for their individual situation. In the near term, outmoded technology will force some banks to maintain the status quo. Others, however, will use sophisticated account analysis systems to offer a variety of compensation models within a single bank and multiple interest rate types and tiers within a single relationship. In this way, technology will play an important role in differentiating the winners and losers from the Act.

As banks offer various compensation models, corporations will have to decide which is best for them. Each situation will be different, and going with a hard interest only bank may not always be the best choice. While earnings credit rates are almost always less than hard ones, they are also tax-exempt. Depending on a corporation's tax situation, a bank that credits both soft and hard interest might make the best partner. That said, earnings credits can only be used to offset service fees, so treasurers must also consider liquidity needs when evaluating banks in this new paradigm. Those treasurers with access to advanced account analysis software will be in the best position to make the correct decision. Software can help treasurers analyze, track, and compare their balance data between banks and against benchmarks. And even after a decision is made, treasurers will want to keep a close eye on their statements to ensure their balances are optimized and their banks' calculations are mistake free.

*Other Considerations*

In evaluating different hard and soft interest approaches, both banks and corporations need to consider the Fed's recent decision to pay interest on required reserves. Many banks are still deciding what to do with this new income: keep it, pass it through to customers, or a mixture of both. The ability to provide hard interest adds another dimension to this decision. Corporations need to closely mind their soft (and soon hard) interest to make sure they understand whether and how their bank is treating this new source of income earned on *their* balances.

Conclusion

The Dodd-Frank Wall Street Reform Act will have a major and lasting impact on account analysis. FDIC fees are almost certain to rise while the repeal of Regulation Q will bring a host of new business models and approaches to the billing and analysis of bank fees. Banks must carefully consider how best to respond to these changes by consulting with their customers and evaluating multiple fee and compensation scenarios. Corporations, on the other hand, must closely analyze their bank statements for fee hikes, especially FDIC fees, as well as watch for changes to their interest earnings. No matter which side of the bank statement equation you are on, automated account analysis software puts in the best position to evaluate your options and get out in front of this new legislation.

To learn how Weiland's award-winning software can help you take advantage of the opportunities created by the Dodd-Frank Wall Street Reform Act, contact 847-735-0577 or email info@weiland-wfg.com today.

**About The Weiland Financial Group, Inc.**

The Weiland Financial Group, Inc. ("WFG") is the leading provider of bank account analysis and management solutions for corporations and financial institutions. Banks use WFG's Commercial Account Analysis (CAA) bank fee billing engine to generate noninterest income while corporate treasurers leverage WFG's Bank Relationship Manager Edge (BRM*Edge*) solution to analyze the bank statements created by systems like CAA for significant expense reduction and improved operational transparency. Treasurers also employ WFG's Bank Administrator Web (BA*Web*) to electronically manage their bank accounts and signatories with the new eBAM standard. Embraced by many of the leading domestic and multinational banks and corporations across a wide range of industries, WFG's software has been recognized as "Best in Breed" by Business Finance Magazine for eight years straight. Two WFG customers have won Treasury & Risk Magazine's Alexander Hamilton Award for their use of WFG software and Executive team members are consistently invited to speak at industry conferences and events. Founded in 1981, WFG is headquartered in Bannockburn, Illinois, a suburb of Chicago.

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