FDIC Consumer News

Fall 2000

Should You Buy a Bank CD from a Broker?

Deposit brokers sometimes negotiate special deals on bank-issued certificates of deposit, but these CDs can be complex and may carry more risks than traditional accounts sold directly by banks. Here's how to tell if a brokered CD makes sense for you.

You've probably seen ads or gotten phone calls or e-mails from brokers saying they've negotiated great deals on federally insured CDs—certificates of deposit—that can mean higher returns than you'd get on your own from a bank. Sounds like a great deal, right? Well, it may or may not be, depending on the offer itself and your personal investment goals.

Generations of Americans have known the CD as a simple, safe, reliable investment for their hard-earned money. With a traditional CD from an FDIC-insured bank or savings institution, if you keep funds in an account for a set period, generally from three months to five years, you get all your money back plus fixed-rate interest payments that are higher than those for regular savings accounts. The guarantees of FDIC insurance, a fixed interest rate, and no loss of principal make the CD especially attractive to consumers who don't want to take chances with their money.

Yes, brokers sometimes can negotiate a higher interest rate on a bank-issued CD because they can bring a large amount of deposits to the bank. But, CDs sold by brokers can be complex

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INSIDE

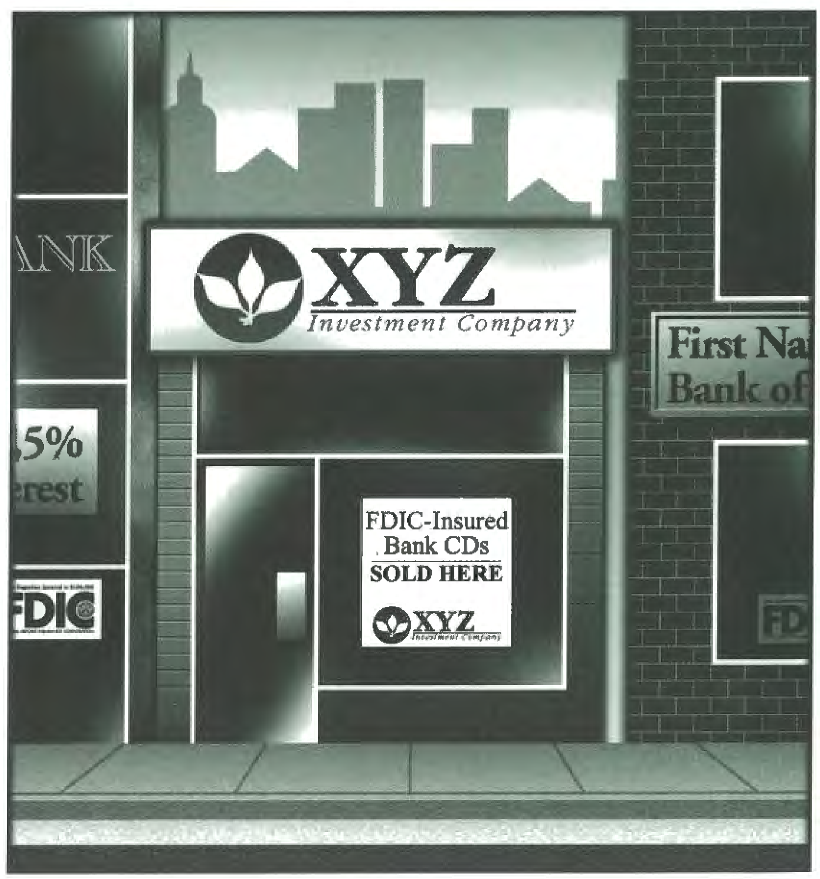

Illustration: T.W. Ballard

and may carry more risks than traditional CDs sold directly by banks, especially in terms of your ability to lock in an attractive interest rate or get your money back early.

Example: The broker may say that if you need your money before the CD matures, the firm will purchase your CD back *without* an early withdrawal penalty. While this feature may sound attractive, the buy-back offer probably means that the broker would attempt to find someone else to buy your CD at the going market rate. If interest rates on new CDs have increased above the rate your old CD pays, your broker would try to find a buyer by selling your CD at a discount—a loss to you that could be more than a bank's early withdrawal penalty, perhaps even resulting in *a loss of some of your original deposit*.

"Before you invest in a CD through a broker, you need to understand the terms and be comfortable that the CD the broker is offering fits your needs," says Kathleen Nagle, a Senior Consumer Affairs Specialist with the FDIC. "Otherwise, you could find yourself unpleasantly surprised when you realize that the CD you purchased from the broker isn't what you thought it was, based on your past experience buying CDs from your local bank."

Adds Kate Spears, an FDIC Consumer Affairs Specialist: "Unfortunately, we've found people entering into transactions without asking the important questions simply because the investment was identified as FDIC-insured."

How to Choose Wisely

If you're thinking about purchasing a brokered CD, ***FDIC Consumer News*** offers these tips to help you make sure you know what you're getting and that it's appropriate for you.

1 Make sure you're dealing with a reputable broker.

A deposit broker can be anyone from one person working alone from home to someone affiliated with a major financial services firm. There is no federal or state licensing or certification process to become a deposit broker, and the FDIC does *not* examine, approve or insure deposit brokers. Given the complexity of brokered CDs and the potential risks—and the fact that there *have* been a few cases reported of unscrupulous deposit brokers allegedly misleading or defrauding investors—consider these precautions.

First, try to deal with someone you believe will only recommend investments that are appropriate for you, and will try to answer your questions and resolve your problems. For a brokered deposit, your best bet may be a financial professional you already know and trust, such as a stockbroker or financial planner with whom you've had a good, long-term working relationship.

But, what if you're thinking about an offer from an unfamiliar deposit broker or company? Independently check on the broker's credentials and reputation for honest dealing. You'll want to find out about the broker's work experience and any history of actual or alleged misconduct by the broker or his or her firm, as evidenced by disciplinary actions by government regulators, consumer complaints about unfair or improper conduct, and similar information. Perhaps the easiest way to get this information is to call your state government's consumer protection office, which will be listed in your local phone book and other directories, often as part of the state Attorney General's office. If that office doesn't have the information you're looking for, ask to be directed elsewhere, perhaps to the state securities regulator or the office that generally licenses businesses in your state.

And, while there is no licensing requirement to be a deposit broker, we suggest that you find out from your state government if the broker or brokerage firm you're considering is authorized by the state or federal government to do *other* business in your state, such as sell securities to the public. The fact that a deposit broker isn't officially licensed in some other field doesn't mean he or she isn't reputable. But, a deposit broker who *is* licensed in another profession comes under government regulation or industry oversight that "provides a higher degree of assurance that the deposit broker is legitimate" even though this regulation or oversight has nothing to do with deposit-brokering activities, says Christopher Hencke, an FDIC attorney. "Remember, someone who's not licensed or registered may not be regulated at all, for all intents and purposes, and that's why it may be riskier sending money to that person."

These steps will help you "collect enough information to obtain a comfort level to proceed or a discomfort level not to proceed with a deposit broker," says Karen Currie, a fraud examiner with the FDIC.

2 Understand the potential risks and rewards of a brokered CD.

Ask questions and read as much information as possible about a CD's terms and conditions, especially regarding the fine print. "Don't solely rely on the broker's oral presentation or mathematical calculations," adds Currie. Here are some of the basic details we think you'd want to learn before agreeing to buy a CD from a broker:

• **Can the bank "call" (redeem) the CD early?** Your ability to lock in a good interest rate for a long time is restricted with a callable CD. Why? If interest rates fall, the issuing bank may call the CD—give you back your money (plus accrued interest) as soon as possible—so it can reduce expenses by issuing new CDs at the lower interest rates. (Note: Call features may appear in some CDs offered directly by banks, but call features are more common with brokered CDs.)

• **Do you understand the difference between a brokered CD's call period and the maturity date?** Don't mistakenly believe that because of the call feature *you* have the option to redeem the CD early without paying for that privilege—only the bank has that option. A 20-year CD that's callable after one year still is a 20-year commitment for the consumer. Vincent Filippini, an FDIC fraud investigator, also notes that regulators have received complaints that "some elderly investors—people in their 70s or 80s—committed to *15- or 20-year CDs* thinking they were purchasing very short-term CDs." He adds that "some seniors are vulnerable to high-pressure sales tactics and may be easily confused about what they are investing in."

• **What would happen if you need to withdraw the CD prematurely, and how much could that cost you?** If you have your own CD through a broker, you should be able to pay an early withdrawal penalty to the bank and get your money back. But, if you are sharing your CD with other customers, the broker would have to find a buyer for your piece of the CD. And, as mentioned before, if interest rates rise the broker might sell your CD at a loss for you, maybe even taking away some of your original deposit. "Don't assume that the broker will pay you approximately the same as you paid for the CD or maybe even a little less," says Beth Corbin, an FDIC bank examiner based in Harrisburg, PA. "I know of one situation where the broker offered only about 75 cents on the dollar for several CDs that had been purchased for $134,000 during the prior two years—a difference of $33,000."

• **Can the interest rate on the CD go down?** If it's a variable-rate CD, be sure you know when and how the rate can change. There may be, for example, a "step-down" feature, where the interest rate starts off high but continues to decline the longer you own the CD. "The initial rate may be attractive but when you figure in the step-down rate, you may be getting less than what local banks are offering directly with a traditional, fixed-rate CD," says Corbin. Or, if the interest rate is tied to an index, such as a measurement of the stock market, you may be taking a chance that the interest payments could fall dramatically… or even completely evaporate. "You could even have a 10-year CD that paid no interest at all, not even a penny, if there's been no growth in the stock market at the end of those 10 years," says Hencke.

3 Make sure your deposit is fully insured.

If full FDIC insurance coverage is important to you—to protect you from loss in the event of a bank failure—we suggest you take these precautions.

Get the name of the bank or savings association where your money is to be deposited. With this information, you can verify that the bank is FDIC-insured. (Call the FDIC's consumer affairs staff listed on Page 7 or search the FDIC's database of insured institutions at www2.fdic.gov/structur/search/findoneinst.cfm on the Internet.) You'll also learn

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Fax: (202) 416-2076

On the Internet

Consumer information from the FDIC is available at www.fdic.gov.

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if the broker plans to put money into an institution where you already own other deposits. This is important to know, because the combination of the brokered CD and your existing deposits could push your total deposited funds over the $100,000 insurance limit. (If you think your funds would exceed $100,000, contact the institution to discuss possible options for staying fully insured, or call the FDIC for additional information about your coverage.)

Also, insist that the broker give you a copy of the exact title of the CD issued by the FDIC-insured bank or savings association. Why? Because if the CD is to be shared by you and many other customers, the deposit broker probably won't list each name in the CD's title. That's permissible, but Hencke says you'll still want the account records to somehow indicate that the broker is acting as an agent for you and other depositors (such as "XYZ Brokerage as Custodian for Customers"). That way, *each depositor can qualify for up to $100,000 of FDIC coverage.* Otherwise, the FDIC would treat the broker as the owner of the CD and insure it only to $100,000 in total, even if the broker pooled the funds of many different depositors into one CD totaling more than $100,000. "If the broker refuses to provide you with documentation reflecting the title, you should not entrust your money to the broker," Hencke says.

On this topic of account records, Martin Becker, an FDIC official who specializes in failed bank matters, offers another reason for dealing only with a reputable broker. He says that if the bank that issued the CD were to fail, the FDIC must receive specific information from the broker in order to determine the insurance coverage for the account. "The sooner the FDIC gets this information, the faster we can send deposit insurance checks to the broker," Becker says. He adds that because interest payments on the CD stop the day the bank fails, "the timely receipt of this information from the broker is even more important to the consumer."

Final Thoughts

Before purchasing a CD from a depository institution *or* a broker, shop around for the best combination of interest rates, minimum deposit requirements, maturity dates, and early withdrawal provisions. Check with at least three or four CD providers, including institutions you already deal with and trust. When comparing interest rates, be sure you're looking at the "Annual Percentage Yield" (APY), a uniform calculation method required by federal regulations to help consumers comparison shop.

Also ask yourself if a particular CD makes sense in terms of your financial goals, your tolerance for risk, and your willingness to commit money to a long-term deposit. Make sure that you understand the CD's features and that you feel comfortable with the investment before you agree to anything. Following this simple strategy will serve you well and assure that your money is safe and secure in the bank—regardless of whether you deposited it yourself or through a broker.

For More Help or Information Regarding Brokered CDs

The Federal Deposit Insurance Corporation (FDIC) can answer your questions about how brokered deposits are covered by federal insurance. Contact the FDIC's Division of Compliance and Consumer Affairs toll-free at 800-934-3342, or by mail at 550 17th Street, NW, Washington, DC 20429. You can also find resource materials and a form to send questions online by going to our Customer Assistance page at www.fdic.gov/consumers/questions/customer/index.html. Also look for more tips and information about brokered CDs at www.fdic.gov/deposit/deposits/certificate/index.html on the FDIC's Web site. Note: The FDIC does *not* examine, approve or insure deposit brokers.

If you want to check out a person or company selling brokered CDs, or if you want to file a complaint, a good place to start is **your state government's consumer protection office**, which will be listed in your local phone book and other directories, often as part of the state Attorney General's office.

If your question or complaint involves a securities broker or brokerage firm, you may want to go directly to **your state securities regulator**, which will be listed in your phone book or at www.nasaa.org/regulator on the Web site of the North American Securities Administrators Association. Other sources of consumer information and assistance in matters involving securities brokers and brokerage firms include the **Securities and Exchange Commission** (Office of Investor Education and Assistance, 450 5th Street, NW, Washington, DC 20549; www.sec.gov) and the **National Association of Securities Dealers** (a self-regulatory industry group at 800-289-9999; www.nasdr.com).

Did You KNOW...?

It Pays to Ask Questions Before Paying for Credit Card Insurance

Do you really need credit card insurance? If so, are the card insurance programs being offered to you a good deal? The answers depend on which of the many forms of credit card insurance you're considering... and who's offering it.

There is, for example, insurance to pay your credit card bills if you become disabled or you lose your job. This type of insurance may be a good thing if your other potential sources of income wouldn't be enough to pay your monthly debts. But, there may be a waiting period before you'd receive your first benefit payment, and the insurance may only pay the *minimum* card payment each month (up to the policy coverage limit). So, unless you are disabled or out of work for a very long time, the cost of the premiums could easily exceed any monthly benefits. Likewise, insurance that will pay off card balances if you die may make sense only if you have a lot of credit card debt and little or no other life insurance. In general, you might be better off insuring yourself against income loss or death by purchasing regular disability or life insurance instead of credit insurance.

Some credit card protection plans are basically notification services—they'll contact your card issuers if your cards are lost or stolen and arrange for new cards, or maybe they'll periodically send you copies of your credit report so you can review it for accuracy. "This may be a useful service for some people, but it offers nothing you cannot do yourself with a minimum amount of effort," says Gene Seitz, an FDIC fraud investigator in Washington. If you think you want this kind of service, though, Seitz suggests that you first ask your card issuers if they offer the same service more cheaply or at no cost.

Some telemarketers are aggressively selling insurance that covers the fraudulent use of your credit card. Do you really need that kind of credit card insurance? Most experts say no. "Federal law already limits your liability to the first $50 of fraud losses per account, provided you make a reasonable effort to notify the card issuer of any lost or stolen cards within a reasonable period of time," says Kathleen Nagle, a Senior Consumer Affairs Specialist with the FDIC. "And in many cases, the issuer will waive the $50 requirement." If your card issuer still insists on the $50 payment, Seitz suggests that you check with the company that insures your home, because your existing policy may cover that loss.

Seitz also cautions you never to give your credit card number to anyone selling credit card loss protection insurance over the telephone, because you may be dealing with a con artist who could make unauthorized charges to your card.

If you are considering credit card insurance, FDIC credit card specialist Janet Kincaid suggests asking: Why do you want this type of protection? What benefits will you gain from it, and how much are you willing to pay? Does the extra insurance make sense for your spending and borrowing habits? ("For example," Kincaid says, "if you only charge a minimum amount, what would be the purpose of buying insurance to pay off your credit card bill?") Also, are you sure you're dealing with a legitimate company? If you have doubts about an insurance plan or the company offering it, contact your state government's insurance commissioner or office of consumer affairs.

Banks Have Limited Authority to Open, Close and Access Accounts

When you want to open a checking account, get a credit card or sign up for some other product or service from a bank, you may be asked to fill out an application and sign papers that essentially are contracts between you and the financial institution. These documents recognize that you have the right to be treated fairly under state and federal laws, but they also explain that the bank has certain rights to open, close and, under limited circumstances, to access accounts. Because consumers often misunderstand what banking institutions may or may not do, we offer the following examples.

A bank may reject your application for a checking or savings account. When you apply to open an account, the bank may obtain a copy of your credit report. If your credit report indicates you have a history of mishandling an account—perhaps you've bounced a lot of checks or done something to cause another financial institution to close one of your accounts (see next item)—the bank may refuse to open an account for you. Note: If the bank declines your application based on information in a credit report, you must be told so and be given a chance to correct information in your report that may be inaccurate.

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Your bank may close your deposit account and give you your money back. Examples of when that could happen: You bounce a certain number of checks. You refuse to pay the fees for bouncing checks (or some other fees, for that matter). Your account balance falls below a certain amount. Or, you don't make any deposits or withdrawals for many years and the bank's efforts to locate you prove unsuccessful, in which case the bank typically will transfer funds from these "dormant" accounts to the state government's unclaimed property office.

Your credit card issuer may cancel your account. "Your bank may have the right to close your charge account if you exceed your credit limit or fail to pay certain fees, such as late-payment penalties," says Ann Johnson, an FDIC consumer law attorney in Washington. "The bank also may cancel your credit card account if the checks you send in for payment are returned because of insufficient funds."

Your bank may deduct money from your account under certain circumstances. Suppose you have an auto loan with the same bank where you have a checking account. If you don't make a monthly loan payment, the bank may be able to deduct the payment from your deposit account. The bank's right to divert money to cover a debt is governed by state law, which can vary significantly from state to state. If your bank has the right to take funds to cover money you owe the institution, this right is probably noted in your loan contract. Some state laws require the bank to give you advance notice before taking the loan payment; others don't.

There also are times when a court will order a bank to freeze a customer's account so that funds can be used to pay another creditor or for child-support or back taxes. In these situations, the customer will be notified before any money is transferred out of the bank, so that he or she has a chance to contest the matter in court.

A court also can order your bank to open your safe deposit box. Robert Patrick, another FDIC consumer law attorney in Washington, says this often occurs if the person renting the box dies and the executor of the estate doesn't have access to the box. Other examples, according to Patrick: If law enforcement authorities convince a judge that the box contains evidence of a crime. If someone claiming you owe money gets a court order to see whether the box contains anything of value. ("Of course, you'd first have the opportunity to show the contents of the box voluntarily," adds Patrick.) Finally, the bank may need to open the box to turn unclaimed property over to the state, in much the same way that dormant savings and checking accounts are handled.

A Bank By Any Other Name May Still Be the Same Bank

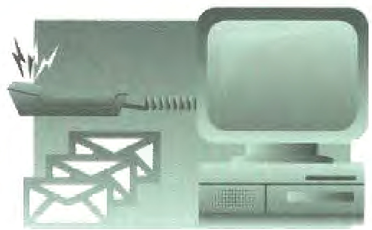
We've previously cautioned readers that some banks and thrifts operate branches and Internet sites under a different "trade" name than the company's "legal" name. The FDIC is especially concerned that depositors who are confused about the true identity of a particular institution could inadvertently exceed the $100,000 insurance limit. Suppose you have $70,000 in a savings account at Main Street Bank and, after surfing the Web, you deposit an additional $50,000 at Internet Bank, which you didn't realize was a division of Main Street Bank. "If Main Street Bank fails, so does Internet Bank because they are really the same bank," says Marc Goldstrom, an FDIC attorney in Washington. "Your accounts would be combined and insured up to $100,000, so you could lose $20,000."

Because the FDIC continues to get inquiries from consumers about banks or Web sites with unfamiliar names, we offer these suggestions:

First, the more unusual the name, the more likely it's worth your time to check out the bank before conducting business. "A snappy or high-tech sounding name that's not common for a bank is a tip-off that this might be a division of a traditional bank or not even a bank at all," says Cynthia Bonnette, a bank technology specialist with the FDIC in Washington. You may call toll-free 800-934-3342 or write the FDIC's Division of Compliance and Consumer Affairs (see the next page) to confirm that a particular bank or savings institution is FDIC-insured. The FDIC also maintains an online database of insured banking institutions at www2.fdic.gov/structur/search/findoneinst.cfm. However, your search must use the legal name of the bank because the system does not include trade names of branches or Internet sites.

Because the FDIC and other federal regulators have advised banks to clearly identify their legal names in advertisements, you also should be able to find the official name of a bank on its Internet site. The wording might say something like "Internet Bank is a division of Main Street Bank" or "Internet Bank is a service of Main Street Bank." Also, look for a link from the home page to a section (often called "about us") with facts about the history of the institution, any ties to other financial institutions, and perhaps details about its FDIC insurance coverage.

For More Information



For questions about consumer or civil rights laws, or complaints involving a specific institution: First attempt to resolve the matter with the institution. If you still need assistance, write to the institution's primary regulator listed on this page. Although the FDIC insures nearly all banks and savings associations in the United States, the FDIC may not be the primary regulator of a particular institution.

For questions about deposit insurance coverage: The FDIC insures deposits up to $100,000 at federally insured banks and savings associations. For more information, contact the FDIC's Division of Compliance and Consumer Affairs. The National Credit Union Administration insures deposits up to $100,000 at federally insured credit unions. Addresses and phone numbers are listed on this page.

Federal Deposit Insurance Corporation
Supervises state-chartered banks that are not members of the Federal Reserve System. Insures deposits at banks and savings associations.

FDIC
550 17th Street, NW
Washington, DC 20429

Home Page: **www.fdic.gov**

For information about consumer protections and deposit insurance:

FDIC Division of Compliance and Consumer Affairs
550 17th Street, NW
Washington, DC 20429

Phone: **(800) 934-3342**

TTY: **(800) 925-4618**

Fax: **(202) 942-3427**

E-mail: Start on the Internet at **www.fdic.gov/consumers/questions/customer/index.html**

For questions, concerns or complaints about the Federal Deposit Insurance Corporation:

FDIC Office of the Ombudsman
550 17th Street, NW
Washington, DC 20429

Phone: **(800) 250-9286**

Fax: **(202) 942-3040**

E-mail: **ombudsman@fdic.gov**

Office of the Comptroller of the Currency
Charters and supervises national banks. (The word "National" appears in the name of a national bank, or the initials "N. A." follow its name.)

Customer Assistance Unit
1301 McKinney Street
Suite 3710
Houston, TX 77010

Phone: **(800) 613-6743**

Fax: **(713) 336-4301**

Home Page: **www.occ.treas.gov**

E-mail: **consumer.assistance@occ.treas.gov**

Federal Reserve System
Supervises state-chartered banks that are members of the Federal Reserve System.

Division of Consumer and Community Affairs
20th Street and Constitution Ave., NW
Washington, DC 20551

Phone: **(202) 452-3693**

Fax: **(202) 728-5850**

Home Page: **www.federalreserve.gov**

National Credit Union Administration
Charters and supervises federal credit unions. Insures deposits at federal credit unions and many state credit unions.

Office of Public and Congressional Affairs
1775 Duke Street
Alexandria, VA 22314

Phone: **(703) 518-6330**

Fax: **(703) 518-6409**

Home Page: **www.ncua.gov**

E-mail: **pacamail@ncua.gov**

Office of Thrift Supervision
Supervises federally and state-chartered savings associations plus federally chartered savings banks. (The names often identify them as savings and loan associations, savings associations or savings banks. Most federally chartered savings associations have the word "Federal" or the initials "FSB" or "FA" in their names.)

Consumer Affairs Office
1700 G Street, NW
Washington, DC 20552

Phone: **(800) 842-6929 or (202) 906-6237**

Home Page: **www.ots.treas.gov**

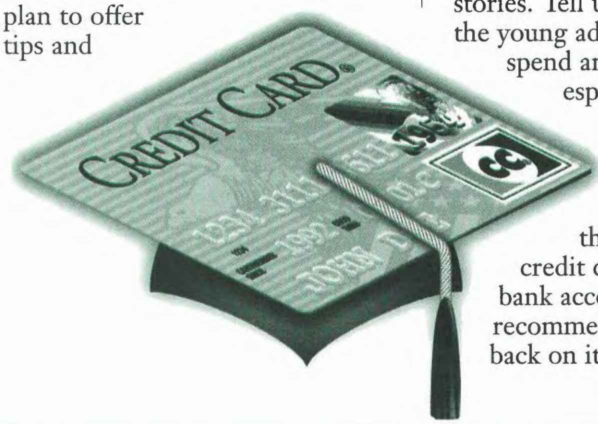
E-mail: **consumer.complaint@ots.treas.gov**

Some banking matters may involve state laws. For assistance, contact the appropriate state financial institution regulatory agency or state Attorney General listed in your telephone book and other directories.

Wanted: Parental Advice for Teaching Teens About Spending and Borrowing Responsibly

Please send us your suggestions, questions and stories about helping kids learn the right way to use their first credit cards, debit cards and checking accounts

Before teenagers are out making financial decisions on their own—at the shopping mall, away at college or anywhere else—they need to be taught the importance of good money management. In an upcoming issue of ***FDIC Consumer News***, we plan to offer tips and information primarily to help parents help their high school- and college-age kids prepare for the real world of credit cards and cash registers.



How can you help? Please send us your suggestions and personal stories. Tell us how you taught the young adults in your family to spend and borrow wisely, especially when using credit cards. What rules, limits and incentives seemed to work? Were there special kinds of credit cards, debit cards or bank accounts that you'd recommend? Also, looking back on it, what would you do differently, and why? The best suggestions may appear in our upcoming report.

If you have questions or topics you'd like addressed in our feature, we're glad to get those, too.

Write by December 1, 2000, to: Jay Rosenstein, Editor, ***FDIC Consumer News***, 550 17th Street, NW, Washington, DC 20429. You also can send an e-mail to jrosenstein@fdic.gov or fax your comments and questions to 202-898-3870. Please include your name, address, and phone number. No names will appear in print without permission.

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Federal Deposit Insurance Corporation
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