

# State of Ohio's Local Government Officials' 2017 Annual Conference

## How to Best Navigate the CD Market

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## AGENDA

- Overview
- FDIC Insurance Coverage
- Liquidity considerations
- Yields
- Utilization of CDs by Municipalities
- Comparison of CD Acquisition Methods
- What to look for – What to look out for
- FDIC-Insured Deposit Account Alternative

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## CD Overview

- Time deposit at a Financial Institution
  - Fixed term - usually one month to 5 years
  - Fixed or floating interest rate
  - Can be issued in any amount
  - Insured by FDIC up to \$250,000 (principal plus accrued interest) per person/tax-id, bank, & ownership category
  - Physical or DTC Eligible Book entry (Brokered CD)

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## Additional CD Classifications

- **Brokered CDs** - purchased through a brokerage (BDs) firm
  - The bank issues the CD
  - BDs distribute to investors
  - Institutional size raised – higher negotiated yields - more competitive market
- **Jumbo CDs** – BD Wholesale – Large Denominations - Uninsured
- **Odd-lot CDs** – Secondary Market < \$100,000 – Higher Yields
- **DTC Eligible** — Book entry – CUSIP system Identification - tradable in Primary & Secondary Market
- **NCUA** – Federal Agency that insures Credit Unions – same full-faith-and-credit U.S. Government backing as the FDIC

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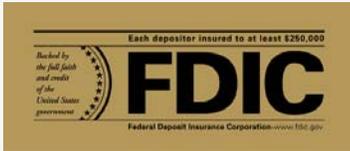
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## FDIC-Insured CDs – Full Faith & Credit

- FDIC insurance is **backed by the full faith and credit of the United States government**  
Since the FDIC was established in 1933, no depositor has lost a penny of FDIC-insured funds
- Only significantly **well-capitalized** insured depositories allowed to issue Brokered CDs
- U.S. Market – 6,800 FDIC insured banks – 1500 issue **Brokered CDs**



- **When a bank fails** – Non-brokered deposits acquired by stronger insured bank or paid by FDIC with brokered CDs by the Wednesday following a typical Friday announcement

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## Brokered vs. Non-Brokered CDs

	Brokered	Non-Brokered
<b>Liquidity</b>	DTC-Eligible	None
<b>Penalties</b>	None	Early Withdrawal
<b>Yield</b>	Higher (using odd-lots)	Intro Rate Expires on Rollover

**U.S. Market** – 6,800 FDIC-Insured banks, 1500 issue Brokered CDs

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## Criteria to issue FDIC-Insured Brokered CDs

- Section 29 of the FDIC Act (Part 337.6) limits banks issuing brokered deposits
- Only a **well-capitalized** insured depository institution is allowed to solicit and accept, renew, or roll over any brokered deposit without restriction
  - Significantly exceeds the required minimum level** for each relevant capital measure




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## When an FDIC-Insured Bank Fails

- Federal law [12 USC 1821\(f\)](#) requires FDIC to restore funds ASAP
- Practice – brokered deposits almost always paid by the Wednesday following the Friday announcement**
- Non-brokered deposits acquired by stronger insured bank

<https://www.fdic.gov/consumers/consumer/news/cnfall14/misconceptions.html>

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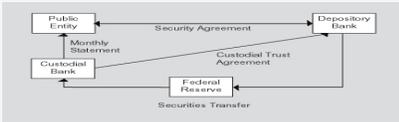
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## Municipal Collateralization of CDs



- Purpose – reduce Municipal risk of loss due to a bank failure
- Non-FDIC Insured depositories required to pledge securities approximately 105% of CD market value
- Typically collateralized by; Treasuries, Agencies and Municipal Bonds
- Monthly mark-to-market accounting and adjustments
- Many states allow surety bonds in lieu of collateralization

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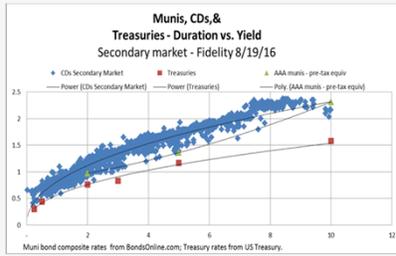
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## Relative Yield Snapshot



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## Secondary vs. Primary Market CD Yields

Secondary Market CD Yields tend to be higher than Primary Market Yields

	Secondary Market	Primary Market
<b>Market</b>	Live Market Pricing	Snapshot Pricing
<b>Pricing</b>	(negotiated bid-ask spread)	(yield set often weeks in advance of issue)
<b>Size</b>	Smaller odd-lots priced below market	Price of Buy is same irrespective of size
<b>Seller</b>	Advantageous pricing for CD holder depending on liquidation need	Many issues are "best efforts", underwriters do not take issues on their books

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## Utilization of CDs by Municipalities

- General Account excess cash
- Bond Reserve Funds – Funds Controlled by Trust Indenture
- Bond Anticipation Notes
- New Money GO / Ban Bond Proceeds
- Bond Reserve Funds



**FDIC meets restrictive investment policies – U.S. Full Faith and Credit Backing**

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## Accessing CDs – Directly from Banks

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"><li>• Full Control</li><li>• FDIC-Insured</li><li>• Can Keep Deposits Local</li></ul>	<ul style="list-style-type: none"><li>• High Administrative Burden</li><li>• Not Liquid</li><li>• Early Withdrawal Penalties</li><li>• Fragmented Reporting</li><li>• Initial teaser rates not at available upon reinvestment</li></ul>



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## Accessing CDs – Thru Broker Dealers

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"><li>• Easy</li><li>• Increased investment diversification</li><li>• Higher capacity</li></ul>	<ul style="list-style-type: none"><li>• UW &amp; Distribution Concession Fees</li><li>• UW /Inventory / Trading Partner biases</li><li>• BDs sell what they hold on their books</li><li>• BDs focus on speed to capture fees</li><li>• Mark-up CDs bought at discount to Par</li><li>• No Fiduciary Responsibility</li></ul>



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## Accessing CDs –Thru Investment Portals

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"> <li>• Full Control</li> <li>• Quick On-line direct access - Banks &amp; CUs</li> <li>• Known annual subscription fee</li> <li>• No Broker fees &amp; mark-ups</li> </ul>	<ul style="list-style-type: none"> <li>• Administrative Burden                             <ul style="list-style-type: none"> <li>– control limits</li> <li>– manage reinvestments at maturity</li> <li>– laddering complexity</li> </ul> </li> <li>• Initial teaser rates - not at reinvestment</li> <li>• No access - higher yield Secondary Market</li> <li>• Early withdrawal penalties</li> <li>• Not Liquid</li> </ul>



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## Accessing CDs – Thru RIA Proprietary System & Strategy

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"> <li>• FinTech System advantages:                             <ul style="list-style-type: none"> <li>➢ Pricing information edge</li> <li>➢ Speed to id &amp; buy best before competition</li> <li>➢ Automatic Laddering</li> <li>➢ Built in amount &amp; date liquidity</li> <li>➢ Odd-lot capabilities</li> <li>➢ Auto control of FDIC-Insurance limits</li> <li>➢ Custody at any bank</li> </ul> </li> <li>• Higher yielding</li> <li>• Access to all banks brokered CDs</li> <li>• Easy - Low administrative burden</li> <li>• Rebate BD mark-ups &amp; U/W Concession Fees</li> <li>• Annual bps fee</li> <li>• Fiduciary responsibility</li> </ul>	<ul style="list-style-type: none"> <li>• New to many Municipalities</li> <li>• Time needed to understand tailoring options &amp; benefits</li> </ul>

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## What to Look Out For

- High fees - Early withdrawal Penalties - Initial "teaser" rates - Mark-ups
- Non-negotiability
- Lack of flexibility to tailor accounts
- Forced custodial bank
- Low capacity
- Broker Dealer bias / conflicts of interest
- Lack of Transparency
- Lack of Fiduciary responsibility - Placing client first
- Marketing Platforms that outsource CD acquisitions to third parties
- Unamortized CD price above par not covered by FDIC



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## What to Look For

- Open depository institution network accessing all banks offering brokered CDs
- Low fees – rebate concession fees & discounts to par – no additional fee to sell
- DTC eligible liquidity
- Ability to tailor portfolios for numerous liquidity choices
- Proprietary systems with full in-house processing
- Robust transparent and Sub-account reporting
- Systems that ensure flawless control of FDIC P+I insurance limits
- Ability to handle higher yielding Secondary Market odd-lot CDs
- Reinvestment of maturing CDs at current yields
- No early withdrawal penalties or forfeiture of accrued interest
- Fiduciary responsibility to place clients interests first



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## FDIC-Insured Overnight MM Deposit Accounts

- Daily deposits reinvested at FDIC-Insured platform member banks
- Platforms access proprietary groups of 200-750 member banks
- Deposits accepted daily – 6 withdrawals allowed per month (Reg D) or Daily
- Yields vary - ordinarily exceed; treasuries, and bank deposit or MM accounts
- Require the use of platform's custodial bank

**Pass-Through Insurance** – covers qualified fiduciary / custodial deposit accounts

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## FDIC-Insured Overnight Deposit Accounts



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## FDIC-Insured Overnight MM Deposit Accounts

	CDARS	FDIC INSURED MMDA
<b>SAFETY</b>	U.S. Gov't full faith and credit	U.S. Gov't full faith and credit
<b>LIQUIDITY</b>	non-negotiable <b>NOT</b> Liquid	Daily Liquidity
<b>YIELD</b>	do not always exceed Treasuries	significant yield enhancement
<b>CAPACITY</b>	funds placement <b>not guaranteed</b>	\$50 - \$100 Million
<b>TERM</b>	fixed terms 4-13-26 wk. 1-2-3-5 yr.	No term held as overnight deposits
<b>PENALTIES</b>	Substantial penalties for early withdrawals	None

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## Disclosures

Performance quoted is past performance and is not a guarantee of future results. Current performance may be higher or lower than the performance data shown.

Saxon Securities LLC is not a member of FDIC, but the banks issuing the CDs are FDIC members. Saxon Securities LLC investment advisory services are not guaranteed nor insured by the FDIC. Only the CDs purchased from FDIC member banks are insured up to applicable FDIC insurance limits; for FDIC insurance information and applicable limits, see [fdic.gov](http://fdic.gov).

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