

Special Alerts

DEPOSIT BROKER ALERT

SA-78-2003
December 5, 2003

TO: CHIEF EXECUTIVE OFFICER
SUBJECT: Zero-Coupon Investments, Rate Quest
Investments, Laguna Hills, California

Summary: *Deposit broker links purchase of zero-coupon investments with brokered deposits.*

The Federal Deposit Insurance Corporation (FDIC) has identified potential concerns with brokered deposit arrangements that federally insured financial institutions have entered into with Rate Quest Investments (RQI), Laguna Hills, California.

RQI is an unregistered financial services broker that places brokered deposits with financial institutions. RQI was incorporated by primary principal Bruce Carter, who was also an executive of Prime Yield, Inc., San Clemente, California. Prime Yield Inc., and Bruce Carter, individually, stipulated and consented to a Cease and Desist Order and Order to Pay a Civil Money Penalty, with the National Credit Union Administration, dated July 10, 1997. The Order addresses oral and written misrepresentations made to federally insured credit unions. Mr. Carter was also an account executive of San Clemente Financial Group, Inc., San Clemente, California, which was the subject of a prior Deposit Broker Alert issued by the FDIC on June 29, 2000 (FIL-41-2000).

RQI has been known to conduct transactions with insured financial institutions that are seeking funding. As part of the transaction, RQI has required the purchase of long-term, zero-coupon certificates. RQI conducts these transactions through several custodial banking arrangements. If your institution has any deposit or securities transactions with RQI or any other financial services broker, comprehensive due diligence should be conducted to ensure a full understanding of all the costs associated with the transactions. Your analysis should determine whether the zero-coupon investment price is at the market and how the cost and yield of the investment compare to other investments of similar maturity. The level of exposure to interest rate and liquidity risks involved with the funding agreement should also be assessed. Furthermore, the financial capacity of RQI or any other financial services broker should be reviewed prior to engaging in any transaction to ensure the broker's ability to fulfill its obligations.

The FDIC has identified a number of concerns in connection with an institution's participation in a funding agreement requiring the purchase of long-term, zero-coupon certificates of deposit. Although the brokered deposits are generally offered at a below-market rate, the funds are short-term and the total cost of the zero-coupon certificates of deposit appears to be priced above the market and is considerable in comparison with a U.S. Treasury security of comparable maturity. The below-market yield on the investment ultimately eliminates any economic benefit achieved through the below-market cost of funding.

Financial institutions should be cautious when participating in unusual financial arrangements and should be particularly thorough when assessing investments that offer an above-market rate of return or a below-market cost of funding. Additionally, it is imperative that an appropriate level of due diligence is performed to verify the legitimacy and experience of the entity offering any such

arrangement prior to engaging in any transaction.

Inquiries may be directed to the FDIC's Special Activities Section, 550 17th Street, NW, F-4044, Washington, D.C. 20429. For your reference, FDIC Special Alerts may be accessed from the FDIC's Web site at <http://www.fdic.gov/news/news/SpecialAlert/2003/index.html>. To learn how to automatically receive FDIC Special Alerts through e-mail, please visit <http://www.fdic.gov/news/news/announcements/index.html>.

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