

Federally Insured Brokered CDs: A Unique Opportunity for Public Fixed Income Portfolios

In today's uncertain market, opportunities to enhance returns while maintaining a prudent risk profile, are increasingly rare. One often-overlooked option is FDIC Brokered Certificates of Deposit (CDs). These are FDIC-insured bank deposits (subject to applicable insurance limits and pass-through coverage rules), which under the right conditions, can offer a compelling alternative to traditional government or corporate bonds. For public pension plans tasked with balancing performance, safety, and fiduciary responsibility, these CDs may represent a practical and prudent solution.

The Value Proposition: Insurance and Yield

At their core, FDIC Brokered CDs are simple instruments. Issued by banks, they carry explicit federal insurance through the Federal Deposit Insurance Corporation (FDIC) — the same protection afforded to traditional bank CDs. However, unlike traditional CDs, brokered CDs trade in secondary markets, behave like bonds, and can be structured with various maturities and pricing flexibility.

What makes them especially attractive to institutional investors is their exceptional risk-return profile within the fixed Income space. When FDIC-insured bank deposits have similar (if not higher yields) than the unsecured debt at those same banks, the opportunity is significant. Investors can access returns that rival investment-grade credit while reducing exposure to certain credit risks when structured appropriately, thanks to FDIC insurance.

Historical Opportunities to Add Value with Federal Insurance

The appeal of FDIC Brokered CDs isn't theoretical. Over the past 15 years, there have been repeated periods where certain market environments have created notable opportunities to add yield to portfolios without sacrificing quality.

In 2011, brokered CD's came to our attention when larger, high-quality banks were seeking additional funding sources, resulting in yields over one full percentage point above equivalent US Treasuries. This was repeated several times over the past decade and a half, including but not limited to December 2018, June 2020 and again in March of 2023. These

opportunities arise from technical bond market factors, temporary supply and demand imbalances, or periods of broader market volatility and reinforce the value of having these instruments available within a flexible investment policy.

The key takeaway: FDIC Brokered CDs tend to offer their greatest value during times of higher volatility, when more traditional instruments may be mispriced or offer less yield for more risk.

Insurance Advantage for Public Pension Plans

For public trustees managing defined benefit or defined contribution pension plans, FDIC Brokered CDs carry an additional benefit: expanded FDIC coverage through "pass-through" insurance.

Under standard FDIC rules, insurance coverage is capped at \$250,000 per depositor, per bank. However, qualified pension plans are eligible for significantly greater protection based on the plan's internal beneficiary structure. Specifically, the FDIC applies a "pass-through" formula where coverage is based on the net present value of the largest beneficiary of the fund (see sample below). -This may result in higher levels of coverage depending on plan structure and compliance with FDIC requirements — a significant safety net for large public plans.

Pass-Through Insurance Calculation:

The formula to determine the insurance level is:

\$250,000

Largest beneficiary's (%) share of plan asset

For example, if the largest beneficiary of a fund's stake is 1% of the plan's total assets, then the FDIC insurance coverage for bank X would be calculated as follows:

$$\frac{\$250,000}{1\%} = \$25,000,000$$

A Strategic Fit for Conservative Investors

With **U.S. Treasuries bonds making up roughly 46%** of the Bloomberg U.S. Aggregate Bond Index, many public portfolios are heavily weighted toward government debt. However, yields on these instruments can lag significantly during periods of economic uncertainty or low interest rates.

Brokered CDs provide a way to maintain the same credit profile as US Treasuries, while enhancing yield, especially on securities with less than five years to maturity. For example, recent market environments have seen brokered CD yields match or exceed those of corporate bonds— but with a layer of federal insurance that corporates do not offer.

Final Thoughts

Public fiduciaries may be well-served by exploring this option as part of a diversified, risk-aware investment policy. In a market where higher yields often come with higher risks, FDIC Brokered CDs stand out as a rare exception — offering the potential for attractive returns without increasing credit or structure risk in the portfolio.

In the current environment, where high-quality yield is at a premium, CS McKee has been actively adding these FDIC backed securities at yield and spread levels at or better than the unsecured debt of the same issuers. Our approach has focused on high-quality, large industrial banks, which tend to issue frequently, in larger sizes, and at higher yields to attract institutional demand. As opportunities create greater risk and yield spreads, we would look to increase our positioning.

To learn more about how CS McKee has implemented this strategy during past periods of market dislocation — or to discuss how it might fit within your portfolio — please contact Zach Vigneault at zvigneault@csmckee.com or 814-505-7997, or visit csmckee.com.

Risks and Considerations

Brokered CDs are subject to interest rate risk, and their market value may fluctuate prior to maturity. Secondary market liquidity may be limited under certain conditions. FDIC insurance is subject to applicable limits, eligibility requirements, and proper structuring, and may not cover all amounts invested.

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