Deposit Account Control Agreements

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Introduction

Deposit Account Control Agreements (DACAs) are too often given little thought by a depository institution that signs them. It is all too common that a depository institution does not have the proper controls in place, including engagement of counsel for advice when appropriate, to protect the depository institution's interest when signing and implementing a DACA. This is in stark contrast to lenders, who typically engage counsel to meticulously review and edit the DACA to ensure that the lender's security interest in any deposit accounts are perfected and to shift the exposure under the DACA to the depository institution. The result is that a depository institution can expose itself to significantly more risk than necessary when entering into DACAs.

Purpose of DACAs

DACAs are tri-party agreements between a lender (also often referred to as the secured party), a borrower and a depository institution. The purpose of a DACA is for a lender to gain control over its borrower's deposit accounts that are held at a depository institution other than the lender, so that the lender can perfect its security interest in the deposit accounts. Some DACAs are structured so that the lender has exclusive control of the deposit accounts immediately upon execution of the DACA. Other DACAs allow the borrower to access, withdraw and transfer funds in the deposit accounts until such time that the lender provides a notice to the depository institution that the lender is taking exclusive control and that borrower is no longer permitted to access, withdraw or transfer funds from the deposit accounts.

Three DACA Pitfalls for a Depository Institution

A depository institution that enters into a DACA is incurring significant obligations to both the secured party and its depositor customer. Failure by a depository institution to fulfill its obligations can diminish the value of the lender's deposit account collateral. Furthermore, if the rights and obligations of all parties to the DACA are not clearly set forth, or if modifications to the DACA change a depository institution's standard implementation process, a depository institution may inadvertently take actions that could also diminish the value of the lender's deposit account collateral. As such, it is critical that a depository institution carefully evaluates whether there are any flaws in its own DACA review and implementation process.

Depository institutions often make one or more of the following three oversights:

1) Accept a form DACA that has not been specifically crafted by that depository institution for use by that depository institution;

2) Failure to have adequate internal safeguards and procedures to enter into DACAs; and

3) Failure to have adequate internal safeguards and procedures to implement DACAs.

1) DACA Forms

The first step a depository bank must take to protect itself is to start with a good DACA form. DACA forms that are provided to a depository institution by a lender will not be drafted with the depository institution's unique operational, business and legal needs in mind. And, more likely than not, they will contain provisions that are more lender-friendly than is market in the industry. By crafting and insisting on the use of its own DACA form, a depository institution can be sure that its unique operational needs are considered, including notice information and amount of time provided to implement any instructions from the other parties. Furthermore, by consistently using its own form, the individuals implementing DACAs at the depository institution will become more familiar with the depository institution's obligations under the DACA, making it less likely that there will be an error or oversight in implementation. Oftentimes, the individuals who are responsible for implementation of DACAs are not familiar with reviewing and interpreting agreements. As such, an unfamiliar DACA form will be difficult to interpret to understand all of the depository bank's obligations. If the depository bank's form is consistently used, then any attorney who negotiates a DACA for the depository institution can point out any changes to the DACA that may alter the depository institution's obligations.

2) Entering Into DACAs

Even if a depository institution requires its own form DACA, depository institutions still must be vigilant about changes that a lender or borrower and their counsel make to the DACA form before signing. Oftentimes, the other parties to the DACA will seek to substantially modify important provisions protective of the depository institution, including indemnification, lien priority and termination provisions. Depository institutions should have the suggested modifications reviewed by counsel that is familiar with negotiating DACAs from the perspective of a depository institution (i.e. understands bank operations, cash management and deposit operations, as well as the importance of certain legal protections to the depository institution). The depository institution's attorney will need to communicate to the depository institution how any proposed changes modify each party's respective rights and obligations under the DACA, and the practical consequences of those changes to the depository institution's relationship, business and operational teams. Further, depository institution's counsel must have a deep understanding of what is the market, and fend off unreasonable requests from other parties that are not in line with the market.

3) Implementation of DACAs

Depository institutions should have an experienced internal team that is responsible for the implementation of all DACAs. Relationship officers should not be implementing DACAs, but should be instructed about the importance of sending any DACA requests through the depository institution's DACA preparation, review and implementation protocol. So long as the DACA is thoughtfully prepared and appropriately negotiated by the depository institution's counsel, improper implementation of a DACA is a depository institution's principal source of exposure. The depository institution must make sure that all necessary controls have been placed on the applicable deposit accounts, and that the depository institution is prepared to implement, and capable of implementing, all instructions it receives within the timeframes set forth in the DACA. Smaller depository institutions, in particular, should be mindful of the absence of key personnel, and have backup procedures in place so that DACA instructions are always implemented promptly. If, for example, the depository institution fails to act upon a lender's notice requesting exclusive control of the deposit accounts within the timeframe required in the DACA, the depository institution could be liable to the lender for all withdrawals from the deposit accounts by the borrower after the date exclusive control should have been implemented.

Conclusion

It is important that a depository institution evaluate from time to time its DACA forms and DACA review and implementation process to ensure it is not incurring unnecessary exposure. Vorys has extensive experience representing depository institutions in the structuring, negotiation, and implementation of DACAs and can assist with your DACA evaluation. Please contact us with any questions you have about how to better protect yourself from potential DACA liability.