KASASA

December 2, 2024

James P. Sheesley
Assistant Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington D.C. 20429
(comments@fdic.gov)

Re: Request for Information on Deposits - RIN 3064-ZA42

Dear Mr. Sheesley,

Thank you for opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC's") request for information on deposits ("Request").

POLICY OBJECTIVES

Via this Request, the FDIC is seeking information on the characteristics that affect the stability and franchise value of different types of deposits. The FDIC is seeking to understand whether and to what extent certain types of deposits behave differently from one another, particularly during periods of economic or financial stress.

INTRODUCTIONS

Kasasa, Ltd. ("Kasasa") is a third-party service provider whose mission is to help community financial institutions compete with financial technology ("fintech") providers and our nation's large regional and global systemically important banks. Kasasa supports hundreds of community financial institutions across all 50 states, by providing professional banking services; digital enablement technologies; and innovative retail offerings (collectively "Services") that help IDIs attract and retain customers; improve executional efficiencies; and reduce operational expenses.

Kasasa does not build, own, or control any depositor relationship. Kasasa does not receive or place any depositor funds with insured depository institutions ("IDIs"). Kasasa does not have any authority to close any deposit account or move any depositor's funds. Kasasa is not involved in negotiating or setting rates, fees, terms or conditions of any deposit account at any insured depository institution. Kasasa does not propose or determine deposit allocations at any IDI. And Kasasa does not receive any compensation for any deposits residing at any financial institution.

Our Services enable IDIs to establish singularly sourced, direct relationships, that the institution owns and controls, with individual depositors who live and work within the IDI's local community. As you will see in the Comment and Analysis Sections of this letter, these customers utilize a wide range of banking services (e.g., direct deposit, online bill pay, debit card, online banking, loans) from their financial institution, and their associated deposits serve as a low-cost, locally gathered, stable source of funds upon which the IDI can safely, soundly and profitably operate its business.

We believe these direct depositor relationships – owned and controlled by the IDI – and the associated deposits they provide advance the interests of the FDIC.

COMMENTS

Per Question 10 within the Request ("*Please provide any other comment or information that would be useful for the FDIC to consider*"), we respectfully offer the following insights regarding the stable nature of the deposits residing in reward-based transaction accounts and the contributions they make to an institution's franchise value.

Call Report Reporting:

For Call Report purposes, with a few exceptions, a "transaction account," is defined as a deposit or account from which the depositor or account holder is permitted to make transfers or withdrawals by negotiable or transferable instruments, payment orders of withdrawal, telephone transfers, or other similar devices for the purpose of making payments or transfers to third persons or others or from which the depositor may make third-party payments at an automated teller machine, a remote service unit, or another electronic device, including by debit card.

For Call Report purposes, savings deposits (both money market deposit accounts and other savings deposits) are excluded from transaction accounts.

Banks report transaction and nontransaction accounts by depositor type on Schedule RC-E, items 1 through 6.

Transaction Accounts:

Transaction account deposits have been used informally by the banking industry as a "proxy" for what "core deposits" are intended to connote since they are the result of an ongoing depositor relationship and involve a continual series of deposits and withdrawals to meet the depositor's primary banking needs.

Core deposits are not defined by statute. Rather, core deposits are defined in the Uniform Bank Performance Report (UBPR) as the sum of all transaction accounts, money market deposit accounts (MMDAs), non-transaction savings deposits (excluding MMDAs), and time deposits of $250,000 and below, less fully insured brokered deposits of $250,000 and less. (emphasis added). While useful for analytical and examination purposes, this definition does not establish a brightline understanding of what constitutes a "stable source of funds" which the term is intended to convey.

Per its July 2011 Study on Core Deposits and Brokered Deposits ("Study") the FDIC states core deposits "are intended to include those deposits that are stable and lower costs and that reprice more slowly than other deposits when interest rates rise. These deposits are typically funds of a local customer that also have a borrowing or other relationship with the bank." [1]

Further within the Study, the FDIC states "Core deposits have historically been categorized as stable, less costly deposits obtained from local customers that maintain a relationship with the institution. [2] "[A]s used within the Study, the word "relationship" implies considerably more than that a person is simply a customer of a bank. At a minimum, it requires that a customer has:

- A single deposit of some kind and also has a loan or uses other services of the bank or a bank affiliate (e.g. wealth management, broker-services); or

- An active checking account and either of the following: (i) uses direct deposit, banks online or uses automatic bill pay; or (ii) has another deposit of some kind." [3]

Duration:

The Study states "In calculating the duration of core deposits, most studies must make assumptions about interest rate sensitivity, effective maturity, and retention rates, including when and to what degree a bank responds to changes in market interest rates. After making these assumptions, these studies estimate durations for core deposits as ranging from 6 to 15 months for money market deposit accounts, one to two years for transaction accounts, 7 years for NOW accounts, and 3 years for savings accounts. One study, using actual retention rates from 5 institutions, found longer durations for each of these types of accounts." [4]

The Study also states "The duration of a deposit can present or mitigate the problem of a deposit leaving a bank for higher rates or when the bank is under stress. The longer a deposit's remaining time to maturity and the stricter the restrictions on early withdrawal, the less likely it is to be withdrawn when an institution is under stress. Conversely, with one exception, the shorter a deposit's remaining time to maturity and the looser the restrictions on early withdrawal, the more likely it is to be withdrawn when an institution is under stress or to leave for higher rates. The exception is demand deposits, which, as

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[1] FDIC: Study on Core Deposits and Brokered Deposits. (the "Study"), Page 5 (July 8, 2011)
[2] Study, Page 32
[3] Study, Page 50
[4] Study, Page 36

the studies discussed above show, have an average duration of six months to seven years, depending on the type of deposit. For these non-maturity deposit accounts, the expected life of the deposit or its duration may depend on features of the account that make it less likely the customer will withdraw funds. For example, a NOW account customer that has ***direct deposit and uses electronic bill pay, all other factors being equal, may have a longer duration than one that does not.*** *(Emphasis added)"*[5]

Reward-Based High Interest Transaction Accounts:

We believe deposits residing in singularly acquired reward-based checking accounts that are (a) entirely covered by deposit insurance; (b) opened by an individual, (c) held in the name of that same individual; (d) used monthly by that same individual to make payments, receive funds, conduct transactions, reach savings goals and earn rewards as a function of satisfying banking activities established by the IDI and (e) with respect to which only that same individual is recognized by the insured depository institution as being authorized to close that account and designate withdrawals or payments be made from the account should be expressly identified and treated as "core" deposits.

These are the singularly acquired, low-cost deposits the FDIC wants its supervised institutions to build their businesses upon as they are associated with deeply connected individual depositor relationships that are directly established between an IDI and a consumer who works and/or lives in the community the IDI serves.

- **How Reward-Based Checking Accounts Work:**

  Reward-based deposit accounts were introduced to the market in 2003. These accounts are free, interest-bearing checking accounts with no minimum balance requirements that enables the accountholder to earn a high rate of interest and nationwide ATM withdrawal fee reimbursements when the accountholder meets certain account conditions ("qualifiers").

  Common qualifiers include engaging in a certain number of debit card transaction monthly (usually 10 to 15); making at least one direct deposit, Automated Clearinghouse (ACH) credit or payment transaction monthly; enrolling in the institution's online banking program and agreeing to receive electronic bank statements. These qualifiers permit banks to profit from interchange fee income, reduce expenses associated with printing and mailing statements, and decrease overhead expenses as consumers shift from engaging in branch location activities to conducting transactions online.

  In addition, to control interest expenses, IDIs establish a "cap" that limits the balances upon which the high interest rate will be paid and pay a separate, lower interest rate on the balances that are above the "cap" threshold when the accountholder meets their account's qualifications.

  Should an accountholder not satisfy her/his account's qualifications during a specific cycle period, the accountholder still earns a rate of interest that is typically comparable to the national rate published by the FDIC and has the opportunity to qualify for their account's higher rewards again during the next cycle period.

  The qualifiers and rewards help community banks create deeply connected, actively engage, loyal, long-lasting relationships with individually acquired depositors who live and work within their local market area(s).

  In addition, the non-interest income and operational cost savings generated by the accountholders banking behaviors significantly offset, and often completely offset, the expenses associated with the account's attractive rewards thus, making the associated deposits one lowest cost sources of funds within the institution.

- **Extensive Research Proves Reward-Based Deposits Are "More Core Than Core":**

  Rather than repeat the extensive and detailed information we have previously provided the FDIC, we respectfully refer Staff to the materials we shared with the agency (i) in April 2013 (face-to-face presentation); (ii) on January 9, 2014 (face-to-face presentation); (iii) on March 3, 2014 (information packet); (iv) on May 20, 2014 (conference call); (v) on

[5] Study, Page 51

April 23, 2019 (comment letter); (vi) on April 27,2020 (Zoom call); (vii) on May 27, 2020 (comment letter); and (viii) on October 16, 2024 (comment letter).

That said, we have summarized several salient points from the proprietary research we have conducted on specific accountholder and deposit behaviors. This research reflects twenty (20) years of data across more than nine hundred (900+) individual community financial institutions operating in over six thousand (6,000+) branch offices across all fifty (50) of our United States. The analysis is based on more than a half a billion individual data records associated with more than 3 million individually acquired reward-based checking accountholder relationships our community financial institution clients have established directly with their depositors. Over the past two decades, our clients have distributed over $3 billion dollars in account rewards, to these individual depositors.

- **Reward-based checking accounts create singularly acquired, direct, local depositor relationships:**
  - 95% of all new reward-based checking accounts are opened in an institution's branch office
  - 49% of all reward-based checking accounts are associated with an IDI's existing depositors
  - 87.92% of reward checking accounts are associated with residents who live within 10 miles of one of their primary institution's branch offices.

- **Reward-based checking accounts create deeply connected & actively engaged depositors:**
  - 75% of all reward-based accountholders have 1+ direct deposit or ACH transactions per month
  - 73% of all reward-based accountholders utilize their online banking service at least once a month
  - 75% of all reward-based accountholders receive monthly electronic statements from their IDI
  - 83% of all reward-based accountholders communicated with their IDI electronically
  - 93% of all reward-based accountholders say they like or love their checking account
  - Reward-based accountholders use their debit card twice as often as "free" checking accountholders
  - Reward-based accountholders are twice as likely to have a loan with their IDI than are "free" accountholder
  - Reward-based accountholders utilize 33% more banking services from their IDI than do "free" checking accountholders

- **99.88% of all reward-based checking account deposits are fully insured:**
  - Insurance Status of Reward-Based Checking Accounts by Balance Tier

Balance Tier Minimum	Balance Tier Maximum	% of All Accounts
Less than	$2,000	63.03%
$2,001	$5,000	12.68%
$5,001	$10,000	7.61%
$10,001	$15,000	4.69%
$15,001	$20,000	3.18%
$20,001	$25,000	2.07%
$25,001	$30,000	1.70%
$30,001	$35,000	0.94%
$35,001	$50,000	1.58%
$50,001	$100,000	1.69%
$100,001	$150,000	0.44%
$150,001	$200,000	0.17%
$200,001	$250,000	0.09%
$250,001+		0.12%

- ***The reward-based checking account structure results in extremely low-cost deposits:***

  - Qualification Requirements: Reward-based checking accounts require accountholders to meet certain requirements each cycle period in order to qualify for their rewards. These requirements generate non-interest income (i.e. debit card interchange revenue) and cost savings (e.g. electronic statements, online banking) for the bank that offset, and often eliminate the expenses associated with offering the account.

- *Rate Cap:* IDIs establish rate caps to limit the cost of the rewards associated with their reward-based accounts. Our interest-bearing account features a reverse tier structure that pays a high rate of interest up to a certain threshold ("cap") and a lower rate of interest on any dollars that are above that threshold. Thus, the "blended cost" is substantially lower than the promoted interest rate and thus extremely affordable for the institution to offer and manage.

- *Failure To Qualify:* On average, approximately 35% of all reward-based accountholders fail to qualify during each cycle for their rewards. Consequently, they receive only the base rate associated with the account across the entirety of their account balance. Accountholders, of course, have the opportunity to qualify for their rewards again during the next cycle period.

The True Cost of Deposits Reward-Based Checking Compared to 1 Year & 3 Year CDs

Account Elements	Reward -Based Checking	1 Year CD	3 Year CD
Total Balances	$7,439,247	$7,439,247	$7,439,247
Promoted Interest Rate	5.00%	4.75%	4.15%
Cost of Funds	2.74%	4.75%	4.15%
Interest Expense, Annualized	($203,494)	($353,364)	($308,729)
Non- Interest Expense	($43,838)	$0	$0
Non-Interest Income	$135,350	$0	$0
Annual Marginal Cost / Expense	($111,982)	($353,364)	($308,729)
Effective Cost of Deposits	1.51%	4.75%	4.15%

  - *Definition:* Cost of deposits serve as a holistic "all in" metric of all revenues and expenses associated with the reward-based checking account.

  - *Formula:* Cost of Deposits = [Non-Interest Income] – [Interest Expense + Non-Interest Expense]

- *Results:* The account's (a) qualifications, (b) rate cap and (c) failure to qualify elements result in a cost of deposits that is significantly lower than the account's promoted interest rate.

  Community banks DO NOT have to invest in risky assets to fund the attractive rewards offered on their reward-based accounts. Since the account is a reverse tier, qualification-based, reward offering, accountholder behavior generates enough non-interest income and operational cost savings for the IDI to significantly offset interest expenses making the account's deposit a consistently lower cost, stable source of funds as compared to alternative funding options.

- *Conclusion:* The deposits held in reward-based accounts by individual accountholders who have established a direct ongoing relationship with their financial institution are "more core than core" by every measurable metric the FDIC uses to evaluate an insured depository institution's deposit portfolio and should be considered and treated as "core" rather than "non-core" funding.

ANALYSIS & CONCLUSIONS

In its 2011 Study on Core Deposits and Brokered Deposits ("Study"), the FDIC uses the following characteristics to determine whether specific deposits pose the following potential problems – (1) rapid, risky growth; (2) deposit volatility; and (3) lower franchise value.

Deposit Characteristics That Can Contribute to Potential Problems

	Potential Problem		
Characteristic	Rapid Risky Growth	Deposit Volatility	Lower Franchise Value
High-Interest Rate	X	X	X
No Relationship	X	X	X
Easy to Obtain in Large Quantities	X	X	X
Uninsured		X	X
Short Term to Maturity		X	

Unfortunately, the Study evaluated all high-interest rate deposits as a single group. The FDIC <u>did not</u> break out reward-based high yield deposits and research these funds on their own merits. The FDIC also stated that its research was hampered by a lack of data since Call Reports do not collect detailed information on interest rates. ***By lumping reward-based deposits with other high-interest rate deposits, the agency's 2011 conclusion that all high-interest rate deposits appear to pose all three of the major problems a deposit can pose is completely inaccurate.***

The fact of the matter is, as evidenced by the information shared previously on pages 6 and 7 of this comment letter, <u>reward-based</u> high rate deposits are a low-cost, stable source of funding that enable banks to operate their business in a safe and sound manner while at the same time maximizing their franchise value via the deeply connected relationships they establish directly with individual depositors who reside in their local market.

Reframing the FDIC's "potential problem" matrix to identify "desired benefits" we offer the following evaluation matrix to demonstrate how reward-based deposits do not cause any of the problems the FDIC fear and actual advance the safety and soundness interests the FDIC espouses.

	Desired Benefits		
Reward-Based Deposit Characteristics	Managed Responsible Growth	Stable Source of Funds	High Franchise Value
Low Cost	X	X	X
Deeply Connected Relationships	X	X	X
Singularly Acquired	X	X	X
Fully Insured	X	X	X
Long Duration	X	X	X
Strategic Flexibility	X	X	X

Low Cost: As demonstrated on page 6 of this letter, community banks DO NOT have to invest in risky assets to fund the attractive rewards offered on their reward-based accounts. Since the account is a reverse tier, qualification-based, reward offering, accountholder behavior generates enough non-interest income and operational cost savings for the institution to significantly offset the account's interest expenses making the account's deposit a consistently lower cost, stable source of funds as compared to alternative funding options such as certificates of deposit. The account's cost of funds is often 50% of the account's promoted interest rate and when the operational savings and non-interest income is factored in, the true cost of the deposits is roughly 30% of the promoted rate and is always significantly less than fixed term CDs.

Deeply Connected Relationships: As demonstrated on page 6 of this letter, reward-based accountholders use their reward-based checking account as their primary financial vehicle and their bank as their primary financial institution. They utilize direct deposit, debit cards, online banking, electronic communications (all services the create deposit stickiness) and are twice as likely to have a loan with their institution than an individual who utilizes a traditional free checking account. And reward-based depositors utilize 33% more banking services than a typical free checking accountholder – evidencing a tangible direct ongoing relationship is in place. Additionally, only 1.6% of all reward-based accountholders are non-relationship customers ("Rate Shoppers").

Singularly Acquired, Local Depositors: 95% of all reward-based checking accounts are opened at an institution's branch. 49% of all reward-based accounts are opened and maintained by an existing depositor who already has a relationship with the institution. 63% of reward-based accountholders live within 5 miles of one of their institution's branch locations and 88% live within 10 miles of their institution's branch location. 99% of community financial institutions who offer reward-based checking accounts restrict online applications to their specific market area – 26.71% restrict online applications to specific zip codes; 38.36% restrict online application to a single state; 34.25% restrict online applications to a region that is less than 4 states (reflecting their branch network / market) and only 0.68% of community financial institutions offering the account accept online applications nationwide. All depositor relationships directly established by the bank and are owned and controlled by that institution.

Fully Insured: 99.90% of all balances held within reward-based accounts are below the FDIC's $250,000 insurance threshold. In fact, as the chart on page 6 of this letter indicates, 74.13% of all reward-based accountholders have balances less than $5,000, and 63.21% have balances less than $2,000 both indicators that the accounts are being as the accountholder's primary checking account.

Long Duration: In Advisory Opinion No. 93-30, FDIC General Counsel Alfred J.T. Byrne provided some guidance on core deposits by examining "accountholder retention". He cited the retention rates for endorsed money market accounts and certificate of deposits ranging from 80% - 85% and 60% - 75% respectively and noted that the bank he was providing commentary on regarded those deposits as "core."

With a 43% lower annual attrition rate than free checking, Kasasa's annual <u>retention rate</u> equates to 92% - clearly demonstrating the long-term "core" nature of Kasasa accountholder relationships.

Additionally, our twenty years of data shows little to no deposit run off when a new institution enters a market with a higher rate or when an institution reduces its rate due to market or regulatory conditions. In fact, only 4.57% of an institution's reward-based deposits departed after it significantly cut its rate in a 337.6 situation.

High Franchise Value: In its discussion of franchise value, the Study states "Characteristics that may make deposits more attractive (to an acquirer) are a low relative cost, a continuing customer relationship, and the potential for the funds to remain stable and not leave the bank after acquisition." [6]

As discussed earlier, reward-based deposits serve as stable source of low-cost funding. Applying the non-interest income and the operational savings that the accounts generate against the interest / incentive expenses associated with the accounts' rewards, these deposits often rank as one of the most affordable and profitable sources of funds within the institution. In fact, our products often generate a "negative cost of deposits" which means that our products generate profits <u>before</u> the deposits are deployed by the institution into loans and investments.

We have also demonstrated the deeply connected nature of the ongoing relationships our client institutions establish with their customers. These are direct relationships, that the institution owns and controls, with highly satisfied individual depositors who live and work in their local community. And the industry has shown its willingness to pay for reward-based customer relationships as demonstrated in 2013 when a large institution acquired a well-capitalized, well managed smaller institution and paid a 2.3% premium for the smaller institution's reward-based customers vs a National median value of 0.9%.

Strategic Flexibility: Competition for deposits in today's market is intense. Reward-based transaction accounts provide IDIs with flexibility that other funding sources do not. For example, as shown in the chart on page 5 of this letter rather than

[6] Study, Page 48

running an expensive 1 or 3 year "CD special" that will undoubtedly (a) reprice (higher) a meaningful amount of an institution's current deposits and (b) attract new consumers who will immediately remove their funds upon maturity, institution offering reward-based checking accounts can adjust the account's rate, cap and qualifications to retain and attract new depositors who will adopt the banking behaviors that generate operational savings and non-interest income to offset the expenses associated with the account's rewards. As shown in the chart, the effective cost of the deposits is significantly lower than either of the fixed rate CDs. In fact, many of our institution chose to lower their account's cap and raise the rate on their reward-based checking account to the highest rate offered by their institution. The results – while other institutions saw their deposits decline, these institutions grew their deposits by 4%, were 66% less reliant on fixed term deposits and their overall cost of funds were 30% lower than institutions that implemented traditional CD strategies.

SUMMARY

Reward-based checking accounts are free, interest-bearing transaction accounts with no minimum balance requirements that enable accountholders to earn a high rate of interest and nationwide ATM fee refunds when they meet the account's qualifications during a specified timeframe.

The account's qualification requirements encourage accountholders to adopt specific banking behaviors that generate non-interest income (e.g. debit card interchange) and operational cost savings (e.g. direct deposit, online banking, electronic statements) for the bank that offset and / or completely eliminate the expenses associated with offering the account. It is therefore <u>unnecessary</u> for any institution to invest in risky assets in order to fund the account's rewards.

These accounts enable IDIs to establish singularly sourced, direct relationships, that the institution owns and controls, with individual depositors who live and work within the IDI's local community. These customers utilize their account as their primary transaction account and their bank as their primary financial intuition as evidenced by the wide range of services (e.g., direct deposit, online bill pay, debit card, online banking, loans, credit card, etc.) these customers consume from their financial institution.

Rather than causing any of the concerns the FDIC fears, reward-based checking accounts systematically help community banks and savings associations grow in a responsible fashion and operate in a safe and sound manner by providing a stable and affordable deposits that are generated through local, deeply connected and long-lasting direct depositor relationships that increases franchise value.

WITH APPRECIATION

Thank you for the opportunity to share our extensive research on reward-based high-interest rate deposits. This research reflects twenty (20) years of data across more than nine hundred (900+) individual community financial institutions operating in over six thousand (6,000+) branch offices across all fifty (50) of our United States. Our analysis is based on more than a half a billion individual data records associated with more than 3 million individually acquired reward-based checking accountholder relationships our community financial institution clients have established directly with their depositors.

Per the information shared within this letter, we believe **deposits held in reward-based transaction accounts** by individual accountholder who have established a direct, ongoing relationship with their financial institution **are "more core than core" by every measurable metric the FDIC uses to evaluate different types of deposits** and the potential problems they may pose and should be considered and treated as "core" rather than "non-core" funding.

Sincerely,

[redacted]

Patrick J. Laughlin
Chief Compliance Officer
Kasasa, Ltd.