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NAIB
National Association of Industrial Bankers

UTAH BANKERS
ASSOCIATION

November 21, 2024

Federal Deposit Insurance Corporation
550 17th St NW
Washington, DC 20429
Attention: James P Sheesley, Assistant Executive Secretary

RIN 3064-AF99

Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

Ladies and Gentlemen:

We appreciate the opportunity to submit the following comments on the proposed amendments to 12 CFR Parts 303 and 337 described in RIN 3064-AF99, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (Proposed Rule).

This comment was submitted by the National Association of Industrial Bankers (NAIB)[1], the Utah Bankers Association (UBA)[2] and the Nevada Bankers Association (NBA)[3]. The views expressed in this letter represent the views of our members. Our member banks have a significant interest in the proposed amendments and in the laws and regulations governing brokered deposits generally. Many of our members utilize brokered deposits. They understand the markets where those deposits originate and have a strong record of managing the risks in relying on those deposits.

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[1] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in Nevada and Utah.

[2] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

[3] Nevada Bankers Association is the united voice of Nevada's diverse banking industry: our members are dedicated to providing the best financial products, services and resources to drive and support economic growth, job creation and prosperity throughout the state of Nevada.

The efficient operation of all banks depends to a degree on consistent and carefully crafted regulations. Regulatory standards that change frequently or for reasons unrelated to operational factors and risks can be unnecessarily disruptive. Our comments are directed to the reasonableness and fairness of the proposed amendments from a business and public policy perspective.

Recommendation

For the reasons stated below, we urge the FDIC to withdraw the Proposed Rule. It is arbitrary, capricious and exceed the FDIC's delegated authority. It fails to address any risk or problem that has developed since the last revisions to the regulations in 2020. The Proposed Rule is intended to effectively repeal, and not implement, federal laws authorizing the use of brokered deposits and the development of branchless banks. It is anti-innovation and conflict with the natural development of the nation's financial services market. The Proposed Rule is likely to result in litigation that will erode confidence in the banking industry and the regulatory system.

On August 21, 2024, NAIB and several other national trade associations submitted a comment letter to the Proposed Rule requesting the Proposed Rule be withdrawn and additional time for analysis and public comment. While we appreciate the additional 30 days for public comment, the arguments and concerns raised in the August 21 letter persist. Rather than repeat those arguments and concerns here, we wish to incorporate them by reference. In addition, others, such as the American Bankers Association, the Bank Policy Institute, and the Securities Industry and Financial Markets Association, will submit additional comments regarding the failure of the Proposed Rule to address the underlying procedural and substantive flaws in the Proposed Rule. We wish to associate ourselves with those comments as well.

The History of Brokered Deposits

Brokered deposits began during the 1980s when the national economy suffered from stagflation. Depository institutions that held large amounts of long-term credits, especially savings and loans that held mostly mortgages, were failing due to inflationary pressures on deposit rates. Many of those banks and thrifts tried to grow out of their problems using the newly available brokered deposits to fund new shorter term credits. To attract these deposits the banks had to pay above market rates. In many cases, that only increased losses for the deposit insurers when the banks and thrifts failed, often due to high losses among the new loans.

Congress addressed this problem in 1989 by passing Section 29 of the Federal Deposit Insurance Act, 12 U.S.C. 1831f. It prohibits a bank from taking brokered deposits if it is not well capitalized but permits the FDIC to allow brokered deposits for a bank that is adequately capitalized on a case-by-case basis.

Since the enactment of Section 29, brokered deposits have developed into a stable and cost-effective source of deposits offering a degree of safety comparable to government securities. Rates on brokered CDs now generally track government securities. CD contracts prohibit early withdrawal unless the depositor dies or is placed in the care of a conservator. That makes brokered CDs effectively “run proof”.

Rates on brokered CDs are often higher than CDs offered directly at a branch, but the cost savings from not having branches more than offsets the difference, making brokered CDs a lower net cost of funding for a branchless bank. This is true even for some banks with branches. Over 80% of brokered deposits are held at the largest national banks, which also issue over 80% of the nation’s credit cards. Those credit card operations essentially operate as branchless divisions within the bank.

Today, brokered deposits are used by community and commercial banks mostly to fill gaps in balance sheets or liquidity when loan demand rises, or unusually high withdrawals occur. A big advantage of brokered deposits is match funding. Core deposits flow in and out of a bank with branches for reasons not connected to loan demand. Core deposits come in when customers have extra money and are withdrawn when they have bills to pay. Loan demand varies with local economic activity. That requires additional liquidity to pay withdrawals and fund new loans. In contrast, brokered deposits can be directly linked to loan demand. They can be obtained when needed to fund a loan and the terms of a CD can be matched to the loan to lock in profitability and eliminate rate risk. It is the financial equivalent of real time inventory management.

Another advantage is the deposits are “run proof”. The problem that arose in the 80s when brokered deposits were “hot” money that would move if the bank did not pay top of the market rates no longer exists. Brokered deposit cannot be withdrawn until the CD matures except in certain hardship cases. The risk of a classic bank run remains only for banks with core deposits. That happened in several recent bank failures such as Silicon Valley Bank, which failed due to a run by largely uninsured depositors fueled by rumors on social media. There have been no instances of a run on brokered deposits or a disruption in the supply of brokered deposits for banks that rely on them.

These advantages are crucially important to banks delivering products and services electronically to national and international markets. Credit card issuers, for example, cannot compete on rates and rewards if they rely on core deposits for funding. That is why most community banks outsource credit card programs and only offer them as an accommodation to customers.

Despite the advantages and stability of brokered deposits today, the current chairman of the FDIC has a deeply held bias against brokered deposits. He has not discussed that publicly or even acknowledged he holds these views, even in response to Congressional inquiries. During periods when he has served as Chairman over the past 17 years, he has consistently blocked applications when the proposed bank would rely on brokered deposits. This is a de facto policy, implemented surreptitiously, although in some instances applicants were told by regional officials that using brokered deposits would not be approved under any circumstances. The subterfuge in implementing these policies violates federal administrative laws and implies that the Chairman understands that this policy would not pass muster if vetted through public disclosure and comment, as required by law, and undermines Congressional intent that expressly allows branchless banks to qualify for deposit insurance and banks to use brokered deposits.

The Chairman's only attempt to justify this biased policy is publishing studies that purport to show banks using brokered deposits are more likely to fail and cause losses for the FDIC insurance fund. These studies utilize regression analysis and coefficients that are not used in any other regulatory context and are gibberish to most bankers and people. More to the point, the findings of these studies are flatly contradicted by the FDIC's own data on actual failures. That data shows the 530 bank failures that occurred between 2007 and 2017 were almost entirely concentrated in commercial banks with branches that held mostly or only core deposits. More than half of those banks held no brokered deposits. Another 45% held mostly core deposits. 33, representing 6% of the failed banks, held a majority of brokered deposits but also held substantial amounts of core deposits and of those only two held more than 90% brokered deposits.

These studies are spurious and misleading. They could not identify any specific causal link between failure and holding brokered deposits. The studies ultimately speculate it must be the case that anyone reckless enough to use brokered deposits must be reckless with everything else including lending, which is absurd and wholly at odds with the FDIC's own data. There has never been an instance of runs on brokered In comparison while there is a well-known risk of runs on core deposits. Core deposits clearly pose the greater risk If there is any correlation between deposits and failure.

The last changes in the regulations governing brokered deposits were adopted in January 2021. Since that time, no problems or losses involving brokered deposits have happened that justify or explain the proposed amendments.

The Proposed Rule

The Proposed Rule is designed to further impede the use of brokered deposits. It significantly alters the FDIC's brokered deposit framework adopted in 2020 without sufficient and transparent data or robust policy rationale. The Proposed Rule relies on a 2011 study that was updated in 2019, both were available and considered during the 2021 rulemaking. No legislative changes or market developments justify the significant revision of the current rule on brokered deposits that was adopted in 2020. The only change was in the chairmanship of the FDIC.

In June of this year, the US Supreme Court overturned *Chevron v. National Resources Defense Council*, specifically and finally removing the deference to administrative agencies. In the *Loper Bright Enterprises v. Raimondo*, the Court raised concerns with the type of whipsaw effect that the Proposed Rule would have on regulated industries and the public if federal agencies were able to reinterpret the underlying law and implementing regulations based solely on the change of the political leadership of the agency.

Two of the proposed changes to the brokered deposit regulations exemplify their arbitrary nature. One is the change in the percentage of assets under management that serves as a guideline for exempting asset administrators under the primary purpose exemption (PPE). Another is changing the process for an asset manager to qualify for the PPE. Both changes would significantly limit the application of this statutory exemption.

The PPE is set forth in Section 29. It excludes a program administrator from the definition of a deposit broker if depositing money it controls into insured deposits is secondary to the primary purpose for that program. It comes at the end of a list of specific program exemptions such as retirement programs and health savings accounts. The PPE is clearly intended to capture other programs whose primary purpose is not making deposits into insured accounts. The current regulation says a program presumably qualifies for the exemption if it places fewer than 25% of the assets it manages into deposits, a standard adopted in the 2021 amendments.

The Proposed Rule would reduce the qualifying percentage to 10%, which would effectively nullify the exemption in most cases. The problem is that the placement of money into deposits can vary with market conditions. In a growing economy more funds are likely to be invested into stocks and other higher risk assets then "flee to safety" of deposits in a downturn. To avoid disrupting the overall program, the percentage of deposited money cannot ever exceed 25% so deposits need to stay well below that limit in the normal course. Decreasing that percentage to 10% would virtually eliminate the deposit option, at least for banks that are not well capitalized, regardless of the primary purpose for that program. More to the point, that would effectively repeal the PPE exemption even though Congress expressly intended such programs to be exempt.

The Proposed Rule would also change the procedure for a program to obtain a designation as exempt under the PPE. Currently, a program can apply to be designated as exempt and can then deposit its beneficiaries' money in any bank. The amendment would eliminate that process and instead require each bank to apply for advance approval for that depositor. This makes no sense when the deciding factor is the *depositor's primary purpose*. That has nothing to do with the bank holding the deposit. How could a depositor be exempt for one bank but not exempt for another? Its apparent purpose is to delay making deposits at a new bank and subject applicants to one of the current chairman's preferred ways to surreptitiously block things, which is to just delay or never give approval.

Other proposed changes are designed to expand the scope of what qualifies as brokered to further restrict the use of deposits that are not directly placed by a customer at a branch. Elimination of the "placing" and "facilitating" prongs is an example. It would also add to the definition of a "deposit broker" "a person who proposes or determines deposit allocations, including through the operation or use of an algorithm." These are designed to capture deposits that do not otherwise qualify as brokered if the depositor uses a consultant or program to recommend the best banks for their deposits. Some might call that capitalism.

These changes are not in the interest of depositors or banks. As the markets innovate and evolve, restricting deposits only forces the money out of the banking system into places that are riskier and less stable. The main benefit of the banking system is how it stabilizes the economy, and the FDIC's primary role is to stabilize the banking system. Driving people out of the banking system is antithetical to that mission.

For these reasons as well as those in our August 21 letter, we urge the FDIC to withdraw the Proposed Rule. Once the Proposed Rule is withdrawn, we welcome the opportunity to work with the FDIC to address any substantive concerns the agency has with the current rule on brokered deposits that are supported by actual marketplace data and experience.

Again, we appreciate the opportunity to submit these comments for the record. Please let us know if you have any questions or need additional information.

Sincerely,

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