U.S. Chamber of Commerce

Washington, DC 20062-2000
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James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429

Re: Request for Comment on Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions – RIN: 3064-AF99

Dear Assistant Executive Secretary Sheesley:

The U.S. Chamber of Commerce (the "Chamber") Center for Capital Markets Competitiveness submits these comments in response to the Federal Deposit Insurance Corporation's (the "FDIC") proposed revisions to the brokered deposits framework, entitled Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (the "Proposal").

The Chamber believes the FDIC fails to articulate the need for updates to the current regulatory framework for brokered deposits. Additionally, the FDIC does not provide data to support the changes outlined in the Proposal. A federal court would likely find this rulemaking to be arbitrary and capricious if not supported by a clear rationale and supporting data.[1] Additionally, the Commission should not engage in promulgating Midnight Regulations and pause the current proceeding until the next presidential administration.

The most recent revisions to the brokered deposits regulations are only four years old and have not manifested a threat to the stability of insured depository institutions ("IDIs") or the broader financial system. In fact, altering the regulatory regime would cause significant disruptions to IDIs' current deposit structure and existing business relationships. The Proposal would significantly increase the number of deposits that are considered brokered and increase the operational burden associated with the framework, which would make it more difficult and costly for well-capitalized IDIs to accept a range of deposits. The result would be significant changes to a range of deposit relationships and, by extension, the ability for customers to access valuable financial services. Additionally, the Proposal would result in higher funding costs for all products and services, further harming IDIs' ability to support the needs of their customers. The Chamber is concerned that the FDIC has not studied the potential negative consequences the Proposal would have on IDIs, their customers, and the American economy.

<u>Background</u>

[1] https://uscode.house.gov/view.xhtml?req=granuleid:USC-2000-title5-section706&num=0&edition=2000

The Chamber commented on the brokered deposit rule finalized in 2020 (herein, the "2020 rule"), stating that, we "believe[] it will make important updates to the brokered deposit framework reflecting recent innovations in our modern financial system and make it easier for financial companies to meet the evolving needs of consumers."[2] For example, online banking and mobile payment products have revolutionized how and where banks gather deposits and engage with their customers. Some banks now operate exclusively online or have fintech subsidiaries that provide deposit accounts to both consumers and small businesses. The 2020 rule updates appropriately captured and considered the new landscape of the American financial system, while appropriately protecting the safety and soundness of the banking system.

Unfortunately, the Proposal would undo many of the important reforms from the 2020 rule and result in an array of stable deposits being treated as brokered under the FDIC's regulations, without adequate, evidence-based justification for this treatment. The FDIC should recognize that fostering a strong relationship between banks and their customers necessitates offering a wide range of integrated and convenient products and services, which may be aided by technological solutions and third-party relationships. The 2020 rule helped strengthen these relationships and offered consumers benefits through increased access to the banking system. However, the Proposal, much like the brokered deposit regime in place before the 2020 rule, would hinder financial institutions' ability to deliver high quality services for consumers.

Discussion

Lack of Rationale

The FDIC does not offer a clear rationale for why it is proposing to update the regulations governing brokered deposits. The current regulatory construct is working as intended and provides clarity and stability to IDIs and their customers. The Proposal fails to consider the 2020 rule and the FDIC's rationale for adopting it. Furthermore, the FDIC does not explain its change in policy. For instance, the Proposal cites a decrease in deposits that are classified as brokered but does not clarify why these deposits should be considered brokered. Instead of addressing the rationale from the 2020 rule, the Proposal often refers to the FDIC's experience or perceived confusion among institutions, without explaining its disagreement with the classification of certain deposits as brokered or not brokered. As another example, in proposing to replace the current "25 percent test"—a critical designated business exception for many stable deposit arrangements—with a new "Broker-Dealer Sweep Exception" ("BDSE"), the FDIC makes the conclusory argument that "placing less than 10 percent of customer funds at IDIs would be more indicative that the primary purpose for broker dealers and investment advisers in placing customer funds at IDIs is to temporarily safe-keep customer free cash balances . . . that are awaiting reinvestment." Rather than providing any true rationale for concluding that 10 percent of assets is a more suitable threshold than 25 percent to

[2] https://www.uschamber.com/assets/documents/ccmc/6.9.20_CCMC_BrokeredDeposits_FDIC.pdf

demonstrate a primary purpose of placing deposits, the FDIC relies upon an unsupported assertion to justify the BDSE.

Chairman Martin Gruenberg's comments regarding the Proposal underscore the nebulous, perception-based approach to the rulemaking: "More recent events have also underscored the uncertain nature of third-party funding arrangements. Experience has shown they can be highly unstable, with either the third party or the underlying customers moving funds based on market conditions or other factors." [3] If it is the case that deposits which should be classified as brokered are impacting stability and introducing abnormally high risk to IDIs, then the FDIC should be able to provide concrete examples of where this is taking place. Additionally, Chairman Gruenberg cites the failures of Silicon Valley Bank and First Republic Bank as a result of runs on uninsured deposits, but none of the FDIC's reports on the failures implicated brokered deposits as a cause of these failures.[4] Instead of providing a rigorous, evidence-based explanation for the Proposal, Gruenberg offers mere innuendo and false equivalency to make changes to a rule that he objected to four years ago. [5]

By contrast, the 2020 rule was a result of a deliberative process comprising an advanced notice of proposed rulemaking, a study of core and brokered deposits, and two opportunities for public comment. Additionally, in the 2020 rule, the FDIC explained amendments to brokered deposit regulation, addressed public comments and outlined expected impacts of the rule. This thorough process is a far cry from the haphazard rulemaking exhibited by the current Proposal.

Lack of Data

Unlike the 2020 final rule, the Proposal does not provide data to support changes to the brokered deposit regulations. If it is necessary to update a rule that is only 4 years old, the FDIC should provide new data to support the relatively sudden change in policy. The FDIC should provide data that shows the number of deposits that would be considered brokered under the new rule as well as data showing that reclassifying those deposits would be responsive to a change in their risk profile and reflect the stability of deposits at IDIs.

FDIC Director Jonathan McKernan raised similar concerns regarding the Proposal in stating, "This proposal does a good job of marshalling evidence of the risks posed by brokered deposits. The proposal does not, however, offer any evidence that some of the deposits that this proposal would re-classify as brokered deposits actually present the same or similar risks." [6] Director McKernan goes on to write, "…it is important that the FDIC make a case for its rulemakings." The Chamber agrees with this statement and believes any proposed rule should

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[3] https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corpoation

[4] https://www.americanbanker.com/opinion/there-is-no-need-for-the-fdic-to-tinker-with-its-brokered-deposits-rule

[5] https://www.fdic.gov/news/speeches/2020/spdec1520f.html

[6] https://www.fdic.gov/news/speeches/2024/statement-jonathan-mckernan-director-fdic-board-directors-proposed-brokered

be buttressed by sound rationale and supporting data. The Proposal does not meet that standard and, in the Chamber's view, is arbitrary and capricious. [7]

As a further example, Chairman Gruenberg claims that, under the current rule, a bank could rely for 100% of its deposits on a sophisticated, unaffiliated third party without any of those deposits considered brokered.[8] However, he provides no examples of this happening in practice.

The FDIC is relying on anecdotes and perception to guide policymaking instead of presenting data that supports the necessity of the rule and allows for public discourse regarding the benefits and costs of changing brokered deposits regulation.

Disruption of the Current Regime and Negative Impacts to the Financial System

The Proposal would disrupt IDIs' current deposit structure and existing business relationships. If the Proposal is implemented, banks would need to significantly adjust their strategies and operations. These disruptions will not only affect the individuals and businesses the IDIs serve but also could have an impact on the safety and efficiency of the financial system as a whole. By drastically altering the regulatory framework for brokered deposits, the FDIC is injecting unnecessary uncertainty into the banking system while disregarding the significant changes to the marketplace that have occurred since the 1980s.

A third party, such as small business or non-profit, might have an existing banking relationship with an IDI. This third party could refer depositors to the IDI and receive a small referral fee in return. These referrals are based on the broader banking relationship between the third party and the IDI, not because the third party is in the business of facilitating deposit placements. Once the depositor establishes a relationship with the IDI, the third party is no longer involved in the depositor's ongoing banking activities. In these arrangements, the deposits and the relationship between the depositor and the IDI do not exhibit the attributes of what are understood to be brokered deposits. Specifically, the third party cannot move the deposits to another IDI. Additionally, the depositor has no incentive to move their deposits based on fees paid to the third party by the IDI, but the Proposal would consider the fees received by the third party as tantamount to engaging in the business of facilitating the placement of deposits, thereby classifying the third party as a deposit broker. This simply does not make sense and would discourage these third-party arrangements and could potentially reduce the number of new deposits for IDIs with these relationships.

Notably, the Proposal would shift much of the operational burden of the brokered deposit framework to IDIs by requiring IDIs to submit notices and applications for the primary

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[7] https://uscode.house.gov/view.xhtml?req=granuleid:USC-2000-title5-section706&num=0&edition=2000
[8] https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corpoation

purpose exception. This change will further increase the complexity and costs associated with the brokered deposits regulations.

By increasing the costs and complexity associated with IDIs accepting a variety of deposit types, the Proposal would harm consumers that benefit from safe options to hold their funds in IDIs. For example, many retail investors rely on sweep arrangements between broker-dealers and IDIs to temporarily hold uninvested cash in deposit accounts. However, by expanding the deposit broker definition, narrowing the available exceptions, and increasing the operational complexity of obtaining an exception, the Proposal would make it more difficult and costly for well-capitalized IDIs to accept sweep deposits – even though such arrangements are a stable source of funding for IDIs.

Increased costs and complexity introduced by the Proposal would also disproportionately hurt smaller, community banks. Brokered deposits are typically used by smaller institutions to manage liquidity and fund growth. Increased costs via stricter regulation on brokered deposits will limit their ability to attract these deposits and force smaller banks to pursue more expensive funding sources. Increasing the cost to use brokered deposits could also put smaller institutions at a competitive disadvantage relative to their larger peers, who have more access to more diversified funding sources. A decrease in competition for smaller institutions could result in more consolidation in the financial services industry.

The higher costs of deposits that result from the Proposal may reduce banks' lending activities. Again, this will be particularly acute for smaller, community banks. As the Chamber has previously noted, small and midsized banks are "important providers of financial services for small and medium-sized business and collateralized deposits for local governments and nonprofits."[9] Additional strain on smaller IDIs will inevitably affect small businesses and the customers they serve in the form of increased costs on loans and lines of credit. Increased costs on lending services will certainly be a drag on economic growth and will limit inclusion for customers with less-than-ideal credit. Additionally, if banks are not able to use certain deposits in the same way as under the current regime, they may offer customers lower interest rates. This would negatively impact individuals who are relying on interest income as a part of their savings plan.

Conclusion

The FDIC fails to provide a sound rationale as to why changes to the current brokered deposit regulatory regime should be updated. The FDIC also does not provide data supporting its claims that the current rule is insufficient for managing the risk that brokered deposits pose to the stability of IDIs and the financial system. Due to its lack of sound rationale, the absence of supporting data, and the harmful consequences, the Chamber urges the FDIC to withdraw this Proposal.

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[9] https://www.uschamber.com/assets/documents/240617_USChamber_Comments_SOPBankMerger_FDIC_RIN-3064-ZA31.pdf

Sincerely,

Bill Hulse
Senior Vice President
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U.S. Chamber of Commerce