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FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 337

Interest Rate Restrictions on Institutions That Are Less Than
Well-capitalized
Notice of Proposed Rulemaking

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice of proposed rulemaking.

SUMMARY: The FDIC is proposing to amend its regulations relating to the interest rate restrictions that apply to insured depository institutions that are not well capitalized. Under the proposed rule, such insured depository institutions generally would be permitted to offer the "national rate" plus 75 basis points. The "national rate" would be defined, for deposits of similar size and maturity, as an average of rates paid by all insured depository institutions and branches for which data are available. For those cases in which the "national rate" does not represent the prevailing rate in a

particular market, as indicated by available evidence, the depository institution would be permitted to offer the prevailing rate plus 75 basis points.

The purpose of this proposed rule is to clarify the interest rate restrictions for certain insured depository institutions and examiners.

DATES: Written comments must be received by the FDIC no later than [insert date 60 days after publication in the Federal Register].

ADDRESSES: You may submit comments by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Agency Web Site: <http://www.fdic.gov/regulations/laws/federal>. Follow the instructions for submitting comments.
- E-mail: Comments@FDIC.gov. Include "Part 337–Interest Rate Restrictions" in the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

- Hand Delivery/Courier: Comments may be hand-delivered to the guard station located at the rear of the FDIC's 550 17th Street building (accessible from F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: Submissions must include the agency name (FDIC) and also must use the title "Part 337-Interest Rate Restrictions." All comments generally will be posted without change (including any personal information) on the agency's Web Site at:

<http://www.fdic.gov/regulations/laws/federal/propose.html>.

Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATION CONTACT: Louis J. Bervid, Senior Examination Specialist, Division of Supervision and Consumer Protection, (202) 898-6896 or lbervid@fdic.gov; or Christopher L. Hencke, Counsel, Legal Division, (202) 898-8839 or chencke@fdic.gov, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Section 29 of the Act

Section 29 of the Federal Deposit Insurance Act ("FDI Act") provides that an insured depository institution that is not well capitalized may not accept deposits by or through deposit brokers. See 12 U.S.C. 1831f(a). Notwithstanding this prohibition, section 29 also provides that an adequately capitalized institution may accept brokered deposits if it obtains a waiver from the FDIC. See 12 U.S.C. 1831f(c). In contrast, an undercapitalized institution may not accept brokered deposits under any circumstances. See 12 U.S.C. 1831f(a) and (c).

The purpose of section 29 generally is to limit the acceptance or solicitation of deposits by insured depository institutions that are not well capitalized. This purpose is promoted through two means: (1) the prohibition against the acceptance of brokered deposits by depository institutions that are less than well capitalized (as described above); and (2) certain restrictions on the interest rates that may be paid by such institutions. In enacting section 29, Congress added the interest rate restrictions to prevent such institutions from avoiding the prohibition against the acceptance of brokered deposits by soliciting deposits internally through "money desk operations." Congress viewed the gathering of deposits by

weaker institutions through either brokers or "money desk operations" as potentially an unsafe or unsound practice. See H.R. Conf. Rep. No. 101-222 at 402-403 (1989), *reprinted in* 1989 U.S.C.C.A.N. 432, 441-42.

Section 29 imposes interest rate restrictions on different categories of insured depository institutions that are less than well capitalized: (1) adequately capitalized institutions with waivers to accept brokered deposits; (2) adequately capitalized institutions without waivers to accept brokered deposits; and (3) undercapitalized institutions. The statutory restrictions for each category are described in detail below.

Adequately capitalized institutions with waivers to accept brokered deposits. Institutions in this category may not pay a rate of interest on deposits that "significantly exceeds" the following: "(1) the rate paid on deposits of similar maturity in such institution's normal market area for deposits accepted in the institution's normal market area; or (2) the national rate paid on deposits of comparable maturity, as established by the [FDIC], for deposits accepted outside the institution's normal market area." 12 U.S.C. 1831f(e).

In this category, an institution must adhere to (or not "significantly exceed") the prevailing rates in its own "normal market area" only with respect to deposits accepted from that market area. For other deposits, the institution is permitted to offer (but not "significantly exceed") the "national rate" established by the FDIC. Thus, an institution in this category is not permitted to outbid local institutions for local deposits but is permitted to compete with non-local institutions for non-local deposits.

Adequately capitalized institutions without waivers to accept brokered deposits. In this category, institutions may not offer rates that "are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in such depository institution's normal market area." 12 U.S.C. 1831f(g)(3). In other words, the institution must adhere to the prevailing rates in its own "normal market area" for *all* deposits (whether local or non-local). Thus, the institution will be unable to compete with non-local institutions for non-local deposits unless the rates in the institution's own "normal market area" are competitive with the non-local rates.

For institutions in this category, the statute restricts interest rates in an indirect manner. Rather than simply setting forth an interest rate restriction for adequately capitalized institutions without waivers, the statute defines the term "deposit broker" to include "any insured depository institution that is not well capitalized . . . which engages, directly or indirectly, in the solicitation of deposits by offering rates of interest which are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in such depository institution's normal market area." 12 U.S.C. 1831f(g)(3). In other words, the depository institution itself is a "deposit broker" if it offers rates significantly higher than the prevailing rates in its own "normal market area." Without a waiver, the institution cannot accept deposits from a "deposit broker." Thus, the institution cannot accept these deposits from itself. In this indirect manner, the statute prohibits institutions in this category from offering rates significantly higher than the prevailing rates in the institution's "normal market area."

Undercapitalized institutions. In this category, institutions may not offer rates "that are significantly higher than the prevailing rates of interest on insured deposits (1) in such institution's normal market areas; or (2) in the market area in

which such deposits would otherwise be accepted." 12 U.S.C. 1831f(h). Thus, for deposits in its own "normal market area," an undercapitalized institution must offer rates that are not "significantly higher" than the local rates. For non-local deposits, the institution must offer rates that are not "significantly higher" than *either* of the following: (1) the institution's own local rates; or (2) the applicable non-local rates. In other words, the institution must adhere to the prevailing rates in its own "normal market area" for *all* deposits (whether local or non-local) and *also* must adhere to the prevailing rates in the non-local area for any non-local deposits. Thus, the institution will be unable to outbid non-local institutions for non-local deposits even if the non-local rates are lower than the rates in the institution's own "normal market area."

As described above, section 29 of the FDI Act imposes interest rate restrictions based on a depository institution's capital category (and whether the depository institution has obtained a waiver to accept brokered deposits). Also, section 29 authorizes the FDIC to "impose, by regulation or order, such additional restrictions on the acceptance of brokered deposits by any institution as the [FDIC] may determine to be appropriate." 12 U.S.C. 1831f(f). This broad grant of

authority does not refer to capital categories. Thus, the FDIC could adopt additional restrictions on the acceptance of brokered deposits without regard to capital categories. To date, the FDIC has not adopted any such additional restrictions, but the FDIC is interested in obtaining comments on whether the adoption of such restrictions would be appropriate.

II. Section 337.6 of the FDIC's Regulations

The FDIC has implemented section 29 of the FDI Act through section 337.6 of the FDIC's regulations. See 12 CFR 337.6. Section 337.6 adds several significant definitions to the statutory rules, including the following: (1) the "national rate" is defined; (2) the terms "significantly exceeds" and "significantly higher" are defined; and (3) the term "market area" is defined. Each of these definitions, and the reasoning behind the definitions, are discussed in greater detail below.

The "National Rate." In section 337.6, the "national rate" is defined as follows: "(1) 120 percent of the current yield on similar maturity U.S. Treasury obligations; or (2) In the case of any deposit at least half of which is uninsured, 130 percent of such applicable yield." 12 CFR 337.6(b)(2)(ii)(B). In

defining the "national rate" in this manner, the FDIC relied upon the fact that such a definition is "objective and simple to administer." 57 FR 23933, 23938 (June 5, 1992). By using percentages (120 percent or 130 percent of the yield on U.S. Treasury obligations) instead of a fixed number of basis points, the FDIC hoped to "allow for greater flexibility should the spread to Treasury securities widen in a rising interest rate environment." *Id.* In deciding *not* to rely on published deposit rates, the FDIC offered the following explanation: "The FDIC believes this approach would not be timely because data on market rates must be available on a substantially current basis to achieve the intended purpose of this provision and permit institutions to avoid violations. At this time, the FDIC has determined not to tie the national rate to a private publication. The FDIC has not been able to establish that such published rates sufficiently cover the markets for deposits of different sizes and maturities." *Id.* at 23939.

"Significantly Exceeds." Through section 337.6, the FDIC has provided that a rate of interest "significantly exceeds" another rate, or is "significantly higher" than another rate, if the first rate exceeds the second rate by more than 75 basis points. See 12 CFR 337.6(b)(2)(ii), (b)(3)(ii) and (b)(4). In adopting this standard, the FDIC offered the following explanation:

"Based upon the FDIC's experience with the brokered deposit prohibitions to date, it is believed that this number will allow insured depository institutions subject to the interest rate ceilings . . . to compete for funds within markets, and yet constrain their ability to attract funds by paying rates significantly higher than prevailing rates." 57 FR at 23939.

"Market Area." Section 337.6 defines "market area" as follows: "A market area is any readily defined geographical area in which the rates offered by any one insured depository institution soliciting deposits in that area may affect the rates offered by other insured depository institutions operating in the same area." 12 CFR 337.6(b)(4). In adopting this definition, the FDIC offered the following explanation: "Under the final rule, the market area will be determined pragmatically, on a case-by-case basis, based on the evident or likely impact of a depository institution's solicitation of deposits in a particular area, taking into account the means and media used and volume and sources of deposits resulting from such solicitation." 57 FR at 23939.

These rules and definitions in section 337.6 have been difficult for insured depository institutions and examiners to apply. One issue is that section 337.6 defines "market area" but does not

define "normal market area."¹ The latter term could be defined with reference to a depository institution's location (such as the location of the main office or the location of branches); in the alternative, the term might be defined with reference to a depository institution's marketing practices. Under these circumstances, institutions and examiners have struggled to determine "normal market areas."

The problem with defining "normal market area" can be illustrated by an example. Two insured depository institutions might maintain offices in the same area but have vastly different deposit gathering strategies. The first institution might concentrate on obtaining deposits from the local area; in contrast, the second institution might focus on a much wider area and each would tailor its rates to the deposits being solicited.

This uncertainty has made it difficult for banks and regulators to administer the regulation. Also, this uncertainty appears to have resulted in the payment of high rates by less than well capitalized banks. For example, based on the most recent information currently available, the average 1-year certificate of deposit rate paid by less than well capitalized banks was

¹ Prior to 1992, the term "normal market area" was defined in a footnote in section 337.6. Under this definition, a depository institution's "normal market area" depended upon the institution's advertising practices in soliciting deposits. See 12 CFR 337.6(a)(1)(ii) (1992) (footnote 11).

2.87 while the average 1-year certificate of deposit rate paid by all insured banks and branches over the same period for which the FDIC had data was 2.18 percent. In paying these rates, the banks have argued that such rates prevail in their "normal market areas."

Another issue is that the definition of the "national rate" is outdated. As discussed above, the "national rate" is defined as "120 percent of the current yield on similar U.S. Treasury obligations" (or 130 percent in the case of a deposit "at least half of which is uninsured"). 12 CFR 337.6(b)(2)(ii)(B). In the past, this definition functioned well because rates on Treasury obligations tracked closely with rates on deposits. At present, however, the rates on Treasury obligations are low compared to deposit rates. Consequently, the "national rate" as defined in the FDIC's regulations is artificially low. For example, at January 4, 2009, the "national rate" as computed under section 337.6 for 1-year certificates of deposits was 0.48 percent while the average 1-year certificate of deposit rate paid by all insured banks and branches for which the FDIC had data was 1.95 percent. By setting a low rate, the FDIC's regulations require some insured depository institutions to offer unreasonably low rates on some deposits, thereby restricting access even to market-rate funding.

In response to these issues, the FDIC has decided to seek public comments on a proposed rule. The purpose of the proposed rule would be to provide insured depository institutions and examiners with a clear method for determining the highest permissible interest rates for those institutions that become less than well capitalized. Below, the operation of the proposed rule is explained in detail.

III. The Proposed Rule

The proposed rule would amend three paragraphs of section 337.6. Each of these paragraphs is discussed in turn below.

Paragraph 337.6(a)(5)(iii). At present, this paragraph provides that the term "deposit broker" includes "any insured depository institution that is not well capitalized, and any employee of any such insured depository institution, which engages, directly or indirectly, in the solicitation of deposits by offering rates of interest (with respect to such deposits) which are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in such depository institution's normal market area." 12 CFR 337.6(a)(5)(iii). This provision in the regulations is based

upon corresponding language in the statute itself. See 12 U.S.C. 1831f(g)(3). As previously discussed, the effect of this provision is to prohibit adequately capitalized insured depository institutions from offering rates of interest significantly higher than the prevailing rates in the institution's normal market area.

Through the proposed rule, the FDIC would add the following sentence: "For purposes of this paragraph, the prevailing rates of interest in such depository institution's normal market area shall be deemed to be the national rate as defined in paragraph (b)(2)(ii)(B) unless the FDIC determines, based on available evidence, that the prevailing rates differ from the national rate." This amendment would serve the purpose of providing depository institutions and examiners with a clear method for determining the highest permissible interest rates. For example, the boundaries of a particular depository institution's normal market area might be unclear. Further, insufficient evidence might be available as to the prevailing rates.

Paragraph 337.6(b)(2)(ii)(B). At present, this paragraph defines the national rate as follows: "(1) 120 percent of the current yield on similar maturity U.S. Treasury obligations; or (2) In the case of any deposit at least half of which is

uninsured, 130 percent of such applicable yield." For the reasons previously explained, the FDIC believes that this definition is outdated. Through the proposed rule, the national rate would be redefined as "a simple average of rates paid by all insured depository institutions and branches for which data are available."

For the convenience of insured depository institutions and examiners, the FDIC would monitor the rates paid by insured depository institutions and use this data to calculate the "national rate." Again, the national rate would be the average rate on deposits of similar size and maturity.

Paragraph 337.6(b)(4). This paragraph defines the effective yields or prevailing rates in relevant markets. At present, this paragraph provides as follows: "For purposes of the [interest rate restrictions in section 337.6], the effective yields in the relevant markets are the average of effective yields offered by other insured depository institutions in the market area in which deposits are being solicited." In addition, this paragraph defines "market area" as follows: "A market area is any readily defined geographical area in which the rates offered by any one insured depository institution soliciting deposits in that area may affect the rates offered by

other insured depository institutions operating in the same area."

Though "market area" is defined, paragraph 337.6(b)(4) does not define "normal market area." As previously noted, depository institutions and examiners have struggled in determining both what is a "normal market area" and what are the effective yields or prevailing rates in that area. Through the proposed rule, the FDIC would address this problem by replacing the language quoted above (defining "effective yield") with the following: "For purposes of [the interest rate restrictions in section 337.6], a presumption shall exist that the effective yield in the relevant market is the national rate as defined in paragraph (b)(2)(ii)(B) unless the FDIC determines, based on available evidence, that the effective yield differs from the national rate."

In most cases, under the proposed rule, determining a permissible rate would involve a simple two-step process. First, the insured depository institution would determine the national rate simply by obtaining information from the FDIC. Second, the institution or examiner would add 75 basis points. In the absence of evidence that the applicable prevailing rate

differs from the national rate, this two-step procedure would yield a permissible rate.

The FDIC proposes to post the national rate for deposits of a particular size and maturity and also by posting the "rate cap" for such deposits. The "rate cap" would be the national rate plus 75 basis points. Using data available to the FDIC as of January 4, 2009, under this proposed rule, the FDIC would have published the following schedule of "national rates" and "rate caps." This table would be published on the FDIC Web site and updated weekly.

Deposit Products	National Rates	Rate Cap
Non-maturity Products	0.60	1.35
1 month CD	0.64	1.39
3 month CD	1.22	1.97
6 month CD	1.55	2.30
12 month CD	1.95	2.70
24 month CD	2.15	2.90

36 month CD	2.37	3.12
60 month CD	2.73	3.48

In those cases in which evidence exists that the average rate in a relevant market exceeds the national rate, the bank would be permitted to offer the higher average rate plus 75 basis points. In most cases, however, the FDIC expects that the highest permissible rate would be the national rate plus 75 basis points.

Through the proposed rule, the FDIC would not change its interpretation that an interest rate "significantly exceeds" a second rate, or is "significantly higher" than a second rate, if the first rate exceeds the second rate by more than 75 basis points.

In making this proposal, the FDIC has relied upon the fact that competition for deposits among insured depository institutions has grown increasingly national in scope. This competition is largely the product of improvements in technology as well as the growth of a number of insured depository institutions into nationwide businesses. Today, a consumer can compare interest rates around the country simply by checking certain Web sites. In light of this development, the FDIC has concluded that the

national rate (based on national averages) is a reasonable estimation of the prevailing rate in any market absent persuasive evidence to the contrary.

The proposed rule would permit insured depository institutions that are not well capitalized to determine the highest permissible interest rates on deposits more simply. Rather than gathering information on the rates offered by all depository institutions in a particular market area (after determining the boundaries of the relevant market area) to determine the relevant prevailing rate for purposes of comparison, the insured depository institution could simply compare its rate to the FDIC's national rate. Further, if the institution can demonstrate to the FDIC that the actual prevailing rate in the relevant market exceeds the "national rate," the institution would be permitted to offer the higher rate. By amending section 337.6 in this manner, the FDIC could simplify the interest rate restrictions while providing insured depository institutions with sufficient flexibility to respond to the market environment.

Request for Comments

The FDIC seeks comments on all aspects of the proposed rule. In particular, the FDIC requests comments on the following questions:

1. Should the FDIC amend its definition of a "market area"? Should the FDIC add a definition of "normal market area"? If so, what should be the definition of an insured depository institution's "normal market area"?
2. Should the FDIC create a presumption that the prevailing rate in any "market area" or "normal market area" is the national rate? If not, how should the FDIC determine the prevailing rate in a particular "market area" or "normal market area"?
3. Should the FDIC, in addition to publishing a "national rate" that can be used as a proxy for the "normal market area" rate, also provide a schedule that lists prevailing rates for maturities by state for those institutions soliciting deposits only in those states?
4. Should the FDIC redefine the "national rate"? If so, should the FDIC define the "national rate" as "a simple average of rates paid by all insured depository institutions and branches for which data are available"? If not, how should the FDIC define the "national rate"?

5. Should the definition of the "national rate" be made more flexible? For example, in the event of changes in market conditions, should the FDIC possess the discretion to add or remove a multiplier to the "national rate" (so that the "national rate" might be the "average of rates times 1.20" or some other multiplier)?
6. Should the FDIC set forth a specific procedure for determining average or prevailing rates? For example, should the FDIC specify that data may be obtained from one or more private companies as to the rates paid by insured depository institutions?
7. Should the FDIC establish a procedure for disseminating information about average rates or rate caps? For example, should the FDIC post such information on its Web site for use by insured depository institutions and examiners?
8. Should the FDIC establish a procedure through which an insured depository institution could present evidence about the prevailing or average rates in a particular market?
9. Under the FDIC's regulations, a rate of interest "significantly exceeds" another rate, or is "significantly higher" than another rate, if the first rate exceeds the

second rate by more than 75 basis points. Should the FDIC change this standard?

10. Should the FDIC adopt restrictions in addition to the current restrictions based on a depository institution's capital category?

Community Development and Regulatory Improvement Act

The proposed rule does not impose any new reporting or disclosure requirements on insured depository institutions under the Riegle Community Development and Regulatory Improvement Act.

Paperwork Reduction Act

The proposed rule does not involve any new collections of information under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*). Consequently, no information collection has been submitted to the Office of Management and Budget for review.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the FDIC certifies that the proposed rule will not have a significant impact on a substantial number of small entities. This conclusion is based upon the fact that the proposed rule would merely clarify the interest rate restrictions set forth in the Federal Deposit Insurance Act. The proposed rule would not impose any new restrictions. Indeed, under the proposed rule, the burden of complying with the interest rate restrictions would be eased because insured depository institutions that are not well capitalized (including any small entities) could rely on the "national rate" determined by the FDIC. In those cases in which the insured depository institution believes that the rates in its "normal market area" exceed the "national rate," the proposed rule would permit the institution to offer evidence of the "normal market area" rates just as the current rules permit institutions to offer evidence of "normal market area" rates.

Impact on Families

The FDIC has determined that the proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as

part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105-277, 112 Stat. 2681).

Plain Language

The FDIC has sought to present the proposed rule in a simple and straightforward manner. The FDIC invites comments on whether the rule could be written so that it is easier to understand.

List of Subjects in 12 CFR Part 337

Banks, Banking, Reporting and recordkeeping requirements, Savings associations, Securities.

For the reasons stated above, the Board of Directors of the Federal Deposit Insurance Corporation proposes to amend part 337 of title 12 of the Code of Federal Regulations as follows:

1. The authority citation for part 337 would continue to read as follows:

Authority: 12 U.S.C. 375a(4), 375b, 1816, 1818(a), 1818(b), 1819, 1820(d)(10), 1821(f), 1828(j)(2), 1831.

2. § 337.6(a)(5)(iii) would be amended to read as follows:

Notwithstanding paragraph (a)(5)(ii) of this section, the term *deposit broker* includes any insured depository institution that is not well capitalized, and any employee of any such insured depository institution, which engages, directly or indirectly, in the solicitation of deposits by offering rates of interest (with respect to such deposits) which are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in such depository institution's normal market area. For purposes of this paragraph, the prevailing rates of interest in such depository institution's normal market area shall be deemed to be the national rate as defined in paragraph (b)(2)(ii)(B) unless the FDIC determines, based on available evidence, that the prevailing rates differ from the national rate.

3. § 337.6(b)(2)(ii)(B) would be amended to read as follows:

The national rate paid on deposits of comparable size and maturity for deposits accepted outside the institution's normal market area. For purposes of this paragraph (b)(2)(ii)(B), the national rate, which would be calculated and published by the FDIC, shall be a simple average of rates paid by all insured depository institutions and branches for which data are available.

4. § 337.6(b)(4) would be amended to read as follows:

For purposes of the restrictions contained in paragraphs (b)(2)(ii)(A) and (b)(3)(ii) of this section, a presumption shall exist that the effective yield in the relevant market is the national rate as defined in paragraph (b)(2)(ii)(B) unless the FDIC determines, based on available evidence, that the effective yield differs from the national rate. An effective yield on a deposit with an odd maturity violates paragraphs (b)(2)(ii)(A) and (b)(3)(ii) of this section if it is more than 75 basis points higher than the yield calculated by interpolating between the yields offered by other insured depository institutions on deposits of the next longer and shorter maturities offered in the market. A market area is any readily defined geographical area in which the rates offered by

any one insured depository institution soliciting deposits in that area may affect the rates offered by other insured depository institutions operating in the same area.

Dated at Washington, D.C., this XX day of January, 2009.

Authorized to be published in the Federal Register by Order of the Board of Directors of the Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary.