Maryland Bankers Association

September 11, 2015

Submitted via Email: comments@fdic.gov.

Robert E. Feldman, Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Maryland Bankers Association—Comments on Proposed Rulemaking - RIN 3064-AE37

Dear Executive Secretary Feldman:

On behalf of our members, the Maryland Bankers Association (MBA) respectfully submits this letter commenting on the Federal Deposit Insurance Corporation's (FDIC) proposal to revise premium assessments for banks under $10 billion (RIN 3064-AE37).

Founded in 1896, MBA is the only Maryland-based trade group representing banks in the state. The 116 banks operating in Maryland hold in excess of $120 billion in FDIC-insured deposits in nearly 1,700 branches across the state. The banking industry employs more than 40,000 banking professionals in Maryland. MBA's members include banks of all sizes and charter types including: Maryland state-chartered banks, national banks and thrifts, and state banks chartered outside of Maryland. We appreciate your consideration of our concerns that are described on the following pages on this important rule change.

Proposed Rule Change

In short, the proposed system would eliminate the risk categories such that assessment rates for all banks under $10 billion would be based on the same formula. Under the proposal, a deterioration of a bank's capital ratio or supervisory rating is not expected to lead to a dramatic jump in its assessment rate, only a somewhat higher rate. The proposed system is calibrated so that it will be revenue neutral and thus not increase the amount of total assessments collected by the FDIC. However, as a result of the proposed changes, some banks will pay more and some banks will pay less.

MBA's General Concerns and Questions

MBA appreciates the thoughtful approach of the proposed rule change and the opportunity to comment. Based on MBA's communications with our member institutions, several issues of concern have been raised including:

- The proposal would elevate the importance of the leverage ratio to such a degree that even a small reduction in the ratio can have a noticeable impact on assessments.

- The distribution of types of loans in a bank's portfolio could have a significant impact on assessments. Banks that concentrate on construction and development (C&D) lending, in particular, as well as commercial and industrial (C&I) loans and leases and consumer loans could pay higher assessments. Agricultural banks, especially, and mortgage lenders would pay lower assessments. MBA is concerned that this measure ignores important factors such as: the quality of loan underwriting, risk mitigation, and portfolio management. Banks with solid underwriting and risk management practices should not be unduly penalized for mistakes made by some institutions in the past. The proposed changes could also

lead to a situation where banks are penalized for loans that are not yet delinquent.

- Concerns were also raised that supervisory evaluations, CAMELS ratings, would be underweighted in the proposed system.

Discussions and communications with impacted bankers also raised the following questions and considerations:

- Are the proposed factors for one-year asset growth (adjusted for mergers) a good partial replacement for an "adjusted brokered deposit ratio" in the assessment formula?

- Is the proposed loan portfolio concentration a useful new measure? Could the new measure cause banks to change their loan portfolios away from loan categories that had high charge-off rates during the recession? If so, what will be the resulting impact to surrounding communities and local economies?

- Is there a variable, besides the ones included in the proposed formula that could predict the likelihood of decline in bank health that would not create arbitrary disincentives for specific types of loans?

- Should the new system, once finalized, be delayed until the quarter after the FDIC insurance fund reaches 1.15 percent of insured deposits?

Recommendation: ***MBA strongly encourages the FDIC to consider these concerns and questions before finalizing the proposed rule.***

MBA's Specific Concerns on the Proposed Treatment of Reciprocal Deposits

In addition, many of our members have expressed deep concern regarding how reciprocal deposits would be treated under the proposed deposit insurance assessment system. The previous FDIC assessment model excluded reciprocal deposits from the category of brokered deposits for assessment purposes. However, the proposed assessment does not include that exemption for assessment purposes and effectively makes banks pay higher premiums for reciprocal deposits then may otherwise not be the case.

Under the FDIC proposal, banks would enjoy lower assessments to the extent that they fund with "core deposits," as defined by the FDIC. However, the FDIC proposal takes a narrowed view of "core deposits" and a broadened view of "brokered deposits," which would be subtracted from what is considered "core." For example, "reciprocal deposits" such as Certificate of Deposit Account Registry (CDARS) and Insured Cash Sweep® (ICS) services reciprocal deposits would count as brokered. Funding with Federal Home Loan Bank (FHLBank) advances in place of deposits could also lead to higher assessments.

This is an important issue for MBA member institutions, as well as for community banking. To provide a better understanding of the impact of this proposed change to MBA members, of the **67 Maryland headquartered, FDIC-insured institutions, 37 (or 55 percent) offer the Certificate of Deposit Account Registry (CDARS) and/or Insured Cash Sweep® (ICS) service Reciprocal Deposits.** These banks rely on reciprocal deposits as a stable source of cost-effective funding. Currently, 25 of the 37 institutions have active balances and cumulatively hold approximately $1 billion in reciprocal deposits.

MBA strongly recommends the FDIC to continue to treat reciprocal deposits as it does under the current system, excluding reciprocal deposits from the category of brokered deposits for assessment purposes for the following reasons which are further discussed on the following pages. Those reasons include: (1) reciprocal deposits are different than brokered wholesale deposits and should be treated differently; (2) local customers and local lending benefit from reciprocal deposits; and (3) the proposed change to count reciprocal deposits as brokered deposits is not needed.

- **Reciprocal Deposits are Different Than Wholesale Brokered Deposits and Should Be Treated Differently**

A bank's usage of reciprocal deposits such as CDARS, ICS, and FHLBank advances is considerably different than an institution going into the market to purchase wholesale brokered deposits. Unlike reciprocal deposits, wholesale brokered deposits are typically used to fuel rapid bank growth. Conversely, reciprocal deposits share three characteristics that define core deposits:

1) Reciprocal deposits are overwhelmingly gathered within a bank's geographic footprint through established customer relationships;
2) Reciprocal deposits have a high reinvestment rate; and
3) Banks set their own interest rates on reciprocal deposits, rates that reflect a bank's funding needs and local market.

Because reciprocal deposits are built on established local customer relationships, are highly "sticky," and are insulated from rate volatility, they are the functional equivalent of a core deposit and they do not increase an institution's risk profile beyond what any core deposit would. The current assessment system in fact recognizes that "reciprocal deposits may be a more stable source of funding for healthy banks than other types of brokered deposits and that they may not be as readily used to fund rapid asset growth." The proposed system would not.

- **Local Customers and Local Lending Benefit From Reciprocal Deposits**

By using reciprocal deposits such as CDARS and/or ICS, a Maryland bank can provide a valuable product to the customer, at a higher interest rate, than they would be able to provide if these accounts are considered "brokered" under the FDIC assessment proposal. The proposed change would make it more difficult and expensive to offer this very popular product to bank customers that need and/or prefer full FDIC insurance coverage. Increased FDIC assessment costs on reciprocal funds will discourage banks from offering the CDARS and ICS services and/or will result in less desirable rates for clients. This product is used by local customers. Local communities benefit from the reciprocal deposits since the funds remain local and are in turn used to generate local lending.

Reciprocal deposits such as CDARS and ISC provide important benefits to Maryland bank customers. Typical customers that utilize reciprocal deposits include Maryland state and local governments, nonprofits, business customers, religious institutions, trade associations and more. Deposit examples from a local community bank include: a $3 million CD deposit from Montgomery County government, a $1 million escrow from a local law firm that will be used to pay court settlements, and a $500,000 reserve fund from a local church for their buildings. Reciprocal deposits allow Maryland banks to provide local customers with a popular product that provides both fully FDIC insured deposits on accounts over the $250,000 cap at competitive interest rates.

Brief summaries of how the CDARS and ICS services function to benefit local banks and customers follows:

CDARS: CDARS, in essence, breaks up a customer's large deposit balances into smaller amounts of less than the applicable FDIC insurance limit and places those deposits at other banks within its network. The network can insure up to $10 million of a single customer's deposit. Operational and financial benefits to customers include: maintaining one bank relationship, receiving one consolidated bank statement, and getting one interest rate at CD level which can be higher than other collateral alternates. Financial service institutions pay a fee to participate in the network, but there is no fee to the customer. The CDARS program may also increase the investment income of local clients as a result of maintaining a relationship with one financial institution instead of several institutions for these deposits. Presumably, clients may be able to negotiate a better rate with one financial institution.

ICS: By using ICS, banks can offer customers access to multi-million-dollar FDIC insurance and a return on funds placed in demand deposit accounts, money market deposit accounts, or both. Like CDARS, with ICS Reciprocal, banks receive matching deposits – that is, funds are exchanged on a dollar-for-dollar basis so that each bank comes out whole. As a result, the full amount of a customer's deposit can be available for lending in the local community. ICS benefits local customers and banks by:

- Providing customers with convenient access to multi-million-dollar FDIC insurance and a return for funds placed into demand deposit accounts, money market deposit accounts, or both.
- Easily replacing more cumbersome and expensive funding options (e.g., repo sweeps and letters of credit) so its existing relationships are more profitable and generate a higher interest rate for customers.
- Increasing asset liquidity.
- Lowering the risk of collateral-value deterioration.

- **Proposed Change to Count Reciprocal Deposits as Brokered Deposits is Not Needed**

If the proposal were to go into effect as written, reciprocal deposits would be treated as brokered and banks holding reciprocal deposits would have to pay premiums higher than would otherwise be the case. MBA does not understand why the FDIC is proposing this change in direction.

Just as with the current system, the new system is required by law to be risk-based. In other words, premium assessments for each individual institution are supposed to reflect the specific and measurable risks of loss to the Deposit Insurance Fund (DIF) posed by the bank's assets and liabilities. The key question, therefore, is whether reciprocal deposits do in fact increase an institution's risk profile. Nowhere in the proposal does the FDIC proposal present any empirical data or analysis that they do. Without appropriate justification, the proposal simply proposes treating reciprocal deposits in the same way as traditional brokered deposit.

It is our understanding that the studies that have been conducted on the issue conclude that reciprocal deposits have either no effect or a salutary effect on the probability of bank failure for many of the reasons that are described in the section of this letter that discusses the differences between reciprocal deposits and brokered deposits.

In addition, not only would the FDIC's assessment proposal unfairly penalize banks that hold reciprocal deposits with a new tax, it would also unfairly stigmatize reciprocal deposits as a class. The stated purpose of the proposal is to more accurately match the perceived risk to the DIF of certain banking practices with a premium that better

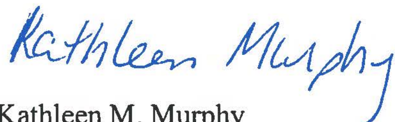
reflects that perceived risk. Clearly, the FDIC perceives traditional brokered deposits, at least in some circumstances, to be of greater risk than core deposits, and is thus trying to discourage significant reliance on traditional brokered deposits. MBA appreciates this concern. However, by lumping reciprocal deposits in with traditional brokered deposits, the proposal would also discourage bankers from holding reciprocal deposits. MBA has strong concerns about this outcome.

Recommendation: ***MBA strongly recommends the FDIC continue its previous exemption for reciprocal deposits from the definition of brokered deposits in its proposed assessment rule so that banks can continue to offer these attractive products at competitive rates.***

Furthermore, we respectfully urge the FDIC to support exempting reciprocal deposits from the definition of brokered deposits in the Federal Deposit Insurance Act, in part to eliminate the possibility that reciprocal deposits might become unintended collateral damage in future regulatory efforts to discourage the use of traditional brokered deposits.

Please contact me if you have questions or would like to discuss MBA's concerns in greater detail. Thank you for the opportunity to comment on this proposal.

Sincerely,



Kathleen M. Murphy
President and CEO
Maryland Bankers Association

cc: Maryland U.S. Senator Barbara A. Mikulski
Maryland U.S. Senator Benjamin L. Cardin
Maryland U.S. Congressman Andy Harris
Maryland U.S. Congressman C.A. Dutch Ruppersberger
Maryland U.S. Congressman John Sarbanes
Maryland U.S. Congressman Donna Edwards
Maryland U.S. Congressman Steny H. Hoyer
Maryland U.S. Congressman John Delaney
Maryland U.S. Congressman Elijah E. Cummings
Maryland U.S. Congressman Chris Van Hollen