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November 28, 2018

VIA ELECTRONIC MAIL

Mr. Robert E. Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: RIN 3064–AE89; FDIC's Brokered Deposits Regulation

Dear Robert:

Enclosed please find our comments and suggestions for clarification of the status of certain categories of deposits as not being "brokered deposits" within the meaning of 12 U.S.C. § 1831f and the Federal Deposit Insurance Corporation's ("FDIC") regulation at 12 C.F.R. § 337.6. As explained more fully in the enclosed letter, our comments are prompted in part by the FDIC's publication of a notice of proposed rulemaking to amend its brokered deposits regulation to implement certain provisions of the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 related to reciprocal deposits.[1] In that rule proposal, the FDIC stated its intention to seek further public comment on its brokered deposits regulation at a later date. We submit these comments for the FDIC's consideration as it reevaluates its brokered deposits regulation and existing interpretive guidance in connection the formulation of its planned rulemaking.

[redacted]

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[1] Limited Exception for a Capped Amount of Reciprocal Deposits From Treatment as Brokered Deposits, RIN 3064-AE89, 83 Fed. Reg. 48,562 (Sept. 26, 2018).

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Encl: Letter from David F. Freeman Jr. dated November 28, 2018, re: Planned Rulemaking on Brokered Deposits; Suggested Issues for Guidance

Cc: Rebecca A. Berryman, FDIC
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Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Planned Rulemaking on Brokered Deposits; Suggested Issues for Guidance

Dear Robert:

The Federal Deposit Insurance Corporation ("FDIC") announced in September 2018 that it plans to conduct a rulemaking on its brokered deposits regulation, 12 C.F.R. § 337.6 (the "Brokered Deposits Rule"), that will go beyond updating the Brokered Deposits Rule to conform to the reciprocal deposits provisions of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018.[1] The FDIC has addressed interpretive aspects of the Brokered Deposits Rule in a series of interpretations issued over the past several decades, and in guidance titled "Identifying, Accepting and Reporting Brokered Deposits, Frequently Asked Questions" (last revised July 14, 2016) (the "2016 FAQs").

Set forth below are our suggestions for clarification of the status of certain categories of deposits as not being "brokered deposits" within the meaning of 12 U.S.C. § 1831f and the Brokered Deposits Rule. Most of these areas have not been the subject of past discussion in connection with prior rulemakings, the 2016 FAQs or recent FDIC interpretations. We raise them at this stage so that the FDIC will be aware of these areas in advance of publishing its proposed rules.

For the most part, these suggested clarifications do not require amendment of the FDIC's current regulations and are consistent with the plain language of the statutory text and the policies behind the statutory requirements, and could be addressed by

[1] Limited Exception for a Capped Amount of Reciprocal Deposits from Treatment as Brokered Deposits, 83 Fed. Reg. 48,562 (Sep. 26, 2018).

interpretation. They could, however, be included in the proposing release for the upcoming rulemaking or, if the staff deems it appropriate, in the text of the Brokered Deposits Rule to be codified in the FDIC's regulations. In addition, we also offer certain observations and recommendations regarding the methodology for the calculation of deposit interest rates for purposes of the rate limitations established under the Brokered Deposits Rule.

(1) Deposits of customers of bank operating subsidiaries.

Deposits referred within a bank—such as from one branch or department of the bank to another branch or department of the bank—by statute are not "brokered deposits."[2] Deposits made by customers of operating subsidiaries of the bank (including deposits intermediated by employees of an operating subsidiary) should have the same status as internal deposit referrals from another department within the same bank and should not be deemed to be "brokered deposits."

Banks' operating subsidiaries are limited to "bank eligible" activities and assets,[3] and are separately incorporated simply to address regulatory licensing requirements,[4] or as a convenience. Common examples of bank operating subsidiaries include insurance agencies, brokerage firms, investment advisers and a range of financial consulting, administration and data processing businesses that operate in tandem with the parent bank.[5]

The legal basis upon which national banks and state member banks of the Federal Reserve System, and thus FDIC-insured state-chartered banks, are allowed to own operating subsidiaries[6] is that operating subsidiaries are deemed to be part of the bank.[7]

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[2] 12 U.S.C. § 1831f(g)(2)(A) & (B); 12 C.F.R. § 337.6(a)(5)(ii)(A) & (B).

[3] 12 C.F.R. § 5.34.

[4] *See generally* 12 C.F.R. Part 218 (securities brokerage licensing and bank exemptions); Securities Exchange Act § 3(a)(4) & (5), 15 U.S.C. § 78c(a)(4) & (5) (limits on bank exclusion from "broker" and "dealer" definition and SEC registration and regulation); 12 U.S.C. § 1831x(g)(1)(B) (preservation of state authority to regulate insurance activities); 15 U.S.C. §§ 6701 & 6711 (state functional regulation of insurance); Investment Advisers Act § 202(a)(11)(A), 15 U.S.C. § 80b-2(a)(11)(A) (limit on bank exclusion from definition of "investment adviser" to registered investment company).

[5] 12 C.F.R. § 5.34(e)(5)(v).

[6] 12 U.S.C. § 1831a(c); 12 C.F.R. § 362.3.

[7] 12 C.F.R. § 250.141; Federal Reserve Board Letter to Chase Manhattan Bank (Aug. 16, 2000).

Bank operating subsidiaries are treated for various federal banking law purposes as a part of the bank—essentially incorporated departments of the bank—rather than as "affiliates" of the bank.[8] The banking laws that apply to the parent bank also generally apply to an operating subsidiary.

Operating subsidiaries are consolidated with the parent bank for call report and financial reporting purposes, and are treated as part of the bank for purposes of the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act and Regulation W.[9] Loan-to-one borrower limits generally do not apply to loans by a bank to its majority-owned operating subsidiaries.[10]

Deposit balances at a bank by customers of the bank's operating subsidiary brokerage firm do not present the types of risks that the brokered deposit definition and rules were intended to address. Deposits of bank operating subsidiaries, like branch deposits, should be viewed as relationship deposits or "sticky" deposits and therefore as "core deposits" outside the scope of the Brokered Deposits Rule. The FDIC's 2011 Study and Report to Congress on Core Deposits and Brokered Deposits (the "FDIC 2011 Report") noted that sweep deposits from an affiliated broker-dealer generally are not subject to the same volatility as sweeps or other deposits from an unaffiliated broker-dealer.[11] In adopting the final liquidity coverage ratio ("LCR") rule, the FDIC and other federal banking regulators noted that the "agencies consider brokered deposits . . . to be a more volatile form of funding than stable retail deposits . . . because of the structure of the attendant third-party relationship . . . ."[12] These are client relationships of the bank, not relationships intermediated through a third party.

In a receivership, the ownership interest in an operating subsidiary and its client relationships are assets of the receivership estate and the value accrues to the FDIC as

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[8] *Id.*

[9] 12 U.S.C. §§ 371c & 371c-1; 12 C.F.R. § 223(k) & (w). We note that the brokerage sweep arrangement permitted under FDIC Interpretive Letter No. 05-02 involved a bank and a broker-dealer owned by the same bank holding company, rather than an operating subsidiary of the bank, as revealed by the letter's discussion of the arms' length fee requirements of Section 23B applicable to that arrangement.

[10] 12 C.F.R. § 32.1(c)(2)(ii).

[11] *See* FDIC, Study on Core Deposits and Brokered Deposits Submitted to Congress pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jul. 8, 2011) at 48-50, 54-57 ("FDIC 2011 Report"), *available at* http://www.fdic.gov/regulations/reform/coredeposit-study.pdf.

[12] Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule; 79 Fed. Reg. 61,440, 61,491, (Oct. 10, 2014), *citing* FDIC 2011 Report at 34–45.

receiver and can be sold like other assets of the bank and to the same extent as branch relationships. Deposits are less stable where the bank does not own the client relationship and would not be part of the "franchise value" of the bank that could be sold in a receivership. Deposit funding is more stable where the relationship belongs to the banking organization, whether that be the bank or its operating subsidiaries.[13]

For the reasons set forth above, we respectfully suggest that operating subsidiaries be treated as part of the parent bank and not as "deposit brokers" in respect of client funds referred or placed with the parent bank, and that the Brokered Deposits Rule be clarified to treat deposits from customers of operating subsidiaries of the bank as not "brokered deposits."

(2) Local government investment pool deposits.

Local government investment pools ("LGIPs") are investment funds operated by state governments (typically the state treasurer, in some cases with assistance from an external investment adviser) for investment of government assets and are exempt from registration and regulation under the Investment Company Act of 1940.[14] LGIP operations and investments are governed by detailed state statutory and regulatory requirements.[15] Many of these pools operate like money market mutual funds and are used by the states to pool and manage their cash balances.[16] LGIPs invest as principal in U.S. government securities, commercial paper, corporate bonds, repurchase agreements and a range of other money market assets such as certificates of deposit ("CDs") and other bank deposits, including CDs of non-insured foreign banks. As noted, LGIPs may contract with external advisers and other third-party administrators and custodians. Such third-party service providers are subject to the statutory and regulatory restrictions that apply to the LGIP and their activities are overseen by the state treasurer or other authorized government officials.

[13] *See* FDIC 2011 Report at 48-50 & 54-57.

[14] Investment Company Act § 2(b), 15 U.S.C. § 80a-2(b).

[15] *See, e.g.*, Colo. Rev. Stat. Ann. § 24-75-701 *et seq.*; Del. Code Ann. tit. 29, § 2718; Ga. Code Ann. § 36-83-8; Mich. Comp. Laws Ann. § 129.141 *et seq.*; Or. Rev. Stat. Ann. § 294.805; Tenn. Code Ann. § 9-4-701 *et seq.*; Tex. Gov't Code Ann. § 2256.001 *et seq.*; Va. Code Ann. § 2.2-4600 *et seq.*

[16] The Governmental Accounting Standards Board ("GASB") establishes accounting and financial reporting standards for U.S. state and local governments with which LGIPs must comply; *see also* Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47,735, 47,807 (Aug. 14, 2014) (SEC adopting release for 2014 amendments to money market mutual fund regulations established under SEC Rule 2a-7 containing a discussion of the implications of such amendments for LGIPs).

LGIP managers are typically compensated in the form of an annualized management fee paid by the LGIP and indirectly borne by the LGIP's participants. Fees are generally fixed based on the LGIP's assets under management and are not dependent upon the specific investment decisions of the LGIP manager. LGIP managers are not compensated by the banks that accept the deposits, nor are LGIP managers compensated based on whether or how much an LGIP invests in CDs or other bank deposits. Moreover, any CD or deposit purchased or placed by an LGIP is owned as principal by the LGIP, not the participants in the LGIP. The LGIP manager makes investment decisions in accordance with the investment objectives and guidelines established by the state treasurer pursuant to the LGIP's authorizing statute or regulation. LGIP investments are not specifically selected or directed by participants.

LGIPs are not "deposit brokers" within the meaning of the first clause in 12 U.S.C. § 1831f(g)(1)(A) because LGIPs invest their portfolio assets as principal and not as agent. LGIPs operate robust diversified portfolios and are not simply a means for third parties to invest in interests in insured bank deposits and thus are not "deposit brokers" within the meaning of the second clause in 12 U.S.C. § 1831f(g)(1)(A).

In a 1992 interpretive letter involving a parallel CD placement arrangement that the external investment adviser and administrator operated alongside an LGIP as an optional supplemental service, the FDIC staff indicated that the placement as agent by the adviser/administrator on behalf of other governmental entities directly into bank CDs was deposit brokerage.[17] The letter did not specifically address the status of deposits made by the LGIP as principal in connection with the LGIP's management of its broader investment portfolio, nor did the letter address the role of the external adviser and administrator to the LGIP in that regard; however, the implication of the 1992 letter, by distinguishing between deposits placed through the parallel CD agent program and the LGIP's own portfolio deposits placed as principal, is that the LGIP deposits are not "brokered deposits."

We respectfully suggest that the FDIC specifically address the status of LGIP portfolio deposits made as principal and confirm that they are not "brokered deposits."

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[17] FDIC Interpretive Letter No. 92-66, *Investment Advisor/Fund Administrator for Governmental Authorities is Deposit Broker With Respect to Optional Certificate of Deposit Placement Program It Offers* (Oct. 11, 1992).

(3) Deposits owned by other investment funds as principal, provided that the fund is not intended to invest primarily in deposits of FDIC-insured institutions.

As is the case with LGIPs, other forms of investment funds, from Securities and Exchange Commission- ("SEC") registered investment companies through a range of other investment funds that are exempt from registration, invest portions of their portfolios as principal in bank deposits. For some investment funds the deposits are limited to temporary cash balances awaiting investment or distribution or are used for collateral purposes. For other funds, bank CDs (some from FDIC-insured institutions, others from non-U.S. banks or their U.S. branches that are not FDIC-insured institutions) are a part of the investment portfolio along with government securities, corporate bonds, repurchase agreements, and various other money market instruments and investments.

The funds are legal entities (most commonly corporations, business trusts, limited liability companies or limited partnerships) that own the deposits for their own account as principals, and do not act as agent for investors. Like LGIPs, other types of investment funds therefore are not "deposit brokers" within the meaning of the first clause in 12 U.S.C. § 1831f(g)(1)(A) because the investment funds invest their portfolio assets as principal and not as agent. Investment funds are not "deposit brokers" within the meaning of the second clause in 12 U.S.C. § 1831f(g)(1)(A) because they have diverse portfolios and are not simply a means to invest in interests in insured bank deposits.

Most investment funds have investment advisers, custodians and administrators that act as fiduciaries and as agent for the funds. As is the case with LGIPs that have third-party advisers, custodians and administrators, these fiduciaries do not act for the "primary purpose" of investing fund assets in deposits of FDIC-insured institutions. Funds normally compensate their advisers and other external service providers with a periodic fee based on assets under management (and in some cases a performance fee or allocation) on a periodic basis, or through periodic flat fees or per account fees, which do not change based on whether the fund invests in bank deposits at all or the amounts of any bank deposits owned in portfolio. Moreover, the compensation is paid by the fund to the adviser, custodian and administrator and is borne indirectly as an expense by investors, and is not paid by the bank that issues the CDs or other deposits owned by the funds.

We respectfully suggest that the FDIC clarify that deposits of externally-managed investment funds whose investment portfolios are invested primarily in assets other than deposits of FDIC-insured institutions not be treated as "brokered deposits." In this regard, if the fund's portfolio, once fully invested, consists 40% or less of deposits in

FDIC-insured depository institutions it should not be viewed as having the "primary purpose" of investing in deposits of insured depository institutions.[18] For this purpose we would suggest excluding from the calculation the short periods of time between when capital calls are made before assets are invested and when assets have been sold and the fund has not yet distributed the proceeds.

(4) Deposits for investment adviser client accounts.

SEC rules require that investment advisers not hold custody of their clients' assets, but instead place them in custody at a bank, trust company or securities broker-dealer.[19] Investment advisers act as fiduciaries and agents for their clients for the purpose of investing the clients' assets as agent in securities and other investments, very little of which gets invested or held in deposit balances with banks and, in any event, investment advisers generally select investments from a broad array money market instruments and are not compensated specifically for their selection of bank deposits. Investment advisers therefore operate very much like bank trust departments in their management of client accounts.[20] The client account assets are fiduciary deposits and should be treated same as deposits of fiduciary clients of a bank trust department or non-depository trust company,[21] *i.e.*, they should not be viewed as brokered deposits unless the fiduciary arrangement was established for the primary purpose of investing in deposits of insured depository institutions.[22]

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[18] The benchmark percentage of investment activity that constitutes the "primary" activity of an investment fund is defined at a 40% level in an analogous provision of the Investment Company Act. Section 3(a)(1) of the Investment Company Act defines what investment funds are "engaged primarily" in the business of investing in securities. The Investment Company Act defines an issuer that either "holds itself out" to the public as engaged primarily in investing, reinvesting and trading in securities or that invests more than 40% of its assets in investment securities as triggering that Act's requirement that it either register with the SEC or fit within an exemption or exclusion.

[19] 17 C.F.R. § 275.206(4)-2.

[20] *See* 12 C.F.R. § 9.2 (defining "fiduciary accounts" of a national bank to include investment adviser accounts); 12 C.F.R. § 5.34(e)(5)(vii) (requiring a national bank to have trust powers in order to own an operating subsidiary SEC-registered investment adviser).

[21] FDIC Interpretive Letter No. 93-47, *Whether Independent Trust Company Which Conducts Activities On Behalf of Affiliated Bank Must Register as Deposit Broker* (July 21, 1993).

[22] *Cf.* FDIC Interpretive Letter No. 92-87, *Agreement Entered into Between Trust Department and Customer For Primary Purpose of Placing Funds With Insured Depository Institutions Requires Bank to Register as Deposit Broker* (Dec. 9, 1992) (bank trust department non-advised custodial arrangement established for the primary purpose of investing in CDs deemed to be deposit brokerage and distinguished

Footnote continued on following page.

(5) Sweep deposits of unaffiliated broker-dealers that otherwise meet requirements of FDIC Interpretive Letter No. 05-02.

FDIC Interpretive Letter No. 05-02 addressed an arrangement where the free credit balances of certain brokerage accounts were swept by a broker-dealer into money market deposit or transaction accounts at affiliated depository institutions. The FDIC determined that such deposits would not be treated as brokered provided that (1) the swept funds do not exceed 10 percent of the total balance of the brokerage account(s); (2) this limitation is to be calculated and applied on a monthly basis and shall not be exceeded in consecutive months or for a period of three months during any 12-month period; and (3) the bank shall provide the FDIC with monthly reports reflecting these monthly calculations and will make available daily calculations upon request.[23]

The FDIC's 2011 Report noted that deposit sweeps from unaffiliated broker-dealers are more volatile and tend to contribute to rapid growth more so than deposit sweeps from affiliated broker-dealers.[24] The FDIC reached this conclusion despite the acknowledged absence of supporting evidence and the submission of extensive commentary and data suggesting that unaffiliated deposit sweeps are, in general, stable, low-cost forms of funding with high customer retention rates. Interpretive Letter No. 05-02 does not, however, address the significance of the affiliate relationship between the banks at which swept funds would be deposited and the placing broker-dealer.

By the terms of the statute and the Brokered Deposits Rule, the existence of an affiliate relationship between the involved institutions should not have a material effect on the deposit broker analysis and therefore should not preclude the application of the "primary purpose" exception.[25] In addition, the data and practical evidence that is available suggests that unaffiliated deposit sweeps should be viewed as core deposits to the same extent as affiliated deposit sweeps. Accordingly, we request that the FDIC

Footnote continued from previous page.
from other fiduciary relationships) and FDIC Interpretive Letter No. 93-47 (drawing same distinction for non-depository trust company's non-advised custodial vs. advised fiduciary accounts, and treating non-depository trust company fiduciary accounts as within the insured bank trust department exclusion).

[23] FDIC Interpretive Letter No. 05-02, *Are Funds Held in "Cash Management Accounts" Viewed as Brokered Deposits by the FDIC?* (Feb. 3, 2005).

[24] FDIC 2011 Report at 56.

[25] The FDIC clarified in the 2016 FAQs that, in general, even when a bank places deposits exclusively within a network of affiliated banks, the bank is acting as a deposit broker and, as a result, all such deposits are brokered deposits. *See* FAQ C3.

clarify that broker-dealers are permitted to sweep cash balances of brokerage accounts into deposit accounts at unaffiliated depository institutions provided that the other qualifications established in Interpretive Letter No. 05-02 are satisfied.

(6) Broker-dealer and custodial sweep deposits.

Further to the above, we request that the FDIC codify its sweep deposit interpretation set forth in Interpretive Letter No. 05-02 within the Brokered Deposits Rule (with the above modification regarding unaffiliated institutions). The FDIC should also remove any requirement that each bank obtain its own separate letter of approval from the FDIC prior to the commencement of any sweep deposit arrangement. The FDIC publicly relaxed its position on this issue when it published the 2016 FAQs.[26] However, we understand that the FDIC has continued (at least selectively if not as a matter of course) to require institutions to submit a request for a formal determination of the application of the "primary purpose" exception to a particular arrangement. Given the absence of statutory or regulatory authority for such a pre-approval requirement, the FDIC should clarify that no such requirement exists.

(7) Broker-dealer 15c3 reserve balance deposits.

A 1994 FDIC interpretive letter concludes that deposits of securities broker-dealers placed as "reserve balance deposits" pursuant to SEC Rule 15c3-3(e) are not "brokered deposits" because the broker-dealer does not make the deposit for the "primary purpose" of placing funds with a depository institution but instead to comply with applicable regulatory requirements.[27] Although we agree with the result and the conclusion, we note that the simpler way to reach this result is to clarify that the broker-dealer that makes reserve balance deposits pursuant to SEC Rule 15c3-3(e) owns them as principal (notwithstanding the "exclusive benefit of clients" language required by the SEC rule) and not as agent or trustee.

These special reserve deposit account balances appear on the broker-dealer's balance sheet and factor into its net capital calculations (unlike deposits held by a broker as agent, such as sweep deposits placed pursuant to SEC Rule 15c3-3(j), which are not

[26] A statement providing that the application of the "primary purpose" exception "typically requires a specific request for a determination by the FDIC" was removed from the 2016 FAQs. *See* FAQ E9.

[27] FDIC Interpretive Letter No. 94-39, *Brokered Deposits: Are Funds Deposited in a Special Reserve Bank Account for the Exclusive Benefit of Customers Brokered Deposits Under Sections 29 and 29A of the FDI Act* (Aug. 17, 1994).

balance sheet assets of the broker and are instead held as agent for customers). The interest in the reserve balances benefits brokerage customers by protecting them as creditors of the broker. The required Rule 15c3-3(e) reserve account balances roughly correspond in the aggregate to the "free credit balances" (*i.e.*, cash balances owed by the broker-dealer to its customers that have *not* been swept off the balance sheet of the broker-dealer as agent for the customer and invested in money market fund shares, bank sweep deposits, or repurchase agreements, net of any amounts due to the broker-dealer from the customer). The broker free credit balances are short-term debt obligations of the broker-dealer to its customers as principal, but the reserve balance deposits placed by the broker-dealer in a bank do not belong to the customers.

Because they are not agency deposits, there is no need to apply the "primary purpose" exception to conclude that they are not "brokered deposits."

(8) Transferrable deposits.

We request that the FDIC clarify that transferrable or negotiable CDs that have a CUSIP or that are issued by a bank that is rated by a rating agency and acquired as principal by a depositor with the intent to hold to maturity are not automatically viewed as "brokered deposits" if the context does not otherwise cause them to be viewed as such. Even when they plan to hold to term and repeatedly renew, municipal governments, corporate treasurers and money market mutual funds (to comply with SEC Rule 2a-7), private liquidity funds that voluntarily follow Rule 2a-7 portfolio requirements, and other investment funds commonly require term deposits to be "transferrable" to establish that they are not "illiquid" or qualify as liquid assets or cash equivalents for accounting purposes and further require that they be investment grade.[28] In addition, municipal governments often require term deposits to be issued by a bank that is rated investment grade and be transferrable in order qualify them as permissible investments in amounts above $250,000 without collateral or credit enhancement.[29] In each case, the depositor is acting as principal and not as agent for others, and is not simply a vehicle for securitizing and selling fractional interests in deposits at insured institutions. As a result, these depositors are not "deposit brokers" as defined in the statute or the Brokered Deposits Rule and the deposits they own are not "brokered deposits." We request that the FDIC address the issue and clarify the status of such deposits.

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[28] 17 C.F.R. § 270.2a-7(a)(18); GASB Statement No. 79 ¶¶ 24 & 33 (Dec. 2015).

[29] *See, e.g.*, Cal. Gov. Code §§ 16430(h), 53601(i) & 53649 *et seq.*; California Debt and Investment Advisory Commission, *Local Agency Investment Guidelines* (2018).

(9) "Middle-market" companies that perform primarily operational, non-financial intermediary functions.

FDIC Interpretive Letter No. 17-02 establishes that a number of "middle-market" companies with which banks maintain relationships and from which banks receive deposits are not generally viewed as deposit brokers pursuant to the "primary purpose" exception of the Brokered Deposits Rule provided that such companies' relationships with banks are not "programmatic" and that they are not compensated directly or indirectly for their placement of deposits with banks.[30] By contrast, the FDIC's interpretation indicates that companies which primarily perform investment, asset management or other traditional financial services functions *are* generally viewed as deposit brokers because the primary purpose of such companies is advising clients about investing and managing money, and deposit placement activities are carried out in furtherance of that purpose. For the reasons outlined in item 4 above, we do not believe that approach is consistent with the text of the statute and the Brokered Deposits Rule or prior FDIC interpretations, which generally exclude fiduciary investments where the fiduciary relationship is not established for the primary purpose of investing in deposits of insured depository institutions.

Because Interpretive Letter No. 17-02 addresses a number of highly-specific intermediary relationships and establishes certain conditions that are difficult to apply to a variety of different facts, we request that the FDIC establishes clear criteria within the Brokered Deposits Rule which clarify when an intermediary that performs a servicing or operational function for a bank places deposits with the bank in an agency capacity is eligible to rely upon the "primary purpose" exception.

(10) Calculation of deposit interest rate limitations.

The Brokered Deposits Rule prohibits undercapitalized banks from offering interest rates on deposits that are significantly higher than the prevailing rates on insured deposits in an institution's normal market area or in the market area in which deposits would otherwise be accepted. In general, a bank that is not well capitalized may not offer an interest rate on brokered deposits that is higher than the "national rate" established by the FDIC plus 75 basis points.[31] The "national rate" is defined under the Brokered

[30] FDIC Interpretive Letter No. 17-02, *Question Regarding Whether Certain Deposits Placed Through a Bank's Relationship With Certain "Middle Market Companies" Are Considered Brokered Deposits* (June 19, 2017).

[31] 12 C.F.R. § 337.6(b).

Deposits Rule, with respect to deposits of similar size and maturity, as a simple average of rates offered by all insured depository institutions and branches for which data are available. Where the FDIC determines, at a bank's request and on the basis of available evidence, that the published national rate does not represent the prevailing rate in a particular market area, the bank will be permitted to offer the prevailing rate for deposits obtained from within that market area.

Although the FDIC has published guidance aimed at clarifying its approach to the calculation of applicable interest rate caps, the existing methodology is limited in certain respects and often produces an ineffective measure of "high rate" deposits, because the published rates that the FDIC relies upon are lower than the actual interest rates at which banks accept deposits after negotiation with depositors.

Thus—like the soon-to-be-abandoned London Interbank Offer Rate formerly used to benchmark variable rate commercial loans ("LIBOR")—the FDIC's national benchmark deposit rate is not based on actual market data and does not accurately reflect the current competitive market interest rates, with the error bias consistently being towards the low side. For the intended purpose of prohibiting undercapitalized banks from attracting funding by paying above-market interest rates, the national rate understatement may inadvertently prevent these banks from matching actual market rates and cause them to shrink. While that might be a good thing in some circumstances, it is not the stated objective of the statute or the Brokered Deposits Rule and may be destabilizing both for the institutions affected and for the financial system as a whole.

To the extent that the FDIC or other regulators or market participants and analysts use the national market rates published by the FDIC under the Brokered Deposits Rule for other contractual, supervisory or analytic purposes, the error is compounded by using a benchmark rate derived from faulty data and applying it in the wrong contexts.

We offer below for the FDIC's consideration the following observations and recommendations regarding this interest rate setting methodology.

- The deposit rate average for purposes of the "national rate" calculation should be weighted to account for deposit balances (*i.e.*, actual observed flows).

- Available data sources should not reflect only listed or published rates, but should also reflect the rates of funded deposits as this more closely demonstrates the market rate for a deposit. Depositors negotiate rates upward from the advertised rates. That normal practice is not captured in the existing data used by the FDIC and results in an understatement of actual current interest rates on deposits.

- The methodology should address the calculation of a comparable deposit rate for "off tenor" CDs (CDs with a maturity that does not have an equivalent benchmark rate).

- The methodology should include an option for determining whether a deposit is a high-rate deposit based upon a minimum acceptable rate to which a spread would be applied for purposes of the determination—for example, the risk-free rate of return for U.S. Treasury bills, imputed interest rates on overnight and term repurchase agreements, financial issuer commercial paper rates, federal funds rates, and current yields on money market mutual funds. This data is published based upon actual market transactions and may provide a deeper and more accurate picture of the current interest rate environment.

- The methodology should account for instances in which the bank-issued deposit has a tenor that is greater than the longest tenor of the benchmark rates, as interpolation would not be possible in such a situation.

- The FDIC should consider applying a variable spread to the applicable rate based on tenor of the deposit. The spread generally should be larger for longer-term deposits and smaller for shorter-term or non-term deposits. A variable-spread approach would be a disincentive for banks against issuing only short-term CDs. In general, yield curves are initially upward sloping with rates increasing less rapidly as tenor increases. Spreads against yield curves often increase as the term structure increases. A flat spread unbiased as to the term of a deposit assumes that investors would not differentiate the risk associated with term structures that vary significantly. Use of a variable spread would incentivize banks subject to the rate limits to diversify CD issuances across a range of short, medium and longer terms and thereby create more stable funding for bank balance sheets.

- The FDIC should clarify to what extent interpolation is allowable, and whether benchmark rates should be matched with the origination date of a deposit, in which case it is possible a "two way" interpolation would be necessary to match based both on tenor and origination date.

- The methodology should permit consideration of relationship pricing. Many banks use pricing matrices that account for the depth of customer relationship.

Rather than at the account level, benchmarking should be calculated at a relationship level.

We appreciate the FDIC's consideration of the requests and comments described in this letter. We would be pleased to provide additional information if it would be useful to the FDIC in this regard.

Respectfully submitted,

[redacted]

David F. Freeman, Jr.

[redacted]