From: [Utah Banker]
Sent: Wednesday, March 27, 2019 6:05 PM
To: Comments
Cc:
Subject: February 6, 2019 - Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions; Comment Request (RIN 3064–AE94)

To Whom it May Concern:

My name is and I am the chief financial officer of Utah. Our bank has approximately $750 million in assets and is primarily a lender for small to medium sized businesses. We have no branches and have primarily used wholesale and brokered deposits for funding during the entire 20-year existence of the bank. I am writing in response to the request for comments related to the proposed rulemaking related to brokered deposits as part of the FDIC's review of the regulatory approach to brokered deposits.

Introduction

I opened my first personal savings account in Utah, when I was 12 years old at the local Bank branch. My account number was tied to the branch. In order to make a deposit I would stop at the branch and fill out a deposit slip. Almost all the deposits that I made were with cash earned from either various jobs, allowance, or birthday cards. When I was 17 years old I opened a checking account at the same branch. The account included a debit card, which I had to explain to my parents. Again, all deposits into this account were done in-person at the branch. I kept that same savings and checking account relationship for several years. Then, after marriage and frustration with a lack of services – especially internet banking – I left Bank altogether and moved to another institution. When I think back on how banking worked, only 30 years ago, I am amazed at the progress that has been made in the financial services sector. But I am alarmed at the threat facing the industry from non-banks. I believe that the single greatest reason that these external threats exist is a lack of progress both with banks as well as with regulators.

I posit that there has been, and continues to be, a belief that branches play an integral part in the financial services industry. My first savings account was tied to my branch. But once I left home that branch never played a role in my banking experience. I might occasionally visit one of the other branches of my bank, but that was rare and usually only involved fixing problems. The idea that the branch somehow was "core" to my experience just didn't play out in reality. Further, my first car loan was processed through the dealer, so my branch or even my bank relationship didn't play a role in my decision of which loan to use. That decision was purely made based on interest rate. One might argue that the car dealer acted as a "broker" in my decision. Did the bank who wrote my loan have a relationship with me? No. Their decision to underwrite me was strictly based on information that I had provided on an application and from credit reporting agencies.

The reason that I provided the details above stems from the ongoing concern that brokered deposits somehow make a bank "unsafe." In reality, it is problem loans that make a bank unsafe and for years, we have allowed banks and other lenders the flexibility to underwrite these sight-unseen from the borrower. Why, then, is it so scary for a bank to accept deposits in a similar manner? The fact that brokered deposits are negatively viewed when brokered loans are not leads me to several potential conclusions as to their perception:

1. Brokered deposits are perceived to allow reckless loan growth.
2. Brokered deposits are perceived to reduce the franchise value of a bank.

3. Brokered deposits are perceived to otherwise demonstrate risky behavior for a bank.

I would like to discuss my thoughts on each of these three perceptions and provide some alternative thoughts on the value of brokered deposits to an institution.

Reckless Growth

There is a perception that brokered deposits allow an institution to grow at an unmanageable pace, either to ramp up revenue or to hide potential problems. While there might have been a correlation in the past between the amount of brokered deposits held by an institution and failure rates, I do not believe that the negative treatment of brokered deposits is warranted by this correlation. That is because banks do not fail because of deposit risk, but because of toxic loans. Regulators perform exams on bank safety and soundness on a regular basis. Guidelines exist for concentration of loan portfolios as a percentage of capital. Banks are required to hold adequate reserves for future loan loss. In fact, these reserves are being expanded to cover the entire life of the credit, rather than the historical loss emergence period. All of these are tools to help manage a bank's credit risk related to loans.

On the other hand, because of the rapid shift of consumers away from historical deposit behaviors and branch dependency, banks are being forced to look elsewhere for funding. Online advertising and deposit marketing are rapidly replacing traditional marketing channels. To further challenge these old models, non-financial institutions are competing with banks for customer deposits. These may be in the form of gift cards or apps (look at the like of Starbucks) or new payment processing platforms (look at Venmo, Paypal, Google Pay, Samsung Pay, Apple Pay, etc.). These funds are not directly managed by a consumer through their bank branch, nor is the average consumer even aware of whether these funds are protected via FDIC insurance. In some cases the funds insured are, but not through a direct relationship between the consumer and the bank.

The shift from traditional channels to these new channels, combined with the broken belief that loan growth can be managed through deposit growth, lead to a dangerous footing for financial institutions in the new economy – one that may call into question the very survival of the banking model. The more banks are forced to rely on third parties for funding needs the more these funds will appear to be brokered deposits under new rules. Thus, if a bank WERE to get into trouble with its loans, even more funding will be impacted by current regulations and even more banks will be in danger of collapse.

Franchise Value of Deposits

The traditional means for a bank to expand into a new market was by building a new branch. The idea was that the new branch would attract depositors and, in turn, new loan customers. This may have worked in the past, but the value of these branch relationships is quickly disappearing. I read the case of a bank acquisition of Wells Fargo branches in 2018, where the acquiring bank saw a 20% drop in deposits at the acquired branches immediately. This was attributed to people who no longer lived in the area just moving to a new bank. Again, the fallacy is that there is a value to the branch model retaining customers. ABA surveys of consumers showed that in 2004 over 80% of those surveyed would not do business with a bank without branches. In 2014 that number had dropped to 62%. I cannot imagine that the number has not decreased significantly in the past five years. Based on this shift in branch value tied to deposits, I do not believe that there is a significant franchise value to deposit pools at traditional bank branches.

I believe that in the future bank deposits will be highly correlated with the experience that a customer has with the bank's online or mobile platform. Since these are location agnostic, a bank that has an exceptional service in one region could expect highly satisfied customers from a separate region. In the traditional sense, these out-of-region customers would not be considered core, in that they did not depend on a branch for their relationship. However, these might even be a stronger customer for the bank because of their experience. If a bank were to partner with a provider to source these customers, the deposits would be deemed to be brokered under current definitions.

Thus, the franchise value of the brokered deposit might actually be higher than the value of branch-based deposits.

Other Risky Use
I believe that banks who use brokered deposits on a regular basis are deemed inherently riskier than "traditionally funded" banks. This is not because of the risk of the brokered deposits in and of themselves but applies to a perception that a bank that uses brokered deposits must also be doing other risky things. This is particularly true of special purpose banks or those banks that specialize in certain lending categories. However, these banks tend to also have a much deeper understanding of their cohorts and can use that understanding to negotiate products or services where a traditional bank might fail miserably. Our bank is a prime example of this. We have used brokered deposits as a significant source of funding for years. We have a significant concentration of credit in the [redacted] – one that is difficult for many banks to understand. Further, we offer factoring as a product, which requires a specialized skillset. Our use of brokered deposits could lead an examiner or regulator to assume that our other products are risky. This is not the case because of years of experience and specialization that we have developed. Brokered deposits don't make these products riskier at all.

Brokered Deposits Advantages
There are several very important advantages that brokered deposits offer to institutions, which I believe drive their use even in the face of regulatory scrutiny. I will discuss a few of them.

First, brokered deposits offer a safe, certain funding source. Since the pool of deposits is driven by market economics, banks have a virtually limitless supply of deposits available to meet their needs. This allows banks more certainty in planning for asset growth, income and capital management, as well as resource allocation. By focusing efforts on supporting loan growth, risk management, and collection, banks can more readily deal with changing economic factors. Our bank has taken an approach in the past that has worked very well. We concentrate on growing and managing loans and then simply identify how many deposits we need to manage funding. By not splitting the bank's resources in marketing and managing retail deposits we have been able to effectively manage loan risk and growth. Since brokered certificates are only callable upon death, they represent a sure source of funding. Replacement deposits when certificates mature can be scheduled ahead of time to ensure adequate funding always exists.

Second, brokered deposits make managing interest rate risk much simpler. As a bank we can review our maturities for loans and match funding exactly using brokered deposits. This greatly simplifies the interest rate risk management processes of the bank. Further, the use of brokered deposits greatly simplifies the process of using interest rate hedging products such as interest-rate swaps. The effectiveness of these swap instruments is always almost 100% effective because the term of the swap facility and the term of the deposits can be matched.

Third, brokered deposits allow the bank to leverage efficiencies of the broader financial markets – something that is difficult to do in a traditional branch model. Deposit brokers work with large institutional investors to manage portfolio risk using brokered deposits. The economies of scale of these large market management tools allow for a cheaper acquisition cost for banks than the management of branch locations, staffing of branch personnel, marketing of deposit products, competing with large banks for deposit gathering, and potential threats from non-bank entities as noted above.

Conclusion
I believe that the financial services industry marches toward two potential futures – one where banks become irrelevant because of arcane regulations and traditionalism and one where banks can serve as a vital role of support of consumer and business needs with liquidity, information and identity management, and consumer protection. It is up to our regulators to help not only guide the transition to a new economic model, but to

remove barriers that no longer provide protection and might inhibit growth. I appreciate the FDIC leadership for taking the time to earnestly review the rules in place and to seek input from those who manage these processes on a daily basis. Please feel free to reach out to me if you have any questions or comments on the points that I have included in my response.

Thank you for your consideration,

Utah