

April 25, 2019

To Robert E. Feldman, Executive Secretary

Attention: Comments Regarding February 6, 2019 - Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions; Comment Request (RIN 3064–AE94)

Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429

Dear Mr. Feldman,

Thank you very much for accepting input on these very important issues. Our bank serves a low-middle-income customer base who are net borrowers, including a large proportion of minorities. These customers do not have the deposit resources to support their loan demand, so the rate cap restrictions and brokered deposits rules directly affect these consumers.

In addition to consumer concerns, the current rate cap calculation results in rates which are dangerously below current market rates. This poses a dire threat to the Deposit Insurance Fund if an economic downturn were to cause many banks to become less than well-capitalized. This is an unnecessary risk and can be easily remedied as it was in a similar situation in 2009.

My four topics below explain why I think the rules, which I believe are harming consumers and could cause needless loss to the DIF, need to be changed. The current rules are hampering the efforts of banks to serve LMI consumers if those banks don't have access to plentiful local deposits.

Effects of brokered deposits on the failure and resolution of a failed bank

There is a strong belief that brokered deposits (BDs) are a red flag, are inferior to "core" deposits, have been a strong factor in bank failures, and have caused the DIF to take greater losses. However, the Barth report shows evidence that BDs are correlated to safer and more profitable banks. It can be argued that poor and/or dishonest management and/or excessive risk-taking involving questionable investments are much more to blame for failures and losses than are BDs.

I believe the decades-long stigma or bias against BDs is the main reason for their devaluation during the resolution of a failed bank. The well-known view of BDs by regulators makes BDs undesirable to acquirers of troubled banks. It's a self-fulfilling prophecy created by the consistent negative attitude toward BDs by regulators, which is widely known and is experienced by bankers who use BDs.

The FDIC's July 8, 2011 Study on Core Deposits and Brokered Deposits quotes the FDIC's Risk Management Manual of Examination Policies as follows:

"...there should be no particular stigma attached to the acceptance of brokered deposits per se and the proper use of such deposits should not be discouraged."

In practice, it would be hard to find any banker or bank examiner anywhere who believes the intent of this statement is being followed.

Benefits of brokered deposits versus competing for local “core” deposits at real, actual, market rates

Because we were concerned about the pressure we were receiving from regulators about our high usage of BDs, we decided to begin to migrate our BD portfolio into “core” deposits. We gradually increased the rates we were offering for local deposits, which meant that the deposits we already had on our books received the higher rates. Our local competitors were fighting to keep their deposits from moving to us, therefore they were matching our rates. We were doing worse than spinning our wheels – we were increasing our cost of funds and gaining no new funds. We would have been a lot better off to just continue replacing our maturing BDs with new BDs.

In fact, BDs are superior in many ways to traditional deposits, as several comment letters have already explained in detail.

The concern of volatility

Volatile deposits can be defined or viewed in several ways, and can be predictably volatile (is that an oxymoron?) or unpredictably volatile. Assumptions made in this discussion are that BDs are in the form of CDs, and it is understood that early withdrawal is only allowed due to the death or adjudication of incompetence of the holder.

A deposit can be volatile if it can disappear overnight or unexpectedly. All “core” deposits can be volatile in this way. BDs are not volatile in this way.

Even though a decay rate on “core” deposits may be calculated on past performance, in a stress situation all bets are off. When it counts, “core” deposits are very unpredictable and can be very volatile.

Brokered deposits are predictable; you know they are going away, and you know when they are going away. This is an advantage in liability management.

Real life example of how flawed the National average rate is

On 4-8-19, the National average rate for a Jumbo Money Market account was 0.29%, and the rate cap was 1.04%. Just a quick check of online MM rates shows over 50 banks offering a higher rate than 1.04%. Opening an account online is easy. These banks are our direct competitors. Many of these banks are offering between 2.25% and 2.50%. How does an average rate of 0.29% have any relevance to the current market rate required to attract or keep a MM account? Yet if we offer a MM rate of 1.05%, it is considered a risky, volatile, high-rate account. Where in the real world does this make sense?

The National average rate for a Jumbo 12 month CD is 0.74% and the rate cap is 1.49%. Checking a well-known listing service, there are 189 banks offering a rate higher than 1.49% and 172 of those banks are offering 2.0% or more. These are the actual rates we are competing against; not 0.74%. To be in the running for attracting or retaining 12 month money, we are having to pay 2.64%. This is in rural Arkansas! According to current regulations, this rate is considered “high rate” and rate-sensitive, therefore unstable or volatile. In reality, the rate we are paying is a normal market rate. Interestingly, we could obtain brokered deposits at a lower rate and the funds would be more stable in a stress situation, but we are being discouraged from taking that option.

BDs are considered high rate, even when obtained at below local market rates. Rates above rate cap are considered high rate, even though they are normal market rates. This causes some havoc during exams and requires examiners to spend their time and resources to determine why in the world a bank would find it necessary to pay current market rates for their BDs and local deposits.

Surely with the application of logic and common sense, we can arrive at rules and regulations that are more in tune with real life than trying to work with fantasy rates.

In the case of a rate cap restriction, some offer as a solution that a bank should simply determine that it is in a high-rate area and use the local rates to establish their rate cap. We went through this exercise, and found that it is useless for all practical purposes, because the same flawed rates being used to establish the National average rates are also being used to establish the local rate caps. In many cases, banks report a rate much lower than they are willing to pay as their posted rate, and then they either negotiate with each individual depositor to pay a market rate, or run an odd-month special so as not to cannibalize their standard-term customers who don't care or aren't paying attention. The survey for the National average rate is based only on posted rates and not actual rates.

There are numerous ways to prove that the National average rates don't accurately represent actual rates being paid to attract or retain deposits. If money were available at 0.74%, why would the one year Treasury be paying 2.43%? Why would banks be borrowing from the FHLB for 2.57% for one year?

The flaw in the rate cap calculation has been thoroughly demonstrated. It would seem to be obvious that the flaw should be corrected immediately, before any more viable banks fail because of the flaw and before any more of the DIF reserves are wasted on unnecessary bank failures.

Conclusion

Brokered deposits can be a valuable tool when used properly. We ask that the stigma be removed and the proper use not be discouraged. If rapid growth is a problem, then limit the growth, but don't make a bad situation turn into a disaster by cutting off liquidity.

If rate caps must remain, make them realistic instead of the incorrect, flawed, false representation of actual market rates that they are now.

Thank you for your consideration, and I hope action can be taken very quickly to prevent more needless losses to the DIF.

Sincerely,

Mary Fowler, CEO

