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Via email: comments@fdic.gov

May 6, 2019

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

Re: RIN 3064-AE94

Request for Comment On Proposed Rulemaking To Amend 12 C.F.R. Part 337 To Review Current Brokered Deposit Regulations And Interest Rate Restrictions Applicable To Banks That Are Less Than Well Capitalized.

Dear Mr. Feldman,

We are writing in response to the Federal Deposit Insurance Company's (FDIC) February 6, 2019 advanced notice of proposed rulemaking (ANPR) regarding brokered deposits and interest rate restrictions.

We appreciate Chairwoman McWilliam's invitation to comment on this important topic and we applaud her desire to review the current rules in light of the significant changes the financial industry has seen in technology, business models, product offerings, delivery channels, third-party service providers, FinTech companies and consumer banking behaviors that have occurred in the thirty (30) years since the deposit broker / brokered deposits regulations were originally put in place.

As shown below, community banks play a vital role in our nation's economy:

- *Access to Financial Products & Services*: 16.3 million Americans would have limited access to banking services if it weren't for community banks. Nearly one in five of our nation's 3,000 counties would have no physical banking presence if it weren't for community banks.

- *Access to Local Credit*: Over 900 counties across the United States rely exclusively upon community banks for extension of local credit.

- *Business Loans*: Community banks are responsible for 52% of all small business loans and 82% of all agricultural loans.

- *Local & National Economy*: Since the 1970s, small businesses have generated 55% of all jobs and 65% of all net new jobs.

And yet, according to the FDIC's figures from 2002 through Q3 2018, on average, one (1) small bank (defined as less than $1 billion in asset size) has disappeared each business day over the past fifteen (15) years.

Equally as disturbing is the fact that 45% of all new checking accounts are being opened by just three (3) banks (Chase, Bank of America and Wells Fargo) whose institutions represent just 24% of all branch offices within the United States. *(Source: Wall Street Journal, March 2018).*

Unfortunately, these large banks have inherent business model advantages (i.e. scope, scale, staffing) that many community banks simply do not have. Consequently, community banks must leverage our finite resources by partnering with industry innovators and third-party service providers to deliver the innovative financial products, the competitive rates and the omnichannel customer experiences that will attract new consumers (and their deposits) to our institutions.

As currently interpreted by the FDIC, the brokered deposit rules are making it harder for community banks to gather deposits that are often the cornerstone of an individual consumer banking relationship.

Banking is not just about taking deposits and lending money; it is also about cross selling financial services to customers. In many cases the bank's initial contact with a customer is through the deposit account relationship, which gives the bank an ongoing view into the customer's financial resources and needs.

In order to reach out to customers and offer them attractive deposit services in today's rapidly evolving financial services world, community banks must be empowered to work with industry innovators and third-party service providers to expand our product offerings, marketing services, digital delivery capabilities and customer / consumer nurturing programs.

Unfortunately, the current deposit broker rules and FDIC staff interpretations are a web of broad interpretations of scope and coverage and narrow interpretations of exceptions that makes it extremely difficult for community banks to use external resources to help our institution's gather deposits.

The regulatory "reach" associated with today's deposit brokering rules is exceedingly broad and it is also ill defined and uncertain. For example, per question B2 (show below) within its June 30, 2016 (revised July 14, 2016) Identifying, Accepting And Reporting Brokered Deposits Frequently Asked Questions ("FAQ"), the FDIC states that <u>any</u> action of <u>any</u> third party that helps an insured depository institution attract new consumers <u>may</u> constitute the facilitation of deposits.

> "What activities qualify as 'facilitating the placement of deposits?"
>
> "When a third party takes any actions that connect an insured depository institution with depositors or potential depositors, the third party may be "facilitating the placement of deposits. Hence, the third party may be a deposit broker."

The ramifications of this broad interpretation are enormous, particularly in light of the emergence of digital-only banks and internet sites that help consumers shop for, evaluate and select financial products, services and providers. Institutions like ours must be able to utilize external resources to assist us to identify prospective consumers, deliver digital capabilities, promote our institution online, participate in social

media activities and constantly communicate with our customers and consumers without fear of potential retroactive and negative deposit brokering ramifications.

Furthermore, the current deposit brokering rules results do not apply to credit unions (other than low income status institutions). Consequently, the limitations imposed upon community banks by the FDIC inexplicably cede an unfair market and competitive advantage to credit unions. Credit unions for example can utilize shared service organizations (CUSOs) and pool marketing funds and advertising activities among multiple institutions to attract new members and deposits without fear of any negative regulatory ramifications.

Let us be clear, we do not underestimate the difficulty of the FDIC's reevaluation task and will not attempt to recommend a comprehensive definition of brokered deposits.

We recognize that an inappropriately narrow definition of brokered deposits could put insured depository institutions, the deposit insurance fund, and ultimately tax payers, at risk.

At the same time, an inappropriately broad definition of brokered deposits is likely to accelerate further consolidation within our country's banking system, increasing the systemic implications of problems at individual banks, and potentially creating even greater risks to the deposit insurance fund and taxpayers.

We believe the modernization of the brokered deposit rules will be facilitated most effectively, and without creating undue risks to individual banks or to the banking system itself, by identifying characteristics of deposits that the FDIC would not consider to be brokered deposits however they are acquired.

For example, the following deposits should be not considered to be brokered deposits.

- *Multi-Service Relationship*: All deposits (checking, savings, MMA, CDs) associated with an individual customer who has another ongoing bona fide financial services relationship with the bank should not be considered to be brokered deposits. The existence of another relationship, such as a loan, demonstrates an ongoing relationship between the individual depositor and the bank.

- *Transaction Accounts*: Bona fide transaction accounts (including reward-based checking accounts) should not be considered to be brokered deposits. These accounts are used for transaction purposes, are difficult to move, and result is a stable relationship between the depositor and the bank.

In addition, accounts that are opened directly by an individual depositor rather than by a third party and are held directly in the name of the beneficial owner of the funds and are subject to the individual depositor's control are less likely to be withdrawn in times of stress than accounts that are held in the name of unaffiliated third parties. These accounts should not be considered to be brokered deposits absent compelling evidence that the accounts are being controlled by a third party. And the fact that a bank utilizes external resources to help it attract new customer relationships should not be interpreted as the third-party having control over an account regardless of the form of compensation the third party receives. Customer nurturing activities (i.e. identify, attract, engage, develop, retain) including personalized marketing messages build customer loyalty—the problem with brokered deposits in the past has been the absence of such individual customer loyalty.

Brokered deposit regulations were originally designed to restrict certain kinds of deposits that institutions in a weakened capital position could accept. The language and legislative history of Section 29 of then Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) make clear that Congress

sought to achieve an explicit purpose: restricting the facilitation of deposit gathering for misuse by troubled banks.

But the regulations — written over 30 years ago — did not contemplate the advent of the internet, smart phones or how the industry has evolved along with the preferences of its customers. Moreover, brokered deposits themselves have evolved. For example, deposit regulations often don't consider how banks have changed the ways that they communicate with their customers and the rules can interfere with customer interactions, penalizing banks for finding new and innovative ways to provide deposit services.

Under the FDIC's "national rate cap," less-than-well-capitalized banks may not pay interest rates that significantly exceed the prevailing rate in the institution's market area or the prevailing rate in the market area from which the deposit is accepted. For out-of-area deposits, the rate cannot exceed the national rate caps. Recognizing that competition for deposit pricing has become increasingly national in scope, the FDIC established in 2009 a presumption that the prevailing rate in all market areas is the FDIC national rate cap.

Also in 2009, the FDIC decided that pegging the national rate cap to 120% of the current yield on U.S. Treasury obligations with similar maturities was not working. Treasury yields were so low that year that they fell well short of the national average rates that banks were paying on their certificates of deposits. The FDIC decided to address the problem by redefining the national rate caps, for deposits of similar size and maturity, to be "a simple average of rates paid by all insured depository institutions and branches for which data is available."

Currently, the FDIC uses a private firm to survey all insured depository institutions and their branches on the interest rates they pay. It adds 75 basis points to that average to determine the national rates caps. The FDIC has a rate cap for certificates of deposit of differing maturities, interest checking accounts, money market accounts and savings accounts. These are published weekly on the FDIC website.

There are many problems with the current process the FDIC uses for determining the national rate caps. However, the worst problem of all is the result. During the past two years, the caps have not been close to current Treasury yields nor to what community banks must pay to obtain deposits through a listing service or third-party broker. For example, the current one-year Treasury yield is 2.42%, whereas the current national rate cap for a one-year non-jumbo CD is 1.40%, a 102-basis-point difference. Furthermore, community banks must pay close to 2.60% to obtain a one-year certificate of deposit through a listing service.

Another problem with the rate caps is they are based on deposit products at all bank branches. Because the nation's largest banks have nationwide branch networks with identical deposit products and prices, they tilt the scales on the FDIC's calculation heavily in their favor. Meanwhile, branchless and rapidly growing web-based banks such as Ally and Goldman Sachs are underrepresented, contributing as much to the calculation as the smallest community banks.

The rate cap also misses promotional rates for non-standard products, such as 13- or 19-month CDs. The rates on these products can be 150 to 200 basis points higher than standard rate offerings, yet they are excluded from the FDIC's calculation. The same goes for deposit rates at credit unions, which are a primary competitor for many community banks, and non-interest accommodations such as discounts on bank services.

This faulty methodology could lead to a liquidity crisis of its own making for many banks. When the economic upswing eventually comes to an end—for whatever reason—regulators will likely react with CAMELS rating downgrades and even regulatory orders for some community banks, leading to de facto

less-than-well-capitalized designations. These actions will in turn restrict the rates affected banks can pay on deposits, likely resulting in a shedding of depositors, a true liquidity crisis for many institutions, and failures that could have a ripple effect and pose a needless drain on the Deposit Insurance Fund. Ultimately, the rate caps could in and of itself create a liquidity crisis.

While some have encouraged community banks to calculate and use locally based rate caps as FDIC rules allow, the national rate cap could itself be improved by the FDIC with some relatively simple fixes. First, policymakers should calculate the rate cap using one entry per bank, rather than the current per-branch system, and should include credit union rates. This would address the distortions created by megabank branch networks and non-traditional deposit incentives while offering a fairer assessment of the deposit rates that financial services competitors offer.

And rather than relying on standard CD maturity terms, the cap could incorporate a series of maturity ranges to include both traditional and promotional products to provide a more accurate assessment. Finally, when banks become subject to an enforcement order, they should not necessarily also be subject to the onerous national rate caps.

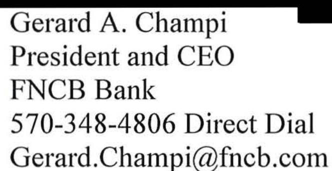
Meanwhile, the FDIC should at least stick to enforcing the cap on less-than-well-capitalized institutions. Regulators are reportedly bringing up the national rate caps during exams of well-capitalized banks, insisting in many cases that they explain what would happen to their deposits if they were suddenly downgraded. This is a misuse of the policy.

Regulators are justified in monitoring liquidity risks in an environment of rising interest rates, but their methodologies should be as sound as possible to avoid marketplace distortions. While well intentioned, the national rate cap has flaws that should be addressed.

We believe that a ground-up review of the deposit broker rules, interest rate restrictions and FDIC interpretations is an important step in aligning depository regulation with twenty-first century consumer expectations, modern banking practices and our industry's ever evolving marketplace realities.

We appreciate the opportunity to share our perspectives with the FDIC as the agency reviews its current deposit broker / brokered deposit regulations and interest rate restrictions and look forward to the outcome of the FDIC evaluation process.

Sincerely,



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