**DISCOVER**
BANK

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*Via Electronic Submission*

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20249

***Re: Brokered Deposits and Interest Rate Restrictions [RIN 3064-AE94]***

Discover Bank ("Discover") appreciates the opportunity to provide input to the Federal Deposit Insurance Corporation ("FDIC") in connection with its advanced notice of proposed rulemaking on brokered deposits and the interest rate caps applicable to banks that are less than well capitalized.[1] As described in the notice, the FDIC is inviting input on how it can update its regulations and interpretations to reflect changes in technology, business models, products, and the economic environment since the statutory restrictions on brokered deposits were originally established in 1989. Discover strongly supports the FDIC's efforts to modernize its regulations and we agree that a fresh look at the classification and treatment of brokered deposits is particularly appropriate given the very significant developments over the past 30 years. We believe there are opportunities for the FDIC to update its rules and interpretations in a manner that would encourage banks to develop innovative approaches to serving their customers, better reflect the modern banking environment, and better fulfil the FDIC's statutory obligations.

Discover is one of the leading direct banks in the United States, offering a broad array of retail banking services to consumers, including checking, savings, and money market deposit accounts, as well as credit cards and other types of consumer loans. We have a distinctly modern approach to banking that utilizes advances in technology to establish direct relationships with our customers primarily through digital channels, including a full service website, one of the top-rated mobile applications, and dedicated 24 hour a day customer support teams. As a direct bank, we offer consumers the ability to conveniently open, fund, and access a wide range of deposit products from anywhere in the United States without ever visiting a brick-and-mortar branch. While this approach is not unique in the current market for banking services, it is a model that almost certainly was not contemplated when the FDIC originally adopted its brokered deposit regulation in 1990.

The FDIC's regulation and the statute upon which it is based were precipitated by what policy-makers described as "flagrant abuse of the deposit insurance system" by some unhealthy banks

[1] "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions," 84 Fed. Reg. 2366 (February 6, 2019).

during the savings and loan crisis in the 1980's. As explained by one of the law's sponsors, the restrictions were principally intended to address the problem of failing banks using third party brokers to "buy funds" as a last chance for survival when their loan quality deteriorated and core depositors had begun to flee.[2] These "deposit brokers" were businesses that enlisted certificate of deposit investors from all over the country who were looking for higher yield but otherwise indifferent to which insured bank held their funds. The brokers matched their investors with struggling banks that were desperate for funding and willing to pay above market rates even for low quality deposits with no promise of a lasting customer relationship. Lawmakers were explicitly *not* concerned about regulating the practices of healthy institutions, which is why none of the restrictions apply unless a bank is no longer well capitalized.[3]

Nevertheless, there are significant implications today even for healthy banks if they hold deposits that are classified as "brokered" under the FDIC's rules. For example, the FDIC's insurance rules impose higher annual assessment rates on banks that hold brokered deposits.[4] Brokered deposits also receive punitive treatment under the banking agencies' liquidity regulations, the liquidity coverage ratio and proposed net stable funding ratio.[5] There is also very often a regulatory stigma associated with brokered deposits that can adversely impact a bank in various ways, including through the supervisory process. Given the negative implications, banks must think twice before accepting deposits that would be classified as brokered even when those deposits are from the bank's core customers and part of a sound business plan. It is therefore critical that the FDIC ensure its rules and supervisory approaches appropriately delineate between the imprudent conduct and "hot money" that the restrictions were originally intended to address and other more responsible funding and asset liability management practices.

Our recommendations below include several ways we believe the FDIC can adjust its brokered deposit regulation and related interpretations to more effectively meet its policy goals, better reflect the modern banking environment, and promote innovation. Specifically, Discover recommends that the FDIC make the following changes:

I. Narrow the interpretation of "deposit broker" in the context of digital marketing;

II. Clarify that deposits are not "brokered" when placed by a consumer in a transactional account or by a consumer who has multiple relationships with the bank; and

III. Update the methodology for establishing interest rate caps to account for a bank's business model and true competitive market for gathering deposits.

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[2] *See*, Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (April 19, 1989).

[3] In the words of the law's co-sponsor, "[y]ou do not see healthy institutions soliciting for brokered deposits. They do not need them." *Id.*

[4] *See*, 12 CFR Part 327.

[5] *See, e.g.*, 12 CFR § 329.32(g).

We address each of these recommendations in more detail below.

**I. The FDIC should narrow its interpretation of what constitutes "facilitating" the placement of deposits within the marketing context to avoid designating deposits as brokered when placed directly by a consumer without intermediation of a third party**

The FDIC's current guidance regarding the definition of "deposit broker" in the context of third party marketing relationships is overly expansive and does not reflect the modern banking environment or consumer preferences. The term "deposit broker" is defined by statute and in the FDIC's regulation to include "[a]ny person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions."[6] The FDIC has issued numerous advisory opinions over the years interpreting this definition, which it recently summarized in a set of Frequently Asked Questions.[7] Through these informal advisory opinions, largely issued in the 1990's and early 2000's, the FDIC has gradually expanded the list of conduct that would constitute "facilitating the placement of deposits" and therefore trigger brokered classification. In contrast to the first prong of the deposit broker definition (i.e., placing deposits), which requires that a third party "actually delivers the funds" to the bank, the FDIC views facilitating the placement of deposits very broadly to encompass potentially "*any actions* that connect an insured depository institution with depositors or potential depositors."[8]

In establishing the contours of this very broad interpretation of the deposit broker definition, the FDIC has categorized the various forms of activities it believes constitute "facilitating" the placement of deposits, such as certain types of marketing, referral arrangements, third party endorsements, and deposit listing services, among others. Each of these categories has its own set of fact-based criteria that must be assessed on a case-by-case basis in order to attempt to determine whether the FDIC would consider the third party to be a "deposit broker." The criteria are at times needlessly complex and typically do not address the underlying stability or quality of the resulting customer relationship. For example, the FDIC generally considers a deposit account to be brokered if it results from a marketing campaign that involves a third party who is compensated based on the volume of accounts or dollar amount of deposits that are derived from the campaign.[9] This volume-based fee criterion does not consider the third party's actual conduct vis-à-vis the depositor (i.e., whether the third party is in fact *facilitating* the placement of another party's deposits), nor does it have a demonstrable correlation with the stability or quality of the resulting deposit account relationship.

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[6] 12 U.S.C. § 1831f(g)(1); 12 C.F.R. § 337.6(a)(5).

[7] FIL-42-2016, *Identifying, Accepting and Reporting Brokered Deposits: Frequently Asked Questions* (Updated June 30, 2016; Revised July 14, 2016) (hereinafter, "FAQs").

[8] *See* FAQs at B2.

[9] *See* FAQs at B4.

Unlike in 1989, or even five or ten years ago, when proximity to a branch office typically determined where a consumer chose to open a bank account, today's consumer increasingly looks to digital channels such as mobile applications, personal finance websites, and social media platforms to shop for financial services. While deposits gathered outside of a bank's geographic branch network may have historically been correlated with less stable, more rate-sensitive behavior characteristics, an increasing number of banks now have the capability to meet their customers' needs without any physical branches at all. This trend includes a growing number of traditional banks that have launched or are planning to launch a digital-only banking platform. With the rise of digital banking, consumers today are less concerned about branch access and increasingly base choice-of-bank decisions on other factors such as the bank's reputation for customer service, the quality of its digital applications, the range of other products and services it offers, the existence of account features like peer-to-peer payments, mobile wallets and budgeting tools, and the rate of return the bank is offering in the form of interest and reward programs. As a result of these significant changes in the banking environment and consumer preferences, the policy underpinnings of what constitutes a "core" deposit has definitely shifted.

As consumers move more and more into digital spaces to shop for financial services, banks have also necessarily shifted their marketing approach to meet consumers where they shop. Unlike traditional marketing platforms such as print, radio, and television, digital marketing is significantly more interactive, which allows businesses to engage and build relations with consumers in ways that traditional marketing did not. For example, businesses today increasingly use tools like social media and marketing partnerships to help define and build awareness for their brand and to learn what consumers want in order to improve their services. Another important distinction is that the results of digital marketing are far easier to measure. This has altered the economics of marketing, leading to the creation of new metrics and entirely new fee structures such as cost-per-click (CPC), cost-per-thousand impressions (CPM), and cost-per-acquisition (CPA).

These new approaches provide banks and other online businesses with powerful tools to more effectively and efficiently allocate their marketing resources. However, when it comes to marketing *deposit* products, banks are often confronted with difficult questions about whether their preferred approach might trigger brokered deposit classification. For example, the use of a results-based fee structure, such as a CPA structure where the business only pays the website publisher if the consumer clicks through a banner advertisement and makes a purchase or opens an account, would raise questions about how the resulting deposits will be treated under the FDIC's rules. With CPA being one of the most common fee structures in digital advertising today, this can have a significant chilling effect on the way banks are able to market and deliver their products in online environments.

To modernize its rules and address the above concerns, we recommend that the FDIC amend its regulation or issue interpretive guidance to more clearly distinguish between what it means to be "in the business of...facilitating" the placement of deposits and ordinary run-of-the mill marketing in the digital age. This could be achieved in several different ways but one simple approach would be to clarify that deposits placed by a consumer *directly* with a bank, using its normal account opening systems (e.g., the bank's website, mobile application, or phone process), would not be "brokered" regardless of how the consumer came to learn about the bank—be it, for example, after hearing a radio or television advertisement or by clicking on a banner advertisement on a third-party's website. In such cases, the consumer is choosing to engage with the bank directly, without any intermediation or "facilitation" of a third-party. From the consumer's perspective, the account relationship is virtually indistinguishable.

Further, given the dynamics of modern digital marketing, merely hosting a bank's advertisement on a third party's website should not make the owner of that website a "deposit broker" even if the website owner is compensated based on the effectiveness of the advertisement, as is commonplace in today's environment. We are not aware of any data demonstrating that such a factor has any bearing on the quality or stability of the customer relationship that is established. In our experience there is not a meaningful difference in customer behavior or attrition rates based on marketing fee structures. For these reasons, we believe this change would permit the FDIC to meet its policy objectives while ensuring its rules do not serve as an impediment to banks being able to develop innovative methods to meet the banking needs of *all* consumers, including those that may not live near a traditional bank branch.

**II. The FDIC should clarify that deposits placed by a consumer in a transactional account, or by a customer with multiple relationships, are not "brokered deposits"**

To better align its brokered deposit regulations with the original intent and purpose of the statute, and the FDIC's own stated objectives, the FDIC should clarify that deposits placed directly by a retail customer into a "transactional" account (e.g., a checking account) and deposits placed by a customer who maintains more than one account with the bank, are not "brokered deposits." These types of accounts evidence a more committed customer relationship and are inherently more stable. They also do not present any of the risks associated with "brokered deposits" that are identified by the FDIC in its advanced notice of proposed rulemaking.[10] For example, such deposits are not of a nature that they can be gathered quickly to fuel rapid growth and they would very likely be viewed as "attractive to the purchasers of failed banks."[11] The federal banking agencies have all publicly acknowledged that transactional and multiple-account relationships with retail customers are generally more stable than other types of deposit accounts.[12] The FDIC has also separately

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[10] *See* 84 Fed. Reg. at 2,369.

[11] *Id.*

[12] For example, the interagency Liquidity Coverage Ratio regulations define a "stable retail deposit" as an insured deposit that is either: (a) held in a transactional account, or (b) placed by a depositor that has another established relationship with the bank "such as another deposit account, a loan, bill payment services, or any similar service or product provided to the depositor that the FDIC-supervised institution demonstrates to the satisfaction of the FDIC would make deposit withdrawal highly unlikely during a liquidity stress event." *See,* 12 CFR § 329.3.

acknowledged that such accounts add to a bank's franchise value and would thus be valuable to the purchaser of a failed institution.[13]

It is entirely consistent with the plain text and expressed purposes of the statute for the FDIC to clarify that deposits placed by customers with more than one relationship with the bank are not "brokered." As noted above, the term "deposit broker" is defined in both the statute and the regulation to include persons, "engaged in the business of placing deposits, or facilitating the placement of deposits, <u>of third parties</u> with insured depository institutions."[14] It is reasonable for the FDIC to interpret the term "third parties" in this context as excluding a bank's <u>existing</u> customers.[15] This is particularly true given the context in which the statutory restrictions were enacted when "deposit brokers" were used to acquire funding from out-of-market investors with no other connection to the bank. There is also a textual and policy basis to infer from the statute that transactional deposits placed directly by a consumer should be presumed not to have been "facilitated" by a deposit broker, absent unusual circumstances, given the interactive nature of the accounts and the manner in which customers select them. For instance, consumers are typically more selective in deciding where to open a transactional account and they generally are not motivated by higher yields.

### III. Interest rate caps under the FDIC's brokered deposit rule should be calculated on the basis of a bank's true competitive market for gathering deposits, with recognition of its business model, not just competition in a given *geographic* market

The FDIC's current rules impose default interest rate caps on less than well capitalized banks that are based on a national average rate for deposit products of similar type and tenor. These caps are currently set artificially low as a result of the existing methodology, which is inherently weighted by the largest banks with extensive brick-and-mortar branch networks. The statute limits a bank from paying rates that "significantly exceed" the rates offered in the bank's "normal market area" or the national rate for deposits accepted *outside* its normal market area. The statute does not define these terms. For a direct bank that offers deposit accounts to consumers throughout the United States, defining its "normal market area" solely in terms of geography is problematic. For one, such a bank's normal market area is effectively the entire United States. More importantly though, the "national rate" as currently defined by the FDIC is not reflective of business model considerations or true competitive forces that impact a direct bank's pricing decisions. The capability to offer compelling deposit products without a physical branch network is a distinct advantage that direct banks are able to pass on to their consumers. To illustrate, the current national average rate as

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[13] *See, e.g.*, FDIC, *Study on Core Deposits and Brokered Deposits* (July 8, 2011) at 51 ("deposits that are based upon a customer relationship are likely to contribute to franchise value because they are more stable and they allow the bank to acquire long-standing relationships").

[14] 12 U.S.C. § 1831f(g)(1); 12 C.F.R. § 337.6(a)(5) (emphasis added).

[15] In this regard, the FDIC appears to adopt a similar view in the ANPR where it states that a deposit broker, as defined in the statute, places or facilitates the placement of deposits "of another third party (such as [the deposit broker's] customers)." 84 Fed. Reg. at 2,371.

published by the FDIC for a savings account is a mere 0.10%, while the rates offered by most direct banks are above 2.00%—more than 20X the national average as calculated by the FDIC. This divergence is not the result of direct banks paying higher rates "out of desperation" but instead a reflection of their business model and their ability to pass along cost efficiencies to their customers.

To address this issue, we request that the FDIC revise its methodology for calculating average deposit rates to better account for diverse business models and competitive markets. We also request that the FDIC amend its brokered deposit rule to explicitly permit consideration of a bank's business model and other competitive factors beyond mere geography to determine the bank's "normal market area." The FDIC might, for example, define a bank's interest rate caps using a relative value in excess of the average rate offered by that bank's normal competitors. This approach would be more consistent with the way banks manage their liquidity risks. It would also better reflect the diversity of the modern financial services landscape and would be fairer to all market participants while remaining true to the statute and the FDIC's policy objectives.

Discover appreciates the FDIC's attention to these very important issues and we are grateful for the opportunity to comment on the advanced notice of proposed rulemaking. We respectfully request that the FDIC consider the recommendations in this letter and we would welcome further dialogue on opportunities to ensure the FDIC's rules and interpretations are aligned with modern banking practices, consumer preferences, and safety and soundness objectives.

Sincerely,

[redacted]

D. Christopher Greene
Acting General Counsel