EnerBankUSA®
SALT LAKE CITY, UTAH | MOORESVILLE, NORTH CAROLINA

VIA EMAIL

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

Re: Request for comments regarding advance notice of proposed rulemaking with respect to brokered deposits and interest rate restrictions (RIN 3064-AE94)

Dear Mr. Feldman,

EnerBank USA ("EnerBank" or "we") greatly appreciates the opportunity to respond to the Federal Deposit Insurance Corporation's ("FDIC") request for comment in its advanced notice of proposed rulemaking regarding brokered deposits and interest rate restrictions. As background, EnerBank is an industrial loan company ("ILC") founded on June 1, 2002 and headquartered in Salt Lake City, Utah. EnerBank provides unsecured home improvement loans to consumers working with strategic business partners and independent home improvement contractors throughout the United States. EnerBank's strategic partners include manufacturers, distributors, franchisors, and major retailers of home improvement, remodeling, and energy saving products and services.

We applaud the FDIC for "undertaking a comprehensive review of the regulatory approach to brokered deposits and the interest rate caps," and its recognition that these regulations need to be modernized "in light of significant changes in technology, business models, the economic environment, and products since the regulations were adopted." As part of that review, we encourage the FDIC to consider the important role certain brokered deposits, specifically brokered Master Certificates of Deposit ("Master CDs"), play in providing a stable, low-risk source of deposits and liquidity to banks. Accordingly, we encourage the FDIC to update the deposit insurance assessment to avoid stigmatizing brokered deposits. We also urge the FDIC to revise the interest rate cap formula by incorporating the pre-2009 methodology for determining the "national rate" as an option. We believe the existing method is not indicative of the actual rates required to attract new deposits, especially considering that accurate price signals are more essential now than in the past because digitization has created a highly competitive national marketplace for deposits.

**EnerBank, ILCs, and Brokered Master Certificates of Deposits**

ILCs like EnerBank lend on a nationwide basis and do not maintain branch networks, so they often rely on deposits sourced by the brokerage community across the national marketplace.



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In particular, ILCs generally issue brokered Master CDs—an aggregation of individual CDs—which are held in book-entry form by the Depository Trust Company ("DTC"). EnerBank acquires brokered Master CDs that can only be redeemed prior to their maturity dates upon the death of the holder or legal adjudication of incompetence of the deposit holder and presentment of an official government document verifying death or such adjudication. These restrictions make these brokered Master CDs quite stable, as depositors cannot "break" their CD and redeem it prior to the scheduled maturity date to take advantage of higher interest rates.

Certain brokered deposits—like the type of brokered Master CDs that EnerBank issues—actually reduce the likelihood of a liquidity crisis, bank failure, and, ultimately, erosion of the Deposit Insurance Fund ("DIF") because of their stable nature. A "bank run" is the greatest liquidity-related threat to a bank because depositors, *en masse*, withdraw their non-maturity deposits from an institution because of public concerns about the institution. Whether the withdrawals are warranted or not, they create a cascading effect, resulting in additional withdrawals that could lead to the bank's insolvency. A bank that predominantly holds traditional core deposits is susceptible to such a risk, whereas a bank funded solely by brokered Master CDs is not vulnerable because such deposits can only be withdrawn before maturity if the depositor dies or is declared incompetent by a court of law. Material levels of unexpected deposit outflows are, therefore, impossible. So too is the cascading effect of a quick series of withdrawals. Because of these characteristics, effectively managed banks are able to incorporate brokered Master CDs into their funding and risk management strategies.

By acquiring brokered Master CDs, EnerBank sources funds at a competitive price without having to maintain an otherwise unnecessary and capital-intensive branch network. By using brokered Master CDs instead of core deposits, we are able to fund our balance sheet in lock-step with loan growth in all types of economic environments. Core deposits typically surge during recessions when loan growth is low, and they typically leave the bank when the economy improves and loan growth strengthens, inhibiting banks' ability to serve their customers.

Brokered Master CDs provide an effective tool for mitigating interest rate risk. All of our loans are fixed-rate installment loans and we have significant loan prepayment data that allows us to accurately forecast expected cash flows. Using this data, we effectively match the duration of loans with our deposits. This methodology allows us to operate a matched book and, in our opinion, is preferable to funding a long-term fixed-rate loan with non-maturity, variable rate "core" deposits.

**Digitization and the National Market for Deposits: Increasing Competitive Pressures**

For years, many ILCs have effectively managed their risk exposure and liquidity by integrating brokered Master CDs into their portfolios. Rapid digitization of financial services, however, has created a highly competitive national market for deposits that is more susceptible to volatility and risks that are entirely unrelated to brokered deposits. The near ubiquity of the Internet has enabled banks to acquire deposits quickly by offering an unsustainable promotional interest rate that consumers across the country can take advantage of by simply opening an account online. With just a few clicks, these customers can transfer their funds to the next high-rate bank, effectively becoming "rate chasers." These rate chasers are often difficult to manage and add complexity and risk to the bank. As a result, determining a depository institution's franchise value based on its relationships with individual depositors is now more difficult. Importantly, such deposits are still considered core deposits even though they are far more volatile and riskier than brokered Master CDs.

The disparate treatment between fundamentally more stable products like brokered Master CDs and these highly volatile "core" deposits that provide little franchise value further underscores the need for brokered deposit reform. Without reform, EnerBank will continue to be penalized for implementing prudent risk management strategies simply because our deposits are sourced from a third party, while the threat to the DIF from Internet deposits remains unchecked.

An additional benefit of brokered Master CDs is that they allow banks that lend nationwide to fund those loans with deposits that are also sourced from a nationwide marketplace. This benefits community banks by limiting the competition for deposits in their local markets.

**Proposed Reforms**

Considering brokered Master CDs' characteristics, and the rise of Internet banking, EnerBank respectfully submits the following proposed reforms for the FDIC's consideration.

*Are there ways the FDIC can improve its implementation of Section 29 of the FDI Act while continuing to protect the safety and soundness of the banking system? If so, how?*

Correlation is not always causation. Brokered Master CDs play an important role in enabling EnerBank to serve its customers. For many years, however, brokered deposits have been categorically associated with unsustainable asset growth, particularly in risky assets, high volatility, and low franchise value. As a result, banks with substantial brokered deposit holdings have been considered significant risks for failure and, thus, the erosion of the DIF. However, as the FDIC's "Study on Core Deposits and Brokered Deposits" states, "there should be no particular stigma attached to the acceptance by well-capitalized banks of brokered deposits *per se* and that the proper use of such deposits should not be discouraged." However, the existing methodology for calculating the deposit insurance assessment actually does stigmatize brokered deposits. According to one 2018 study, "Bank Funding Sources: A New Look at Brokered Deposits" by James Barth and Yanfei Sun ("Barth Study"), if a highly rated, well-capitalized bank with a 10% brokered deposit ratio should increase that ratio to 50%, the deposit insurance assessment would increase 500%.

EnerBank agrees with the FDIC's finding. The type of deposits banks utilize or the growth banks experience does not cause banks to fail. Rather, poor loan quality, insufficient capital or a lack of liquidity cause banks to fail. In the cases of the 472 FDIC-insured banks that failed between

2004 and 2013, publicly available financial data published by the FDIC shows a clear and dramatic progression from lower troubled asset ratios to higher troubled asset ratios (on average from 20.6% to 241.5%) during the three-year period preceding the institution's failure. The same group of banks experienced an equally clear and dramatic progression from higher reserve to troubled asset ratios to lower reserve to troubled asset ratios (on average from 958.6% to 25.0%) during the same three-year period for each failed institution. This data demonstrates that poor loan quality and poor risk management resulted in inadequate capital and liquidity, which caused these banks to fail. Conversely, the Barth Study found that the 100 banks with the highest ratio of brokered deposits-to-total deposits "have lower (better) efficiency ratios and slightly higher capital ratios than all banks with brokered deposits, as well as all banks."

***Recommendation:*** Remove the Brokered Deposit Ratio component from the FDIC deposit insurance assessment calculation. This component currently causes low-risk banks that use brokered deposits to be charged higher assessments than their actual risk profile would justify.

*Are there areas where changes might be warranted but could not be effectuated under the current statute? Are there any statutory changes that warrant consideration from Congress?*

No, we believe that previous administrations at the FDIC have gone beyond the scope and intent of the existing statute. At a high level, the statute says that a bank needs to be well-capitalized to use brokered deposits. We agree with that. The statute does not require the higher deposit insurance assessments or the increased examiner scrutiny that was instituted by previous administrations at the FDIC. We believe that the FDIC has the authority to make the necessary changes.

*Do institutions currently have sufficient clarity regarding who is or is not a deposit broker and what is or is not a brokered deposit? Are there ways the FDIC can provide additional clarity through updates to the brokered deposits regulation, consistent with the statute and the policy considerations described above?*

Many financial institutions employ the use of HSAs in their deposit and funding strategy. EnerBank has classified HSA deposits as non-brokered based on two relevant exceptions to the definition of a deposit broker. The first covers "the trustee of a pension or other employee benefit plan, with respect to funds of the plan;" and the second is "a person acting as a plan administrator ... in connection with a pension plan or other employee benefit plan provided that that person is performing managerial functions with respect to the plan." Further, an agent is also excluded whose primary purpose is not the placement of funds with depository institutions. We also operate under the assumption that the HSA administrator we work with is acting as a trustee and plan administrator for the deposits they manage. Their primary purpose is managing HSA programs. That they must place funds with depository institutions is secondary.

Some institutions classify these deposits as brokered and others as non-brokered. EnerBank is unaware of any definitive regulatory guidance or an "official interpretation" that settles the questions as to whether or not these deposits should be classified as brokered or non-brokered.

***Recommendation:*** We request that the FDIC provide definitive guidance that classifies HSA deposits as non-brokered.

*Should the amount of the rate cap, currently 75 basis points over either the national rate or the prevailing market rate, be revised? If so, how?*

Based on our own experience and a limited number of other depository institutions we monitor, the FDIC national rate is not indicative of the actual rates required to attract new deposits in the normal course of business. As the deposit rates we offer are more closely tied to wholesale funding rates like U.S. treasuries and FHLB advances, we find that the old method of tying the rate cap to U.S. treasuries plus a margin was a better indicator of the national rate. To create a more even playing field in the increasingly competitive national market for deposits, we recommend that the FDIC replace the current interest rate cap formula with the original formula, the sum of the U.S. treasury yield and a preset margin, given its simplicity, transparency, and independence from proprietary data. Moreover, and most importantly, it would accurately reflect the price of deposits.

With respect to promotional rates and special features, EnerBank recommends that such rates be excluded from the formula for calculating the national rate, provided the FDIC does not otherwise modify it, because banks that are less than well-capitalized should be prohibited from offering promotional rates or deposit rates with special features, and the FDIC should not amplify the distortions these banks bring to the market.

**Conclusion**

EnerBank appreciates the opportunity to comment in ways that we believe will promote safety and soundness of the banking industry and foster economic growth. Please do not hesitate to contact me if we can be helpful. We look forward to working together to create a risk-focused regulatory framework for the banking system.

Sincerely,

[redacted]

Charlie Knadler
President & Chief Executive Officer
EnerBank USA