Community Bankers Association of Illinois®

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June 8, 2020

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

Regarding: Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions RIN 3064-AE94

Dear Mr. Feldman:

The Community Bankers Association of Illinois ("CBAI"), which proudly represents 300 Illinois community banks, appreciates the opportunity to comment on the Federal Deposit Insurance Corporation ("FDIC") proposed rule regarding brokered deposit restrictions ("Proposal"). CBAI agrees with the goals of the Proposal articulated by the FDIC Chairman in her December 11, 2019 speech "Brokered Deposits in the Fintech Age." Those goals are to:

- Develop a framework that encourages innovation within the industry and allows banks to serve customers the way customers want to be served;

- Take a balanced approach to interpreting Section 29 of the FDI Act that tracks to the letter and spirit of the law;
- Minimize risk to the Deposit Insurance Fund ("DIF"); and
- Establish an administrative process that emphasizes consistency and efficiency by establishing an easy-to-understand, bright-line standard for determining whether an entity satisfies the statutory definition of a "deposit broker" or not, and by creating an application process for implementing the primary purpose exception ("PPE").

CBAI believes the FDIC Proposal properly recognizes the substantial evolution of the banking industry since the enactment of Section 29 of the Federal Deposit Insurance Act ("FDI Act") over 30 years ago. Since then, consumer preferences and the manner of delivering banking products and services have changed dramatically. Today, Internet search engines proliferate and the use of digital devices to deliver banking services is commonplace. The use of data to improve customer products and experiences has exploded together with the emergence of artificial intelligence, data analytic tools, and the introduction of new technologies and financial technology ("fintech") companies. Against this backdrop, community banks rely upon third-party service providers to help them serve their local communities and compete with large and regional banks, credit unions and fintech providers.

While we agree with the FDIC's desire to update the current brokered deposits rule to reflect today's banking practices and consumer preferences, we believe the Proposal must be revised to align with the goals of the Proposal, as articulated by the FDIC Chairman, and to fully recognize the necessity for community banks' access to services offered by third-party service providers. This comment letter describes our concerns with the Proposal and the revisions we recommend to address these concerns.

CONCERNS

If implemented as currently written, the Proposal will fail to accomplish the goals expressed by the FDIC Chairman for a modernized brokered deposit rule. CBAI's primary concerns are that (1) the proposed definition of "facilitation" is too broad and will negatively impact community banks; (2) the Proposal fails to recognize the stable nature of deposits that reflect an ongoing direct relationship between an individual depositor and his or her bank; (3) the proposed PPE application process is impractical and unnecessary; and (4) the industry has relied on well-established staff advisory opinions which may potential be negated by this Proposal.

- **The "Facilitation" Definition Is Too Broad and Will Negatively Impact Community Banks**

  The Proposal introduces a new "facilitating the placement of deposits" definition that delineates specific activities that the FDIC sees as representing the activities of a deposit broker. Rather than creating the bright-line standard that Chairman McWilliams identified, the new "facilitating" definition is overly broad and would inappropriately capture a wide range of industry participants who were previously unaffected by the current statute and rule. This will negatively impact community banks who rely on third-party resources to assist them in providing deposit offerings to their local communities.

  Part of the proposed "facilitation" definition appears to restrict community banks from receiving any external information from any third party (and by extension, any interpretations based on that information) about their current customers and/or potential new customers. Specifically, this prong will inappropriately restrict insured depository institutions ("IDIs") from being able to build comprehensive profiles of their customers; limit banks from being able to send customized messages and account alerts to their accountholders and essentially put an end to a bank's ability to expand their customer relationships by offering additional products, services and capabilities. In a world of hi-tech customized messages, consumer convenience and instant digital device access to information, we do not believe that it is the FDIC intention to prohibit the exchange of information that make these capabilities possible. We recommend removing this restriction altogether from the proposed definition of "facilitation".

  Another part of the proposed "facilitation" definition would impede banks from using advisory and consulting services to assist them develop, deliver, and improve their retail deposit offerings. As such, we believe if the Proposal is enacted as currently written, our members would no longer be able to utilize companies that provide market research, product development; price elasticity studies, profitability assessments, non-interest income, retail optimization services, behavioral and activity insights, asset liability management advice, overdraft protection services, reward and customer loyalty programs, and many others.

  Community banks rely on knowledgeable third parties to help them with these activities and yet, the language used in the Proposal would deny IDIs access to these experienced resources. Rather than providing safety and soundness protections, the proposed language would diminish safety and soundness by preventing community banks from utilizing industry experts and advanced analytic banking tools, models, and analysis. We recommend that the Proposal be revised to make it clear that community banks can continue to utilize third-party service providers to assist them develop, enhance, and deliver their retail deposit offerings to the communities they serve without suffering any negative regulatory repercussions.

Finally, we are concerned that the last part of the proposed "facilitation" definition prohibits IDIs from being able to use any external resources for anything other than "administrative services." The proposed language neither describes what an "intermediary" is nor what activities such entities are engaged in. We fear the proposed language may be broadly and improperly applied to limit community banks' use of online account opening applications, identity verification fraud detection services, search engine optimization and geolocation services, artificial intelligence and pattern identification tools, digital delivery mechanisms, automatic marketing platforms and other similar services, and capability that third parties now provide to assist many of our members to promote their institutions and attract, engage, and cultivate current and potential customers.

In our view, the primary flaw within the proposed "facilitation" definition is that it focuses upon the "activities of the third party" leading up to the placement of the deposit, rather than on the "direct relationship established between an individual depositor and their selected bank" when that deposit is gathered. We believe a more effective approach would be to focus on the strength and characteristics of the direct relationship that is established between the individual depositor and his or her IDI (and the stable nature of that depositor's associated funds) rather than on an IDI's use of a third party or third-party service, provided that the third party has no contractual relationship with the individual depositor to place, manage or control the individual depositor's deposits, banking decisions or financial activities. As long as the bank owns and manages the depositor relationship, the institution should not be penalized from outsourcing activities and services that would otherwise be permissible if conducted directly by the institution.

- **The Proposal Fails to Recognize the Stable Nature of Specific Types of Deposits**

The Proposal fails to acknowledge the stable nature of certain types of deposits – deposits that demonstrate an ongoing direct relationship has been established between the individual depositor and their bank. Transaction account deposits and deposits that demonstrate an expanded relationship is in place between the bank and the depositor (i.e., savings, MMAs, CDs) are stable sources of funding that do not increase safety and soundness concerns or result in additional risk to the DIF because they are associated with direct depositor relationships that have been individually gathered and are owned and controlled by the IDI. These deposits actually increase our members' franchise values and they represent the preferred type of funding the FDIC encourages our member institutions to utilize to operate their businesses.

- **The Proposed Primary Purpose Exception [PPE] Application Process Is Impractical and Unnecessary**

Throughout her tenure at the FDIC, Chairman McWilliams has stated her desire to provide the industry with more transparency into the FDIC's decision making processes and determinations. We applaud her efforts but we believe the PPE application and determination process contained within the Proposal is inconsistent with the Chairman's transparency objective. It seems that if there was absolute clarity regarding the "deposit broker" definition and that definition was supported by objective, clearly articulated, and fully understood criteria, the PPE application process would be wholly unnecessary.

If the "deposit broker" definition is objectively clarified, IDI's and industry participants would be able to apply the regulation to their specific lines of business and alter their offerings, services and/or activities to align with the requirements of the regulation. Compliance could be achieved through proper due diligence and vendor management being conducted by the IDI on all third parties that it engages with and by the longstanding process of bank examination and regulatory agency oversight.

If the FDIC determines the PPE application process is necessary, the "primary purpose" exception criteria should be made clear and available to the public and the application process used selectively by the FDIC to address substantially new and innovative forms of deposit gathering activities that were not previously and publicly considered.

In addition, requiring IDIs to: track whether a third party has applied to the FDIC; please be aware of what, if any, constraints are placed by the FDIC on the third-party's conduct; and report and monitor the third-party's subsequent behavior and compliance is unrealistic and burdensome on the institution. At best, it will result in industry confusion, complexity, and costly compliance burdens.

Similarly, the Proposal suggests that the reporting requirements, including the frequency and any calculation methodology, would be specific to its written approval to each applicant. Yet, concerns about transparency and, indeed, fairness would direct that the FDIC's reporting requirements and calculation methodology be standardized and made public for all applications that are granted – in addition to the granted applications themselves.

In short, The PPE application process would not only be cumbersome and time consuming, it would also stifle innovation as community banks, industry participants, and third-party service providers would face an extended "pending" status of at least four months before new deposit offerings and delivery services could be deployed. Our member banks already face stiff competition from large banks, credit unions, and fintech providers. Community banks should not be put at a market disadvantage because of a cumbersome and unnecessary administrative process.

- **The Industry Has Relied on Advisory Opinions**

  The FDIC recognizes within the Proposal that IDIs and third-party service providers may be operating under existing Staff Advisory Opinions. The Proposal states that that the FDIC intends to evaluate existing Advisory Opinions to identify those that are no longer relevant or applicable based on any revisions that are made to the brokered deposit regulations. The Proposal states that the FDIC "plans as part of any final rule to codify staff opinions of general applicability that continue to be relevant and applicable, and to rescind any staff opinions that are superseded or obsolete or are no longer relevant or applicable."

  It is important to note that many of the long-standing and well-established services that community banks receive from third parties are provided in reliance upon Advisory Opinions previously published by the FDIC. Industry participants and community banks have made significant investments, including those in the products, platforms, and services in reliance upon these Advisory Opinions and the protections they provide. Eliminating the ability of community banks to continue to rely on these existing Advisory Opinions would further harm community banks and industry participants as it would prevent all parties from realizing the return on the investments they have made in reliance upon these Advisory Opinions and negatively impact their competitive position in their markets.

RECOMMENDED REVISIONS

If the Proposal is implemented as currently written, a sizable amount of deposits would be deemed to be "brokered," potentially causing banks of all sizes and capital categories to exceed their 10% brokered deposit threshold resulting in higher DIF assessments and liquidity coverage concerns.

This outcome would force community banks to either absorb the additional insurance assessments or withdraw deposit offerings that are supported by external resources and replace them with more expensive sources of funding like one-year and five-year certificates of deposits.

On behalf of CBAI members, we respectfully recommend that the FDIC implement the following revisions within its final brokered deposit rule. We believe these recommendations would result in modernized rule that will achieve the goal stated by Chairman McWilliams in her "Brokered Deposits in the Fintech Age" speech.

- **Recommendation 1 – Exclude Transaction and Multi-Service Account Deposits from the "Brokered Deposit" Definition**

  All community banks utilize a relationship-based business model. Our member institutions know their communities and the small business owners who enable their customers to provide for their families. Our members are the economic engines of the communities, they sponsor community events, and are actively involved in civic organizations. Our members build relationships one at a time and those relationships typically begin with a transaction account, such as a checking account, and then expand to include other deposit accounts, such as savings accounts and CDs, as well as additional banking services, such as direct deposit, various loans, online banking, remote deposit capture, and credit cards.

  Individually gathered and associated with direct depositor relationships that are established and owned by the bank, these deposits are an extremely stable source of funds that enable safe and sound operations. Consequently, we believe that transaction account deposits that are (i) fully-insured; (ii) opened by an individual depositor; (iii) titled and held in the name of that same individual depositor; (iv) governed by terms established by the bank; (iv) utilized by that same individual depositor on a monthly basis to receive funds or make payments; should be excluded from the definition of "brokered deposit" in the FDIC's final rule where the bank acknowledges that only that same individual depositor has the authority to designate withdrawals from or close that account. Further, and by extension, all other deposits that are associated with that same transaction account depositor (*i.e.*, savings, MMA, CDs) should also be excluded from the definition of "brokered deposit."

This recommendation can be implemented by creating a narrow, express exclusion from the definition of "brokered deposit" in 12 C.F.R. § 337.6(a)(2) for transaction and relationship-based account deposits where a *bona fide* independent relationship is established directly between an individual depositor and a bank and that bank owns and controls that depositor relationship, using language similar to the following:

> ***Brokered deposit*** *means any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.*
>
> *i.* <u>*Brokered deposit does not include a deposit held in a deposit account provided by an insured depository institution where the account is:*</u>
> - *A.* <u>*Pursuant to a bona fide independent relationship established directly between the individual depositor and the insured depository institution, for the primary purpose of enabling the individual depositor to make payments or other transactions or to reach savings goals;*</u>
> - *B.* <u>*Titled and held in the name of the same individual depositor;*</u>
> - *C.* <u>*Governed by terms established by the insured depository institution; and*</u>
> - *D.* <u>*Controlled by the depository institution and where only the same individual depositor has the authority to close or withdraw funds from the account.*</u>

- **Recommendation 2 – Exclude Third-Party Service Providers from the Definition of "Deposit Broker"**

Community banks often lack the same technical and financial resources that large banks and fintech providers have to design, build, deploy, and support the modern deposit products and services that consumers desire. Our members rely on industry innovators and third parties to help them provide these capabilities to their communities.

We believe all third parties that enable IDIs to offer financial products, services, and capabilities and that help IDIs establish direct relationships with individual depositors – relationships that our member institutions own, maintain and nurture – should be excluded from the definition of "deposit broker" in the FDIC's final rule. These third-party service providers are positive "enablers" – they help our members build and own direct, long-lasting individual depositor relationships. Our community bank members should be able to use third-party services that enable these enduring depositor relationships.

This narrow exclusion from the definition of "deposit broker" can be accomplished by adding language similar to the following at the end of 12 C.F.R. § 337.6(a)(5)(iii), as redesignated:

> *[The term deposit broker does not include] <u>(K) A person that provides services to an insured depository institution in connection with a deposit account established directly between the insured depository institution and the individual depositor where the insured depository institution owns and controls the depositor relationship.</u>*

- **Recommendation 3 – Create Express Exclusions in the Primary Purpose Exceptions for Certain Third Party Service Providers**

In the unfortunate event the FDIC decides not to expressly exclude third-party service providers from the "deposit broker" definition and stable sources of funding from the definition of "brokered deposits," then, at minimum, the FDIC should create an express exception from the PPE application process for third parties that assist our members offer deposit products, aid our members in establishing direct depositor relationships, and help our members secure relationship-based deposits that our members use to fulfill their role as primary economic engine within the communities they serve.

This recommendation can be accomplished by including language similar to the following in Section 337.6(a)(5)(iii)(I), as redesignated:

> *[The term deposit broker does not include] (I) An agent or nominee whose primary purpose is not the placement of funds with depository institutions if and to the extent, the FDIC determines that the agent or nominee meets this exception under the application process in 12 CFR 303.243(b)~~; or~~.*
>
> *a. <u>An agent or nominee shall be determined not to be engaged in the primary purpose of the placement of funds with insured depository institutions, and such an agent or nominee need not make an application under 12 CFR 303.243(b), if the agent or nominee:</u>*
>
> *<u>Enables an insured depository institution to offer to depositors a deposit account provided by the insured depository institution that is:</u>*
>
> *A. <u>Opened directly by an individual depositor;</u>*

B. *Governed by terms established by that insured depository institution*
C. *Titled and held in the name of such individual depositor at the same insured depository institution for the primary purpose of that same individual depositor to make payments or other transactions or reach savings goals; and*
D. *Subject to only the authority of the same individual depositor to close or withdraw funds; or*

ii. *Enables the placement of a depositor customers' funds into deposit accounts held at insured depository institutions and the amount of customer funds that it places at the insured depository institutions represents less than 25 percent of the total amount of customer assets the agent or nominee manages for depositor customers; or*

iii. *Provides services to an insured depository institution in connection with a deposit account established directly between the insured depository institution and the individual depositor, and has no contractual relationship with the individual depositor to place, manage or control the individual's deposits, banking decisions or financial activities; or*

- **Recommendation 4 – Ensure All Advisory Opinions Remain Intact Following Adoption of the Final Rule**

  We recommend that the FDIC retain all but clearly obsolete current Advisory Opinions following adoption of the final brokered deposits rule. In this time of immediate and likely prolonged health, economic and social unrest and uncertainty, now is not the time for the FDIC to review and eliminate long-standing determinations that community banks rely on to build, offer and support financial products and services that support our customers and our communities.

- **Recommendation 5 – Reservation of the Right to Prevent Evasion**

  Under the FDI Act, it is clear that the FDIC has the authority to implement the above-described recommendations within its final rule regarding brokered deposits, including the express exemption for third-party service providers.[1] If, however, the FDIC is concerned that the above recommendations may be exploited in some manner, the FDIC should explicitly reserve the right within the rule. This reservation of the right to prevent circumvention or evasion is a common regulatory construct.[2] Such a provision would give the FDIC the ability to address broad-based evasions by rule and to address potential individual evasions by order, while still operating within the procedural protections of the Administrative Procedure Act.

CONCLUSION

CBAI supports modernizing the FDIC's brokered deposit rule to reflect today's banking practices and evolving funding strategies. At the same time, we believe that if the Proposal is adopted as currently written, it will severely impact our members' ability to serve their communities.

As our members work to serve their communities throughout the challenges of the COVID-19 pandemic and social unrest, local decision-making has never been more important. Local relationships, local knowledge and local understanding of customers and communities leads to the provision of loans and credit that is essential to the financial wellness of small and rural communities in these difficult times. Community banks support the communities, small businesses, and citizens that the big banks and fintech providers ignore. Our members must be permanently empowered to gather the deposits they need to provide loans to the small businesses that operate in their local communities and to serve the financial needs of the citizens who live in the small towns and the rural communities that they serve.

CBAI respectfully recommend that the FDIC revise the Proposal in accordance with the recommendations described in our letter. Incorporating our recommendations would ensure that the final rule both achieves the goals articulated by Chairman McWilliams and enables community banks to continue to support their customers and communities.

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[1] *See, e.g.*, 12 U.S.C. §§ 1819(a)(Tenth), 1820(g), 1831f(f).

[2] *See, e.g.*, 12 C.F.R. § 325.1(c) (reservation of authority regarding annual stress tests); 12 C.F.R. § 304.14 (reservation of authority regarding implementation of reduced reporting requirements); 12 C.F.R. § 204.2(e)(6) (reserving discretion for the Federal Reserve Board under Regulation D), 12 C.F.R. § 235.6 (prohibition on circumvention or evasion under the Federal Reserve Board's Regulation II).

Thank you for the opportunity to respond to this Proposal. If you have any questions or need additional information, please do not hesitate to contact me at (847) 909-8341 or davids@cbai.com

Sincerely,

[redacted]

David G. Schroeder
Senior Vice President
Federal Governmental Relations