June 9, 2020

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.,
Washington, D.C. 20129
Attn: Comments
Re: RIN 3064-AE94
Via email to*: c*omments@fdic.gov

Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

Dear Sirs and Madam,

We are submitting this letter jointly on behalf of the National Association of Industrial Bankers[1] and the Utah Bankers Association[2]. Our associations represent a variety of banks, including branchless banks that offer specialized financial products and services nationwide. Many of these banks rely primarily on brokered deposits for funding. We are proud of the fact that for the past more than forty years our member banks have consistently been among the strongest, best capitalized and most profitable group of banks insured by the FDIC.

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[1] The National Association of Industrial Bankers (NAIB) is a national trade association for industrial banks. These specialized banks operate under the titles of industrial banks, industrial loan corporations (ILCs), and thrift and loan companies. NAIB champions innovative and safe financial services for Americans, including the underserved. ILCs comply with the Community Reinvestment Act. First chartered in 1910, ILCs provide a broad array of products and services to consumers and small businesses nationwide. They do not offer demand checking accounts, but do accept time deposits, savings deposit money market accounts and NOW accounts. Industrial banks are regulated by state chartering authority and the FDIC at the federal level. Currently ILCs are state supervised in California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah.

[2] The Utah Bankers Association (UBA) is the professional trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates for the interests of its members, enhancing their ability to be preeminent providers of financial services.

Our members appreciate the opportunity to submit the following comments regarding the history, use, benefits and risks of brokered deposits. This subject has needed careful review and updating for several years and we appreciate you taking the initiative to begin that process. With the goal of improving the standards and guidelines that apply to brokered deposits, and in recognition of the substantial changes since this type of funding was first offered many years ago, we hope you find the following comments helpful.

At the outset, we believe the changes reflected in the questions in the ANPR are in most cases too insignificant to achieve the changes needed to update and modernize the FDIC's policies and guidelines for the use of brokered deposits, so we will not address most of them. Prior to 2008, the FDIC approved many applications for banks that relied on brokered deposits for funding and those banks have generally performed better than banks in general. Since 2008 the FDIC has regularly characterized brokered deposits as "volatile," "high rate," and a major contributor to unsafe growth resulting in bank failures. In reality, brokered deposits have matured into a stable, reliable, abundant and cost effective source of funding for banks that do not maintain branches. Furthermore, the FDIC studies demonstrate that brokered deposits did not significantly contribute to bank failures in the last several decades.

Since 2008 applicants for new banks were told that a plan mostly reliant on brokered deposits will not be approved regardless of how thoroughly the plan is developed to ensure liquidity and mitigate risks. It has also resulted in regulatory pressure on existing banks that rely on brokered deposits to transition to other funding strategies even if the bank is well established and operating safely and soundly otherwise. We respectfully suggest that this growing tension between policy and reality should be the primary focus of this examination of brokered deposits.

Context, historical and now

To provide context for our comments, we will begin by describing changes in how brokered deposits are obtained and used since they first developed in the 1980s. That matters because the law, regulations and general attitude about brokered deposits within the FDIC have not changed since the 1980s. That has created a growing tension as new bank models reliant on brokered deposits have developed. The difference between the time these deposits first entered the market and today could not be starker. What began as high rate volatile deposits used by the most financially troubled and unstable banks has evolved into the most cost effective stable funding used mostly by the strongest and most stable banks insured by the FDIC. We believe this change must be acknowledged in order to develop sound rules and policies to govern these deposits in the future.

We understand the abuses of brokered deposits when they first appeared in the 1980s and why that prompted Congress to enact the current law. Brokered deposits then were volatile and overpriced and used by many failing banks. Inflation rates that at times exceeded 20% had turned interest margins negative in many depository institutions, especially savings and loans that only held mortgage loans. The only hope many of those institutions had to

survive was to make new loans at higher rates and to do that they needed to raise a lot of new deposits quickly. The original deposit brokers filled that need without regard for the quality of the loans as long as the deposits were federally insured and paid above market rates. Those higher rates increased the loan risks because only higher risk borrowers would pay the high rates the banks had to charge to earn a profit. In some cases that morphed into outright fraud that resulted in massive losses for the deposit insurer.

The early deposit brokers scoured the nation for the highest rates offered for federally insured deposits. That was the brokers' primary purpose. At the time depositors needed high rates to offset the erosion of the value of their money due to inflation. The quest for the highest rates explains why brokered deposits acquired a reputation as "hot money." Early depositors and brokers were only loyal to the rates and would pull their deposits as soon as another bank offered a higher rate.

Before the 1980s competition for rates was largely limited to the local area where the depositor lived. The deposit brokers made competition national in scope which made the most anomalous rates offered anywhere the benchmark for all banks. It was a perfect storm ultimately paid for by taxpayers when the negative rate margins and bad loans bankrupted the Federal Savings and Loan Insurance Corporation. The resulting laws and regulations were intended to stop those abuses.

Regulators and policy makers should always be mindful of this history, but it is also important to take into account how brokered deposits have fundamentally changed since the 1980s. Those changes include the following:

- *Today only healthy banks hold brokered deposits*. The banks that accept brokered deposits now are healthy and not subject to the heated competition for rates that affected failing savings and loans thirty to forty years ago. Current laws only allow a well capitalized bank to take brokered deposits without restriction. Adequately capitalized banks can only take new brokered deposits with prior approval and less than adequately capitalized banks – the kind of bank that abused brokered deposits in the 1980s – are prohibited from taking new brokered deposits.
- *Conditions that lead to abuses no longer exist*. Inflation and the savings and loan crisis are over. Rates for brokered deposits have dropped significantly as the brokered markets matured and now tend to be closer to U.S. government securities, which they resemble because of the federal deposit insurance. Regulators also learned hard lessons from the S&L crisis and no longer tolerate poor lending by banks desperate to grow out of their failing condition.
- *New safe kinds of banks require new funding strategies that can include brokered deposits*. New technology has enabled banks to efficiently obtain deposits outside of a branch network, including brokered deposits, which has facilitated the development of new business models such as branchless banks. These new models have fundamentally changed the economic factors and have developed as a group into the best capitalized and most

profitable banks insured by the FDIC. The combination of savings in operations costs from not having branches together with economies of scale in serving nationwide markets result in significantly higher margins even when the nominal rates on brokered deposits are slightly higher than branch based retail deposits. Many branchless banks report efficiency ratios around 30%, which is half the rate of a typical bank that relies on retail deposits and results in significantly higher ROAs and ROEs. A few notable examples of such branchless banks are American Express, Discover Card, Citibank South Dakota and Synchrony Bank. Today the comparison that matters is the profitability of different business models, not rates on deposits.

- *Many critically important banks in the nation's payments system rely on brokered deposits*. Wholesale deposits, including brokered deposits, have played a key role in facilitating the development of banks that play a critical role in today's payment systems such as many credit card issuers that market products and services nationwide. Without a means to raise large amounts of deposits efficiently, these banks would not be able to compete with the few banks that have nationwide branch networks. This competition is critical to preventing a few large banks from dominating the nation's financial services markets.

- *Brokered deposits are no longer hot money*. New technology has made national rate competition the rule for all banks and all deposits, but two things have brought rates down to below normal levels. One was the end of inflation. The other was the development of the brokered deposit markets into mainstream, high capacity providers of funding for banks. Today the supply of brokered deposits meets and may, at times, exceed the demand, enabling the banks to set rates that more rationally balance supply and demand. Most brokers and depositors are now more concerned with safety than rates. Brokered deposits are a convenient way to acquire an investment as safe as a U.S. government security.

- *Brokered deposits have become the most stable and cost effective deposits available to a bank*. Brokered deposits have evolved into the most stable deposits available to any bank, especially in the form of time deposits (CDs). The common practice today limits withdrawal before maturity from a CD unless the depositor has died or been adjudicated incompetent. Withdrawals before maturity almost never happen regardless of the circumstances. Brokered CDs are the first kind of deposit that is virtually run proof. This was proven in instances that occurred during the Great Recession when a bank failed due to a run by its local retail depositors while its brokered CDs were unaffected. And after operational savings are considered, the all in cost of a brokered CD is significantly below a retail deposit.

- *Supplies of brokered deposits are adequate and counter cyclical*. Banks that rely on brokered deposits have always been able to obtain all that they need. In a downturn the supply of brokered deposits rises as people flee to safety. A bank reliant on brokered deposits has little or no risk of a liquidity crisis in an economic downturn, and really not at any time, unless its capital becomes impaired.

- *Brokered deposits facilitate match funding*. Another advantage of the branchless model is that the ability to obtain amounts of CDs just when needed facilitates match funding and reduces liquidity needs. Traditional transaction and savings deposits flow in and out of a bank for reasons unrelated to the bank's need for money to fund loans. That requires keeping more liquid funds on hand for lending, withdrawals and operating expenses. Using brokered CDs instead directly coordinates lending and funding. The money to lend arrives just when it is needed, and the terms of the CDs are matched to the loan terms reducing rate risks by locking in a profitable margin.
- *Sources of non core deposits has grown dramatically*. Technology and cost savings increasingly make branches obsolete for many customers. Many younger people rarely or never visit a branch. While branches remain an important convenience for many customers, the nation's financial services markets are becoming increasingly segmented. The full service banking model at the core of banking prior to the 1980s has been increasingly displaced by specialized products such as credit cards used mostly for payments and specialized lenders for larger purchases such as cars, houses, furniture and appliances. These trends are fundamental to modern banking; they are not temporary fads. Regulators cannot fight segmentation and the trend away from branches without forcing core banking products and services into unregulated structures and destabilizing the banking system.
- *Deposits and funding strategies have the potential to change perhaps more than other products and services*. Checking and savings accounts are increasingly disconnecting from other products and services and from branches. Most consumers who have a checking account at a bank don't seek other financial services from that bank, especially if it is a community bank. Mobile banking and other new technologies could transform checking dramatically in the future. It is possible that, in time, even community banks will fund most of their operations with brokered deposits or funding sources that will qualify as brokered. Bankers and regulators must always remember that their business is driven by the market and the market is not static. Indeed, the financial services markets have changed more in the past 40 years than in the entire history of the nation previously. To help ensure the stability of banking in the future, boards and regulators should be testing and developing other funding strategies.

With this background in mind, we offer the following comments on the proposed brokered deposit regulation.

Primary Purpose Exemption

One of the most helpful things the new rule can do is reexamine and clarify what qualifies for the primary purpose exemption. Our members believe the FDIC has restricted this exemption excessively, to the point of almost repealing it. Current guidance emphasizes that no entity automatically qualifies for the exemption and every deposit placed with the assistance of a third party is presumed to be brokered unless it qualifies under another statutory exemption. All entities that believe they are exempt because they have another

primary purpose must apply for designation and be approved in advance. During the past several years, most applications for the primary purpose exemption have been summarily delayed and denied.

The FDIC's refusal to exempt almost all tax advantaged savings programs is a good example of an area where we recommend the exemption be utilized. People contribute money to health savings accounts, IRAs, education savings accounts and similar programs to qualify for tax deferral or exemption. The plan beneficiaries are not primarily seeking the assistance of plan administrators to deposit their money into high rate federally insured deposit accounts. In many cases a majority of plan money is invested in other kinds of accounts such as mutual funds. Plan administrators are not deposit placement agents, they are fiduciaries whose primary responsibility is ensuring the plans qualify for tax deferral or exemption. They deposit or invest funds in beneficiary accounts as part of their duty to manage the beneficiaries' accounts.

Our members appreciate the FDIC's efforts to clarify some of the less well-defined parts of the law and regulation in the proposed rule, especially which organizations qualify for the primary purpose exception. Clarifying and streaming the exemption process will facilitate innovation and competition and provide increased access to stable funding sources for the industry to support credit activities and to provide enhanced competitive benefits to depositors.

We also appreciate the challenge in drafting the new standards and bright line tests. The proposed rule classifying an entity as a broker if deposits constitute more than 25% of its assets under management is an improvement over the current ambiguity, which by default effectively makes every entity in the zone of uncertainty not exempt.

However, we note that this standard is potentially problematic. For example, it will present issues if an organization fluctuates above and below the 25% standard from time to time. A manager of a savings program or a beneficiary of a self directed program might primarily invest in securities when the economy is growing but shift out of stocks and into deposits during an economic downturn. One day the program would be exempt, the next not exempt. How would the bank holding the deposits respond?

And how do such changes make sense, especially if the accounts are self directed and beneficiaries choose how their money is invested or deposited? The organization and its program would not change. Its beneficiaries would make the same choices as if they were directly placing their money into stocks or deposits. Deposits would potentially be classified as brokered if a customer directed a broker dealer to sell securities and put the money into insured deposits, and not be brokered if the customer withdrew the money from the sale of the securities and placed it directly into a savings account or purchased a CD. In today's market, banks advertise CDs on listing services that a depositor can purchase directly or through a broker. If the customer places the deposit directly, it would not be brokered. If the broker placed the same deposit at the customer's direction it would be brokered. The only functional

difference is that withdrawing the money from the broker dealer then opening an account at a bank is less convenient for the customer. In many cases administrators of tax advantaged savings accounts place deposits for beneficiaries because the money is legally required to be held in a managed account such as a self-directed IRA.

For this reason, we encourage the FDIC to consider expressly including all tax advantaged programs such as health savings accounts, education savings accounts and retirement accounts as exempt under the primary purpose exemption. Investing the money they hold is an incidental part of their overall responsibility to manage the savings accounts in compliance with the legal requirements for tax deferral or exemption. These organizations are primarily concerned with safety and select deposits when they want to provide the maximum safety for the money they manage.

We understand that the proposed rule provides for administrators and organizations to apply for exemption. The proposed application process will represent a step forward if it works that way. However, organizations have always been able to apply for exemption on a case by case basis. In fact, they are required to do that under the current guidelines. But few were ever approved. The new application procedures will not fix this problem if that practice continues.

The proposed rule does not go far enough – a fundamental change in the use of brokered deposits is needed.

We believe a more fundamental change is needed to modernize the rule and match it to current market realities. For several years the FDIC has consistently characterized brokered deposits as inherently unsafe and risky citing the abuses that occurred in the 1980s as proof. FDIC examiners and regulatory officials regularly refer to brokered deposits as “volatile,” “hot,” and “unstable” even though they have developed into the most stable and cost-effective deposits available today.

This has resulted in added insurance assessments on branchless banks that ignore the bank’s otherwise superior capital ratios, ROA, ROE, NIM and other measures of strength and safety. It is also evidenced by a continuing refusal to consider applications (or a bias against the applications) for new branchless banks that would rely primarily on brokered deposits for funding, even if the applicant demonstrates that it can operate safely and soundly. These decisions ignore the fact that existing branchless banks have a long established record as the best capitalized and most profitable group of banks insured by the FDIC.

It is evidenced in the NPR at page 46 and repeated verbatim on page 62 which states:

> . . . Given limitations on available data, however, historical studies have not been able to differentiate the experience of banks based on the different types of deposits accepted.

This is simply not true. For over 40 years, our branchless bank members, many of which rely on brokered deposits for funding, have consistently maintained above average capital ratios,

ROAs, ROEs, NIMs and other measures of financial health, and have proven to be among the safest and strongest group of banks insured by the FDIC, even during the Great Recession. State by state figures from FDIC quarterly reports over the past 40 years show that our member banks overall have consistently been the best performing and financially strongest banks in the nation. These facts are taken directly from FDIC data.

In 1987 the FDIC published an official study titled "The Mandate for Change" that analyzed various market trends, including the development of branchless banks, and recommended changes in laws and regulations to facilitate those developments. Congress made many of those changes in the same year when it enacted the Competitive Equality Banking Act of 1987. Notably, the FDIC no longer refers to this landmark study or makes it available.

The only comment we have heard a senior FDIC official make about branchless banks in the past several years is to say the FDIC has adequate authority to regulate them. We agree and greatly appreciate that statement. However, to our knowledge, since 2007, senior FDIC officials and official FDIC publications have never acknowledged the noteworthy record of safe operations and consistently above average performance by branchless banks. During the Great Recession, 529 traditional banks failed while all but one branchless bank remained profitable and many branchless banks actually grew. These facts are not ambiguous or uncertain. In terms of assessing risks, they are among the most striking and profound facts in an abundant record of banks' performance during an extended period.

We suggest that brokered deposits are not inherently more or less risky than other funding sources. They are a simply a type of funding. The management of risk has developed through industry practices and through the regulatory environment. The management of risk has improved in the industry and the tools for the FDIC to oversee banks and maintain the safety of the banking system have improved. We encourage the FDIC to modernize the brokered deposit rules in light of other regulatory modernization efforts of the banking system. Treatment of brokered deposits in a manner similar to other funding sources will allow the banking system to evolve and improve in its services, effectiveness and competitiveness.

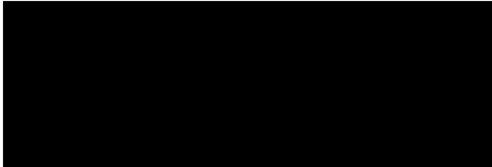
This has had a broader impact inhibiting the development of new kinds of banks regardless of how safe and legally compliant they might be. This practice can only be understood today as a disguised policy designed to inhibit the development of non traditional banks. For many of our members this is the main issue. The standards and procedures described in the proposed rule cannot work as they should if the FDIC continues to restrict the use of brokered deposits by safe and sound banks. That practice goes beyond any authority granted to the FDIC by Congress. More importantly, an accurate understanding of how modern financial markets operate is crucial to effective regulation.

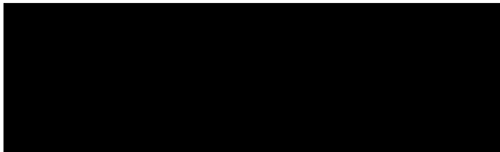
Therefore, we respectfully request that the FDIC consider the dynamics of banking in the 21st-century, the excellent track record of branchless banking especially by our members and the history and potential of brokered deposits. It is in the best interest of the nation, the

economy, the customers and the banking industry to enhance the relevancy of regulated banking and prevent its obsolescence. That is what is truly at stake and we hope the updated rules reflect such important objectives.

Again, we appreciate the opportunity to participate in this important discussion.

Sincerely,





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