Community Bankers of Michigan™

One Mission. Community Banks.

Via electronic submission

June 9, 2020

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington D.C. 20429
(comments@fdic.gov)

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

Dear Mr. Feldman:

Community Bankers of Michigan ("CBM")[1] appreciates this opportunity to comment on the FDIC's proposed revisions to its brokered deposit restrictions that apply to less than well capitalized insured depository institutions ("IDIs"). The proposed rule (the "Proposal") would create a new framework for analyzing certain provisions of the "deposit broker" definition including "facilitating" brokered deposits and the "primary purpose exception." The Proposal would also establish an application and reporting process with respect to the primary purpose exception.

Background

Section 29 of the Federal Deposit Insurance Act (FDI Act) restricts the acceptance of deposits by insured depository institutions (IDIs) from a "deposit broker." Although well capitalized IDIs are

[1] The Community Bankers of Michigan® is a 250-member trade association serving community banks, and their financial services partners, throughout Michigan. With headquarters in East Lansing, Michigan, the Community Bankers of Michigan is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, professional education programs, and high-quality products and services. One Mission. Community Banks.

not restricted from accepting deposits from a deposit broker, those IDIs with a significant concentration of brokered deposits may pay higher quarterly FDIC assessments.[2] An "adequately capitalized" IDI may accept deposits from a deposit broker only if it has received a waiver from the FDIC. A waiver may be granted by the FDIC "upon a finding that the acceptance of such deposits does not constitute an unsafe or unsound practice" with respect to that institution. An "undercapitalized" IDI is prohibited from accepting deposits from a deposit broker.

Section 337.6 of the FDIC's Rules and Regulations implements and closely tracks the statutory text of Section 29, particularly with respect to the definition of "deposit broker" and its exceptions. Section 29 of the FDI Act does not directly define a "brokered deposit," rather, it defines a "deposit broker" for purposes of the restrictions. Therefore, the meaning of the term "brokered deposit" turns upon the definition of "deposit broker."

Section 29 and the FDIC's implementing regulation essentially define the term "deposit broker" to include "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties." There are nine different statutory exceptions to the definition. Due to the efforts of CBM and our national affiliate ICBA, Section 29 of the FDI Act was amended in 2018 as part of the Economic Growth, Regulatory Relief, and Consumer Protection Act, to except a capped amount of certain reciprocal deposits from treatment as brokered deposits.

As of June 30, 2019, of the total domestic deposits held by IDIs, $1.1 trillion or 8.5 percent were classified as brokered deposits. Approximately 41 percent of IDIs (2,154) reported some positive amount of brokered deposits. As for the use by small banks—defined as banking organizations with total assets of less than or equal to $600 million under the Regulatory Flexibility Act—the Proposal states that 1,297 small IDIs reported holding some volume of brokered deposits. As of June 30, 2019, there were only sixteen adequately capitalized and undercapitalized banks.

[2] Under current assessment rules, brokered deposits affect a small bank's assessment rate based on its risk category. For established small banks (i.e., those banks with less than $10 billion in total assets) that are assigned to Risk Category I (those that are well capitalized and have a CAMELS composite rating of 1 or 2), the adjusted brokered deposit ratio is one of the financial ratios used to determine a bank's initial assessment rate. The adjusted brokered deposit ratio increases a bank's initial assessment rate when a bank has both brokered deposits that exceed 10 percent of its domestic deposits and a high asset growth rate. Established small banks in Risk Categories II, III, and IV (those that are less than well capitalized or that have a CAMELS composite rating of 3, 4, or 5) are subject to the brokered deposit adjustment, one of three possible adjustments that can increase or decrease a bank's initial assessment rate. The brokered deposit adjustment increases a bank's assessment rate if it has brokered deposits in excess of 10 percent of its domestic deposits.

CBM's Comments on the ANPR

On December 18, 2018, the FDIC approved an advance notice of proposed rulemaking (ANPR) to obtain input from the public on its brokered deposit and interest rate regulations. **In response to the ANPR, CBM finds that brokered deposits can be a stable source of funding and a cost-effective way for community banks to meet their funding needs provided the risks of holding these accounts are managed properly. We believe that the current deposit broker rules and FDIC staff interpretations of Section 29 make it difficult for community banks to attract these deposits and, in some instances, to work with third party service providers to expand their deposit product offerings.**

Regarding transaction accounts, including reward-based checking accounts, we believe these deposits are a source of stable funding and should rarely be considered brokered. In contrast to certificates of deposit, where a depositor makes a fixed, often one-time, placement of funds at a bank, a traditional transaction account is usually the product of a direct and ongoing relationship between the bank and its depositor, involving a continual series of deposits and withdrawals by the depositor to meet the depositor's transactional needs. As a result, most transactional account customers have a direct, ongoing relationship with the bank, and all deposits from these relationships result in consistent, stable funding for the bank. Furthermore, even where the depositor is introduced to a bank through the mediation of a deposit broker, subsequent deposits placed solely by the depositor through the use of their transactional accounts should not be deemed brokered where the deposit broker does not continue its mediation or placement of deposits.

In most instances, federal or state agencies using debit cards or prepaid cards to deliver funds to the beneficiaries of government programs should not be considered "deposit brokers." In order to be a deposit broker, a person or entity must be "engaged in the business of" placing deposits or "engaged in the business of" facilitating such placement. We do not believe that government agencies that deliver funds via debit or prepaid cards as part of benefits programs are "in the business of" placing or facilitating deposits.

CBM's Comments on the Proposal

CBM acknowledges the difficult job the FDIC is undertaking to modernize its brokered deposit regulations to reflect recent technological changes and innovations that have occurred over the past thirty years. Since the enactment of section 29 of the FDI Act regarding brokered deposits, there have been substantial changes in the design, development and delivery of bank products and services. These changes include the proliferation of internet search engines, increasing

popularity of digital devices, an explosion of data-driven products and services and the creation of financial technology ("fintech") companies. Consequently, community banks have had to rely more on third-party service providers to help them service their local communities and compete with other banks, credit unions, and fintech companies.

The Proposal's goals include (1) developing a framework that encourages innovation within the banking industry with minimal risk to the Deposit Insurance Fund and (2) establishing an administrative process that emphasizes consistency and efficiency with easy-to-understand, bright-line standards for determining whether an entity satisfies the statutory definition of "deposit broker." **CBM believes the Proposal needs to be revised to achieve those goals.** Our concerns and recommendations are described below.

The Proposed "Facilitation" Definition is Much Too Broad

CBM believes the FDIC did not intend to broaden the definition of "deposit broker" so that more entities would be subject to those restrictions. However, the Proposal, if enacted, would do just that. A person meets the "deposit broker" definition of the FDI Act if it is engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions." Under the Proposal, a person would meet the "facilitation" prong of the "deposit broker" definition by, while engaged in business, engaging in any one or more of the following activities:

1. The person directly or indirectly shares any third-party information with the insured depository institution;
2. The person has legal authority, contractual or otherwise, to close the account or move the third party's funds to another insured depository institution;
3. The person provides assistance or is involved in setting rates, fees, terms or conditions for the deposit account; or
4. The person is acting directly or indirectly, with respect to the placement of deposits, as an intermediary between a third party that is placing deposits on behalf of a depositor and an insured depository institution, other than in a purely administrative capacity.

The first prong within the proposed "facilitation" definition can be interpreted as restricting community banks' ability to receive any external information from any third party about their own customers and potential customers. Such a restriction would inhibit a bank's ability to deepen its customer relationships by offering customers additional products, services and capabilities from the bank. We believe that the FDIC should not prohibit exchanges of information that make these capabilities possible.

The third prong within the proposed "facilitation" definition appears to restrict banks from using consulting services that assist them with developing, delivering and improving their deposit offerings. Thus, if the Proposal is adopted without change, community banks would no longer

be able to engage third-party service providers to provide necessary consulting services such as market research, product development, profitability assessments, non-interest income, retail optimization services, asset liability management advice, overdraft protection services, reward and customer loyalty programs, and more. This provision is one of the most problematic in the proposal and should be deleted.

Community banks rely on industry experts to help them with these activities and services and yet the Proposal would deny community banks access to these resources. Rather than providing safety and soundness protections, the Proposal would diminish safety and soundness by prohibiting community banks from utilizing industry experts and advanced modeling tools and analysis.

Similarly, we are concerned about the fourth prong of the "facilitation" definition as it appears to restrict community banks from engaging third parties for any services other than "administrative services." The Proposal neither explains the meaning of "intermediary" nor the types of activities in which an intermediary engages. We are concerned that the proposed language may be broadly and inappropriately applied to restrict community banks' use of search engine optimization, geolocation, online account opening, identity verification, fraud detection, digital delivery, marketing programs executed via an automated platform and other like services that third parties provide to assist community banks with promoting their own products and services and with attracting, engaging and cultivating current and new customers.

Recommendations for Improving the Facilitation Definition

CBM believes that all third parties that enable IDIs to offer financial products, services and capabilities and that help IDIs establish direct relationships with individual depositors should be excluded from the definition of "deposit broker" in the FDIC's final rule. Community banks should be able to obtain third party services that enable these depositor relationships. Community banks must compete with fintech companies and large banks, but community banks lack comparable financial budgets or technical resources to design, build, deploy and support the modern deposit products and services that consumers desire. They rely on external resources to help them offer these capabilities to their communities.

We recommend adding the following to the definition of "deposit broker" at the end of 12 C.F.R. Section 337.6(a)(5)(iii) as follows:

[*The term deposit broker does not include]* *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.*

Because most community bank deposits are associated with individual depositor relationships that community banks own, these deposits are a stable source of funds that enable safe and sound operations. As such, we believe that transaction account deposits that are (i) fully-insured (ii) opened by an individual depositor (iii) held in the name of that same individual depositor and (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 that same account. Further, by extension, all other deposits that are associated with that same transaction account depositor (i.e., savings, MMAs, CDs) should also be excluded from the definition of "brokered deposit."

Community Banks and Sweep Accounts

CBM is concerned that the definition of "facilitation" would also impair access to sweep deposits for community banks. For some community banks, access to broker-dealer sweep deposits depends on the use, by banks and broker-dealers, of third parties that provide matching and allocation services. These services allow community banks, despite lacking direct relationships with large broker-dealers, to acquire stable sweep funding. By defining "facilitation" to capture key tasks of such service providers, the proposed rule would effectively force community banks either to incur unfavorable brokered treatment or to forego sweep deposits. Such a result would unfairly deprive community banks of a stable funding source and further tilt the playing field in favor of the largest banks.

We urge that the definition of "facilitation" be changed so that it clearly excludes the activities of third parties that provide matching and allocation services for broker-dealer sweep programs. When a broker-dealer is sweeping funds for a primary purpose other than deposit placement, a service provider that supports the sweep program is most appropriately regarded as facilitating the broker-dealer's primary purpose, not as facilitating something that is not the broker-dealer's primary purpose.

For example, the broker-dealer – albeit less efficiently than a service provider – can attempt to identify a sufficient number of unaffiliated banks that will receive deposits, establish costs of funds acceptable to them, obtain their commitments to receive funds in specified amounts over specified periods, and try to manage, on an ongoing basis, the allocation of deposits consistent with all the requirements of these arrangements. If the broker-dealer acts with a primary purpose other than deposit placement, these necessary activities if performed by the broker-dealer do not render the deposits brokered. There is no reason to treat the same deposits as brokered merely because a broker-dealer determines that a third party can more efficiently perform the same necessary activities and better manage the overall process. The FDIC should encourage the use

of service providers that make sweep deposits more stable and give community banks access to stable sweep funding.

Primary Purpose Exception

As mentioned above, Section 29 of the FDI Act excludes from the definition of "deposit broker" an agent or nominee whose primary purpose is not the placement of funds with insured depository institutions (the "primary purpose exception"). The FDIC is proposing that the application of the primary purpose exception be based on the business relationship between the agent or nominee and its customers—if the business relationship is not the placement of funds with banks, the exception will apply. Significantly, the FDIC is proposing to establish an application and reporting process to utilize this exception. The application will be submitted by a bank or by a nonbank third party that is placing (or facilitating the placement of) the deposits, and the Proposal describes the type of information that will need to be included in the application. The FDIC would provide a written determination within 120 days of a complete application, and the written determination would include periodic reporting requirements.

CBM is concerned that the application process and the periodic reporting requirements will be a significant regulatory burden on community banks whenever they use the services of a third party with respect to their deposit products. We urge the FDIC to change the Proposal so that most of the periodic reporting requirements will not be placed on the IDI but on the third party. For instance, community banks that partner with fintech companies should not be required to constantly monitor these companies to determine whether most of their revenue comes from activities other than deposit placement activities. The burden associated with complying with Section 29 reporting requirements should be borne by the third-party service provider.

All Advisory Opinions Should Remain Intact Following the Effective Date of the Revisions

Since the intention of the FDIC was not to broaden the definition of "deposit broker" under Section 29, CBM recommends that the FDIC retain all current Advisory Opinions that exempted persons from that definition. Furthermore, in this time of economic uncertainty, now is not the time for the FDIC to eliminate long-standing determinations that community banks have come to rely upon to build, offer and support financial products and services that support their customers and communities. Any person or entity that was not considered a "deposit broker" should not become a deposit broker as a result of the rule revisions.

Conclusion

CBM commends the FDIC for its attempt to modernize its brokered deposit regulations to reflect recent technological changes and innovations that have occurred. However, the proposed "facilitation" definition is much too broad and needs to be narrowed so that third parties that enable IDIs to offer financial products, services and capabilities and that help IDIs establish direct relationships with individual depositors would be excluded from being a "deposit broker." We also urge that the definition of "facilitation" be changed so that it excludes the activities of third parties that provide matching and allocation services for broker-dealer sweep programs.

As for the primary purpose exception, we recommend the Proposal be changed so that most of the periodic Section 29 reporting requirements will not be placed on the bank but on the third-party service provider. Furthermore, since it was not the intention of the FDIC to significantly expand the definition of "deposit broker," CBM recommends that the FDIC retain all current Advisory Opinions that exempted persons from that definition.

CBM appreciates the opportunity to comment on the FDIC's proposal to revise its regulations relating to the brokered deposits restrictions that apply to less than well capitalized insured depository institutions. If you have any questions or would like additional information, please do not hesitate to contact either Michael Tierney at michaeltierney@cbofm.org or Kate Angles at kateangles@cbofm.org.

Sincerely,

[redacted]

Michael Tierney
President and CEO

[redacted]

Kate Angles
Chief Operating Officer