



November 4, 2019

Via Electronic Mail

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

Re: Interest Rate Restrictions on Institutions That Are Less than Well Capitalized (RIN 3064-AF02)

Ladies and Gentlemen:

The Bank Policy Institute¹ appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") notice of proposed rulemaking ("NPR")² on revisions to its regulations relating to interest rate restrictions that apply to less than well capitalized insured depository institutions ("IDIs"). The current calculation of the national rate has become outdated and does not represent a true market rate. In addition, the rate has failed to keep pace with technological advancements in banking. As BPI indicated in its comment letter in response to the FDIC's advance notice of proposed rulemaking addressing the agency's comprehensive review of its regulatory approach to brokered deposits,³ the current approach to the national rate calculation is based on limited geographical factors, does not consider the actual market in which a bank competes, and has consequences even for healthy, well capitalized institutions.⁴

¹ The Bank Policy Institute (BPI) is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

² 84 Fed. Reg. 46470 (Sept. 4, 2019).

³ 84 Fed. Reg. 2366 (Feb. 6, 2019) (the "Brokered Deposit ANPR").

⁴ Bank Policy Institute, *Comment Letter re Brokered Deposits* (May 6, 2019), <https://bpi.com/wp-content/uploads/2019/05/BPI-Comment-Letter-Brokered-Deposits-May-6-2019.pdf>.

We applaud the FDIC's decision to not only propose a revised calculation of the national rate, but also to consider alternative approaches that may better reflect market rates. We support the FDIC's stated goal of creating a calculation that would ensure a more dynamic rate cap that is reflective of actual, prevailing rates offered through all stages of the economic and interest cycles. However, BPI believes the proposed calculation of the national rate will not be reflective of actual, prevailing interest rates offered by insured depository institutions in the market today and does not resolve most of the underlying concerns with the current calculation.

Section I of this letter provides an executive summary of our comments. Section II discusses the proposed calculation of the national rate, BPI's recommendations for alternatives to the calculation and other changes to the methodology. Section III discusses supervisory practices related to high interest rate deposits.

I. Executive Summary

The proposed calculation of the national rate does not adequately reflect market rates and fails to address critical problems with the current calculation. BPI's recommendations are for a national rate calculation that better reflects the market in different economic cycles, takes into account technological advancements, and accounts for various market segments. BPI also recommends additional changes to the methodology around the calculation and publication of the national and local market rates. Specifically, we recommend the following:

- The FDIC should implement a national rate cap of 75 basis points added to the higher of: (1) 120 percent, or 130 percent for wholesale deposits, of the applicable Treasury security rate; or (2) the rate offered at the 95th percentile of rates weighted by domestic deposit share.⁵
- The FDIC should reconsider its definition of "market" to take into consideration non-geographic factors.
- The FDIC should make transparent the way the data used to calculate the national rate is manipulated.
- The FDIC should continue to publish the national rate on a weekly basis and provide 14 days before a new, lower national rate is made effective.
- The FDIC should exempt existing non-maturity deposit accounts from applicability of interest rate restrictions.

In addition, BPI recommends that the FDIC further revise its supervisory practices and guidance to prevent treatment of high interest rate deposits as proxies for liquidity risk.

II. The proposed revision to the calculation of the national rate contains similar flaws as the current calculation.

A. The proposed national rate does not accurately reflect actual market rates.

Under Section 29 of the Federal Deposit Insurance Act ("Section 29"), as implemented by the FDIC's regulations at 12 CFR 337.6(b), an insured depository institution that is adequately capitalized is prohibited from soliciting deposits by offering rates of interest that are "significantly higher than the prevailing rates of interest on deposits offered by other [IDIs] in such [IDI's] normal market area."⁶ The purpose of this restriction is to prevent

⁵ In the alternative, the FDIC should implement the higher of two previous rate caps or the average of the top-payers as presented in the NPR.

⁶ 12 USC § 1831f(h).

depository institutions from “avoiding the prohibition against the acceptance of brokered deposits by soliciting deposits internally through ‘money desk operations’.”⁷

As noted in the NPR, “setting the national rate cap at too low of a level could prohibit less than well capitalized banks from competing for deposits and create an unintentional liquidity strain on those banks competing in national markets.... Additionally, a rate cap that is too low may be inconsistent with the statutory requirement that a firm is prohibited from offering a rate that ‘significantly exceeds’ or is ‘significantly higher’ than the prevailing rate.”⁸ While the proposed calculation is helpful in that it takes into account the interest rates offered by depository institutions that are not sufficiently represented in the current calculation, it does not effectively account for various market segments, does not adequately reflect actual market rates, and fails to address critical problems under the current calculation.

The proposed calculation contains the same flaw as the current calculation. The NPR acknowledges that large banks have been slower to raise interest rates on deposits due in part to their disproportionate share of retail deposits, which has held down the simple average of rates offered across all branches.⁹ The proposed national rate will be the weighted average of rates paid by all insured depository institutions on a given deposit product where weights are the institution’s market share of domestic deposits. Under the proposal, the calculated national rate will continue to be significantly affected by the rates offered by the largest banks, given that those institutions hold a large market share, resulting in a national rate not reflective of actual competitive, market pricing. For example, as illustrated in the NPR, the proposed rate cap for MMDA accounts as of May 20, 2019 was 1.20 percent, which means either (i) that rate was in the 95th percentile of the market or that (ii) the national rate was 0.45 percent, neither of which accords with reality.¹⁰ Furthermore, the proposed calculation does not sufficiently account for recent innovations in technology and business practices that allow for leaner cost infrastructures.

The NPR notes that in determining the proposed national rate, the FDIC would calculate an average rate per institution for each specific deposit product offered and for which data is available. If the FDIC chooses to implement the proposed calculation, BPI recommends that rather than a simple average, the calculation should incorporate the median rate offered across all depository institutions in order to eliminate outlier rates. BPI also requests that the final rule clarify how varying rates for branches and online banks will be incorporated, as well as the significant differences between consumer and commercial deposit products. As discussed further below, due to flaws in the proposed calculation, there are certain deposit markets where the prevailing interest rates routinely exceed the proposed interest rate caps, which undermines the purpose of Section 29 and, for banks with certain business models, would create precisely the kind of unintentional liquidity strain noted in the NPR as a significant risk. To address those flaws, the FDIC should consider alternative rate cap calculations.

⁷ 84 Fed. Reg. at 2374.

⁸ 84 Fed. Reg. at 46473.

⁹ 84 Fed. Reg. at 46473.

¹⁰ 84 Fed. Reg. at 46478.

B. The FDIC should implement an alternative that combines the proposed calculation with the previous rate cap calculation.

The FDIC has noted in the NPR that its intent behind revising the national rate calculation is to ensure that the new rate is dynamic across economic and interest rate cycles.¹¹ As the FDIC found in 2009, when the rates were last revised, changes in monetary policy can cause a national rate calculation to become ineffective. BPI recommends a version of one of the FDIC's alternatives (alternative number one) as a reasonable method for calculating the national rate that would remain effective across different economic and interest rate cycles. The FDIC should implement a national rate cap of 75 basis points added to the higher of: (1) 120 percent, or 130 percent for wholesale deposits, of the applicable Treasury security rate; or (2) the rate offered at the 95th percentile of rates weighted by domestic deposit share.

This alternative calculation will be effective across different economic and monetary policy cycles without facilitating excessive risk-taking among banks and will address the flaws in the current and proposed calculation discussed above in section II.A. Calculating the rate cap using the applicable Treasury security rate is effective during periods where the Federal Reserve is tightening monetary policy, while the calculation using the 95th percentile of rates will be effective during those periods where the Federal Reserve is easing monetary policy. The use of the higher of the proposed rates will better reflect the market rate and will guard against skewing of the national rate by rates offered by banks.

BPI's recommended national rate calculation adds 75 basis points to the 95th percentile of rates to provide additional flexibility, while continuing to impose constraints on undercapitalized institutions from raising funds by paying rates well above prevailing rates. As mentioned above, there are certain deposit markets where the offered interest rates routinely exceed the proposed interest rate cap. For instance, there are significant differences between consumer and commercial deposit markets that may not be appropriately reflected in either of the two alternative rates. Specifically, banks with significant commercial clients or online businesses would face formidable funding limitations in a stressed capital situation if the national rate calculation were finalized as proposed, despite maintaining deposit funding that is well within the market rates for those markets.

BPI reviewed Call Report data to assess the difference in rates paid by online-only institutions relative to branch-based institutions since the data is readily available and online-only institutions account for a relatively small share of deposits outstanding. As a result of the relatively small size of online-only institutions, the 95th percentile of rates may still be well below their offered rates. Indeed, the data shows the median interest rate paid on time deposits by online-only banks was 1.4 percent in the fourth quarter of 2015, while the median rate paid by banks that offer branch-based deposits was 1.0 percent for time deposits with a similar weighted average maturity.^{12,13} Moreover, the 95th percentile of rates of all banks with a similar weighted average maturity was slightly below 1.2 percent. This is consistent with the results shown in Appendix 1 of the NPR which indicate that the proposed rate cap

¹¹ 84 Fed. Reg. at 46474.

¹² Because the Call Report data only gives the combined average interest rate paid on new and existing accounts, it is more accurate to conduct the comparison between the two types of institutions when the federal funds rate was at the zero lower bound. This approach minimizes the difference on rates paid on existing and new deposits.

¹³ As of the fourth quarter of 2015, the sum of large time deposits of online-only banks was \$36 billion, and the weighted average maturity of such deposits was 20 months. The sum of time deposits of institutions that offer branch-based deposits with weighted average maturities between 16 and 24 months was \$664 billion in the fourth quarter of 2015.

was approximately 1.0 percent during this period. Unfortunately, historical data for commercial rates is less readily available, but based on the analysis conducted for online-only institutions the addition of 75 basis points to the higher of the two alternative rates provides some flexibility and will better account for idiosyncratic differences across market segments and deposit products.

The FDIC notes that a concern with basing the calculation of the national rate on U.S. Treasury securities is that they do not have the necessary range of maturities that are prevalent particularly with the recent popularity of non-maturity deposits. According to a 1993 interpretive letter, during the period where the FDIC used U.S. Treasury securities to set the national rate, FDIC examiners “referred to any period of advance notice of withdrawal associated with the product or 7 days for deposits that may be withdrawn on demand.”¹⁴ The interpretive letter further goes on to note that “interpolations are to be made as necessary to derive a yield for maturity comparable to the deposit product under review.” To address non-maturity deposits, the FDIC should utilize the procedures that were in place between 1992 and 2009. In the alternative, the FDIC should use short-term Treasury yields (i.e., one year) as a proxy for non-maturity deposits.

C. If the proposed alternative is unsatisfactory, the FDIC should implement one of the alternatives to the proposed national rate calculation included in the NPR.

BPI’s preferred alternative to the proposed national rate calculation is presented above in section II.B. However, should the FDIC find our recommendation unsatisfactory, BPI believes two of the alternatives on which the NPR requested comment would be more reflective of the market rate for deposits than the proposed calculation.

Under the FDIC’s alternative number one, the national rate cap would be 75 basis points added to the higher of: (1) the current simple average calculation; or (2) the methodology used by the FDIC between 1992 and 2009. This alternative would better account for different points in the economic cycle. As discussed above in section II.B, to address the lack of the necessary range of maturities for U.S. Treasury securities, the FDIC should utilize procedures that were in place during 1992 to 2009 or use short-term Treasury yields as a proxy. While the previously discussed “higher of” rate calculation is ultimately preferable because the average calculation is slightly less weighted toward large institutions, this alternative would provide a more appropriate national rate cap than the proposed single calculation and would more accurately reflect peak market deposit rates throughout the economic cycle.

The FDIC’s alternative two would set the national rate cap based upon the average of the top-25 rates offered by deposit product type. BPI agrees with the FDIC’s assessment that this would be simpler to administer, and the FDIC would be able to provide real-time interest rate caps without needing to maintain and review data from third-party data providers. We also acknowledge the concern the FDIC has raised that the subset of banks paying the highest rate may have a small market share and thus have little to no influence over competitive rates paid in the market. In addition, the FDIC notes that the rates offered by this subset of banks could be significant outliers from rates offered by the market. To address that concern, the FDIC should modify the calculation to mitigate the effect of outlier rates. Two options are to either exclude the top-5 rates or to use the median of the top-25 rates.

¹⁴ “Clarification of Brokered Deposit Interest Rate Restrictions,” FDIC Interpretive Letter 93-32, dated June 21, 1993.

D. The FDIC should reconsider its definition of “market” to take into consideration non-geographic factors.

As discussed above in section II.A and acknowledged by the FDIC in its Brokered Deposits ANPR, “because the national rate is an average for all banks and branches, the largest banks with large numbers of branches have had a disproportional effect on average interest rates.”¹⁵ Small but important market segments are effectively ignored by this skewed average. While the proposed calculation will account for some additional market segments, the same problem remains.

The proposed calculation of the national rate, like the current calculation, provides a mechanism to determine that a bank’s market rate is higher than the national rate, but is based on limited and outdated geographical factors. The term “market” is not defined in Section 29, but the FDIC’s regulations provide that an IDI’s market rate is presumed to be the national rate and that a market “is any readily defined geographical area in which the rates offered by any one insured depository institution soliciting deposits in that area may affect the rates offered by other insured depository institutions operating in the same area.”¹⁶ A narrow interpretation of “market” as being limited solely to a local geographic footprint is no longer justified by the markets and business models through which banks solicit and accept deposits.

As the FDIC notes in the NPR, “competition for deposits among insured depository institutions continues to grow increasingly digital and therefore national in scope.”¹⁷ Today, banks compete not just within local geographical areas but across all market segments, particularly with the advent of mobile banking. The proposed method for calculating the national rate therefore does not adequately consider either the broader markets in which deposits are offered or business models through which higher interest rates simply reflect a lower cost of doing business and not a desire to fund rapid growth through volatile deposits. For instance, and as discussed above, banks with significant commercial client or online businesses would face funding limitations in a stressed capital situation if the rate cap were finalized as proposed, despite maintaining deposit funding that is well within the market rates for those particular markets.

Accordingly, BPI recommends that the FDIC revise the methodology for the calculation of the national rate to account for a wider array of business models and the varying interest rates that are offered to source a variety of stable deposits.

E. The FDIC should make transparent the way the data used to calculate the national rate is manipulated.

The FDIC currently calculates the national rate using data gathered by RateWatch, a third-party data aggregator, and posts the rate to the FDIC’s website each week. RateWatch obtains interest rate information by conducting a survey of interest rates offered on various deposit products at IDIs. However, the manner in which RateWatch collects its information remains opaque. The NPR does not specifically note that the FDIC would continue to use data provided by RateWatch, but does reference basing the calculation on “data which is available.” In addition, throughout the NPR, the FDIC notes that there are potential data limitations with the proposed

¹⁵ 84 Fed. Reg. at 2375.

¹⁶ 12 CFR 337.6(f).

¹⁷ 84 Fed. Reg. at 46478.

methodology in that the FDIC may not capture unreported or unpublished interest rates. While the FDIC notes that it will review the data it receives to ensure that all rate information that has been provided is incorporated, that process would not incorporate data that is not reported to third-party aggregators, which should be considered in the calculation of the national rate.

Regardless of the data collection method the FDIC chooses, BPI requests that the methodology that is employed be transparent to banks. This should include, but not be limited to, a description of the interest rates that are being used, and whether and how they those figures are being manipulated in order to arrive at the output.

As noted in the NPR, “deposit products with special features, such as rewards checking, higher rates on odd-term maturities, negotiated rates, and cash bonuses, ... are not included in the calculation” of the national rate that is posted to the FDIC’s website. In order to achieve a national rate that is reflective of the market rate, BPI recommends that the FDIC include special features and promotions in its calculation of market rates. The FDIC should work with data aggregators to ensure that these special features and promotions are collected from depository institutions and included in the interest rate data provided to the FDIC.

F. The FDIC should adjust the publication and effective dates of the national rate calculation to better reflect the market.

The FDIC proposes to update and publish national rate cap information on a monthly basis, rather than the current weekly publication schedule. BPI recommends retaining the current weekly calculation and publication schedule, or at most calculating and publishing the national rate every two weeks. Monthly publication of the national rate cap may not be reflective of current market rates. More frequent calculations will therefore better capture changes in the market.

Relatedly, the FDIC proposes that any subsequent national rate cap that is lower than the previously published national rate take effect three days after publication. In a competitive market, a requirement that a depository institution make a downward adjustment to its interest rates within three days after publication will put the bank at a disadvantage to direct competitors. BPI recommends that the FDIC provide institutions with 14 days before a new, lower national rate becomes effective. The NPR notes that the FDIC would have, in certain circumstances, the discretion to delay the effective date of the national rate. The FDIC should clarify in the final rule whether delays would be institution-specific or general.

G. The FDIC should revise its proposed treatment of non-maturity deposits.

The NPR proposes to treat non-maturity deposits as “accepted” and “solicited” for purposes of the interest rate restrictions at the time any new non-maturity deposits are placed at an institution. Under this proposed interpretation, the entire balance of an account would become subject to the interest rate restrictions if any funds are deposited after the institution becomes less than well capitalized. BPI appreciates the FDIC’s attempt to address concerns raised that the immediate application of a national rate cap to an insured depository institution’s existing non-maturity accounts upon becoming less than well capitalized may trigger additional outflows and exacerbate liquidity stress. However, by effectively closing these accounts to new deposits, the FDIC’s proposal functionally achieves the same outcome, as customers migrate their balances elsewhere without the broad functionality to transact in and out of their accounts. Banks are therefore left with a choice of either bifurcating existing and new balances within an account, each with their own rules and rates, or subjecting the entire account to the rate cap.

BPI therefore recommends that the final rule exempt existing accounts from applicability of the rate cap, even when new deposits are made after the institution becomes less than well capitalized. The interest rate cap should apply only to those non-maturity deposit accounts that are opened after the institution becomes less than well capitalized.

III. The local rate calculation should better reflect the modernization of banking.

In addition to revising the calculation of the national rate, the proposed rule would also revise the calculation of the local rate. Less than well capitalized institutions would be permitted to provide evidence that any bank and credit union in its local market offers a rate on a particular deposit product in excess of the national rate cap and would be permitted to offer 90 percent of a competing institution's rate on a particular deposit product. Under the proposed rule, the FDIC would define an institution's market area as any readily defined geographical area in which the insured depository institution solicits depositors by offering rates on a particular deposit service. The NPR also notes that less than well capitalized institutions that solicit deposit products outside of their local market area would not be allowed to offer rates on those nationally-sourced deposit products in excess of the national rate cap and would not be eligible for a local rate cap determination for those products.

The FDIC's proposal inappropriately excludes banks that primarily source deposits through online or digital channels from the local rate cap determination process. More and more customers are interfacing with their banks online or through their mobile devices. As such, many insured depository institutions would be prevented from taking advantage of a local rate cap determination for those products that are sourced through online or digital channels. As discussed above in section II.D, the FDIC should reconsider its definition of "market" to take into account non-geographical factors. An institution should be permitted, for purposes of the local rate calculation, to consider its market segment as its local market. In particular, BPI recommends that banks that source deposits through online or digital channels be eligible to reference other similar banks as their "local market area" and apply for relief using the same methodology available for banks that solicit and accept deposits from within a local geographic area.

IV. Supervisory practices should be further revised to prevent treatment of high rate deposits as a proxy for liquidity risk.

The impact of the FDIC's national rate calculation is not limited to banks that are less than well capitalized. The current calculation also influences the supervision of healthy, well capitalized institutions. In many cases, examination and supervisory staff take the view that a bank that is offering interest rates that are "significantly higher" than the national rate (i.e., more than 75 basis points above the national rate) is funding its operations with "high risk," volatile deposits. In turn, supervisory staff will require a bank's stress tests to account for this "high risk" funding, and will require the bank to hold increased amounts of liquidity against it. The underlying rationale for the interest rate restrictions is to prevent a bank from circumventing the brokered deposits restrictions by funding rapid growth through volatile deposits that it raises through its own money desk operations, and should not be used as a supervisory tool to penalize well capitalized banks for raising deposits in a manner that is permitted by both Section 29 and the FDIC's regulations. Furthermore, offering an interest rate that is more than 75 basis points above the national rate is not necessarily indicative of an unsafe or unsound practice, but is a reflection of a national rate calculation that does not adequately reflect the prevailing market rate.

The NPR notes that the FDIC has responded to these concerns by revising its Risk Management Supervision Manual of Examination Policies ("Supervision Manual") and clarifying to examiners that rate caps only apply to institutions that are less than well capitalized. The Supervision Manual now states that "[e]xaminers should

review conformance with interest rate restrictions during examinations of banks that are not well capitalized.”¹⁸ While this edit to the manual is a positive change, the manual and other guidance still contains statements that may continue to cause examiners to view accounts with rates that are higher than those set by the interest rate restrictions or deposits that are obtained through the internet as proxies for liquidity risk.¹⁹ Rather than using high rate deposits as a proxy for liquidity risk, there are other measures that can more accurately predict a potential liquidity issue. For example, through the results of a bank’s internal liquidity stress tests, the FDIC will better be able to identify possible liquidity risk at that institution. BPI recommends that the FDIC further revise its Supervision Manual as well as all other manuals and forms of guidance to reflect technological advancements in banking and to make clear that high rate or internet deposits are not proxies for liquidity risk. If necessary, the FDIC should also provide training for its supervision and examination staff.

Liquidity issues at depository institutions are usually due to practices specific to that institution outside of the interest rate offered on deposits. The nuances of those issues are not easily captured or corrected by requiring banks to lower the interest rates offered on their deposit products. BPI recommends that the FDIC exercise its supervisory discretion to address institution-specific issues that may present themselves using remedies tailored to that institution.

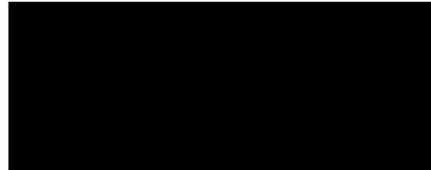
¹⁸ FDIC RMS Manual of Examination Policies, Liquidity and Funds Management, page 11, available at <https://www.fdic.gov/regulations/safety/manual/section6-1.pdf>.

¹⁹ For example, the Supervision Manual continues to include the following statements regarding high interest rate and Internet deposits: “Generally, high-cost or non-relationship deposits, such as Internet deposits or deposits obtained through high-rate promotions, should not be considered stable sources of funds for liquidity purposes.” “Examiners should not wait for PCA provisions to be triggered, or the viability of the institution to be in question, before raising relevant safety and soundness issues with regard to the use of brokered and high-rate deposit sources.” *Id.* at pages 8 and 12. In addition, the 2001 interagency guidance on brokered and rate-sensitive deposits states that “[d]eposits attracted over the Internet...require special monitoring...[because] their inherent risk characteristics are similar to brokered deposits [and] are typically attractive to rate-sensitive customers who may not have significant loyalty to the bank.” Joint Agency Advisory on Brokered and Rate-Sensitive Deposits, May 11, 2001.

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The Bank Policy Institute appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by phone at 202.589.2424 or by email at dafina.stewart@bpi.com.

Respectfully submitted,



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