



June 9, 2020

Via Electronic Delivery

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

Re: Brokered Deposits Restrictions (RIN 3064-AE94)

Ladies and Gentlemen:

PMA Asset Management, LLC (“PMA”) and Public Trust Advisors, LLC (“PTA”) (each an “Advisor,” and collectively the “Advisors”) are pleased to submit this letter to the Federal Deposit Insurance Corporation (“FDIC”) in response to the FDIC’s Notice of Proposed Rulemaking (“NPRM”) on brokered deposits.¹ We appreciate the opportunity to provide comments and support the FDIC’s goal of “modernizing” its brokered deposit regulations.²

Each of the Advisors provide investment advisory services to separate and independent local government investment pools (“LGIPs”). LGIPs are investment vehicles that allow municipal governments and other local government entities (“Local Governments”) to collectively invest their public funds (*i.e.*, funds derived from tax revenue and other sources) in order to take advantage of economies of scale and the opportunity to have their assets professionally managed by fiduciaries. The Advisors have joined together to submit this comment letter for the benefit of their respective LGIP clients, the Local Governments that invest in the LGIPs and the community banks that benefit from the deposits placed by the LGIPs. The Advisors provide services to 18 LGIPs in 14 states with collective total assets of nearly \$50 billion, approximately \$5 billion of which are bank deposits at community banks.

LGIPs are expressly authorized, and governed strictly by, state statutes (“Authorizing Statutes”),³ which restrict LGIPs to invest in the high-quality liquid assets that a Local Government could invest in directly, such as U.S. Treasury or Agency securities, bank deposits, repurchase agreements, and commercial paper. The Advisors are registered investment advisers

¹ FDIC, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020).

² *Id.* at 7453.

³ See, e.g., Tex. Gov’t Code § 2256; Va. Code Ann. §§ 2.2-4600-4606; Ind. Code §§ 5-13-4-1 *et seq.*; Wash. Rev. Code § 43.250; Iowa Code §§ 12B.10, 12B.10A.

with the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940. The Advisors act as investment advisors to the LGIPs.

We request that the FDIC expressly exempt LGIPs and investment advisers to LGIPs from the definition of “deposit broker,” resulting in the deposits placed by LGIPs not being categorized as “brokered deposits.”

The primary purpose of an LGIP’s investment in deposit accounts is not “the placement of deposits,” but is to comply with the investment requirements of the Authorizing Statutes. Categorization of these deposits as “brokered” makes them less attractive to community banks into which many LGIPs deposit funds pursuant to the Authorizing Statutes.

I. Description of LGIPs

LGIPs typically take the form of trusts, which may be statutory or common law trusts pursuant to Authorizing Statutes. LGIPs formed through intergovernmental agreements generally have a commission as a governing body, while those in the form of trusts are governed by a board of trustees. Regardless of structure, LGIP trust agreements and intergovernmental agreements both provide, among other things, that all participants own undivided interests in the applicable pool in which such participants invest.

LGIPs may only be formed by Local Governments. Therefore, LGIPs are not investment companies required to register with the Securities and Exchange Commission (“SEC”) because they rely on the governmental exemption of the Investment Company Act of 1940.⁴ In addition, LGIPs, as structured, are exempt from registration with the SEC under the Securities Act of 1933.⁵

Local Governments are a unique type of investor because of their power to collect tax revenue. Tax revenue is often collected in seasonal patterns and invested into LGIPs to await use when government funds are expended. This seasonal pattern is consistent even during periods of financial stress. During the tax collection period, Local Governments invest revenues into LGIPs, increasing the size of the portfolio. Over the remaining course of the year, Local Governments draw down funds that are invested in LGIPs, but minimum balances remain in each LGIP in order to provide liquidity. Because LGIPs are professionally managed and always maintain these minimum balances, a significant portion of LGIP assets are always held in bank deposits. This provides a predictable and stable source of deposit funding for banks.

States began to use LGIPs as a vehicle for Local Government investments in the 1980’s before the FDIC established its brokered deposit regulations, and have grown significantly in terms of both the number of LGIPs and the total assets invested in all LGIPs. They are now a common investment vehicle for Local Governments. S&P rates 85 LGIPs throughout 28 states that together hold over \$330 billion of Local Government assets as of May 19, 2020.⁶ In

⁴ Investment Company Act Section 2(b), codified at 15 U.S.C. § 80a-2(b).

⁵ See, e.g., Illinois School District Liquid Asset Fund, SEC No-Action Letter (May 16, 1984).

⁶ S&P Global, Monitoring The Effect Of Market Volatility On Local Government Investment Pool Ratings (May 19, 2020), available at <https://www.spglobal.com/ratings/en/research/articles/200519-monitoring-the-effect-of-market-volatility-on-local-government-investment-pool-ratings-11498295>.

general, it is legally permissible either for an LGIP Board, which is made up of employees of the Local Government participants, to manage the LGIP directly, or for the Board to retain the services of third party vendors, including investment management professionals, as permitted by the LGIP trust agreements. As a practical matter, LGIP governing boards generally hire third party vendors including a registered investment adviser to provide discretionary advisory services for the LGIP.⁷

LGIP investment policies are governed by Authorizing Statutes. LGIPs are generally rated by a third-party rating agency, whether such rating is required by an Authorizing Statute, as it is in some states, or as a best practice. Nonetheless, if rated, an LGIP is governed in accordance with the guidelines of the rating agency.

The paramount goal for every LGIP is capital preservation to avoid the loss of public funds.⁸ Authorizing Statutes limit the investments in which Local Governments may invest. Though such statutes vary from state to state, they typically permit, among other things, high-quality liquid assets such as U.S. government and agency securities, repurchase agreements, and, importantly, bank deposits. Due to the organizational structure of the LGIP's, bank deposits are not eligible for "pass-through" deposit insurance under FDIC regulations.⁹

Bank deposits are critical to the overall mix of investments available to the LGIPs. Some Authorizing Statutes allow deposits with banks only within a given LGIP's state; others permit the LGIP to make deposits with banks outside the state, along with banks within the state. In either case, but especially in states where the local banking market includes many community banks, these requirements are often satisfied by depositing funds in community banks. Deposits from LGIPs are a significant source of funding for community banks.

The deposits placed by LGIP's with community banks are mutually beneficial to both the Local Governments that participate in the LGIP's and the community banks, permitting the Local Governments to comply with the limitation on their investment authority and providing a stable source of deposit funding for the community banks. Unfortunately, the current characterization of these deposits as "brokered" makes them a less attractive source of funding for community banks. Scrutiny by bank examiners on the use of brokered deposits and potentially higher insurance premiums increases the cost of these deposits to the banks, while potentially lowering the interest income available to the LGIPs.

II. Investment Advisers and LGIP Investments in Deposit Accounts

Today, most LGIPs are advised by an investment adviser registered with the SEC. Under the Investment Advisers Act of 1940, registered investment advisers are fiduciaries that legally step into the shoes of the LGIP principal when making investment decisions. The practices of

⁷ See Municipal Securities Rulemaking Board, "LGIP Investment Pool Structure," available at <http://www.msrb.org/About-MSRB/Programs/Protection-of-Municipal-Entities-and-Obligated-Persons/LGIPs.aspx>; Government Finance Officers Association, "Local Government Investment Pools," available at <https://www.gfoa.org/local-government-investment-pools>. Since the 2008-09 financial crisis, these industry organizations have issued best practices for the selection of investment advisers for LGIPs. *Id.*

⁸ *E.g.*, Iowa Code § 12B.10.2.(a.-c.) ("a. Safety of principal is the first priority. b. Maintaining the necessary liquidity to match expected liabilities is the second priority. c. Obtaining a reasonable return is the third priority.")

⁹ 12 CFR 330.11(a)(2).

registered investment advisers, such as the Advisors, are heavily regulated. Registered investment advisers are subject to the antifraud provisions of the federal securities laws and must not engage in fraudulent or deceptive practices.

The existence of an investment advisory relationship with an LGIP should not affect the treatment of the deposits held by the LGIP for purposes of the primary purpose exception, because the adviser is merely acting on behalf of its LGIP client when executing its investment policies, rather than placing deposits as a broker for its LGIP client.

Moreover, the advisory relationship between an investment advisor and an LGIP is substantially similar to the relationship between an investment adviser and an employee benefit plan, which is exempt from the definition of a “deposit broker.”¹⁰

III. Primary Purpose of LGIP Investments in Deposit Accounts

The primary purpose of an Advisor in investing an LGIP’s assets in deposit accounts is not the placement of deposits; rather, the primary purpose is complying with the Authorizing Statutes, which mandate the investment of LGIP assets in a discrete set of high-quality liquid investments that preserve the capital of Local Governments. The following factors illustrate that, because the primary purpose of the Advisors is not the placement of deposits, an Advisor is not a “deposit broker,” and deposits in which LGIP funds are placed are not best viewed as brokered deposits:

- An LGIP is managed primarily for safety, not yield, pursuant to Authorizing Statutes or fund organization documents. Deposit accounts are only one type of investment made by an LGIP. Its purpose is to invest public funds in the LGIP in accordance with the requirements of the relevant Authorizing Statute.
- Unlike funds placed by traditional deposit brokers, an LGIP’s investments in deposit accounts are not eligible for “pass-through” deposit insurance to the Local Governments,¹¹ and thus do not expand the insurance liability of the FDIC deposit insurance fund.
- LGIPs delegate investment discretion and authority to an Advisor pursuant to an investment advisory agreement. Pursuant to that agreement and applicable investment guidelines, the Advisor makes all investment decisions for the LGIP. The Advisor does not act as a “broker” in executing investment instructions given by an LGIP because the Advisor acts for the LGIP.
- The relationship between an LGIP and an Advisor is substantially similar to the relationship between an investment adviser and an employee benefit plan that is exempt from the definition of deposit broker.¹²

¹⁰ 12 CFR 337.6(a)(5)(ii)(E).

¹¹ *Supra* n. 9.

¹² *Supra* n. 10.

- As is common for asset managers, including trust departments of banks managing pooled investment vehicles, the Advisors receive a percentage-based fee.
- The banks do not pay any fees to the LGIP or the Advisors.
- The Advisors do not themselves use any other party as a deposit broker in connection with the investments in the deposit accounts.

Unlike other types of investment vehicles, such as registered money market funds and hedge funds, an LGIP is not easily formed, cannot be formed simply for the purpose of placing deposits, and cannot be formed on the Advisor's initiative to obtain additional FDIC insurance coverage. An LGIP must be authorized by an Authorizing Statute and are typically overseen by the State Treasurer or other public officials. An LGIP cannot be formed to obtain additional FDIC coverage for investors. In particular because of the lack of pass-through insurance, investments in deposit accounts by an Advisor for an LGIP would not be motivated by deposit insurance coverage.

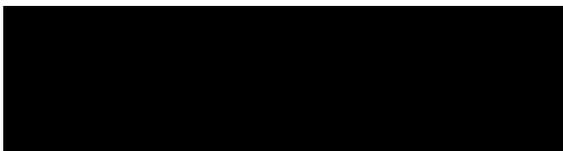
The presence of an Advisor should not affect whether the LGIP or the Advisor are considered a "deposit broker" because, as discussed above, the Advisor's role is limited to carrying out the investment policies and strategy of the LGIP, which are themselves carrying out the purpose of the Authorizing Statute.

Based on the factors set forth above, LGIPs and investment advisers to LGIPs should be exempt from the definition of deposit broker, resulting in the deposits placed by LGIPs not being categorized as "brokered deposits." We ask the FDIC to expressly exempt LGIPs managed by registered investment advisers, and those investment advisers, from being categorized as deposit brokers with respect to LGIP deposits, under the primary purpose exception in the final rule.

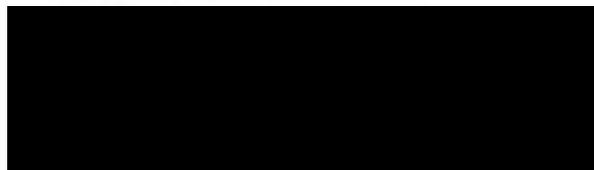
* * *

Thank you for the opportunity to comment on the NPRM. We are available to address any questions and welcome the opportunity for further dialogue to discuss or clarify the issues discussed herein.

Sincerely yours,



James O. Davis
CEO, PMA Asset Management, LLC



Chris DeBow
Managing Director, Public Trust Advisors, LLC