Decision of the
Supervision Appeals Review Committee

Case No. 2010-04

I. Summary of Findings.

After consideration of the timely filed written submissions of the parties, the record of this case, and following the July 1, 2010 deliberative meeting of this Committee, we deny the appeal filed by *** (the "Bank"). For the reasons set forth in this decision, the Committee finds that the FDIC *** Regional Office's material supervisory determination concerning the applicability of the rate restrictions under 12 C.F.R. § 337.6 to the Bank's *** Money Market Savings Accounts ("*** *** Accounts") was correct. Furthermore, for the reasons set forth in this decision, the Committee also finds that the Region's material supervisory determination that these § 337.6 interest rate restrictions take precedence over the asserted contractual obligations of the Bank to account holders of the *** *** Accounts was also correct.

Specifically, the Committee finds that the Division of Supervision and Consumer Protection has demonstrated that the Bank constituted a "deposit broker" as defined under 12 U.S.C. § 1831f(g) and § 337.6(a)(5)(iii) upon the reassignment of the Bank's Prompt Corrective Action ("PCA") capital category to less than "well capitalized." As a deposit broker, the Bank was not able to ignore the rate restrictions of § 337.6 merely because the *** *** Accounts were opened at a time when the Bank's PCA category was "well capitalized," because it was no longer permitting new customers to open such accounts, nor because of the express terms and disclosures for the *** *** Accounts.

II. Background.

A. Introduction.

The Bank, ***, ***, is a state-chartered financial institution with total assets of $** million, operating five branches in ***, ***, and *** counties serving the southeastern area of the state. The bank opened in 1958 as ***. In June 1994 the Bank changed its name to *** Bank. The Bank is presently part of a bank holding company, ***, which controls the Bank through its 100 percent ownership of ***, a one-bank holding company that the Bank purchased in November 2006. In November 2006 the Bank changed its name to *** (the Bank) and moved its headquarters from *** to ***, ***.

This appeal arises from two disputed material supervisory determinations set forth in the December 22, 2009 letter issued by the Regional Office. In a prior letter dated December 16, 2009, also from the Regional Office, the Deputy Regional Director forwarded the examination report and findings following a September 2009 examination conducted of the Bank. As summarized in the prior letter, the examination found that the

overall condition of the Bank had deteriorated significantly, and that it was in troubled condition. It further expressed the Regional Office's conclusion that a formal corrective plan in the form of a Consent Order pursuant to Section 8(b) of the Federal Deposit Insurance Act was necessary to address weaknesses identified in the examination. In the December 22, 2009 letter at issue, the Regional Office specifically addressed a written interpretation the Bank was asserting as to the applicability of the interest rate restrictions under 12 C.F.R. § 337.6 to the Bank's *** *** Accounts in the event the Bank became less than well capitalized.[1]

In the December 22, 2009 letter, the Regional Office concluded that in the event the Bank became less than well capitalized, the Bank would be unable to continue paying the contractual rate of interest on the existing *** *** Accounts if the rate offered exceeds that permitted under 12 C.F.R. § 337.6. The Regional Office asserted that the 12 C.F.R. § 337.6 restrictions apply if a bank is less than well capitalized; moreover, a bank that is otherwise well capitalized will be deemed adequately capitalized if it is operating subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC to meet and maintain a specific capital level. In the Bank's letter to which the Regional Office was responding, the Bank had asserted that, because it had ceased offering *** *** Accounts to new customers, it could continue to pay interest as provided under the terms of previously opened *** *** Accounts notwithstanding the § 337.6 limitations. The Bank argued it could do so because the Bank did not meet the definition of a "deposit broker" because it was not engaged in the solicitation of deposits by offering higher than prevailing rates of interest in the applicable market area, and because to do otherwise would expose the Bank to potential litigation from Account holders negatively affected by a change in rate who might assert a contract breach. In its December 22, 2009 letter, the Regional Office concluded that the *** *** Accounts would have to comply with the interest rate restrictions immediately after the Bank's PCA capital category became less than well capitalized.

On February 19, 2010, the Bank filed a timely Request for Review with the Director (the "Director") of the Division of Supervision and Consumer Protection ("DSC"). The Bank acknowledged that, for a period of time in 2009, it offered the *** *** Accounts under which the Bank pays interest to account holders equaling at least 50 percent of the Wall Street Journal Prime Rate -- an amount which at times exceeds the interest rate restrictions under 12 C.F.R. § 337.6. Although the bank stopped offering the

[1] Capital categories are defined under 12 C.F.R. § 325.103(b). Under these provisions, a bank is "Well capitalized" if its total risk-based capital ratio, Tier 1 risk-based capital ratio, and leverage ratio all meet or exceed specified limits, and provided further the bank "is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC" pursuant to specified provisions of the FDI Act or FDIC regulations "to meet and maintain a specific capital level for any capital measure. 12 C.F.R. § 325.103(b)(1). Banks unable to meet these requirements will fall into the remaining capital categories of "Adequately capitalized," "Undercapitalized," "Significantly undercapitalized," and "Critically undercapitalized." 12 C.F.R. § 325.103(b)(2)-(5). Upon the execution of the March 16, 2010 order setting a minimum capital level, the Bank was "Adequately capitalized," a finding that is unchallenged.

accounts to new customers, some depositors still hold such Accounts and are permitted to, and continue to, make deposits into them.

In its February 2010 Request, the Bank asserted that it was not a deposit broker under § 337.6 and thus was not required to adhere to the interest rate restrictions of Section 337.6 when paying the contractual interest rate on the *** *** Accounts. The Bank argued that such limitations do not take precedence over the rates the Bank promised to pay in its deposit agreements with *** *** Account customers. More specifically, the Bank argued that although a "brokered deposit" is defined under the § 337.6 interest rate restrictions as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker," the Bank was not a deposit broker. The Bank acknowledged that an insured depository institution can be a "deposit broker" when it is not well capitalized and engages "in the solicitation of deposits by offering rates of interest … which are significantly higher than the prevailing rates of interest" offered by other institutions in its normal market area. Nevertheless, the Bank maintained that it was "no longer offering, or soliciting and accepting, deposits" for the *** *** Accounts, and instead was only complying with the contractual obligations of its existing Accounts.

The Bank asserted that the December 22, 2009 material supervisory determination provided no support for its conclusion that a bank is deemed to be "offering" or "soliciting" brokered deposits simply by virtue of paying the contracted rate on existing deposits. The Bank observed that in "Questions and Answers" published previously by the FDIC, the Corporation stated that high-rate certificates of deposits ("CDs") could be held by less than well capitalized institutions until their maturity date. The Bank asserted that the regulation does not distinguish between the treatment of certificates of deposit and other deposit accounts, and that the *** *** Accounts have not been renewed or rolled over. Lastly, the Bank argued that, while it did reserve the right in its change of terms provision to make rate changes, there was sufficient ambiguity between that provision and other language in the account agreement stating that the rate would "never" change that it created sufficient ambiguity to expose the bank to litigation risk (breach of contract) should it lower the rates of he *** *** Accounts. The Bank thus asserts that lowering rates in accordance with the Corporation's § 337.6 limitations can not take precedence over the Bank's contractual "obligations" under its *** *** Account agreements and disclosures.

In response to the Bank's February 19, 2010 Request for review of the material supervisory determinations outlined in the Region's December 22, 2009 letter, the DSC Director, in a letter received by the Bank on April 5, 2010,[2] concurred in both material supervisory determinations. Specifically, DSC upheld the Region's determination that

[2] The Division Director's letter is not dated. In the Bank's subsequent letter of April 30, 2010 filing an appeal of the Division Director's determination, the Bank stated that it received the Division Director's letter on April 5, 2010.

once the Consent Order issued (*i.e.*, rendering the Bank no longer well capitalized but adequately capitalized), if the Bank continued paying significantly higher than prevailing interest rates on the *** *** Accounts (as defined under § 337.6), the Bank met the definition of a "deposit broker" and the payment of such higher rates was prohibited. DSC further upheld the Region's determination that the § 337.6 interest rate restrictions take precedence over the Bank's asserted contractual obligations to its *** *** Account customers.

The Bank timely filed an appeal with the Supervision Appeals Review Committee (the "Committee") by letter dated April 30, 2010. The Bank contests the determinations that it is a deposit broker, and that it must immediately lower the rates for *** *** Account customers in accordance with the § 337.6 interest rate restrictions notwithstanding the language in its Account agreements.

B. A Summary of the Parties' Contentions.

The Bank asserts two principal arguments. First, the Bank contends that it is not a deposit broker, as defined under § 337.6(a)(5)(iii). The Bank acknowledges that an institution that is adequately capitalized may not accept, renew, or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC, and that such deposits may only pay an effective yield which does not exceed the effective yield in the Bank's normal market area or the national rate by more than 75 basis points. *See* 12 C.F.R. § 337.6(b)(2). The Bank recognizes that a "brokered deposit" is defined as a deposit obtained directly or indirectly from or through the assistance of a deposit broker. Under § 337.6(a)(5)(iii), "deposit broker" is defined to include any insured depository institution that is not well capitalized which engages directly or indirectly "in the solicitation of deposits by offering rates of interest (with respect to such deposits) which are significantly higher than the prevailing rates of interest" on deposits offered by other insured depository institutions in the depository institution's normal market area. The Bank also acknowledges that the *** *** Accounts pay interest to account holders that may at times exceed the interest rate restrictions under § 337.6 (at least 50 percent of the Wall Street Prime Rate).

However, the Bank maintains that at the time the *** *** Accounts were offered the Bank was well capitalized and thus did not meet the definition of "deposit broker." Later, at the time the Bank became adequately capitalized, the Bank asserts it was no longer "offering or soliciting deposits for these types of accounts," and contends that because it was no longer offering rates in excess of those rates permitted under § 337.6, the Bank does not constitute a deposit broker.

The Bank contends that the terms "solicitation" and "offering" are not defined in the regulations, but argues that the Bank was not requesting or seeking to obtain deposits, nor was it offering deposits to anyone in an effort to obtain acceptance or to enter into a contract. In sum, the Bank argues that by continuing to pay the contract rate for the *** *** Accounts it was not a deposit broker, but was merely continuing to comply with the

terms of previously executed contracts, and the Bank was not "accepting, renewing or rolling over" a brokered deposit account.

Second, the Bank asserts that it has a contractual obligation to the holders of the *** *** Accounts to pay interest at a rate which can exceed the § 337.6 limitations, as the account agreement provides that, while the rate on the account may change to one-half of the Wall Street Journal Prime Rate on January 1, 2010, and that the rate may be adjusted, the agreement provides that the rate "will never fall below half the Wall Street Journal Prime Rate." The Bank acknowledges that under the Truth in Savings disclosure it expressly stated that the bank could change the rates from time to time if allowed by law, and admitted that it would assert it was allowed to change rates. Still, the Bank believes that there is sufficient "ambiguity" between the change in terms statement and the contractual rate language for the Accounts so as to allow potentially disgruntled Account holders to argue that a lowering of rates by the Bank constitutes a contractual breach.

More specifically, counsel for the Bank analyzed the fact that the *** *** Account agreement and disclosure provide that the rate will never fall below one-half the Wall Street Journal Prime Rate, while the disclosure and signature card simultaneously provide that the bank may change the rates from time to time if allowed by law, and that the signature card for the agreement provides that the customer agrees to all changes to the deposit account agreement, disclosure, and rate and fee schedule from time to time. The Bank asserts that because this right to change language is inconsistent with the language providing that the rate will never fall below one-half the Wall Street Journal Prime Rate, Account holders may argue that the language is inconsistent and thus susceptible to two interpretations -- both of them reasonable. A customer may argue that the Bank is free to change the interest rates, but only to the extent that the rates do not fall below the contract rate. The Bank asserts that it would be vulnerable to a breach of contract suit and an adverse decision because a court would give meaning to both provisions, because the language regarding the rate "never falling below" is more specific than the general allowance the Bank retained to change rates. Moreover, here, where the Bank is the drafter of the purportedly ambiguous language, the ambiguity could be construed against the Bank.

The Bank also responded to DSC's assertion that a court would not compel the Bank to pay an interest rate that would put the Bank in violation of applicable law. Rejecting the DSC assertion, the Bank is nevertheless concerned that the Bank may be charged with having contributed to the predicament, since the imposition of the rate restrictions resulted from the examination findings and the need for the capital agreement. In sum, the Bank is concerned that a judge or jury could find that the Bank's actions contributed to its status of being "adequately capitalized."

The Bank expressed concern that lowering the rates of interest on the *** *** Accounts could damage the reputation of the Bank within the community. During the

Bank's oral presentation to the Committee, the Bank noted that the public or some accountholders might view such a lowering of rates as a "bait and switch" situation.

DSC disputes each of these claims. Preliminarily, DSC states that due to a decline in the bank's overall condition and the need to ensure management addressed those weakness identified in the FDIC's September 2009 Report of Examination, the FDIC issued an order on March 16, 2010 that included a provision setting a minimum capital level. As provided in 12 C.F.R. § 325.103(b)(1)(iv), (2), as a consequence of this order the Bank's capital category was revised from well capitalized to adequately capitalized. As of May 3, 2010, the maximum interest rate (the national rate cap) that a bank with a less than well capitalized Prompt Corrective Action category was allowed to pay for Money Market Demand Accounts ("MMDA") less than $100,000 was 1.06 percent.[3] However, the rate of interest paid on the *** *** Accounts – at a rate equal to one-half the Wall Street Journal Prime – was calculated at 1.63 percent.[4]

DSC maintains that by continuing to pay the contractual interest rate on the *** *** Accounts that were opened prior to the time the Bank was designated as adequately capitalized, the Bank was offering rates of interest that were significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions. As a result, the Bank met the definition of a "deposit broker" under 12 C.F.R. § 337.6 and is thus required to adhere to the interest rate restrictions of that regulation.

Specifically, DSC maintains that under § 1831f, the statutory authority for the FDIC's § 337.6 regulations, an insured depository institution "that is not well capitalized may not accept funds obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts." 12 U.S.C. § 1831f(a). DSC argues that this provision does not prohibit a less than well capitalized bank from *opening new accounts* through deposit brokers; rather, it provides that such a bank "may not *accept* funds obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts," citing 12 U.S.C. § 1831f(a). In sum, DSC maintains that the statutory prohibition is not directed at the "opening of new accounts" but rather focuses on "the acceptance of funds." DSC also stresses that the statute does not distinguish between the acceptance of funds "into 1 or more *new* deposit accounts" nor "into 1 or more *existing* deposit accounts," and this does not qualify the prohibition in the manner suggested by the Bank. Under DSC's interpretation, whether the funds are placed into a

[3] As provided in Section 337.6, the maximum interest rates that may be paid on deposits by a Bank with a PCA category of Adequately Capitalized can be no more than 75 basis points above the national average for rates paid on all insured deposits by type of account and/or maturity period.

[4] Subsequent to the bank's request, the FDIC changed its methodology for calculating the local rate cap to allow banks to include only one office for each bank within their geographic market area. Based on the Bank's Metropolitan Statistical Area, DSC's analysis of the rate caps for non-jumbo and jumbo MMDA accounts were 1.17 and 1.43 percent, respectively. Although the recent policy change results in a limitations calculation more beneficial to the Bank, the Bank's contract rate for the *** *** Accounts still exceeds these higher rate caps.

new account, or placed into an existing account, the statutory prohibition is applicable provided the funds are "obtained, directly or indirectly, by or through any deposit broker."

Although the Bank contends that it is not a deposit broker because, it asserts, it is not "soliciting" or "offering" deposits at high rates, DSC argues that because the Bank admits it is continuing to pay a high interest rate on the *** *** Accounts the Bank is unable to maintain that the Bank does not "offer" a significantly higher rate of interest when it continues to pay such rates to an existing customer on an existing account. As DSC notes, the *** *** Accounts are money market deposit accounts that permit regular deposits, and withdrawals (unlike, for example, a certificate of deposit with a fixed balance), and the Account holders are allowed to deposit "fresh" funds into the *** *** Accounts at any time. DSC maintains that with respect to these new funds, the Bank is "offering" the high rate of interest which it presents to the customer for acceptance, and the customer's subsequent deposit of new funds into the Account is the customer's acceptance of such rate. Also, DSC argues further that, even with respect to funds previously deposited into the Accounts the Bank is "offering" the high rate on a daily basis as the customer is free to withdraw his or her funds. In sum, although the Bank may have ceased to offer the high rate of interest to the general public (*** *** Accounts cannot be opened by new customers), "the Bank continues to offer and pay the high rate" to customers who opened *** *** Accounts prior to the Bank becoming adequately capitalized.

DSC also contends that the Bank's interpretation of the statute and regulatory requirements is not consistent with the legislative intent of the statutory restrictions on the use of brokered deposits and the prudent rate of interest that can be paid on deposits by less than well capitalized institutions under 12 U.S.C. § 1831f(a) and 12 C.F.R. § 337.6. In sum, the legislative history indicates that Congress sought to prevent weaker banks from accepting high-rate deposits and further sought to prevent institutions from avoiding this prohibition through the use of third party deposit brokers even when solicited internally through "money desk operations." DSC argues that it is illogical to distinguish whether the funds are placed into a new account or an existing account, as nothing in the legislative history acknowledges such a distinction. Moreover, reading such an intention and distinction, as advocated by the Bank, would result in a troubled institution being prohibited from accepting high-rate deposits in a *new* account -- even in small amounts -- but would permit such institution to accept high-rate deposits into an *existing* account -- in exceptionally large amounts -- which DSC urges is an illogical result.

DSC maintains that the Bank's interpretation is also undercut by the statute's treatment of renewals and rollovers of accounts such as CD accounts. Under the statute, any renewal of an account in any troubled institution "shall be treated as an acceptance of funds by such troubled institution." 12 U.S.C. § 1831f(b). With respect to a high interest rate CD, the FDIC does not require a less than well capitalized institution to reduce the

rate immediately upon the bank becoming classified as Adequately Capitalized. Instead, the FDIC requires a bank to reduce the interest rate when the CD matures.

In DSC's view, two points can be drawn from this example. First, even if a customer places no new funds into the account but simply allows the account to roll over, the interest rate must be reduced when the CD matures. DSC argues that this demonstrates that existing accounts (*i.e.*, accounts opened prior to the Bank becoming adequately capitalized) are not exempt from the § 1831f interest rate restrictions. Second, this treatment of high interest rate CDs illustrates another weakness in the Bank's interpretation. That is, the Bank's interpretation would require that high rate CDs be reduced when the account matures, but significantly high rates on MMDAs such as the Bank's *** *** Account may be maintained in perpetuity, theoretically, since "Congress could have specified that existing non-maturity deposits reprice when a bank becomes less than 'well capitalized' [but] it did not do so." DSC responds that Congress added a special rule to address accounts such as CDs -- accounts that renew or roll over -- to clarify when the statutory restrictions apply to an account that matures at a later time after a bank is classified as adequately capitalized. The statute does not address other (non-CD) account types without maturity dates, such as the *** *** Account, as no special rule is needed because the interest rate can commonly be reduced immediately under account change in terms provisions.

Lastly, DSC challenges the Bank's assertion that it is compelled to maintain the high rates of interest under the contract terms of its *** *** Accounts due to the inclusion of the language "[y]our interest rate will never fall below half of the Wall Street Journal Prime Rate." The Bank maintains that because of this language the Bank will be vulnerable to litigation and adverse judgments should it lower rates in accordance with § 337.6. DSC argues that the contract's "will never fall below half" language merely addresses the requirement to send notice of a change in terms, and, in any event, neither the Bank not its customers can nullify the statutory interest rate restrictions through private contract. To the extent the contractual language is in conflict with § 1831f and § 337.6, DSC argues such language is void; the Bank must reduce the rates under the *** *** Account, notwithstanding any reputational harm that the Bank alleges could possibly ensue.

In accordance with the *Guidelines for Appeals of Material Supervisory Determinations* ("*Guidelines*"),[5] the Committee reviews such determinations for consistency with the policies, practices, and mission of the FDIC, and the reasonableness of and support for the positions of the parties. When the Committee met to consider the matter on July 1, 2010, the Bank elected to appear, and at that time the Bank made an oral presentation to the Committee and responded to questions from the Committee. The

[5] The FDIC's Board of Directors previously adopted amended *Guidelines* on September 17, 2008. *See* 73 Fed. Reg. 54,822 (September 23, 2008). This year, on April 13, 2010, the Board adopted revised *Guidelines for Appeals of Material Supervisory Determinations.* *See* 75 Fed. Reg. 20,358 (April 19, 2010).

Committee has carefully considered the written submissions of the parties, as well as the oral presentations of the Bank and DSC staff. Under the *Guidelines*, the burden of proof on all matters at issue rests with the institution. Further, the scope of the Committee's review is limited to the facts and circumstances existing at the time of the examination.

III. Analysis.

A. Is the Bank a Deposit Broker as Defined under § 337.6(a)(5)(iii), and thus Subject to the Interest Rate Restrictions?

The central dispute in this appeal pertains to whether the Bank, once it fell from well capitalized to adequately capitalized, engaged in activity that qualified the Bank as a "deposit broker" under applicable law, thus making its *** *** Accounts subject to applicable interest rate restrictions. The Bank maintains that at the time the *** *** Accounts were offered it was well capitalized and thus did not meet the definition of "deposit broker." Subsequently, at the time the Bank became adequately capitalized, the Bank asserts it was no longer "offering or soliciting deposits for these types of accounts," and was not offering rates that would cause the Bank to be in excess of those rates permitted under § 337.6. The Bank maintains that the term "solicitation," as well as the term "offering," are not defined in the regulations, but that the Bank was not requesting or seeking to obtain deposits, nor was it offering deposits to anyone in an effort to obtain acceptance or to enter into a contract, as those two terms are generally defined in a legal dictionary. In sum, the Bank asserts that at the time it was adequately capitalized it was not "accepting, renewing or rolling over" a brokered deposit account by continuing to pay the contract rate for the *** *** Accounts.

DSC maintains that by *continuing* to pay the contractual interest rate on the *** *** Accounts, even if opened prior to the time the Bank was designated as adequately capitalized, the Bank was offering rates of interest that were significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions. As a result, the Bank met the definition of a "deposit broker" under § 1831f and § 337.6 and is thus required to adhere to the interest rate restrictions of those provisions. DSC maintains that because the Bank admits it is continuing to pay a significantly high rate of interest on the *** *** Accounts it errs in maintaining that it does not "offer" a rate when it pays such rate to existing customers on existing Accounts.

The Committee's Findings. By continuing to pay the contractual interest rate on the *** *** Accounts that were opened prior to the time the Bank was designated as adequately capitalized, the Bank was offering rates of interest significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions. As a result, the Bank met the definition of a "deposit broker" under 12 C.F.R. § 337.6 and is thus required to adhere to the interest rate restrictions of that regulation upon becoming adequately capitalized.

Unlike, for example, a certificate of deposit with a fixed balance, the *** *** Accounts are money market deposit accounts with regular deposits and withdrawals, and the customers are allowed to deposit new funds into the *** *** Accounts at any time. As DSC correctly maintains, with respect to these new funds, the Bank is "offering" a rate of interest significantly higher than the prevailing rate which it presents to the customer for acceptance, and the customer's subsequent deposit of new funds into the Account is the customer's acceptance of such rate. Although the Bank may have ceased to offer the high rate of interest to the general public (*** *** Accounts cannot be opened by new customers), the Bank continues to offer and pay the high rate to customers who opened *** *** Accounts prior to the Bank becoming adequately capitalized.

The Bank does not contest the finding that such rates paid on the *** *** Accounts were higher than allowed under Section 337.6, but contests that it was "offering" such rates after it had become adequately capitalized. While it is accepted as fact that the Bank has ceased to offer the high rate of interest "to the general public" since *** *** Accounts cannot be opened by new customers, the Bank still continues to offer and pay the high rate to those customers who opened *** *** Accounts prior to the Bank becoming adequately capitalized. While the Bank believes it is not a deposit broker because it asserts it is not "soliciting" or "offering" deposits at high rates, the Committee concurs in the DSC view that the Bank does in fact "offer" such higher rate when it pays the rate to an existing customer on an existing account.

Here, the *** *** Accounts are money market deposit accounts with regular deposits and withdrawals and the customers are allowed to deposit new funds into the *** *** Accounts at any time. Certainly, with respect to these new funds, the Committee concurs in DSC's determination that the Bank is "offering" the high rate of interest which it presents to the customer for acceptance, and the customer's subsequent deposit of new funds into the Account is the customer's acceptance of such rate. Although unnecessary for our decision, even if new funds were not allowed to be deposited into these Accounts (*e.g.*, the Bank was only paying the higher rate of interest on the existing balance on the date of the PCA agreement but not on new deposits), the Committee agrees with DSC's further assertion that, even with respect to funds previously deposited into the Accounts, the bank is "offering" the high rate on a daily basis, as a *** *** Account customer is free to withdraw his or her funds, and in choosing not to do so the customer is accepting the higher rate on these existing deposits.

The applicable statute sets forth the clear restriction on brokered deposits for institutions that are less than well capitalized:

> An insured depository institution that is not well capitalized may not accept funds obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts.

12 U.S.C. § 1831f(a). The statute expressly defines the term "deposit broker" as "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions." 12 U.S.C. § 1831f(g)(1). The statutory definition does set forth a list of specified exclusions, one of which includes "an insured depository institution with respect to funds placed with that depository." 12 U.S.C. § 1831f(g)(2)(A). Notwithstanding this exclusion, however, the statute narrows the exclusion with respect to depository institutions based on capital category, as follows:

> Notwithstanding paragraph (2), the term "deposit broker" includes *any insured depository institution that is not well capitalized (as defined in section 1831o of this title)*, and any employee of such institution, which *engages directly, or indirectly, in the solicitation of deposits by offering rates of interest which are significantly higher than the prevailing rates of interest* on deposits offered by other insured depository institutions in such depository institution's normal market area.

12 U.S.C. § 1831f(g)(3) (emphasis added); *see also* 12 C.F.R. § 337.6(a)(5)(iii) (similarly defining "deposit broker"). The statute further grants the Corporation the authority to impose, by regulation or order, additional restrictions on the acceptance of brokered deposits that the Corporation determines to be appropriate. 12 U.S.C. § 1831f(f).

The Corporation promulgated regulations addressing this restriction on brokered deposits at 12 C.F.R. 337.6. Consistent with the statute's reference to the capital categories defined in the Prompt Corrective Action authority of 12 U.S.C. 1831o, section 337.6(a)(3)(i) (and note) defines the applicable capital categories by referencing the Prompt Corrective Action capital category definitions set forth under 12 C.F.R. Part 325. The definition of deposit broker excerpted above expressly references "any insured depository institution that is not well capitalized," and thus the Section 325.103(b)(1) definition of "well capitalized" is critical. Under that regulation, a "well capitalized" bank is one that, among other things, "[i]s not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC pursuant to section 8 of the FDI Act (12 U.S.C. 1818), …or section 38 of the FDI Act (12 U.S.C. 1831o), or any regulation thereunder, to meet and maintain a specific capital level for any capital measure." 12 C.F.R. § 325.103(b)(1)(iv).

Here, the Bank became subject to such a capital order on March 16, 2010, and thus it did not meet the definition of a "well capitalized" institution. The Bank in this appeal does not dispute the conclusion that it is not well capitalized for purposes of PCA. Moreover, the Bank does not contest the determination that the rate of interest payable under the terms of the Bank's *** *** Accounts is "significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in

such depository institution's normal market area," as prohibited by the statute.[6] Instead, the Bank contests the finding that it constitutes a deposit broker on the grounds that it believes that it was no longer, after becoming adequately capitalized, "offering or soliciting deposits for these types of accounts [*** *** Accounts] and is not offering rates for any other deposit accounts that would cause it to be a deposit broker under Part 337.6."

After asserting that the regulation does not define the terms "solicitation" or "offering," the Bank employs Black's Law Dictionary to define the former term as "the act or an instance of requesting or seeking to obtain something or an attempt or effort to gain business," and the latter term as the "act or an instance of presenting something for acceptance." However, the Bank incorrectly separates the terms "solicitation" and "offering," and thus unnecessarily resorts to the Dictionary for the meaning of "solicitation." The Bank overlooks the fact that the statute defines solicitation *in relation to* offering, as the language addresses the "solicitation of deposits *by offering* rates of interest which are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions in such depository institution's normal market area." 12 U.S.C. § 1831f(g)(3) (emphasis added). Plainly, one is engaged in "solicitation" of deposits by virtue of offering significantly higher rates for those deposits. Consistent with the statute, the applicable regulation also defines "deposit broker" as including a less than well capitalized insured depository institution engaged in the "solicitation of deposits *by offering rates of interest (with respect to such deposits)*" that are significantly higher than prevailing rates. 12 C.F.R. § 337.6(a)(5)(iii) (emphasis added).

Where, as here, the Bank permits the holders of the *** *** Accounts to continue to make new deposits into the Accounts, for which the Bank offers to pay those customers significantly higher rates, it is clear that the Bank satisfies this statutory and regulatory prerequisite, as it is engaged in solicitation by offering significantly higher rates. We thus reject the Bank's contention that merely because it opened the Accounts when it was well capitalized any ongoing offer to pay significantly higher-than-allowed interest on fresh deposits into such Accounts when the Bank is less than well capitalized does not constitute an "offer" to pay higher rates. Nor is the Bank's interpretation rendered any more persuasive by the Bank's continuing assertion that it is paying a rate precluded by applicable law only because the institution is "solely continuing to comply with the terms of previously executed contracts."

As DSC correctly recognizes, the essential import of the Bank's contention is that the statute only applies to "new" accounts. While the Bank argues that "it is not arguing

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[6] For this reason, it is unnecessary to address in this opinion DSC's actual calculation of the rate cap. In short, the Bank disputes whether the rate cap is applicable in the first instance, and does not dispute the actual rate cap calculation rendered by DSC. *See* FIL 69-2009, *Process for Determining if an Institution Subject to Interest-Rate Restrictions is Operating in a High-Rate Area*; FIL 25-2009, *Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized.*

that Part 337.6 does not apply to existing accounts," such a conclusion is the natural consequence of the Bank's position. In essence, the Bank believes that existing accounts must be governed by their current terms -- even in instances when such terms, due to the Bank's changed condition and applicable law, dictate that such terms are no longer a safe and sound practice for the institution. The Bank's view is that if the existing Account terms *permit* the institution to pay a rate of interest in excess of that rate permitted for an adequately capitalized institution, it is *required* to pay such significantly higher rate even if it is prohibited from paying such rate to a customer who opens a new account after the Bank becomes adequately capitalized. Not only would such an analysis permit the institution to pay the significantly higher rate in perpetuity -- as the Bank's argument and pleadings admit to no ability for the Bank to ever cease paying such rate -- but the Bank asserts here it must also do while allowing the accountholders of *** *** Accounts to continue to make fresh deposits into the Account, without limit, all earning the significantly higher interest rate that federal law disallows. This is clearly inconsistent with the purposes of § 1831f and its implementing regulations.[7]

Moreover, these statutory and regulatory limitations were placed on the "acceptance" of deposits. The statute does not provide that this limitation is narrowly

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[7] As the legislative history for this provision provides, the statute sought to ensure that an institution without sufficient capital may not accept brokered deposits and "is also prohibited from soliciting deposits by offering rates of interest which are significantly higher than the prevailing rates of interest on deposits offered by other insured financial institutions of the same type, *i.e.*, banks or thrifts, in such financial institution's normal market area. This latter provision prohibits the solicitation of deposits by in-house salaried employees through so-called money desk operations." H.R. Conf. Rep. No. 101-222, P.L. 101-73, Financial Institutions Reform, Recovery and Enforcement Act of 1989, 1989 U.S.C.C.A.N. 432, 1989 WL 168167. This Conference Report provides further:

> The FDIC is also explicitly authorized to impose by regulation or rule additional restrictions on the acceptance of brokered deposits by troubled institutions. . . . The provision authorizes the FDIC to waive the prohibition on the acceptance of brokered deposits by troubled institutions, but only after a case-by-case review of applications made by such institutions and then only upon a finding that the acceptance of brokered deposits by a given institution does not constitute an unsafe or unsound practice.
> The conferees understand that there are situations where brokered deposits are useful and needed particularly for liquidity purposes. Although the provision requires a case-by-case application by a troubled institution for waiver of the prohibition, the Corporation may indicate by rulemaking the type or types of situations in which the Corporation would consider granting a waiver consistent with the statute. The prohibition, however, could only be waived by a finding that the use of brokered deposits by a particular troubled institution does not constitute an unsafe or unsound practice for it.

1989 U.S.C.C.A.N. at 441-42. Here, Congress allowed for exceptions to be granted to the statute's restrictions on the acceptance of brokered deposits -- prospectively and only where specifically considered and deemed safe and sound -- but expressed no intention whatsoever that such acceptance be coupled with an additional ability of an institution to accept brokered deposits and pay a rate of interest wholly within an institution's discretion, and regardless of any interest rate caps. The Bank argues that, notwithstanding its capital position, it is entitled to pay significantly higher rates of interest under its *** *** Accounts for as long as the accounts remain open, and that its accountholders may continue to make fresh deposits, *without any limit whatsoever on the amount of such deposits*, notwithstanding its capital position or whether it is a safe or sound practice for the bank to continue doing so.

circumscribed to apply to only newly-opened accounts, as opposed to the rates applicable to existing accounts. The statute and the § 337.6 regulations provide that an insured depository institution "that is not well capitalized *may not accept funds* obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts," and the Bank is unable to circumscribe the scope of the law merely because it perceives litigation risk or reputational harm if the law demands that it to no longer offer a rate that is significantly higher than prevailing rates offered by other institutions. The statutory prohibition is not directed at the "opening of new accounts" but rather to "the acceptance of funds," and does not distinguish between the acceptance of funds "into 1 or more *new* deposit accounts" or "into 1 or more *existing* deposit accounts." 12 U.S.C. § 1831f(a). Rather, the law provides that a bank in a capital position such as the Bank's "may not accept funds obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts." 12 U.S.C. § 1831f(a).

The Bank asserts the statute does not envision that the rates on existing accounts be immediately repriced, and argues that, "although Congress could have specified that existing nonmaturity deposits reprice when a bank becomes less than well capitalized, it did not do so." The Bank notes that the statute permits a less than well capitalized bank to continue to pay the contract rate of interest on a certificate of deposit until the certificate matures, even if the certificate rate exceeds the rate permitted for the institution. The Bank essentially contends that, since the statute permits a CD account to not be immediately repriced, it may not reduce the interest rate on an MMDA account such as the *** *** Account because the statute does not explicitly direct the Bank to do so. As DSC has correctly noted, while it is true that for accounts subject to renewals and rollovers such as CD accounts, the law does not require a less than well capitalized institution to reduce a high rate CD account immediately upon a bank being classified adequately capitalized, consistent with section 1831f(b). Rather than bolster the Bank's position, this specific allowance for accounts such as CD accounts actually undermines the Bank's position.

As discussed below, the *** *** Accounts have express language that permits the Bank to change the rates and terms, which even the bank acknowledges.[8] Moreover, such MMDA accounts such as the *** *** Account permit deposits and withdrawals, and accountholders of the *** *** Accounts can continue to deposit funds into the Accounts even if the Accounts are no longer offered to the general public. This is to be distinguished from a typical CD account which provides for a specific rate of return, for a specific interval of time, earned on a specific certificate balance. Even with respect to such a CD account, Congress does not permit the "status quo" to be maintained following the change in a bank's capital condition to less than well capitalized. For instance, the statute does not permit an automatic rollover of the existing amount of a CD account.

[8] For example, the bank declares, "We recognize that the last sentence of the introductory paragraph to the Truth in Savings Disclosure states, '[w]e may change the rates, fees and charges contained in this schedule from time to time, *if allowed by law*' (emphasis added)("Change in Terms Statement"), and we would argue that this does allow the bank to make the rate changes." (the Bank's letter dated April 30, 2010.)

Even with respect to the existing deposit amount, any renewal or rollover "of any amount on deposit in any such account shall be treated as an acceptance of funds," and therefore the Bank must reduce the interest rate (assuming that rate exceeds the rate cap). In other words, even where the amount on deposit at the bank in a CD account does not change, and the bank and customer merely seek to rollover the existing amount, such requires a reduction in the interest rate if the institution is less than well capitalized and is paying a significantly higher rate of interest than prevailing rates in the normal market area. The Bank, however, argues that its MMDA account, with an account balance that may increase -- and in an unlimited amount -- requires no such reduction in rate. The Committee cannot concur in the interpretation of the statute suggested by the Bank, as such an interpretation renders a nonsensical result and one wholly at odds with the statute's purposes.

*B. Is the Bank Able to Disregard the Statutory and Regulatory Limitation on Interest Rates on Account of the Purported Terms of Account Agreements with *** *** Account Customers?*

The Bank asserts that it has a contractual obligation to the holders of the *** *** Accounts to pay interest at a rate which can exceed the § 337.6 limitations, and that this obligation takes precedence over the applicability of both § 1831f of the statute and § 337.6 of the Corporation's regulations. The Bank acknowledges that the account agreement and disclosures provide that the rate and terms may change, that the rate may change to one-half of the Wall Street Journal Prime Rate on January 1, 2010, and that the latter rate may be adjusted, but the Bank also asserts that the account agreement states that the rate "will never fall below half the Wall Street Journal Prime Rate." The Bank acknowledges further that under the Truth in Savings disclosure it expressly stated that the Bank could change the rates from time to time if allowed by law, and admitted that the Bank would assert it was allowed to change rates under that language. Yet, the Bank still believes that there is sufficient "ambiguity" between the change in terms statement and the contractual rate language for the *** *** Accounts so as to allow potentially disgruntled Account holders to argue that a lowering of rates by the Bank to comply with federal law constitutes a contractual violation if such lowering brings the customer's rate "below half the Wall Street Journal Prime Rate." In sum, on account of this language pertaining to the *** *** Accounts, and litigation concerns the Bank perceives, the Bank maintains that it simply need not comply with the interest rate restrictions set forth in Federal law.

DSC challenges the Bank's assertion that it is compelled to maintain the high rates of interest under the contract terms of its *** *** Accounts due to the inclusion of the language "[y]our interest rate will never fall below half of the Wall Street Journal Prime Rate." DSC first argues that the contract's "never fall below half" language merely addresses the requirement to send notice of a change in terms. Secondly, DSC asserts that neither the Bank not its customers can nullify the statutory interest rate restrictions through private contract. To the extent the contractual language is in conflict with § 1831f of the statute, DSC argues such language is void and the Bank must reduce

the rates under the *** *** Account, notwithstanding any reputational harm that the Bank alleges may ensue.

The Committee's Findings. Although DSC provides two arguments to support its determination that the Bank cannot successfully maintain that its *** *** Account agreements prevent it from lowering the rates on those Accounts, the Committee need only address its latter, broader argument. In short, the Committee rejects outright the assertion by the Bank that the institution, through its account agreement and disclosure documents may contractually nullify applicable federal law under § 1831f -- even assuming its agreements clearly do so in this case.

More specifically, the interest rate restrictions imposed by Congress under 12 U.S.C. § 1831f, and effectuated through the regulations issued by the Corporation under 12 C.F.R. § 337.6, cannot simply be nullified because of an asserted agreement between the Bank and its customers that the Bank may pay a rate of interest in excess of such applicable legal limits. Even if it is assumed that the Bank failed to preserve the legal right for the Bank to change the account terms -- which is not conceded -- the Bank is unable to successfully argue that it may pay a rate of interest that the Congress has concluded is unsafe and unsound for a financial institution in the Bank's specific capital category.

Section 1831f(g) specifically defines "deposit broker" to include a not well capitalized insured depository institution which engages in the solicitation of deposits by offering rates of interest significantly higher than prevailing rates offered by other institutions in the market area. To implement this clear limitation, Congress authorized the FDIC to impose by regulation additional restrictions on the acceptance of brokered deposits by troubled institutions, which the FDIC has done under § 337.6. Congress further authorized the FDIC to waive the prohibition on the acceptance of brokered deposits by troubled institutions, but only after a case-by-case review of applications submitted by such institutions, and then only upon a finding that the acceptance of brokered deposits by a given institution does not constitute an unsafe or unsound practice. Moreover, even with such a waiver, an institution is not permitted to pay a rate of interest that exceeds the rate cap. The Bank effectively argues that the Bank and its customers can, by their independent agreement, completely avoid these statutory limitations, and nullify the Corporation's authority and ability to ensure the Bank is operating in a safe and sound manner. Moreover, if the Corporation is unable to preclude an insured depository institution from engaging in unsafe and unsound practices, it is unable to fulfill its statutory obligations.

The logical consequence of the Bank's position is that, notwithstanding the fact that the Congress and the President enacted Federal statutory law placing limits on brokered deposits -- limits that expressly define "deposit broker" in relation to an insured depository institution's offering of significantly higher rates than other institutions in its market area, and in relation to institutions in the *precise* capital category occupied by the Bank -- such enacted law and the Federal regulations promulgated through public notice

and comment are simply not applicable to the Bank should its deposit account agreements contain inconsistent terms. Simply, the Bank argues it is entitled to pay a rate of interest greater than allowed by law, merely because there is a risk its customers "will assert it promised to do so," and despite the fact that Federal law presumes that rate is unsafe and unsound for a bank in the Bank's capital position even with a waiver. The Committee rejects this contention and concurs in DSC's determination. The proposition asserted by the Bank would nullify the purposes of the statute, thwart the legislative policies it was designed to effectuate, and is flatly contrary to public policy.

As an additional observation, although one not necessary for the Committee's ultimate determination, the Committee notes that it is precisely because of changes in economic conditions, in institutions' business plans, in market competition, and changes in institutions' capital position and overall condition, that institutions commonly include "change in terms" provisions in their account disclosures and agreements. Although it is not this Committee's obligation or appropriate role to assess the relative litigation exposure that the Bank may or may not face as a result of the *** *** Accounts -- that is a function properly left to the Bank and its counsel -- the Bank did include language which provides "[the Bank] may change the rates, fees and charges contained in this schedule from time to time, *if allowed by law*" (emphasis added). The Bank notes in its memorandum to the Committee that the Bank "would argue that this does allow the bank to make rate changes." Still, the Bank asserts that, because of overall ambiguity in the account terms in total, the Bank faces risk that customers will insist it still may never reduce rates below "half of the Wall Street Journal Prime Rate." While it is clear that the perception of litigation risk, however remote, cannot permit an insured financial institution to ignore and frustrate applicable Federal law, the Bank's position suffers from an additional infirmity. In sum, from the reasonable conclusion that its Account language can permit the Bank to make rate changes if *allowed* by law, the Bank leaps to the inexplicable conclusion that this same language precludes the Bank from making such rate changes when the law *compels* it to do so. This is illogical, and underscores yet another evident weakness in the Bank's underlying contentions in this appeal.

The Committee finds that the Division of Supervision and Consumer Protection has demonstrated that the Bank constituted a "deposit broker" as defined under 12 U.S.C. § 1831f(g) and § 337.6(a)(5)(iii) upon the reassignment of the Bank's Prompt Corrective Action category to less than "well capitalized." As a deposit broker, the Bank was not able to ignore the rate restrictions of § 337.6 merely because the *** *** Accounts were opened at a time when the Bank was well capitalized, it was no longer permitting new customers to open such accounts, because of the express terms and disclosures for the *** *** Accounts, nor due to any perceived litigation risk.

IV. Conclusion.

For the foregoing reasons, the Bank's appeal is denied as set forth in this opinion. This decision is considered a final supervisory decision by the FDIC.

By direction of the Supervision Appeals Review Committee of the FDIC, dated September 7, 2010.

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Valerie J. Best
Assistant Executive Secretary