October 31, 2019

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

RE: Notice of Proposed Rulemaking on Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized (RIN 3064–AF02)

Dear Mr. Feldman:

We provide this letter in response to the Notice of Proposed Rulemaking on Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized (RIN 3064–AF02). Over the past 40+ years, our firm has served as an outsourced Chief Financial Officer for hundreds of community financial institutions, primarily those operating in smaller markets and with balance sheets of under $1 billion. During this time, we have had direct experience with the impact of Part 337.6 on client institutions, and have seen the unintended consequences of deposit rate caps. From this experience, we fund that the concept of deposit rate caps within a free market economy is inherently flawed, as the market functions best when freed from government-imposed restrictions. As financial institution failures flow primarily from poor risk management on the asset side of the balance sheet, controls on the liability side of the ledger do not directly address the root cause of failure. Deposit rate caps, when used as an indirect method of constraining growth and excessive risk, create more problems than they solve and place troubled institutions in increasingly difficult positions by restricting the sources of funding available to maintain adequate liquidity while resolving their core problems. Instead of an overly complex mechanism to restrict balance sheet growth through deposit rate limitations, we suggest the use of existing tangible common equity capital ratio regulations (either leverage-based or risk-based) as growth limiters. In recognition of the current regulatory environment and the improbability of sweeping reform that would eliminate deposit rate caps, we will focus the remainder of this comment letter on possible adjustments to the existing rate cap structure that might improve a flawed regulatory model.

<u>Comments on the Proposed Rule -- Weighted Average National Deposit Rate</u>

Whether in a single city, county, MSA, or in a national market, averages and weighted averages fail to provide an effective regulatory limit because these calculations do not reflect actual customer choices, which are typically made at the margin. A customer seeking the highest NOW account rate does not seek out information on the median, average or weighted average offering rate in a given market, nor does he seek a financial institution that brags they offer such a rate. He seeks out information on the prevailing rates available, meaning those that actually attract funds. Rate cap formulas that allow for headroom above an average or median rate do not, in any consistent or meaningful way, reflect the prevailing, market clearing rates at which an institution can retain existing rate-sensitive funds or attract replacement funds. In addition to being fundamentally flawed relative to basic economic principles of supply and demand, the use of a weighted average national deposit rate on a product-by-product basis using the institutions' share of total industry deposits (not calculated on a product-by-product basis) will allow the country's largest four institutions – all of which offered rates significantly below the market clearing rate for several product types over the last decade – to skew rate caps downward. Similarly, the use of branch count-weighted averages also allows larger institutions with low rates too large a voice. If (like JPMorgan Chase Bank, N.A. in 2014-present) the large institution offers an absurdly low rate on a 12-month CD, its size and number of locations within a market (or the nation) is immaterial from a market clearing rate perspective. No rational, rate sensitive depositor would choose that rate over the higher rate offered by smaller institutions. (As of October 29, 2019, www.chase.com offers a rate of 0.02% on a 12-month CD – a rate that has not changed materially in years, despite significant market rate changes.)

Comment on the Alternative Rate Cap Method – Higher of Two Previous Rate Caps / Efficient Frontier

As discussed in the NPR, the combination of the pre-2010 U.S. Treasury-based rate cap and the current rate cap structure should provide a simple, effective rate cap structure for most situations, especially if the current rate cap structure is modified slightly in one or more of the ways discussed in the NPR and in this letter. **Absent a complete departure from the rate cap concept, we find this cap structure to be the most appealing and effective possible outcome of this NPR.** Should this method be adopted, a grace period as discussed in Questions 2, 5 and 9 below would be beneficial to the marketing efforts of banks subject to rate caps. We believe an enhanced version of this method, using the highest rates from three or four different sources (Treasury yield curve, national market rates, the geographically relevant FHLB advance curve, listed national market CD rate curve and/or brokered deposit rate curve), possibly in conjunction with some exemption on a bank's current level of deposits as discussed in Question 11 below, would effectively achieve the intent of Section 29 while minimizing unintended consequences. While not a perfect analogy, this multi-sourced rate curve would represent a type of efficient frontier for market clearing deposit rates.

Local Market Rate Calculations

For institutions in markets with abnormally high rates, additional guidance and clarification on the calculation of in-market rates is necessary. We have recently experience with a client bank that received local market rate exceptions for two counties in its four county market area, while lower national rate caps remained in effect for the remaining market area. This type of regulatory response encourages geographic rate discrimination that makes effective marketing efforts much more difficult is most likely to negatively impact rural, low-to-moderate income populations. For determination of the local rate caps, a simple average of all market participants is not relevant, for the reasons previously discussed. We believe that each institution should be allowed to document the effective market clearing rates in their community and receive prompt approval for a local rate structure aligned with those prevailing rates and applicable across the bank's entire relevant market area.

Responses to Questions Posed in the NPR

Question 1. Does the proposed calculation of the rate caps enable less than well capitalized institutions to compete for deposits while satisfying section 29? If not, please explain why.

The proposed calculations provide some relief relative to the current rate cap calculations but fall short of the stated goal of ensuring that deposit interest rate caps appropriately reflect the prevailing deposit interest rate environment. The proposed local market rate limitation of 90% of a competitor's offered rate should be revised to at least 95%, if not 100%, of the competitor's rate. The proposed limit would restrict a bank to a 2.25% rate relative to a competitor's 2.50% offering, a substantial difference in the eyes of rational depositors. As rates rise, the 10% differential becomes even more substantial in terms of forgone income as a bank seeks to retain its existing deposits.

Question 2. The FDIC proposes to update the national rate cap information every month, with discretion to update the rate cap more or less frequently. Currently, the FDIC updates this information on a weekly basis. Should national rate calculations be provided more or less frequently than every month, as proposed?

Monthly updates, with more frequent updates as market conditions demand, should be adequate. Using QwickRate data from 7/1/1996 to 8/26/2019, we identified six months in which the top rate and average of the top ten rates offered on a 12-month CD rose by more than 50 basis points relative to one month prior. Banks under rate restrictions during times of rapid rate change could be significantly impacted by rate caps adjusted on a monthly basis, so we encourage the FDIC to act promptly to publish more frequent updates during periods of volatility. Under current rate cap restrictions, our clients have expressed concerns about their ability to market a rate that might be above the next week's rate cap. While a monthly adjustment could lessen this concern, some flexibility in rate restrictions (e.g.: Effective rate cap is the higher of the current rate cap or the highest rate cap published in the preceding 45 days, and is valid for the next 45 days) would allow for a month-long marketing campaign without fear of violating rate restrictions.

Question 4. The proposed national rate and rate cap are weighted by deposit share, which gives relatively more influence to Internet-only institutions that have large deposit shares than the current all-branch approach. Is this weighting system appropriate?

No, this weighting system is not appropriate. Both the average and weighted average rate calculations are equally flawed in their inclusion of extremely low rates offered by banks that have no interest in attracting additional deposits in those product types. The currently offered rate of 0.02% by JP Morgan Chase Bank, N.A. for a 12-month CD is a good example of this behavior. Some exclusion of aberrantly low rates should be considered for formulas that use an average or weighted average of market rates. We acknowledge that the 95th percentile calculation is more effective in addressing these low outlier rates, but remain concerned that occasions will arise where the average or weighted average will override the 95th percentile calculation and be skewed by the inclusion of uncompetitive low rates.

Question 5. To address potential downward volatility in the national rate cap, the FDIC is proposing that, for institutions that are subject to the interest rate restrictions, any subsequent published national rate cap, that is lower than the previously published national rate cap, take effect 3 days after publication. In certain circumstances, the FDIC would also have discretion to delay the date on which a national rate cap takes effect. Is this a reasonable approach to address the effects of potential downward volatility in the national rate cap? Are there other ways to address or reduce the effect of potential volatility on less than well capitalized institutions that are subject to the interest rate restrictions?

Limiting monthly downward changes to some percentage change in rate, similar to annual collars on variable loan rate changes, might be an option. Similarly, a longer lag time (two weeks, perhaps) could be beneficial to avoid disruption in advertised rates, product promotions or other planned deposit generation activities.

Question 6. Data limitations do not allow consistent means to include certain special promotions, like cash bonuses, to be included in the proposed national rate calculations. Is it appropriate to incorporate specials and promotions? Is there another way to capture these promotions or deposit products that pay interest based upon an index or are triggered at some future date (e.g., step-up rates)?

While the consideration of these promotions in national rate calculations is likely too complex to be beneficial, allowing a bank to report the existence of such specials as a competitive force in its market and match the offers (as with high local market rates) should be considered.

Question 7. The proposed national rate plus 75 basis points is being proposed as an option for products whose rates converge, as seen with a few deposit products. While this appears to be a useful alternative for a few products in the current rate environment, it might be less appropriate in other rate environments. For example, this alternative could yield a rate cap that does not "significantly exceed" the prevailing rate in a high rate environment. Are there better options for setting a proxy to determine what it means to "significantly exceed" a prevailing market rate when rates converge?

A two-layered test such as "the bank's rate may exceed the prevailing rate by 75 basis points or 15%, whichever is greater" should address this infrequent, but significant, environment. A more effective adjustment may be to focus on a more meaningful national prevailing market rate calculation that excludes exceptionally low rates.

Question 9. If there is significant movement downwards in the national rate cap from one publication period to the next, do institutions need additional time to lower interest rates on particular products in an effort be in compliance with the rate caps? If so, what is an appropriate amount of time?

Yes. A grace period of at least two weeks (preferably four weeks) to come into compliance would allow current advertisements and promotions to run their natural course.

Question 10. Internet institutions are not included in the local deposit rate calculation. Is this a reasonable approach? If the FDIC allowed institutions to use Internet competitors in their local rate calculations, how would they choose such competitors and which ones should be chosen?

The notion of rate restrictions in an age of financial globalization is antiquated and should be eliminated. As additional technological improvements, including round-the-clock real-time payment, become available, smaller financial institutions will be at an increasingly greater disadvantage in deposit generation and retention. Allowing the inclusion of rates advertised via the Internet or direct mail in local rate calculations is appropriate, and we acknowledge the challenges in documenting the impact (or lack thereof) of Internet-based rate offerings. A limitation on deposit growth for institutions that are not well capitalized would eliminate the need for rate restrictions while stabilizing liquidity and allowing management to focus on addressing asset quality.

Question 11. For purposes of the rate restrictions, the FDIC is considering an interpretation under which balances in non-maturity deposit accounts at the time the institution becomes less than well capitalized are not subject to the interest rate restrictions, but the balance would be if new funds were deposited into such accounts. Is this interpretation appropriate? Would there be substantial operational difficulties for institutions to monitor additions to these existing accounts in order to determine when they would be subject to the interest rate restrictions?

We appreciate this interpretation and agree with its intent, but are concerned with the planned implementation parameters. Instead of a single new deposit (which might be a recurring direct deposit) into an existing account triggering rate limitations on that account, we suggest that the aggregate level of deposits in each deposit category or product type as of the date of imposition of rate restrictions (or the average balance for the preceding month or quarter) be exempted, with a 10% allowance for normal deposit fluctuations. This would allow the bank to maintain a stable level of deposits at the existing rates while allowing customers to continue using their accounts in a normal manner without triggering rate reductions on the accounts.

Conclusion

While we would prefer to see a complete elimination of deposit rate caps, we recognize that this desire is beyond the scope of the current NPR. As a second choice, we strongly favor the use of an efficient frontier method built upon the "Higher of Two Previous Rate Caps" concept listed as an alternative in the NPR. This method is likely to address most troubled institutions' needs while serving the intent of Section 29. We would also encourage all financial regulatory bodies to be sensitive to those unique situations that might require special rate waivers or other curative actions, possibly under very short timelines, during periods of financial stress. We appreciate the time and attention that has been devoted to this topic by the various regulatory agencies, previous commenters and others who are responding to this NPR and are open to correspondence from any interested parties to expand upon any of the topics addressed in this letter.

Sincerely,

[redacted]

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