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November 4, 2019

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

Regarding: Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized – RIN 3064-AF02

Dear Mr. Feldman:

The Community Bankers Association of Illinois ("CBAI"), which proudly represents 310 Illinois community banks, appreciates the opportunity to provide our observations and recommendations in response to the Federal Deposit Insurance Corporation's ("FDIC" or "Agency") Notice of Proposed Rulemaking ("NPR") regarding interest rate restrictions on institutions that are less than well-capitalized ("Proposal"), and the FDIC's willingness to "amend its methodology for calculating the national rate cap for specific deposit products ("National Rates" used in determining "Deposit Rate Caps" or "Rate Caps").

Background

CBAI welcomes the FDIC's intent to "modify its regulations to provide a more balanced, reflective, and dynamic national and local rate cap that will ensure that less than well capitalized institutions have the flexibility to access market-rate funding, yet prevent them from offering a rate that significantly exceeds the prevailing rate for a particular product, in accordance with Section 29 [Re: Brokered Deposits]."; and particularly appreciates the Agency's recognition that inappropriately setting the Deposit Rate Caps could "prohibit less than well capitalized banks from competing for deposits and create a liquidity strain."

Even though a small number of banks are subject to the Deposit Rate Caps restrictions, the National Rates must be determined correctly by including all appropriate inputs, and the administration of the restrictions must be flexible, so as not to prevent less than well-capitalized banks from competing for deposits and creating liquidity strains.

In December of 2018, the FDIC sought comments, through an Advance Notice of Proposed Rulemaking ("ANPR"), on "all aspects of its regulatory approach relating to interest rate restrictions, and specifically asked for comments on potential changes to the methodology used to calculate the national rates." CBAI responded to the ANPR, highlighted a number of the problems with the current methodology, and made a number of specific recommendations. While many of these problems were at least addressed in the Proposal, several were not sufficiently addressed to successfully resolve the problems. **CBAI urges the Agency to modify the interest rate restrictions to include the recommendations provided in our Comments and Responses to the NPR below.**

Comments and Responses to Questions

CBAI's April 2019 comment letter stated that how even well-capitalized banks are being adversely impacted by the application of the Deposit Rate Caps in the analysis of liquidity during safety and soundness examinations. We explained how examiners are using the [flawed] Rate Caps as the benchmark in their analysis of bank liquidity. CBAI objected to this practice on two grounds. First, it is wrong to impose regulatory restrictions that are only applicable to non-well capitalized banks on well-capitalized banks. This practice is analogous to the many regulations designed to reign-in the risky behavior of the mega banks which are being improperly applied to community banks – a harmful practice known as "trickledown" regulations. Second, the

National Rates are flawed and result in inaccurate conclusions about banks' liquidity positions which can impact Liquidity in CAMELS ratings. CBAI urged the FDIC not to use the Rate Caps in the liquidity analysis of well-capitalized community banks.

The FDIC stated in the NPR that it has resolved this issue and revised its *Risk Management Supervision Manual of Examination Policies* (Section 6.1 linked in the NPR). The revised Section only refers Rate Caps in the context of banks that "are not well capitalized". While CBAI appreciates the FDIC's addressing this issue in the *Manual of Examination Policies*, the revisions do not specifically prohibit examiners using the Rate Caps in the analysis of liquidity during safety and soundness examinations (i.e., examiners using the Caps as a proxy for "high risk" or "potentially volatile" or "high rate" deposits in liquidity stress testing) of well-capitalized banks. **CBAI encourages to Agency to further revise the *Policy* to specifically prohibit this inappropriate and harmful use of the Rate Caps in examinations of well-capitalized banks, and to also actively monitor examiner compliance with this policy change – as there have been disconnects between new processes and procedures and what is actually occurring during examinations in the field.**

<u>Question #1</u>

From a practical standpoint it remains to be seen if the Proposal's Deposit Rate Caps will enable less than well-capitalized institutions to successfully compete for deposits over a broad array of market conditions and competitive environments. What would provide the best opportunity to accomplish the Proposal's objectives, and avoid wholly foreseeable negative consequences, is for the calculation to consider <u>all</u> appropriate inputs which include the following.

The National Rates used to calculate the Deposit Rate Caps includes both large and small banks. The largest banks, because of their asset size and large branch networks, represent an estimated two-thirds of the rates included in determining the National Rates. As a result, the largest banks have an outsized impact on the calculation. In addition, community banks fund their operations through deposits to a much greater extent than the largest banks, so deposit restrictions are especially harmful to community banks. Also, the largest banks continue to enjoy a too-big-to-fail subsidy which allows them to offer lower deposit interest rates. Despite the change in the Proposal from considering number of physical locations to being weighted by deposits (i.e., percent of market share) it is difficult for us to believe that the largest banks are still not overrepresented in calculating the average and that this change is a distinction without a difference.

In addition, not including credit union deposit rates in the calculation is absolutely indefensible. There are as many credit unions as there are banks, they are a growing segment of the financial services industry, and they offer the exact same deposit products and compete directly with banks for deposits. The average credit union is actually more similar to a community bank than the largest too-big-to-fail banks, yet their deposit rates are not included in calculating the National Rates which irrefutably must present an incomplete picture of the competitive reality faced by community banks in obtaining and retaining deposits.

Also, specials, promotional and negotiated rates are not included in the calculation. These deposits are more prevalent at community banks and are at significantly higher rates than what is stated on their standard rate sheets. The calculation of National Rates that ignores this reality of how community banks operate does not present a true picture of the deposit rate landscape.

CBAI again strongly urges the Agency to count each financial institution only once (regardless of the number of branch locations or market share); include credit unions deposit rates; and specials, promotional and negotiated rates in calculating the National Rates for Rate Cap purposes.

<u>Question # 2</u>

Community banks typically review and potentially adjust their deposit rates on a weekly basis, perhaps even more frequently depending on market conditions and liquidity needs. There is no reason why providing this timely information weekly by the FDIC should not be consistent with this longstanding practice. The potential risk of moving from updating weekly to monthly is that market conditions may move more dramatically and not reflect the current reality which may negatively impact less than well-capitalized bank’s ability to either attract or retain deposits and avoid a liquidity strain. **CBAI recommends the Deposit Rate Caps continue to be provided on a weekly basis, and that the FDIC should have the flexibility to update the Rate Caps more frequently than weekly to be better reflect current market conditions, while also incorporating a reasonable lag time for compliance (see Questions #5 and #9) to mitigate any liquidity stress.**

<u>Question # 4 and Question #10</u>

CBAI believes that no deposit taking financial institutions should be given an inappropriate influence in the calculation of the Deposit Rate Caps either nationally or locally - certainly not the largest banks with their extensive branch networks (or market share). In determining the National Rates, internet-only institutions deposit rates cannot be ignored and must be included, because they are competitors in all markets and impact a community bank's ability to attract and retain deposits and avoid a liquidity strain. **CBAI recommends the FDIC determine a reasonable method for assessing the impact of internet-only banks and incorporate this in the calculation of the Rate Caps.**

<u>Question # 5 and Question # 9</u>

It is important for all community banks to have adequate time to adjust to radical changes to avoid disrupting their operations, and this is particularly true for those institutions that are less than well-capitalized and subject to the Deposit Rate Caps. CBAI appreciates the Agency's acknowledgement of the need for additional time to comply (the 3 day lag period in the Proposal) when subsequently published Rate Caps are lower than the previous one, and also for the FDIC to have the flexibility to delay the date on which the Caps takes effect - both of which will depend on the circumstances and the volatility of the then current rate environment. **CBAI recommends additional time be granted (a minimum of one week or longer versus 3 days) for the Rate Caps to take effect, and for the FDIC to have the flexibility to further delay the effective date of the Caps to avoid creating a liquidity strain where none would have existed if a more reasonable amount of time was allowed to comply with the Caps.**

<u>Question # 6</u>

CBAI understands the limitations on the ability to include certain special deposit promotions in determining the Caps, in particular those where actions by the customer are required and are dependent on a future unknown interest rate environment, which are beyond the control of the bank (i.e., step-ups which may or may not be triggered by the customer). Purely interest rate specials, promotional and negotiated rates (i.e., a 6 month CD or Money Market account that earns a higher interest rate for a set period of time and then renews at or reverts to the standard rate) do not have product features which are impossible to capture and include in calculating the Rate Caps. **CBAI recommends incorporating specials, promotions and negotiated rates in the Rate Caps and explore ways to capture other special promotions in the Deposit Rate Caps.**

Question # 7

CBAI acknowledges that while the 75 bps is the current proxy to determine what it means to "significantly exceed" a prevailing market rate, when rates converge what appears reasonable in one rate environment may not be appropriate in different rate environments. One need to look no further than the current and past modifications in the Deposit Rate Caps to know that a rigid standard is not appropriate in different interest rate environments. **That is precisely why, in CBAI's comment letter dated May 6, 2019, we urged flexibility in the form of allowing banks that are subject to the Rate Caps to select whichever is the highest - National Rates (incorporating the recommendations in this comment letter) or U.S. Treasury Yield Curve Rates for similar maturities. CBAI again urges that this recommendation be adopted, and changing the additional basis points to the National Rates from 75 to 100, and increasing weighted rates from the 95th percentile to the 100th percentile, to provide more flexibility for less than well-capitalized banks.**

Question # 11

CBAI appreciates the intent of the Proposal's interpretation to lessen the impact of the Deposit Rate Caps on existing account balances, which would not be subject to the Rate Caps, versus future higher balances in existing accounts - and new accounts, which would subject to the Caps. CBAI questions the operational feasibility, customer perception problems and compliance disclosure issues which may result particularly from account holders in the same account product earning interest at different (blended APY). Also, there will likely be additional issues when a higher balance account becomes subject to the rate restriction, but then falls below the balance at the effective date of the restriction, and the customer demands that the original higher rate of interest should be paid. **Despite these challenges, CBAI appreciates the willingness of the**

FDIC to help mitigate the negative impact of the Rate Caps and recommends that this concept be explored and if possible, a feasible way be found to accomplish it.

Additional Recommendation

CBAI urges the FDIC to commit to an annual review of the Final Rule's method for calculating the Deposit Rate Caps to compare the actual results with what it expected to happened in various interest rate environments (i.e., back-testing) and to also assess the impact of the Final Rule on less than well-capitalized institutions' ability to successfully compete for deposits over a broad array of market conditions and competitive environments and not create a liquidity strain. The FDIC should share the results of this back-testing with interested constituents and should commit to promptly addressing any unforeseen problems caused by the calculation and implementation of Final Rule on Deposit Rate Caps.

Conclusion

CBAI continues to be concerned about how the National Rates are being incorrectly being calculated for Deposit Rate Caps purposes, and how even well-capitalized banks are being adversely impacted by the application of the Rate Caps in the analysis of liquidity during safety and soundness examinations. CBAI appreciates the Agency's willingness to address and resolve these issues, however this Proposal falls short of completely addressing the problems in determining and applying the Rate Caps. CBAI urges the FDIC to implement the recommendations contained in this letter to address the problems with and consequences of the Deposit Rate Caps which are aggravating already significant problems for less than well-capitalized banks.

Thank you for considering our observations and recommendations on this important issue. If you have any questions or require any additional information, please contact me at davids@cbai.com or (847) 909-8341.

Sincerely,
/s/
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Federal Governmental Relations