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submitted "via email"

Federal Deposit Insurance Corporation (comments@fdic.gov)
RIN 3064–AF02

RE: Interest Rate Restrictions At Institutions That Are Less Than Well Capitalized

Dear Sir/Madam:

First and foremost, allow me to express my sincere gratitude to your organization for your consideration of the issues surrounding deposit rate cap restrictions. Regardless of capital levels, this is topic of great importance to many banks, and one that potentially affects both the function and the safety and soundness of those depository institutions. Though a seemingly narrow and innocuous topic, the impacts of your decisions have wide-reaching implications, including, but not limited to: liquidity levels, earnings, and capital preservation.

The proposed changes as they stand are a step in the right direction, but they still place undue burden on banks and unnecessary risk into the system. It is my opinion that both the current and newly proposed rules actually work against all parties. Still, I understand the need to limit irresponsible behavior among certain banks. My interest lies only in finding a solution that works best for all involved – bank customers, banks themselves, and ultimately, the preservation of the insurance fund.

Before progressing further, I would like to express my support for some of the other proposals I have seen on this topic. Each has a place in this conversation and should be considered further. Some of the most appropriate for consideration include: the inclusion of additional deposit product categories for rate calculation purposes (i.e. categories for term-rate special time deposits), the use of other common funding source rates (i.e FHLB Borrowings) or market rates (i.e. LIBOR/Treasuries), and redefining market competitors to include credit unions.

Though surely not the intended purpose, deposit rate cap restrictions negatively impact both less than well-capitalized and well-capitalized banks. I have personal experience funding a community bank in each of these conditions, and can attest to this fact. Please allow me to share two such examples.

While managing funding for a troubled bank during the financial crisis, I operated under both brokered deposit and deposit rate cap restrictions. With limited off-balance sheet liquidity and asset fluctuations resulting from a mortgage operation, my only course of funding was to keep cash on the balance sheet to fund net asset growth. The rate restrictions at that time, including the use of local market restrictions, enabled the bank to do little more than retain local price-inelastic customers. There was no tool by which the bank could realistically compete with local banks to garner core stable funds from new customers. In that environment and under those imposed restrictions, the only course of ensuring adequate liquidity for the bank was to raise funds through listing service CDs. It was a utilitarian tool that was necessary, but very expensive. Perversely, this dynamic increased risks: to the bank through higher expenses and capital erosion, to customers who had deposited funds greater than the insured limit, and ultimately to the insurance fund as it worked to propel the bank toward receivership. Moreover, this funding process all but eliminated any interest rate risk management tools I would have otherwise had available, placing the bank in further peril.

In contrast, managing funding for a well-capitalized bank in recent years has shown an equally negative, though far less obvious impact of rate restrictions. Though not explicit in its applications, deposit rate caps have found their way into the everyday language of bankers and regulatory examiners alike. Recent examinations have appropriately focused on bank liquidity. This process now includes the identification of potentially volatile funds, of which a key category is high-rate deposits. I cannot speak for other banks, but my commercially-focused community bank has felt for years that a source of great strength was it no cost demand deposit accounts with customers to whom the bank formed well rounded, long lasting relationships. These customers frequently deposit significant balances in both low cost products and higher rate money market. Despite this most basic relationship remaining unchanged, the higher rate deposits of these customers must now be identified and tracked on a regular basis. Further, these funds are implicitly considered hot money and a plan for remediation must be formulated and regularly revised to deal with such deposits. Let me be clear, both experience and modeling demonstrates that these funds represent the very definition of core funding, despite the rate of interest being paid to them. However, managing these deposits on an ongoing basis and determining the potential impact on the bank's safety and soundness scores can be very costly for the bank.

It is in this context that I ask that you consider a slightly modified structure of deposit rate caps - one that provides benefits to customers, flexibility and cost savings to banks, and no additional risk to the insurance fund. I suggest that time deposits and non-maturity deposits have significantly different inherent traits, and thus should be treated differently when calculating rate cap restrictions.

The rate and term of time deposits are most clearly defined, and comparable between the competition. Most banks will roll a maturing time deposit at the bank's posted rates, absent a decision from the customer to do otherwise. For this reason, banks' posted rates often lag in comparison to the market for new money from more price elastic customers. The proposed rule will continue to use posted rates as the basis of the rate caps for these products, and ignores the need to rate caps based on less traditional terms and time deposit specials. The modus operandi for most banks in the current market is to offer one or two rate specials to attract new money as needed, or as a defensive measure against other banks' rate specials. This tool is both imperative for balance gathering and retention, but has also become a key tool in interest rate risk management by allowing banks to move maturities to preferred periods of time. I ask that banks have the ability to formulate rate caps for time deposits in the local market by using a range of terms (i.e. 9 to 13 months) of rate specials offered by the competition. This would truly represent the prevailing rates of the market. Further, I suggest that these funds are no more volatile than listing service deposits or borrowings, but are potentially cheaper and provide an opportunity to form a new relationship. A process must be established by which banks are able to identify local competitors' rate specials,

Non-maturity deposits are somewhat less straightforward, with the terms of the products often set at the bank's discretion and changeable at almost any time. These deposits are widely regarded as core due to their longer average lives, and are generally encouraged by regulatory examiners. Non-maturity deposits are a fundamental element of the financial intermediary process, providing lower cost funds and significant opportunities for enhanced interest rate risk management. Unfortunately, the new rate cap proposal does not significantly enhance the definition of high-rate non-maturity deposits. For less than well capitalized banks, the proposed rule does little to aid banks in the deposit raising or retention process. Further, it continues to place an undue burden on banks that are recently less than well capitalized, as these banks are forced to lower rates for good customers during a period of great stress. Most clearly stated, the imposition of rate caps often leads to the absence of these coveted balances.

A very simplistic and practical solution for non-maturity rate caps may be the application of the caps themselves against the weighted average portfolio rates of each product, as opposed to every account within the product categories. Using a portfolio approach would enable banks operating under rate restrictions to price newer or rate sensitive customers with higher rates, while balancing lower rates for customers who are less price sensitive. This is particularly important in managing these deposits during periods of large market rate changes, and can be essential in managing banks' interest rate risk. Further, this should add no additional risk to the insurance fund as the proposed rate restrictions currently allows every account within a product to be priced up to the rate cap. Having a weighted average rate for a product portfolio is no different.

In summary, I would again like to express my gratitude for your consideration of this topic. It is a topic that many bankers, including myself, feel passionately about. And one that I feel can be substantially resolved with some further refinement.

Respectfully submitted,

[redacted]

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