



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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November 4, 2019

Mr. 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 (FDIC)

Dear Secretary Feldman:

The U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness (“CCMC”) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation’s (“FDIC” or “Agency”) Notice of Proposed Rulemaking on Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized (the “Proposed Rule”).

Under the Proposed Rule, the FDIC would amend the methodology for calculating the national rate and national rate cap for specific deposit products. The Proposed Rule would revise the FDIC’s regulations relating to interest rate restrictions that apply to less than well capitalized depository institutions. We welcome these changes that seek to better align interest rate restrictions to account for the current realities in the marketplace for deposits, including technological advances, consumer preferences, and streamlined business practices.

We stress the importance of ensuring depository institutions maintain a steady deposit base. This important tenant can be achieved with an updated calculation methodology. Specifically, the Chamber offers the following recommendations, discussed below, to improve the FDIC’s Proposed Rule:

- I. **Update the national rate cap calculation to align with market realities; and**
- II. **Provide more flexibility for the local rate cap calculation and decouple “normal market area” from geography.**

Proposed Rule Overview

The FDIC adopted an Advanced Notice of Proposed Rulemaking in December 2018 to obtain input from the public on its brokered deposit and interest rate regulations “in light of significant changes in technology, business models, the economic environment, and products since the regulations were adopted.” The Chamber supports this initiative by the FDIC and believes it is important that regulations be updated to reflect technological changes and other market developments.¹

The ability of an institution to provide competitive interest rates on deposit products is fundamental to its business model and economic growth. Depository institutions depend on a stable supply of deposits to support the growth of their assets, such as the extension of credit, throughout the economy. The Chamber has previously raised concerns about the availability of credit for small businesses and again stresses the need for healthy credit markets. Notably, small business lending by financial institutions dropped by nearly 50 percent over the last decade and a half. Specifically, loans less than \$1 million dropped from 2.5 percent of gross domestic product in 2001 to 1.7 percent in 2017, and such loans make up a smaller portion of total bank assets, dropping from 4.0 percent in 2001 to 2.1 percent in 2016.²

The Proposed Rule notes the policy objective is to “seek comment on a proposal that attempts to ensure that deposit interest rate caps appropriately reflect the prevailing deposit interest rate environment, while continuing to ensure that less than well capitalized institutions do not solicit deposits by offering interest rates that significantly exceed prevailing rates on comparable deposit products.” In general, the Chamber believes

¹ Quaadman, T. Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions – Document Number 2018-28273, RIN 3064-AE94 (FDIC). [Letter written May 7, 2019, to the Federal Deposit Insurance Corporation] Available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2019/05/5.7.19_BrokeredDeposits_FDIC.pdf?#

² Analysis uses U.S. Federal Deposit Insurance Corporation Data for U.S. Commercial and Industrial and Nonfarm Residential Loans less than or equal to \$ 1 million, available at <https://www.fdic.gov/bank/analytical/qbp/timeseries/small-business-farm-loans.xls>

depository institutions should be afforded additional flexibility in the interest rates they can offer on deposits.

The Proposed Rule also notes it will be accepting comments later regarding policy issues more generally related to brokered deposits. The Chamber looks forward to commenting further on this topic.³

I. Update the National Rate Cap Calculation to Align with Market Realities

Under the FDIC's current regulation, a bank that is not well capitalized generally may not offer deposit rates more than 75 basis points above the national rate for deposits of similar size and maturity. The purpose of the national rate cap is to ensure troubled banks are not offering terms that would lead to a "race to the bottom" or otherwise strain their liabilities in a manner that does not reflect market conditions. Therefore, the national rate cap should reflect market conditions and provide sufficient flexibility for depository institutions to offer competitive interest rates without jeopardizing safety and soundness or irreparably harming a bank's franchise value.

According to the Proposal Rule, the FDIC receives interest rate data on various deposit products from a private data aggregator on a weekly basis. The data aggregator computes the simple averages for the various deposit products as well as the corresponding national rate cap by adding 75 basis points to each *simple average*. The FDIC then publishes on a weekly basis the national rate simple averages and corresponding national rate caps on its website.

The FDIC rightly identifies issues with the current calculation of the national rate cap under certain market conditions. Specifically, the Proposed Rule notes that the existing methodology results in rate caps that are low relative to most bank's competitive market and if not revised, "could restrict less than well capitalized institutions from competing for market-rate funding."⁴ The FDIC acknowledges that the largest banks have not raised interest rates on deposits as quickly as other depository institutions. Since the national rate

³ Quaadman, T. Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions – Document Number 2018-28273, RIN 3064-AE94 (FDIC). [Letter written May 7, 2019, to the Federal Deposit Insurance Corporation] Available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2019/05/5.7.19_BrokeredDeposits_FDIC.pdf?#

⁴ The Proposed Rule states that in light of this, the majority of institutions subject to the rate caps have been granted approval to use a higher local rate cap for deposits obtained locally.

cap is a simple average of rates offered across all branches the actions of the banks with the most physical branches have more weight than other depository institutions.

The Proposed Rule would amend the methodology for calculating the national rate and national rate cap for specific deposit products.

a. Proposed Changes to the National Rate Cap Calculation

The national rate, under the Proposed Rule, would be the *weighted* average of rates paid by all insured depository institutions on a given deposit product, for which data are available, where the weights are each institution's market share of domestic products. This change is important in that it recognizes the national rate cap should not be constrained by geographic criteria given the shift in banking to online, mobile, and other electronic channels.

The Chamber believes the proposed change for calculating the national rate is an improvement from the status quo, but it is unclear if the new calculation will accurately reflect market conditions. As the FDIC noted, the current calculation is significantly influenced by the largest banks given it is a simple average that includes the number of branches of an institution. The proposed change is based on an institution's share of total domestic deposits, which would also be skewed towards the rates of the largest banks that tend to maintain large physical branch networks. However, it would be an improvement given it would be less reliant on geographic features like branch network.

The FDIC should adjust the timing of publication and effectiveness of the newly calculated national rate cap. Specifically, the national rate cap should be published more frequently. Currently, the cap is published monthly, which may not precisely reflect market conditions that may have changed during the period. Additionally, the FDIC should provide 14 days after publication for the rate cap to take effect, so depository institutions have adequate time to consider updating the terms of their depository products.

II. Local Rate Cap Calculation and Definition of Normal Market Area

Currently, a bank may present to the Agency that the prevailing rate in a geographic market is higher than the national rate. The institution would be permitted to pay as much as 75 basis points above the local prevailing rate for deposits solicited in its local market area if the Agency agrees with the petition. However, this provision does not apply to deposits acquired from outside of a bank's local geographic market area, which the Proposed Rule states would include any deposits obtained through the internet.

a. Definition of “Normal Market Area”

The FDIC rightly recognizes that competition for deposit pricing has become increasingly national in scope, but the Agency should also permit for consideration of a bank’s specific market conditions when determining a rate cap for a depository institution. The FDIC’s continued use of the term “local” market area rather than “normal” market area, which is the term used in the statute, and the regulation’s focus only on geographic competition rather than the influence of non-geographic market segments, provides an unnecessarily limited opportunity for setting bank-specific rate caps. The FDIC should revise the Proposed Rule to permit consideration of other non-geographic factors in determining what the prevailing rates are in a bank’s “normal market area,” including an assessment of the bank’s business model and cost structure, competitive peer institutions, and historical pricing strategies.

The definition should reflect the business model and market segmentation of depository institutions in order to more accurately recognize the markets they serve. While the Chamber agrees that local geographic considerations should continue to be permitted in making rate cap determinations, especially for smaller community banks, the Proposed Rule’s narrow interpretation of “normal market area” ignores other important competitive forces that may impact a bank’s pricing strategies. This is particularly true for banks with a direct-to-consumer digital model.

Institutions without brick and mortar locations, so-called “digital banks,” for example, generally operate free of geographic constraint. Digital banks differentiate themselves in the market by operating with comparatively less overhead than other institutions so they can compete on price. The lack of physical branches may allow the bank to transfer its cost savings to consumers in the form of higher interest rates while still providing the same or better features and customer service. Indeed, the marketplace for direct-to-consumer deposits offered through digital channels is in some ways a distinct marketplace segment.

Therefore, the rate cap may frustrate the business model of these institutions. For this reason, the FDIC should add a provision in the final rule that permits consideration of a bank’s business model and competitive factors other than local branch-based competition in defining its “normal market area.”

b. Petition Process for Local Rate

The Proposed Rule would allow a depository institution to provide evidence that a bank or credit union in its local market offers a rate on deposit product in excess of the national rate cap. Therefore, this would permit for a direct comparison of rates between competing depository institutions rather than depending on the calculation of a local average. If enough evidence is provided, then the depository institution would be allowed to offer 90 percent of the competing institution's rate on the product. This would replace the current methodology.

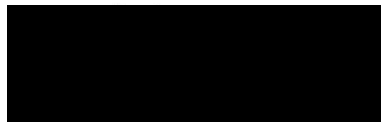
The changes included in the Proposed Rule appears to be an improvement, but the Chamber maintains some concerns. The FDIC does not justify why the petitioning financial institution would not be permitted to provide 100 percent of the competing institution's rate on the product. This 10 percent differential could determine where a consumer chooses to deposit his or her funds. The Chamber requests the petitioning institution be permitted to offer 100 percent of the rate unless the FDIC can justify safety and soundness objections. Finally, the FDIC should ensure its procedures permit for an expeditious determination for depository institutions to quickly respond to changing market conditions that do not arbitrarily favor first-mover advantages.

Conclusion

The Chamber encourages the FDIC to pursue a calculation of a national rate cap that provides flexibility to depository institutions to offer competitive interest rates on their deposits. This calculation should reflect contemporary market forces, encourage diverse business models, and recognize that depository institutions are continually adopting technological advances to meet evolving customer demands and are no longer tied to geographic regions or reliant upon branch-based delivery channels.

Please do not hesitate to contact the undersigned with any questions.

Very Respectfully,

A solid black rectangular box used to redact the signature of Tom Quadman.

Tom Quadman