From: Greg Judge
To: Comments
Subject: [EXTERNAL MESSAGE] RIN 3064-AF02
Date: Monday, November 04, 2019 2:43:17 PM
Attachments: image001.png
image002.png

Hello:

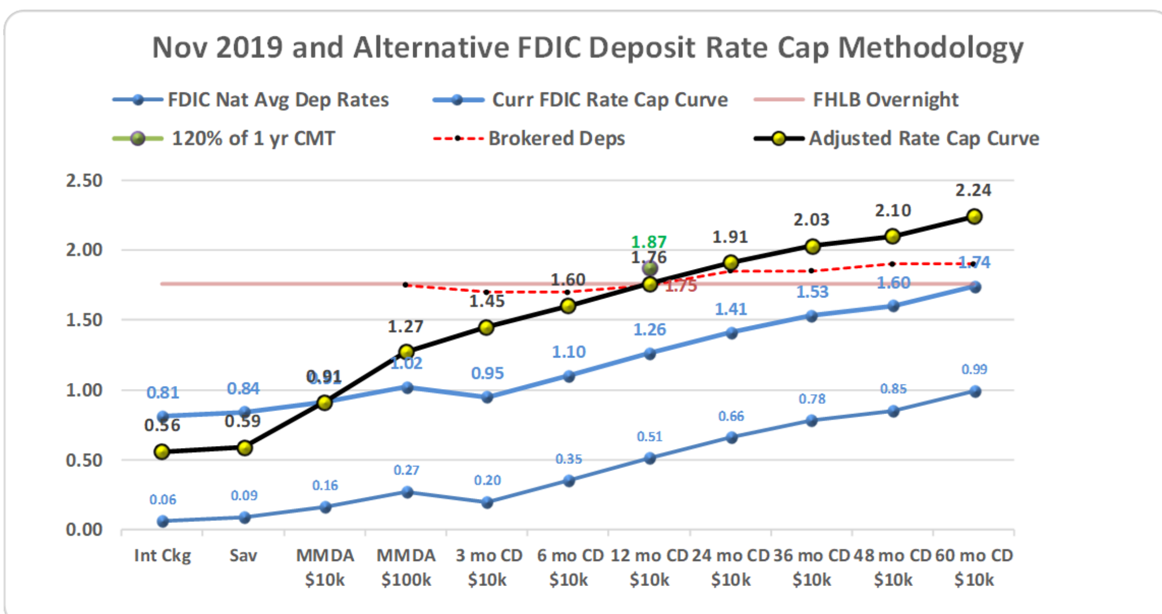
Below are some observations, comments, and suggestions respectfully submitted for revising the FDIC deposit rate caps.

- The problem with the rate caps as currently constructed, is **NOT** with the underlying national average deposit rates. In most local markets, the national average deposit rate curve ties rather closely to the local median deposit rate curve. The median local rates are the statistical midpoint of all the local regular deposit rates for each deposit product – half above, half below.

- The functional problem with the rate caps is that the **75 bps uniform spread** above the national average deposit rates. The flaw is that each deposit product across the curve is treated the same, when in fact, deposit products are very different due to their nature, purpose, and pricing. Transaction accounts, such as checking products, are more feature and purpose oriented rather than rate oriented, and the +75 bp rate cap is actually set far too high for these types of products. On the other hand, non-transaction products, such as CDs, are almost entirely rate-driven and these +75 bps rate caps are probably set too low for these types of products.

- A more appropriate solution could be to modify the rate cap structure using the existing national average rate calculation method such that the rate caps have differing spreads from the underlying average rate depending upon the type of deposit product.

  The graph below illustrates this:



	Int Ckg	Sav	MMDA $10k	MMDA $100k	3 mo CD	6 mo CD	12 mo CD	24 mo CD	36 mo CD	48 mo CD	60 mo CD
Current Rate Cap	0.81	0.84	0.91	1.02	0.95	1.10	1.26	1.41	1.53	1.60	1.74
Modified Rate Cap	0.56	0.59	0.91	1.27	1.45	1.60	1.76	1.91	2.03	2.10	2.24
Modified Cap Spread	+ 0.50	+ 0.50	+ 0.75	+ 1.00	+ 1.25	+ 1.25	+ 1.25	+ 1.25	+ 1.25	+ 1.25	+ 1.25
Change From Current	(0.25)	(0.25)	+ 0.00	+ 0.25	+ 0.50	+ 0.50	+ 0.50	+ 0.50	+ 0.50	+ 0.50	+ 0.50

Additional Detail and Supporting Information:

Most of the above-rate-cap deposit activity to grow deposits occurs with specials, negotiated rates, and with similar defensive measures taken to retain deposits. The rates for this activity often occur between the rate caps and the cheapest short-term wholesale alternative. The benchmark for this can be the 3 month and/or 12 month brokered deposit rate – the FHLB overnight can also be a benchmark although it has been priced until recently above ST brokered alternatives. Local deposits (regardless of term) priced above current ST wholesale alternatives typically have diminished franchise value, and are often of little value to acquiring banks in M&A transactions since the funding can be replicated in the wholesale markets at less cost. Higher-costing funding from any source is much less valuable than conservatively-priced core deposits which cannot be replicated in the wholesale markets.

- Most of the CD activity which occurred in banks during this most recent interest rate cycle had terms under 18 months. To this end, as of Q3 2019, only 23% of all US banks had CDs with remaining terms of over 1 year which represented 15% of their deposits. Put another way, 77% of all US banks had less than 15% of their deposits in these CDs. As such, to attract longer-term CDs, banks must pay exorbitant rates on them (usually via specials), and rarely do these banks generate much activity with these rates. This means the rate caps for these products are not that relevant. The rate caps **do have** meaning for shorter-term CDs, however, and the purpose of the rate caps is to prevent "troubled" banks from disrupting the deposit activity of the "good" banks.

- During the most recent rise and subsequent fall of interest rates, banks prudently held down their regular deposit rates, especially CD rates, to protect their core deposits from undue interest rate increases. Regular CD rates were rarely set to actually attract CDs, and were more often set not to encourage non-maturity deposit customers (i.e. MMDAs and excess-balance transaction account) from shifting these funds to more attractive CD products. Controlled specials and rate negotiations were used to handle more rate-sensitive customers interested in higher-rate MMDAs and CD products.

- As a result of banks prudently holding down their regular deposit rates, more banks than normal ended up having concentrations above-rate cap deposit activity occur. Paradoxically, the greatest risk most banks faced from potentially having restrictions placed upon their deposit activity was not from the possible loss of access to brokered deposits, but from the effects of rate cap imposition on their local, non-brokered deposit activity. The net effect of this was to make banks more conscious of their risk profiles and to ensure they had sufficient capital to remain well-capitalized. This was a good thing. Only the most aggressive and potentially risky banks had outsized concentrations of above-rate cap local deposits – most banks had concentrations which likely represented 20% or less of their deposits.

If the revisions to the rate cap methodology end up making the rate caps overly generous, this could result in banks having even more interest rate pressure on their deposit costs during times of market expansion and rising deposit rates. The FDIC could reserve the right to adjust the rate cap spreads, as necessary, over time and changing market conditions – while leaving the current underlying national average deposit rate calculation method intact.

I do hope you consider the above recommendations. If you have any questions about them or would like some additional supporting documentation, please let me know.

For background, I've been in the banking industry since 1985, was a regulator for 7 years during the thrift crisis and recovery. Since then, I have worked in two different FHLBs and built a successful bank consulting company over the last 14 years which specializes in funding. As part of our advisory and analysis services to our BankCoach clients, we closely track local deposit pricing activity in their collective markets around the country, and its results.

Greg Judge, President
GMJ BankCoach Advisory Services, LLC.
Direct: 515-216-1453
Cell/Text: 515-360-5492
gjudge@mediacombb.net