CONFERENCE OF STATE BANK SUPERVISORS

SINCE 1902

November 4, 2019

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Docket No. RIN 3064-AF02

Re: *Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized*

Dear Mr. Feldman,

The Conference of State Bank Supervisors[1] ("CSBS" or "state regulators") appreciates the opportunity to comment on the Notice of Proposed Rulemaking issued by the Federal Deposit Insurance Corporation (FDIC), titled "Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized" (the "NPR" or "proposed rule"). CSBS broadly supports the proposed amendments to the methodology for calculating the national rate and national rate cap for specific deposit products. We also support the proposed revisions to the local rate cap calculation and process.

Although we generally support these proposed revisions, in this letter we wish to express some reservations regarding the proposed national rate cap methodology and also suggest some modifications to the local rate cap calculation. Specifically, CSBS believes that:

- The proposed national rate cap methodology should not allow the largest institutions to exercise undue influence on the national rate.
- The local rate cap calculation and process should factor in rates offered by internet-only banks.

<u>Proposed National Rate Cap Methodology</u>

State regulators believe the current methodology for determining the national rate cap renders institutions subject to rate restrictions unable to reasonably compete for deposits. Specifically, by weighting by branches, the current methodology gives larger banks undue influence and fails to factor in internet-only banks in the national rate cap calculation. These shortcomings prevent less than well-capitalized institutions from being competitive for deposits, particularly in a low but rising rate environment.

[1] CSBS is the nationwide organization of state regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and examination resource development.

Under the proposed rule, the proposed national rate cap would be set to the higher of: (1) the proposed national rate plus 75 basis points; or (2) the rate offered at the 95th percentile of rates weighted by domestic deposit market share. The proposed national rate would be defined as the weighted average of rates paid by all insured depository institutions (IDIs) where the weights are each IDI's market share of total domestic deposits. CSBS believes this proposed methodology is an improvement relative to the current methodology as it is likely more representative of the amount of deposits placed at offered rates and it should provide for a more dynamic calculation in different interest rate environments.

As explained in the proposed rule, basing the national rate cap on rates paid at the 95th percentile, rather than a simple average, should theoretically reduce the influence exerted by larger banks offering a large mass of rates at the low end of the market. However, in practice, the proposed methodology may not function as theorized whether it is due to data limitations, unanticipated rate environments, or unforeseen forms of disintermediation. Without access to more information, it is difficult for CSBS to be certain as to how the proposed methodology will, in practice, affect the influence exerted by the rates offered by the larger IDIs on the national rate cap. [2]

We appreciate the proposed rule's consideration of alternative national rate cap methodologies, particularly, the "Higher of the Two Previous Rate Caps" alternative that would set the national rate cap at the higher of the two previous rate caps—the current national rate cap methodology and the previous rate cap methodology. This approach is similar to that suggested by CSBS in its response to the FDIC's request for information on brokered deposits. [3] Although we generally support the proposed national rate cap methodology, we believe that the Higher of the Two Previous Rate Caps approach is preferable in a number of respects.

First, the Higher of the Two Previous Rate Caps approach does not suffer from the data limitations present in the proposed methodology and rate information is available and updated with greater frequency relative to the proposed methodology.[4] Secondly, the Higher of the Two

[2] For instance, the charts provided in the NPR do not show which prong of the proposed rate cap would have been determinative in setting the national rate.
[3] In a May 2018 comment letter - CSBS wrote that "state regulators believe the current methodology for determining the national interest rate cap renders institutions subject to rate restrictions unable to reasonably compete for deposits. In light of the current rising rate environment, we believe it may be appropriate to return to the former approach defining the national rate by linking it to the current yield on U.S. Treasury obligations with comparable maturities. To ensure that the methodology does not become obsolete due to future fluctuations in market rates, the FDIC could set the rate cap at the higher of 75 basis points above: (a) the normal market area rate as determined under the FDIC's current methodology (the current approach), or (b) 120 to 130 percent of the current yield on similar maturity U.S. Treasury obligations depending on the extent to which the deposit is insured (the prior approach)."
[4] While, as the proposed rule notes, U.S. Treasury securities do not have the necessary range of maturities to calculate a rate cap for non-maturity deposits, this fact did not preclude the FDIC from basing the national rate cap on Treasury securities from 1992 to 2009.

Previous Rate Caps approach, unlike the proposed methodology, accounts for disintermediation to a certain extent by basing the rate cap on products which may substitute for deposit products.[5]

Despite the advantages of the Higher of the Two Previous Rate Caps approach, CSBS appreciates that the proposed national rate cap methodology represents an improvement relative to the current methodology. Accordingly, CSBS supports the proposed national rate cap methodology provided that it does not, in practice, result in larger IDIs exercising undue influence over the national rate.

Proposed Local Rate Cap Calculation and Process

State regulators believe that the current local rate cap calculation is insufficiently comprehensive and that the process is overly complex and burdensome for struggling institutions. The current methodology entails a two-step process where less than well capitalized institutions request a high rate determination from the FDIC and, if approved, calculate the prevailing rate within local markets.[6] Additionally, the local rate cap calculation fails to appropriately factor in rates offered by credit unions.[7].

Under the proposed rule, less than well capitalized institutions would be able to offer up to 90 percent of the highest rate paid on a particular deposit product in the institution's local market area by an insured depository institution or credit union. The proposed rule would also streamline the process by allowing less than well capitalized institutions to straightforwardly notify its appropriate FDIC regional office that it intends to offer a rate that is above the national rate cap, provide evidence that it is competing against a local market rate in excess of the national rate cap, and then offer 90% of that rate.

We appreciate that the proposed rule would simplify the current local rate cap calculation and process. The proposed rule successfully remediates our two core issues with the current local rate calculation and process. First, the complexity and burden attributed to the current process would be minimized as the process moves from a two-step process to a one-step process. Second, credit unions are clearly referenced as applicable to the local market area.

Although CSBS generally supports the proposed change, we feel that internet banks may be inappropriately left out of the local rate cap determination. Under the proposed rule, the comparable insured depository institution or credit union must be accepting deposits at a

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[5] For example, a customer could receive a higher interest rate on a non-deposit product (with deposit-like characteristics) offered by a nonbank financial institution which effectively then serves as direct competitors to banks on similar maturity deposit products. Although, as noted in the proposal, U.S. Treasury securities are not deposit rates, this fact did not preclude the FDIC from utilizing Treasury rates as a proxy for deposit market rates from 1992 to 2009.

[6] The current local rate determination requires the bank to provide evidence to the FDIC that the prevailing rate in a particular market is higher than the national rate. If the FDIC agrees with this evidence, 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 areas.

[7] Under the current approach, the FDIC may also consider evidence as to the rates offered by credit unions but only if the insured depository institution competes directly with the credit unions in the particular market.

physical location within that market area. We encourage the FDIC to find a way to factor in the rates of internet-based institutions whose deposit footprint may have an acute effect on local market areas.

<u>Conclusion</u>

CSBS appreciates the opportunity to comment on the proposed rule. The proposed revisions to the interest rate cap calculation will allow banks that become less than well capitalized to reasonably compete for deposits to prudently meet their funding needs and continue to serve their customers. As a result, state regulators are broadly supportive of this much-needed proposal although, as noted above, aspects of the proposal could be improved. We look forward to continued engagement with the FDIC on interest rate restrictions and brokered deposits moving forward.

Sincerely,

[redacted]

John Ryan
President & CEO