November 4, 2019

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized 12 CFR Part 337 RIN 3064–AF02 Notice of Proposed Rulemaking

Dear Chairman McWilliams:

I would like to thank the Federal Deposit Insurance Corporation (FDIC) for the opportunity to comment on these issues of critical importance to the FDIC and community banks nationwide.

I have previously provided rather voluminous material on this topic through the public comment process over the past decade, please incorporate that previous material into this comment by reference. Namely,

1. *My public comment letter dated May 6, 2019 for Federal Deposit Insurance Corporation, 12 CFR Part 337, RIN 3064–AE94 Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions.*
2. *FDIC National Interest Rate Cap Discussion Document. September 15, 2018*
3. *My public comment letter dated April 3, 2009 for FDIC ANPR: Interest Rate Restrictions on Institutions that are Less Than Well Capitalized. (Part 337- Interest Rate Restrictions) published in the Federal Register: February 3, 2009 (Volume 74, Number 21, pages 5904-5908).*

Given the extent of my previous comments, I will be brief in this comment letter.

My Comments

1. <u>Well-capitalized by ratio – classified as less than well capitalized by FDIC consent agreement</u>

The proposed rule does not repeal the FDIC's current doctrine of classifying any institution with a consent agreement that includes a capital maintenance provision as less than well capitalized (regardless of its actual capital ratios) therefore making it subject to rate restrictions. It is troubling that the proposed rule is silent on this issue. Based on my interactions with community bankers across the country, the entire industry sees this approach as unreasonable and heavy-handed. This approach also serves as a strong disincentive to investors injecting additional new capital into an institution experiencing difficulties, because there is no guaranty the FDIC won't impose onerous rate restrictions regardless of the amount of capital invested.

2. <u>Weighted averages are not prevailing market prices, no matter what you use as the denominator.</u>

I don't understand the FDIC's unrelenting focus on 'weighted averages' to determine 'prevailing market' prices/rates. Previously the FDIC calculated a national rate based on the average rate weighted by number of branches, and now it proposes a weighted average rate based on dollar volume of domestic deposits. Another way to phrase the proposed methodology would be to say the FDIC plans to let the 15 largest banks in the country set over 50% of the FDIC's national rate cap.

Let's visit that approach from a different real-world vantage point. JP Morgan Chase has roughly 10% of domestic deposits and pays 0.01% on savings accounts. The FDIC plans to multiply 10% x 0.01% in calculating the national rate. But wait, JP Morgan Chase pays $300 if a consumer deposits $25,000 in a savings account for 90 days, that's a whopping 4.8% rate, so isn't the **current** prevailing market rate for JP Morgan Chase 4.8% not 0.01%? This is the rate at which JP Morgan Chase is attracting new deposits (i.e. the 'market' rate'). The proposed rule dismisses this notion out of hand in the background information: *"Incorporate Specials and Promotions Into the Current National Rate Calculation"* because such information would be difficult to obtain.

The FDIC appears fixated on the amount of deposits an institution already has as a component of the market price, whereas the marginal price or current cost is typically the best indicator of a current 'prevailing market price'. I.e. I have 100 gold bars, it doesn't matter that I bought 99 of them for $10, I bought the most recent one at $1,000 and that would be the best indicator of the current market price.

I'll use an analogy of determining the prevailing market price of a publicly traded exchange listed stock. I think we would all agree that the last trade price is the prevailing market price for any particular publicly traded stock.

Applying the FDIC's methodology to determining the prevailing market price of a stock, we would take all the shareholders of a particular stock and multiply their current bid for that stock by the number of shares they own and then divide that number by the total number of shares outstanding. As you can easily surmise – this number would likely be nowhere near the actual prevailing market price of the stock as determined by the most recent trade. Some holders of the stock may have a low-ball bid posted, but they aren't actively trying to get more shares at that bid price, much like many banks have deposit rates posted, yet have no objective to obtain deposits at the posted rate. Why would these 'low-ball' rates be included in any prevailing market rate calculation?

3. What should the FDIC do?

Either ditch the concept of a national rate cap and go back to circumstance specific judgment or use the current prevailing market price.

How would the prevailing market price best be calculated? For a bank that is less than well capitalized, create a list of the highest rates offered (available) to consumers for a comparable product (for term maturities create a range rather than a set term to accommodate odd-term maturities). Pick the *n* (*n* being a number set by the FDIC 10?, 15?, 25?) highest rates and average them. That's the rate for that product. If you want to accommodate the statutory language for "does not significantly exceed" and allow room for the rate to exceed, but not significantly, add a percentage buffer to the rate. i.e. cannot exceed 110% of the average prevailing market rate.

The FDIC looked at this methodology but chose not to pursue it.

> *Average of the Top-Payers*
> *This approach would be simple to administer, and the FDIC would be able to provide real-time rate caps because it would no longer need to maintain and review the extensive data it receives from third party data providers to calculate averages. At the same time, setting the ''prevailing rate'' based upon rates offered at the top of the market might be viewed as inconsistent with the FDIC's historical interpretation that the ''prevailing rates'' offered should include rates offered by all participants in the market. The subset of banks paying the highest rate may have a small market share and have little to no influence over competitive rates paid in the market. Further, this same small subset of banks could be significant outliers from the rates offered by the market*

It's 2020, perhaps the historical interpretation of prevailing rates should be revisited? The second to last sentence is a bit troubling. Is it the FDIC's position that banks like Goldman Sachs (Marcus) and Ally 'have little to no influence over the competitive rates paid in the market'? This is to say nothing of the non-banks/fintechs offering high-yield savings accounts today. They most certainly are influencing the market, if not outright setting it.

4. Regulatory Flexibility Act – Impact on Small Entities

The FDIC's review of the potential impact of this rule on small entities is disconcerting if I understand it correctly.

It appears that the FDIC reviewed the deposit rates of 20 small institutions (out of about 4,000) to determine the impact of the new rate cap proposal. The FDIC sample was selected based upon all 20 institutions in the sample currently being classified as less than well capitalized. The FDIC then compared those institutions' current rates to the proposed rate caps and concluded that any impact was de minimis. Using this study, the FDIC states that the:

> *FDIC certifies that the proposed rule will not significantly affect a substantial number of small entities.*

I believe this is what many statisticians would term a 'biased sample'. These 20 institutions are all already under more austere rate cap limitations while in a good economy with low interest rates, i.e. they have all already lowered their rates (or should have) to comply with the current rule. It would be surprising to learn that there was a large impact to their rates from a new potentially more lenient rate cap methodology.

Perhaps a better approach would be to sample 100 banks from the small bank set (of 4,000) that could become classified as less than well capitalized and analyze if their current rates are above the proposed rate caps. The FDIC could then run a number of stress test scenarios in various interest rate environments (± 300 bps?) and see if these institutions could attract or retain market rate deposits under the proposed restrictions. I think the finding of that study would be a material negative impact on smaller institutions given the proposed rate cap methodology.

Closing Remarks

I've been involved in this issue for over a decade, first on my own bank's behalf and now advocating on behalf of community banks that are likely unaware of this regulatory risk. Through this arduous process it's been my observation that the inertia of the FDIC is often a difficult force to redirect, so it's likely the FDIC will proceed with its proposed rule or some minor derivation thereof. I'll state it here that I believe the proposed approach is a bad idea, but of course I may be wrong. I'll follow my statement with a wager that when we check back on this rule in another decade there will be several thousand fewer community banks and that if we do have an economic downturn in a high interest rate environment during that time, this rule will be a contributing factor to the demise of community banks that otherwise were likely viable.

The proposed rule and current regulatory approach will only serve to accelerate the consolidation and contraction of community banks nationwide as it deters new capital from entering the banking system to the detriment of America and its rural communities. Why would a prudent investor put capital into a bank that can unilaterally be declared less than well capitalized by the FDIC via consent order when they can put it into a fintech startup that offers high yielding accounts via a network of banks (commoditizing the actual bank charter)? If one of those banks becomes less than well capitalized, the fintech can simply remove it from their network of banks. But perhaps that's a larger discussion for a different day.

It will be unfortunate, but of little solace to the employees, owners, and communities served by small banks, when the FDIC implements this rule and creates a regulatory liquidity risk where no material market liquidity risk of failure would exist absent the FDIC's rule, and subsequently the rule precipitates needless stress on small community banks across America and unnecessary bank failures and losses to the FDIC DIF.

The new methodology might be fine for now given it looks like interest rates are headed back down at least for a while, and who knows if we're headed to negative rates, or hyperinflation in the future if the USD is ever unseated as the global reserve currency. Regardless, the proposed rule is a potential time bomb for many small community banks in an economic downturn.

> *"Crises take longer to arrive than you can possibly imagine, but when they do come, they happen faster than you can possibly imagine."*
>
> *Rüdiger "Rudi" Dornbusch*

Respectfully,

[redacted]

Erik Beguin
CEO and President
Austin Capital Bank