Nati l Associ i Industri l Bankers

UTAH BANKERS ASSOCIATION
- SINCE 1908 -

November 1, 2019

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429.

VIA email to: comments@fdic.gov

Re: RIN 3064-AF02

Dear Mr. Feldman,

We are writing on behalf of members of the National Association of Industrial Bankers (NAIB) and the Utah Bankers Association (UBA) to comment on the FDIC's review of deposit rate caps required by Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f(h), as currently set forth in 12 C.F.R. 337.6. We appreciate the opportunity to comment on the proposals the FDIC has announced to change the ways it calculates these rate caps.

The Utah Bankers Association[1] represents banks of every kind based in Utah including commercial, community and industrial banks. The National Association of Industrial Bankers[2] represents industrial banks based primarily in Utah and Nevada. We submit this letter jointly on behalf of our member banks, which have a vital interest in this matter. It should be noted that as of June 30, 2019 Utah depository institutions had combined total assets of 754.6 billion dollars. Of that total, 502.2.4 billion were in banks, 31.0 billion were in credit unions, 129.4 billion were in industrial banks and 92.0 billion were in savings associations. For the past fifty years banks in Utah have consistently been among the best capitalized and most profitable banks in the nation.

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[1] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

[2] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in California, Nevada and Utah.

Our members have expressed appreciation for the FDIC's review of the deposit rate caps and its efforts to find a better balance between limiting imprudent growth through paying excessive rates for deposits while not causing unnecessary liquidity problems at a bank that is working through an otherwise manageable problem. The general comments we have received from our members are that the proposed changes reflect a well-intentioned effort to help resolve the problems with the current caps but still leave a gap that must be addressed before the caps will work as intended and not cause unintended problems for banks that are not otherwise likely to fail.

One of our members summarized these concerns this way: "rate caps seem like a crude tool with unintended consequences and accidental outcomes." We believe the following additional changes would help resolve these issues.

The caps should be related to each bank's funding methods. The nation's current financial services markets represent an array of ways to fund a bank that make one rate arbitrary and unworkable. A brief review of rates offered by banks in Utah for a money market or standard savings account as of the date of this letter vary from .2% if the account is opened at a branch, 1.1% if opened online at the same bank[3], and 1.9% by a large, national branchless bank based in Utah[4]. Calculating a rate cap that factors all of these rates into one combined rate would allow the branch bank to increase rates dramatically before hitting the cap but would effectively prevent the branchless bank from competing for deposits as it normally would while well capitalized, potentially causing a liquidity crisis and even a failure that otherwise might not happen.

The problem with the one cap approach is that in today's markets the cost of deposits involves much more than interest. Branchless banks can pay higher rates than a bank with branches but the savings from not having branches more than offsets the added interest costs. A typical community bank with branches is high performing if its efficiency ratio is below 50% and many routinely operate with ratios exceeding 60%. Many branchless banks have efficiency ratios between 30% and 40%. Branch banks are doing well to report ROAs over 1.5% and many are close to or below 1%, while many branchless banks report ROAs over 2% and some much higher, even though they are paying higher rates on deposits.

This is further complicated by the fact that many banks, such as the bank described above that offers both branch and online accounts, utilize diverse funding sources with different rates. This is both prudent and increasingly necessary as new options for checking and savings compete with traditional accounts.

Another factor is the ability of the largest banks to pay below market rates because many depositors perceive larger banks as inherently safer, especially those that are considered too big to fail. Those advantages cause national rates to be artificially low when applied to all banks.

The method for calculating rate caps should be designed to avoid causing failures as much or more than avoiding increased losses if a bank fails. As it works now, and would work under any single rate standard, a bank could slip below the well capitalized level for a short period while resolving a temporary and manageable problem. It might be accounting adjustments to loans held for sale during a downturn in the secondary market for loans even though the loans themselves are good quality and collectable. That happened in many instances during the last recession. Or it might be during a period of healthy growth when the bank is profitable and needs a short period for its earnings to bring capital back above the well capitalized level. In both cases, the bank might be

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[3] Rates offered at Zions Bank

[4] Advertised rate offered by American Express National Bank

suddenly faced with a liquidity crisis if it holds substantial amounts of brokered or online accounts that have always paid rates above a cap based on the average of all deposits including those offered at branch banks.

It would even be a problem for branch banks that offer online options. This is a common trend among commercial and community banks today. They would potentially face a major liquidity problem if they had to suddenly drop the rates on their online deposits. Unnecessarily creating that kind of havoc was clearly not the intent of the law.

That kind of damage to an otherwise healthy bank is clearly not what Congress intended when it enacted Section 29. Instead, the law was intended to prevent a failing bank from ballooning its balance sheet with a flood of high cost deposits in a desperate effort to avoid or, in some cases, delay failure. This happened in some cases during the savings and loan crisis in the 1980s when brokered deposits first entered the market. **Congress undoubtedly did not intend to create a liquidity crisis in a bank that operated successfully and reported above average results in the past because it slipped below a well capitalized level and suddenly became subject to a rate cap designed for a different type of bank. The rule eventually adopted for setting rate caps must avoid that problem.** That can only be accomplished by allowing a bank to continue operating in its normal manner while preventing it from raising its rates in order to grow unnaturally as a strategy to deal with a potentially fatal problem.

The only way to calculate a fair and logical rate cap for each bank is to take into account its particular business model and segment the rate caps to reflect the markets in which it normally competes. The current methodology recognizes this for a community bank, which can request a rate calculated on competition within a limited geographic area it serves. An equivalent carveout is needed for branchless banks and banks offering both branch-based and online deposits with different rates. Rather than using a different geography, that kind of differentiation would distinguish between online and branch-based deposits.

It would work better to create categories for the different kinds of deposits and calculate rate caps based on the pricing for each category. The regulators could then match those rates to each bank's funding methods. That would also work better to manage isolated but still critical volatility affecting certain kinds of deposits such as the sudden and unexpected volatility in fed funds, repo and other overnight funding rates that occurred recently.

This would not be unduly complicated. The charts in the ANPR show the FDIC already has current market data on different kinds of deposits. It would not be difficult to track the range of market rates for checking accounts, money market and savings accounts, CDs offered by branch banks, brokered CDs and listing service deposits offered online.

Another way to fairly and logically segment the market is by comparing each bank to a group of its actual peers. The FDIC could create categories for basic business models such as branchless, online, small branch and large branch. This is the same method compensation committees use to determine salaries, incentives and benefits. Each bank adopts a list of twenty or thirty institutions with similar characteristics and uses consultants to establish the range of compensation for each senior executive and the directors within that group. To be even more precise, each bank could be required to develop a list of at least 10 peers subject to approval by the regulators whose offered rates would provide an accurate measure of the bank's actual competition. Either method would get much closer to developing a data base to calculate whether a bank in that category is offering significantly higher rates than its competition.

This could be further supplemented with a provision in the rule stating that the cap does not otherwise limit regulators' authority to impose lower rate and growth caps on banks that are experiencing high and escalating loan defaults or other losses and pose a higher risk of failure.

Our members also commented on the idea described by the FDIC in its "Treatment of Non-Maturity Deposits for Purposes of the Interest Rate Restrictions" section of its guidance titled "Interest Rate Restrictions on Institutions that are Less than Well Capitalized." The commenters especially appreciated the effort to address some issues by suggesting that a bank could create new accounts for each depositor that would receive all new deposits and be subject to a rate cap while allowing the original accounts to continue paying rates allowed while the bank was well capitalized. It reflects the FDIC's good faith efforts to minimize problems. The challenges in this strategy include answering a number of questions relating to that structure such as whether the rates on old savings and money market accounts could still float with the market and how withdrawals would be allocated among dual accounts. The operational challenges would also be substantial, and this would also not provide a solution in the case of new online deposits. We believe segmenting the market into different types of deposits would provide a better solution.

In summary, our members emphasize that setting one rate cap applicable to all banks is another example of when one size does not fit all. It especially presents large liquidity risks for banks that rely on online and brokered deposits even though they are otherwise among the healthiest and least risky group of banks insured by the FDIC. Whether any particular rate is above market is a relative term that varies widely among different business models that are otherwise viable, safe and sound. These differences must be factored into the rate calculations in order to achieve the goals of the statute to prevent abuses without inadvertently harming healthy banks.

We appreciate the opportunity to provide these comments and hope you find them helpful.

Sincerely,

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