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VIA EMAIL: *comments@fdic.gov*

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

**Re: Unsafe and Unsound Banking Practices—Brokered Deposits
RIN 3064-AE94**

Dear Mr. Feldman:

This letter is in response to the Federal Deposit Insurance Corporation's ("FDIC") Advance Notice of Proposed Rulemaking (the "ANPR") concerning the FDIC's regulatory approach to "brokered deposits" and the interest rate limitations applicable to banks that are less than "well-capitalized," as those terms are defined and interpreted under Section 29 of the Federal Deposit Insurance Act (the "FDI Act"), 12 U.S.C. § 1831f, and the FDIC's regulations at 12 C.F.R. § 337.6 (the "Brokered Deposits Rule").[1]

I. Introduction

The ANPR is focused on the solicitation of public comment on the impact of changes in technology, business models and financial products in the decades since the adoption of statutory restrictions on banks' acceptance of brokered deposits. The ANPR also seeks input on the interest rate limitations imposed upon banks that are less than well-capitalized in light of the current economic environment. Our comments contain recommendations for the FDIC's consideration regarding the clarification of certain

[1] Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2,366 (Feb. 6, 2019) ("Proposing Release").

categories of deposits as not being "brokered deposits" within the meaning of Section 29 of the FDI Act and the Brokered Deposits Rule, as well as the methodology used to calculate deposit interest rates for purposes of the limitations established under the Brokered Deposits Rule. In general, our comments correspond to the specific requests for comment contained in the ANPR.

II. Discussion

A. Are there ways the FDIC can improve its implementation of Section 29 of the FDI Act while continuing to protect the safety and soundness of the banking system?

We support the FDIC's re-evaluation of the Brokered Deposits Rule and, to the extent that the staff determines that changes to the FDIC's regulation of brokered deposits are appropriate, we encourage the FDIC to propose and adopt such changes within the text of the Brokered Deposits Rule. The FDIC has elected to implement Section 29 of the FDI Act in large part through the issuance of interpretive guidance in the form of advisory opinions[2] and responses to frequently asked questions.[3] The body of interpretive guidance published by the FDIC provides important clarifications on statutory and regulatory requirements; however, the inconsistency and, in certain instances, the lack of transparency with which guidance has been published has presented challenges for industry participants.

In many cases, prevailing interpretations are decades old and lack practical application in the modern banking environment. In others, interpretations do not set forth sufficient factual information to be relied upon by industry participants or applied across similar, but varying situations. In addition, certain interpretations that are recognized by the FDIC as precedent are not made public, which creates confusion among industry participants with respect to both the substance of the FDIC's positions on Section 29 of the FDI Act and the Brokered Deposits Rule, as well as certain procedural expectations associated with compliance. Finally, some of the interpretations are not merely interpretations, but purport to impose new substantive requirements not found in the statute or regulation and which were not adopted in a manner consistent with the Administrative Procedure Act's substantive rulemaking process.

The FDIC can remedy the above issues by codifying its positions and expectations within the text of the Brokered Deposits Rule, to the extent practicable. We also encourage the FDIC to adopt a formal position on its procedural expectations with respect to reliance upon existing FDIC interpretations. For example, the FDIC has adopted what appears to be a shifting and inconsistently-applied policy of requiring

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[2] *See generally* FDIC, Advisory Opinions, Brokerage Activities, https://www.fdic.gov/regulations/laws/rules/4000-100.html#brok.

[3] *See* FDIC, Identifying, Accepting and Reporting Brokered Deposits, Frequently Asked Questions (last revised July 14, 2016), https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf (the "2016 FAQs").

industry participants to obtain prior FDIC approval and file periodic reports with the FDIC in order to rely upon the statutory exemption for an agent or nominee whose "primary purpose" is not the placement of funds with depository institutions.[4] As discussed further below, we do not believe that it is appropriate for the FDIC to require industry participants to obtain a formal determination from the FDIC staff to rely upon the primary purpose exemption from the definition of "deposit broker" as there is no condition imposed upon the exemption by statute or regulation, nor is there any express authority for such an approval requirement. The FDIC should clarify the circumstances, if any, under which industry participants are encouraged to confer with or notify the FDIC staff in connection with reliance on any statutory or regulatory exemption or satisfaction of any substantive requirement of the statute or the Brokered Deposits Rule.

B. Are there types of deposits that are currently considered brokered that should not be considered brokered?

Set forth below are categories of deposits which, in our view, should not be deemed to be "brokered deposits" within the meaning of Section 29 of the FDI Act and the Brokered Deposits Rule. We note that our suggestions are consistent with the plain language of the statutory text and the policies behind the statutory requirements and therefore could be addressed through interpretation without amendment of the FDIC's current regulations; however, as noted above, we encourage the FDIC to consider addressing these issues through notice-and-comment rulemaking to be codified in the text of the Brokered Deposits Rule.

1. *Deposits of customers of bank operating subsidiaries*

Deposits referred within a bank—such as from one branch or department of the bank to another branch or department of the bank—by statute are not "brokered deposits."[5] Deposits made by customers of operating subsidiaries of the bank (including deposits intermediated by employees of an operating subsidiary) should have the same status as internal deposit referrals from another department within the same bank and should not be deemed to be "brokered deposits."

Banks' operating subsidiaries are limited to "bank eligible" activities and assets,[6] and are separately incorporated simply to address regulatory licensing requirements,[7] or

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[4] 12 U.S.C. § 1831f(g)(2)(I). The predecessor to the 2016 FAQs included the statement that the primary purpose exemption "applies only infrequently" and "*typically* requires a specific request for a determination by the FDIC." The 2016 FAQs do not include this statement; however, the FDIC has not declared affirmatively that no such requirement exists.

[5] 12 U.S.C. § 1831f(g)(2)(A) & (B); 12 C.F.R. § 337.6(a)(5)(ii)(A) & (B).

[6] 12 C.F.R. § 5.34.

[7] *See generally id.* Part 218 (securities brokerage licensing and bank exemptions); Securities Exchange Act § 3(a)(4) & (5), 15 U.S.C. § 78c(a)(4) & (5) (limits on bank exclusion from "broker" and "dealer" definition and SEC registration and regulation); 12 U.S.C. § 1831x(g)(1)(B) (preservation of state authority

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as a convenience. Common examples of bank operating subsidiaries include insurance agencies, brokerage firms, investment advisers and a range of financial consulting, administration and data processing businesses that operate in tandem with the parent bank.[8]

The legal basis upon which national banks and state member banks of the Federal Reserve System, and thus FDIC-insured state-chartered banks, are allowed to own operating subsidiaries[9] is that operating subsidiaries are deemed to be part of the bank.[10] Bank operating subsidiaries are treated for various federal banking law purposes as a part of the bank—essentially incorporated departments of the bank—rather than as "affiliates" of the bank.[11] The banking laws that apply to the parent bank also generally apply to an operating subsidiary.[12]

Operating subsidiaries are consolidated with the parent bank for call report and financial reporting purposes, and are treated as part of the bank for purposes of the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act and Regulation W.[13] Loan-to-one borrower limits generally do not apply to loans by a bank to its majority-owned operating subsidiaries.[14]

Deposit balances at a bank that are owned by customers of the bank's operating subsidiary brokerage firm do not present the types of risks that the brokered deposit definition and rules were intended to address. Deposits of bank operating subsidiaries, like branch deposits, should be viewed as relationship deposits or "sticky" deposits and therefore as "core deposits" outside the scope of the Brokered Deposits Rule. The FDIC's 2011 Study and Report to Congress on Core Deposits and Brokered Deposits (the "FDIC 2011 Report") noted that sweep deposits from an affiliated broker-dealer generally are not subject to the same volatility as sweeps or other deposits from an

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to regulate insurance activities); 15 U.S.C. §§ 6701 & 6711 (state functional regulation of insurance); Investment Advisers Act § 202(a)(11)(A), 15 U.S.C. § 80b-2(a)(11)(A) (limit on bank exclusion from definition of "investment adviser" to registered investment company).

[8] 12 C.F.R. § 5.34(e)(5)(v).

[9] 12 U.S.C. § 1831a(c); 12 C.F.R. § 362.3.

[10] 12 C.F.R. § 250.141; Federal Reserve Board Letter to Chase Manhattan Bank (Aug. 16, 2000).

[11] 12 C.F.R. § 250.141.

[12] *Id.* § 5.34(e)(3).

[13] 12 U.S.C. §§ 371c & 371c-1; 12 C.F.R. § 223(k) & (w). We note that the brokerage sweep arrangement permitted under FDIC Advisory Opinion No. 05-02 involved a bank and a broker-dealer owned by the same bank holding company, rather than an operating subsidiary of the bank, as revealed by the letter's discussion of the arms' length fee requirements of Section 23B applicable to that arrangement.

[14] 12 C.F.R. § 32.1(c)(2)(ii).

unaffiliated broker-dealer.[15] In adopting the final liquidity coverage ratio ("LCR") rule, the FDIC and other federal banking regulators noted that the "agencies consider brokered deposits . . . to be a more volatile form of funding than stable retail deposits . . . because of the structure of the attendant third-party relationship . . . ."[16] These are client relationships of the bank, not relationships intermediated through a third party. While this is true of deposit balances of customers of affiliated broker-dealers, it is even more true of deposit balances of customers of an operating subsidiary broker-dealer for the following reasons.

In a receivership, the ownership interest in an operating subsidiary and its client relationships are assets of the receivership estate and the value accrues to the FDIC as receiver and can be sold like other assets of the bank and to the same extent as branch relationships. Deposits are less stable where the bank does not own the client relationship and would not be part of the "franchise value" of the bank that could be sold in a receivership. Deposit funding is more stable where the relationship belongs to the banking organization, whether that be the bank or its operating subsidiaries.[17]

For the reasons set forth above, we respectfully suggest that operating subsidiaries be treated as part of the parent bank and not as "deposit brokers" in respect of client funds referred or placed with the parent bank, and that the Brokered Deposits Rule be clarified to treat deposits from customers of operating subsidiaries of the bank as not "brokered deposits."

2. *Deposits for investment adviser client accounts*

Securities and Exchange Commission ("SEC") rules require that investment advisers not hold custody of their clients' assets, but instead place them in custody at a bank, trust company or securities broker-dealer.[18] Investment advisers act as fiduciaries and agents for their clients for the purpose of investing the clients' assets as agent in securities and other investments, very little of which gets invested or held in deposit balances with banks. Investment advisers generally select investments from a broad array of money market mutual fund ("MMF") instruments and are not compensated specifically for their selection of bank deposits. Investment advisers therefore operate very much like bank trust departments in their management of client accounts.[19] The

[15] *See* FDIC, Study on Core Deposits and Brokered Deposits Submitted to Congress pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act at 48-50 & 54-57 (July 8, 2011), http://www.fdic.gov/regulations/reform/coredeposit-study.pdf ("FDIC 2011 Report").

[16] Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule; 79 Fed. Reg. 61,440, 61,491, (Oct. 10, 2014), *citing* FDIC 2011 Report at 34–45.

[17] *See* FDIC 2011 Report at 48-50 & 54-57.

[18] 17 C.F.R. § 275.206(4)-2.

[19] *See* 12 C.F.R. § 9.2 (defining "fiduciary accounts" of a national bank to include investment adviser accounts); 12 C.F.R. § 5.34(e)(5)(vii) (requiring a national bank to have trust powers or the subsidiary be a

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client account assets are fiduciary deposits and should be treated same as deposits of fiduciary clients of a bank trust department or non-depository trust company.[20] Accordingly, such deposits should not be viewed as brokered deposits unless the fiduciary arrangement was established for the primary purpose of investing in deposits of insured depository institutions.[21]

Moreover, the ANPR notes that among the factors considered by the FDIC in determining whether a third party is "engaged in the business of placing deposits or facilitating the placement of deposits" with banks are whether (i) the third party receives fees from the bank at which deposits are placed that are based, in whole or in part, on the amount of deposits or the number of deposit accounts and (ii) there is a formal agreement in place between the bank and the third party to place or steer deposits to the bank.[22] According to the FDIC's existing standards, where an investment adviser is hired and paid by its clients to provide services most of which do not relate to deposits pursuant to an advisory agreement between the parties and as an incident to that arrangement deposits certain client funds to be held in custody with banks, but does not receive separate compensation or other incentives from a bank in connection with the deposit of such funds (or future deposits), the administrative arrangement between the investment adviser and the bank that allows the investment adviser to act on its clients' behalf in providing instructions on those deposits is not indicative of a deposit broker relationship. Stated another way, key factors in considering whether the investment adviser is a deposit broker should include whether the adviser is hired and paid by the advisory client or the bank, and whether the investment adviser's compensation in determined by how much of the client's account is invested in deposits or is instead based upon the overall account size regardless of amounts invested in deposits.

FDIC Advisory Opinion No. 17-02 establishes that a number of "middle-market" companies with which banks maintain relationships and from which banks receive deposits are not generally viewed as deposit brokers pursuant to the "primary purpose" exception of the Brokered Deposits Rule provided that such companies' relationships with banks are not "programmatic" and that they are not compensated directly or

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registered investment adviser in order for the operating subsidiary to exercise investment discretion over client account or charge a fee for investment advice).

[20] FDIC Advisory Opinion No. 93-47, *Whether Independent Trust Company Which Conducts Activities On Behalf of Affiliated Bank Must Register as Deposit Broker* (July 21, 1993).

[21] *Cf.* FDIC Advisory Opinion No. 92-87, *Agreement Entered into Between Trust Department and Customer For Primary Purpose of Placing Funds With Insured Depository Institutions Requires Bank to Register as Deposit Broker* (Dec. 9, 1992) (bank trust department non-advised custodial arrangement established for the primary purpose of investing in CDs deemed to be deposit brokerage and distinguished from other fiduciary relationships) and FDIC Advisory Opinion No. 93-47 (drawing same distinction for non-depository trust company's non-advised custodial vs. advised fiduciary accounts, and treating non-depository trust company fiduciary accounts as within the insured bank trust department exclusion).

[22] Proposing Release at 2,371–72.

indirectly for their placement of deposits with banks.[23] By contrast, the interpretation indicates that companies which primarily perform investment, asset management or other traditional financial services functions *are* generally viewed as deposit brokers because the primary purpose of such companies is advising clients about investing and managing money, and deposit placement activities are carried out in furtherance of that purpose.

For the reasons outlined above and in the section below, we do not believe that approach is consistent with the text of the statute and the Brokered Deposits Rule or prior FDIC interpretations, which generally exclude fiduciary investments where the fiduciary relationship is not established for the primary purpose of investing in deposits of insured depository institutions. We request that the FDIC establish clear criteria within the Brokered Deposits Rule clarifying when an intermediary that performs a servicing or operational function for a bank places deposits with the bank in an agency capacity is eligible to rely upon the "primary purpose" exception including in connection with investment advisory or other financial services functions.

3. *Sweep deposits of unaffiliated broker-dealers that otherwise meet requirements of FDIC Advisory Opinion No. 05-02*

FDIC Advisory Opinion No. 05-02 addressed an arrangement where the free credit balances of certain brokerage accounts were swept by a broker-dealer into deposit accounts at affiliated depository institutions. The FDIC determined that such deposits would not be treated as brokered provided that (1) the funds into bank deposits do not exceed 10 percent of the total balances of the brokerage accounts; (2) this limitation is calculated and applied on a monthly basis and shall not be exceeded in consecutive months or for a period of three months during any 12-month period; and (3) the bank provides the FDIC with monthly reports reflecting these monthly calculations and will make available daily calculations upon request.[24]

The FDIC's 2011 Report noted that deposit sweeps from unaffiliated broker-dealers are more volatile and tend to contribute to rapid growth more so than deposit sweeps from affiliated broker-dealers.[25] The FDIC reached this conclusion despite the acknowledged absence of supporting evidence and the submission of extensive commentary and data suggesting that unaffiliated deposit sweeps are, in general, stable, low-cost forms of funding with high customer retention rates. Advisory Opinion No. 05-02 does not, however, address the significance of the affiliate relationship between the banks at which swept funds would be deposited and the placing broker-dealer. Similarly,

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[23] FDIC Advisory Opinion No. 17-02, *Question Regarding Whether Certain Deposits Placed Through a Bank's Relationship With Certain "Middle Market Companies" Are Considered Brokered Deposits* (June 19, 2017).

[24] FDIC Advisory Opinion No. 05-02, *Are Funds Held in "Cash Management Accounts" Viewed as Brokered Deposits by the FDIC?* (Feb. 3, 2005).

[25] FDIC 2011 Report at 56.

while the ANPR notes that Advisory Opinion 05-02 permits a brokerage firm to place idle client funds into deposits accounts at an affiliated bank under the primary purpose exemption, it does not address in detail the distinction between affiliated and unaffiliated deposits sweeps or the FDIC's position on the subject.[26]

By the terms of the statute and the primary purpose provisions in the Brokered Deposits Rule, the existence of an affiliate relationship between the involved institutions should not have a material effect on the deposit broker analysis and therefore should not preclude the application of the "primary purpose" exception.[27] In addition, the data and practical evidence that is available suggests that unaffiliated deposit sweeps should be viewed as core deposits to the same extent as affiliated deposit sweeps. Accordingly, we request that the FDIC clarify that broker-dealers are permitted to sweep cash balances of brokerage accounts into deposit accounts at unaffiliated depository institutions provided that the other qualifications established in Advisory Opinion No. 05-02 are satisfied.

4. *Broker-dealer and custodial sweep deposits*

Further to the above, we request that the FDIC codify its sweep deposit interpretation set forth in Advisory Opinion No. 05-02 within the Brokered Deposits Rule (with the above modification regarding unaffiliated institutions). As discussed above, to the extent applicable under current agency practice, the FDIC should remove any requirement that each bank obtain its own separate letter of approval from the FDIC prior to the commencement of any sweep deposit arrangement. Although the FDIC publicly relaxed its position on this issue when it published the 2016 FAQs, we understand that the FDIC has continued (at least selectively if not as a matter of course) to require institutions to submit a request for a formal determination of the application of the "primary purpose" exception to a particular arrangement. Given the absence of statutory authority for such a pre-approval requirement, the FDIC should clarify that no such requirement exists. If there is to be reporting on sweep deposit balances, it should be a line item in the Call Report.

Section 29 of the FDI Act and the Brokered Deposits Rule do not impose an application and approval process requirement or a reporting requirement on banks as a condition to reliance on the primary purpose exemption. Notably, the FDIC has not imposed a prior approval requirement on banks that wish to rely upon other manifestations of the primary purpose exemption in the Brokered Deposits Rule (for example, the trustee deposit exemption for trusts not established for the primary purpose of investing in deposits of FDIC-insured institutions). The substantive statutory or administrative law basis upon which the FDIC has relied to impose this approval and reporting requirement on brokerage sweep arrangements has never been made clear.

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[26] Proposing Release at 2,368–69 & 2,372–73.

[27] The FDIC clarified in the 2016 FAQs that, in general, even when a bank places deposits exclusively within a network of affiliated banks, the bank is acting as a deposit broker and, as a result, all such deposits are brokered deposits. *See* FAQ C3.

Requiring each bank to obtain its own determination letter is inefficient and imposes both significant time delays (the lead time to getting an individual letter is roughly a year) and costs on the bank involved. As the brokerage sweep primary purpose letters all follow the same basic terms, there is not much tailoring to address the individual context that necessitates what amounts to an individual application and approval process.

C. Do institutions currently have sufficient clarity regarding who is or is not a deposit broker and what is or is not a brokered deposit?

The categories of deposits set forth in this section have not been addressed directly by the FDIC in prior interpretive guidance; however, for the reasons discussed below, these deposits should not be viewed as "brokered deposits" under the terms of Section 29 of the FDI Act and the Brokered Deposits Rule. We also discuss below opportunities for the FDIC to provide clarity regarding existing interpretative precedent.

1. *Local government investment pool deposits*

Local government investment pools ("LGIPs") are investment funds operated by state governments (typically the state treasurer, in some cases with assistance from an external investment adviser) for investment of government assets and are exempt from registration and regulation under the Investment Company Act of 1940.[28] LGIP operations and investments are governed by detailed state statutory and regulatory requirements.[29] Many of these pools operate like MMFs and are used by the states to pool and manage their cash balances.[30] LGIPs invest as principal in U.S. government securities, commercial paper, corporate bonds, repurchase agreements and a range of other money market assets such as certificates of deposit ("CDs") and other bank deposits, including CDs of non-insured foreign banks. LGIPs may contract with external advisers and other third-party administrators and custodians. Such third-party service providers are subject to the statutory and regulatory restrictions that apply to the LGIP and their activities are overseen by the state treasurer or other authorized government officials.

LGIP managers are typically compensated in the form of an annualized management fee paid by the LGIP and indirectly borne by the LGIP's participants. Fees

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[28] Investment Company Act § 2(b), 15 U.S.C. § 80a-2(b).

[29] *See, e.g.*, Colo. Rev. Stat. Ann. § 24-75-701 *et seq.*; Del. Code Ann. tit. 29, § 2718; Ga. Code Ann. § 36-83-8; Mich. Comp. Laws Ann. § 129.141 *et seq.*; Or. Rev. Stat. Ann. § 294.805; Tenn. Code Ann. § 9-4-701 *et seq.*; Tex. Gov't Code Ann. § 2256.001 *et seq.*; Va. Code Ann. § 2.2-4600 *et seq.*

[30] The Governmental Accounting Standards Board ("GASB") establishes accounting and financial reporting standards for U.S. state and local governments with which LGIPs must comply; *see also* Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47,735, 47,807 (Aug. 14, 2014) (SEC adopting release for 2014 amendments to money market mutual fund regulations established under SEC Rule 2a-7 containing a discussion of the implications of such amendments for LGIPs).

are generally fixed based on the LGIP's assets under management and are not dependent upon the specific investment decisions of the LGIP manager. LGIP managers are not compensated by the banks that accept the deposits, nor are LGIP managers compensated based on whether or how much an LGIP invests in CDs or other bank deposits. Moreover, any CD or deposit purchased or placed by an LGIP is owned as principal by the LGIP, not the participants in the LGIP. The LGIP manager makes investment decisions in accordance with the investment objectives and guidelines established by the state treasurer pursuant to the LGIP's authorizing statute or regulation. LGIP investments are not specifically selected or directed by participants.

LGIPs are not "deposit brokers" within the meaning of the first clause of 12 U.S.C. § 1831f(g)(1)(A) because LGIPs invest their portfolio assets as principal and not as agent. LGIPs operate robust diversified portfolios and are not simply a means for third parties to invest in interests in insured bank deposits and thus are not "deposit brokers" within the meaning of the second clause of 12 U.S.C. § 1831f(g)(1)(A).

In a 1992 advisory opinion involving a parallel CD placement arrangement that the external investment adviser and administrator operated alongside an LGIP as an optional supplemental service, the FDIC staff indicated that the placement as agent by the adviser/administrator on behalf of other governmental entities directly into bank CDs was deposit brokerage.[31] The letter did not specifically address the status of deposits made by the LGIP as principal in connection with the LGIP's management of its broader investment portfolio, nor did the letter address the role of the external adviser and administrator to the LGIP in that regard; however, the implication of the 1992 letter, by distinguishing between deposits placed through the parallel CD agent program and the LGIP's own portfolio deposits placed as principal, is that the LGIP deposits are not "brokered deposits." We respectfully suggest that the FDIC specifically address the status of LGIP portfolio deposits made as principal and confirm that they are not "brokered deposits."

2. *Deposits owned by other investment funds as principal, provided that the fund is not intended to invest primarily in deposits of FDIC-insured institutions*

As is the case with LGIPs, other forms of investment funds, from SEC-registered investment companies through a range of other investment funds that are exempt from registration, invest portions of their portfolios as principal in bank deposits. For some investment funds the deposits are limited to temporary cash balances awaiting investment or distribution or are used for collateral purposes. For other funds, bank CDs (some from FDIC-insured institutions, others from non-U.S. banks or their U.S. branches that are not FDIC-insured institutions) are a part of the investment portfolio along with government

[31] FDIC Advisory Opinion No. 92-66, *Investment Advisor/Fund Administrator for Governmental Authorities is Deposit Broker With Respect to Optional Certificate of Deposit Placement Program It Offers* (Oct. 11, 1992).

securities, corporate bonds, repurchase agreements, and various other money market instruments and investments.

The funds are legal entities (most commonly corporations, business trusts, limited liability companies or limited partnerships) that own the deposits for their own account as principals, and do not act as agent for investors. Like LGIPs, other types of investment funds therefore are not "deposit brokers" within the meaning of the first clause in 12 U.S.C. § 1831f(g)(1)(A) because the investment funds invest their portfolio assets as principal and not as agent. Investment funds are not "deposit brokers" within the meaning of the second clause in 12 U.S.C. § 1831f(g)(1)(A) because they have diverse portfolios and are not simply a means to invest in interests in insured bank deposits.

Most investment funds have investment advisers, custodians and administrators that act as fiduciaries and as agent for the funds. As is the case with LGIPs that have third-party advisers, custodians and administrators, these fiduciaries do not act for the "primary purpose" of investing fund assets in deposits of FDIC-insured institutions. Funds normally compensate their advisers and other external service providers with a periodic fee based on assets under management (and in some cases a performance fee or allocation) on a periodic basis, or through periodic flat fees or per account fees, which do not change based on whether the fund invests in bank deposits at all or the amounts of any bank deposits owned in portfolio. Moreover, the compensation is paid by the fund to the adviser, custodian and administrator and is borne indirectly as an expense by investors, and is not paid by the bank that issues the CDs or other deposits owned by the funds. The structure of this fee arrangement does not specifically incentivize the placement of deposits with banks, nor does it result in a windfall to the third-party adviser, custodian or administrator in the event that of a more significant volume of deposits or deposit accounts.[32]

We respectfully suggest that the FDIC clarify that deposits of externally-managed investment funds whose investment portfolios are invested primarily in assets other than deposits of FDIC-insured institutions not be treated as "brokered deposits." In this regard, if the fund's portfolio, once fully invested, consists 40% or less of deposits in FDIC-insured depository institutions it should not be viewed as having the "primary purpose" of investing in deposits of insured depository institutions.[33]

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[32] Proposing Release at 2,369 & 2,372.

[33] The benchmark percentage of investment activity that constitutes the "primary" activity of an investment fund is defined at a 40% level in an analogous provision of the Investment Company Act. Section 3(a)(1) of the Investment Company Act defines what investment funds are "engaged primarily" in the business of investing in securities. The Investment Company Act defines an issuer that either "holds itself out" to the public as engaged primarily in investing, reinvesting and trading in securities or that invests more than 40% of its assets in investment securities as triggering that Act's requirement that it either register with the SEC or fit within an exemption or exclusion. For the purpose of calculating the percentage of a fund's portfolio that consists of deposits at which time the portfolio is fully invested, we would suggest excluding from the calculation the short periods of time between when capital calls are made by the fund and those amounts

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3. *Transferrable deposits*

We request that the FDIC clarify that transferrable or negotiable CDs that have a CUSIP or that are issued by a bank that is rated by a rating agency and acquired as principal by a depositor with the intent to hold to maturity are not automatically viewed as "brokered deposits" if the context does not otherwise cause them to be viewed as such.

Even when they plan to hold to term and repeatedly renew, municipal governments, corporate treasurers and MMFs (to comply with SEC Rule 2a-7), private liquidity funds that voluntarily follow Rule 2a-7 portfolio requirements, and other investment funds and institutional investors commonly require term deposits to be "transferrable" to establish that they are not "illiquid" or qualify as liquid assets or cash equivalents for accounting purposes and further require that they be investment grade.[34]

In addition, municipal governments often require term deposits to be issued by a bank that is rated investment grade and be transferrable in order qualify them as permissible investments in amounts above $250,000 without collateral or credit enhancement.[35] In each case, the depositor is acting as principal and not as agent for others, and is not simply a vehicle for securitizing and selling fractional interests in deposits at insured institutions. Ratings and CUSIPs are obtained for the deposits to comply with accounting and investment limitation requirements applicable to the depositor, not with a plan to distribute or resell the deposits. As a result, these depositors who plan to hold deposits with a CUSIP or rated deposits to term are not "deposit brokers" as defined in the statute or the Brokered Deposits Rule and the deposits they own are not "brokered deposits." We request that the FDIC address the issue and clarify the status of such deposits.

4. *Broker-dealer reserve balance deposits*

A 1994 advisory opinion concludes that deposits of securities broker-dealers placed as "reserve balance deposits" pursuant to SEC Rule 15c3-3(e) are not "brokered deposits" because the broker-dealer does not make the deposit for the "primary purpose" of placing funds with a depository institution but instead to comply with applicable regulatory requirements.[36] Although we agree with the result and the conclusion, we note

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are invested and when portfolio assets have been sold and the fund has not yet distributed or reinvested the proceeds.

[34] 17 C.F.R. § 270.2a-7(a)(18); GASB Statement No. 79 ¶¶ 24 & 33 (Dec. 2015).

[35] *See, e.g.*, Cal. Gov. Code §§ 16430(h), 53601(i) & 53649 *et seq.*; California Debt and Investment Advisory Commission, *Local Agency Investment Guidelines* (2018); Mich. Comp. Laws Ann. §§ 21.146 & 129.91; Ark. Code Ann. §§ 19-3-518, 19-3-507 & 19-3-508.

[36] FDIC Advisory Opinion No. 94-39, *Brokered Deposits: Are Funds Deposited in a Special Reserve Bank Account for the Exclusive Benefit of Customers Brokered Deposits Under Sections 29 and 29A of the FDI Act* (Aug. 17, 1994).

that the simpler way to reach this result is to clarify that the broker-dealer that makes reserve balance deposits pursuant to SEC Rule 15c3-3(e) owns them as principal (notwithstanding the "exclusive benefit of clients" language required by the SEC rule) and not as agent or trustee.

These special reserve deposit account balances appear on the broker-dealer's balance sheet and factor into its net capital calculations (unlike deposits held by a broker as agent, such as sweep deposits placed pursuant to SEC Rule 15c3-3(j), which are not balance sheet assets of the broker and are instead held as agent for customers). The interest in the reserve balances benefits brokerage customers by protecting them as creditors of the broker. The required Rule 15c3-3(e) reserve account balances roughly correspond in the aggregate to the "free credit balances" (*i.e.*, cash balances owed by the broker-dealer to its customers that have *not* been swept off the balance sheet of the broker-dealer as agent for the customer and invested in MMF shares, bank sweep deposits, or repurchase agreements, net of any amounts due to the broker-dealer from the customer). The broker free credit balances are short-term debt obligations of the broker-dealer to its customers as principal, but the reserve balance deposits placed by the broker-dealer in a bank do not belong to the customers.

Because they are not agency deposits, there is no need to apply the "primary purpose" exception to conclude that they are not "brokered deposits."

5. *Bankruptcy management software service providers*

The ANPR discusses certain software service providers (*e.g.*, accounting and bankruptcy management firms) whose services involve the placement of deposits with banks in connection with a broader set of administrative functions.[37] The ANPR suggests that such service providers may not be treated as deposit brokers pursuant to the primary purpose exemption depending upon the nature of a service provider's relationship with a bank and the structure of any fee arrangement between the parties. For the reasons discussed below, we believe that deposits placed incident to the provision of integrated software services in connection with a bankruptcy or corporate restructuring are not brokered deposits where there is no payment of volume-based compensation and we request that the FDIC clarify the status of such deposits.

In a typical arrangement between a bank and a bankruptcy management software service provider involving the establishment and maintenance of deposit accounts the mandatory requirement is to have a technological and operational interface between the service provider and the bank to deliver an integrated, all-in-one experience to the trustee. Once integrated with the service provider, the bank works with a trustee(s) to establish an arms-length interest rate agreement for deposits placed in connection with the bankruptcy or restructuring. The bank ordinarily opens one deposit account for each underlying estate to allow the trustee to access each account integrated as part of the overall case

[37] Proposing Release at 2,373.

management workflow. The balance of most underlying accounts falls below the standard maximum deposit insurance amount ("SMDIA"); however, the trustee(s) will generally require the bank to post collateral against any account balances above the SMDIA in accordance with applicable legal or court mandated requirements. The bank makes interest payments on the underlying accounts, from which the trustee(s) usually deducts a fee based on other third-party arrangements. The amount of interest to be paid on the underlying accounts is determined based on competitive, market-based rates. The service provider does not receive any volume-based fees directly from the bank for the placement of deposits.

Deposit placement is only one aspect of a much broader set of case administration services provided by the third-party. In most cases, the third-party is providing a bundle of accounting and reporting wrap services to the bankruptcy court, creditors, the debtor and other interested parties and a minority of cases involve deposit placement or the provision of any banking services. As with certain third-party relationships with advisory firms, custodians and fund administrators, and "middle market" companies, the structure of a trustee's relationship with a third-party bankruptcy management software service provider is not one where the primary purpose of the relationship is the placement of deposits or the obtaining of deposit insurance. Funds that are deposited with banks are placed pursuant to the fiduciary obligations of the trustee(s) overseeing the bankruptcy or restructuring. The administrative agreement allowing the bank to receive court-administered deposits and to facilitate accounting and reporting by the service provider in connection with the bankruptcy proceeding cannot be characterized as "programmatic" as the vast majority of such relationships do not involve deposit placement or other banking services and are subject to the terms and limitations of the trustee(s) relationship with the service provider and other third parties.[38]

6. *Existing interpretive precedent*

As discussed above, industry participants would benefit from greater clarity regarding the exemptions from the FDI Act's definition of "deposit broker" as interpreted over the course of several decades by the FDIC staff through various forms of guidance. Where possible, we encourage the FDIC to provide such clarification within the text of the Brokered Deposits Rule. To the extent that the FDIC intends to continue to rely heavily on existing interpretations to provide clarification and guidance on Section 29 of the FDI Act and the Brokered Deposits Rule, we encourage the FDIC to rescind outdated interpretations that have been superseded or updated by subsequent interpretations, as well as those with diminished utility and practical application in light of the passage of time and advancements in the banking industry. Further, we encourage the FDIC to replace any rescinded interpretations through the issuance of an updated, more comprehensive FAQ and/or other forms of guidance capable of being applied more

[38] *Id.* at 2,372.

broadly (*i.e.*, guidance that is not limited only to the facts supplied by interested parties to the FDIC).

D. Are there specific changes that have occurred in the financial services industry since the brokered deposits regulation was adopted that the FDIC should be cognizant of as it reviews the regulation?

Yes, there have been specific changes in the financial services industry and the larger economic environment subsequent to the adoption of brokered deposits regulation that should be considered. These include (i) the Reserve Primary Fund "breaking the buck" in September 2008 and subsequent changes to SEC Rules 2a-7 (championed by the Federal Reserve and FSOC) and 15c3-3 which resulted in bank deposits becoming a preferred vehicle for holding incidental cash balances for broker-dealer and investment adviser customer accounts; (ii) adoption of global standards for benchmark rates; and (iii) increased use of integrated accounting systems and digital platforms that involve incidental cash balances.

1. *Post-Financial Crisis growth of sweep deposits*

In the aftermath of the Financial Crisis and the imposition of the SEC's reforms to the rules governing MMFs,[39] which require institutional prime and tax-exempt MMFs to operate with a floating net asset value ("NAV"), the utility of such MMFs as cash management vehicles has been diminished. With strong encouragement from the FSOC and Federal Reserve, bank deposits—including in particular, deposits from broker-dealer cash sweep programs—have helped fill the void.[40] Since the Financial Crisis, the total net assets held in MMFs has decreased by nearly $1 trillion. The drop off in holdings of prime MMFs has been even more precipitous, falling from a pre-Financial Crisis peak of $1.86 trillion to $455.40 billion as of year-end 2017.[41] During the same period, the volume of total bank deposits has increased by more than 50% (from $8.08 trillion as of year-end 2008 to $12.32 trillion at present), with brokered deposits representing a growing share of the overall volume of deposits (from $662.21 billion at the start of the Financial Crisis to $985.74 billion at present).[42] The reported volume of brokered

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[39] *See generally* 17 C.F.R. § 270.2a-7.

[40] The 2018 liquidity survey conducted by the Association for Financial Professionals provides that by nearly a two-to-one margin, the most significant factor in the selection of an MMF is the existence of a stable or floating NAV. Accordingly, half of the 637 respondents indicated that their firms have no plans to invest in prime MMFs and bank deposits now account for the largest percentage of corporate short-term investment holdings (49%). *See* Association for Financial Professionals, Liquidity Survey Report (2018), https://www.afponline.org/docs/default-source/default-document-library/pub/2018-liquiditysurveyreport-final.pdf?sfvrsn=2; *see also* Darla Mercado, *Why Money Market Funds Won't Ever be the Same,* CNBC (Sept. 12, 2018), https://www.cnbc.com/2018/09/12/why-money-market-funds-wont-ever-be-the-same.html.

[41] *See* Investment Company Institute, 2018 Investment Company Factbook at 242, https://www.ici.org/pdf/2018_factbook.pdf.

[42] FDIC, Quarterly Banking Profile Time Series Data, https://www.fdic.gov/bank/analytical/qbp/.

deposits includes broker-dealer sweeps to unaffiliated banks, but does not include sweeps to affiliated banks. Taken together, total sweep deposits amount to $1.71 trillion, or 14% of the overall volume of domestic deposits.[43]

The ANPR addresses the proliferation of insured deposit sweep programs, but does not discuss their uses or the factors that have contributed to their increased use. Treating sweep deposit balances as an indicia of systemic risk by labeling them as "brokered deposits" would be ironic in view of the role of the federal bank regulators in forcing this shift under the guise of reducing systemic risk.

2. *Adoption of global standards for benchmark interest rates*

As discussed more fully in Section II.E of this letter, we believe that the FDIC's methodologies for establishing interest rate benchmarks for purposes of Section 29 of the FDI Act and the Brokered Deposits Rule are flawed. This belief is underscored by recent developments regarding the establishment of global standards for benchmark interest rates. Since the Financial Crisis, the Federal Reserve and other central banks, the Financial Stability Board ("FSB"), International Organization of Securities Commissions ("IOSCO"), and the European Union,[44] have recognized the need for global standards for benchmark rates that are based on market data and not subject to manipulation. This was inspired in large part by scandals involving alleged manipulation of the London Interbank Offered Rate ("LIBOR")—historically, the fundamental reference rate in numerous financial and commercial contracts—which is being phased out in favor of alternative interest rate benchmarks. This is in part due to the rate manipulation scandals that have surfaced in recent years and in part to the widespread belief that LIBOR is overly subjective and not based on actual transaction data. These developments have caused financial industry and market authorities to re-evaluate the standards, data and processes used to establish financial benchmarks.

Among the key principles of the developing financial benchmark reform efforts are (i) strengthening benchmark rates by anchoring them to a large volume of actual observable transactions in active markets, (ii) identifying alternative risk-free rates that can be used reliably and consistently in order to promote liquidity, (iii) considering the quality and appropriateness of a benchmark for both its current and future needs in light of a variety of factors relevant to its likely users (*e.g.*, ensuring that the benchmark provides an accurate and reliable representation of the market it seeks to measure in consideration of the economic realities of the market, including its size, liquidity, potential evolution and any factors that might distort the value of the benchmark, and, in the case of interest rate benchmarks specifically, considering whether certain risk elements, such as term and credit risk, should be factored into the benchmark), and (iv) establishing clear guidelines for the hierarchy of data inputs and the use of expert

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[43] Proposing Release at 2,369.

[44] See, e.g., European Securities and Markets Authority, *Benchmarks*, https://www.esma.europa.eu/policy-rules/benchmarks; Financial Conduct Authority, *Benchmarks*, https://www.fca.org.uk/markets/benchmarks.

judgments in determining a benchmark in an effort to promote greater transparency and to ensure the quality, integrity, continuity and reliability of the benchmark.[45]

Many of the above principles —and in particular a preference for benchmark rates based upon actual transaction data rather than published or reported interest rates—are relevant to the FDIC's consideration of the appropriate processes and methodologies to be used to calculate the "national rate" and the prevailing rate in a "market area" under relevant provisions of the statute and regulation. We encourage the FDIC to consider ongoing developments in the global financial benchmark reform process as it evaluates potential updates to its own interest rate setting methodologies.

3. *Increased use of automated systems and digital applications that link into deposit balance information*

Processes for tracking, accounting for and reporting on expenses and payments have undergone considerable technological change in recent years. Many governmental entities, business and other organizations have adopted automated accounting systems that are integrated with their cash management, payment and other related systems in order to capture information accurately and in real time. These systems are used by organizations to streamline and improve their control of and accounting and reporting of expenses and payments—not to place deposits with banks. Moreover, consumers and businesses alike rely increasingly on point-of-sale digital applications to transfer and receive payments. These applications are often linked to bank deposit accounts; however, the depositing of funds transferred using such applications is optional and incidental to the electronic payment transactions that the applications were designed to process. They do not exist primarily for deposit placement purposes.

The purpose of the Brokered Deposits Rule is not to impose artificial 20th Century barriers on the systems and processes described above by treating them as existing for the primary purpose of placing deposits.

E. Questions regarding the interest rate restrictions of Section 29 of the FDI Act

The Brokered Deposits Rule prohibits undercapitalized banks from offering interest rates on deposits that are significantly higher than the prevailing rates on insured deposits in an institution's normal market area or in the market area in which deposits would otherwise be accepted. In general, a bank that is not well capitalized may not offer

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[45] *See, e.g.*, Financial Stability Board, *Reforming Major Interest rate Benchmarks* (Nov. 14, 2018), http://www.fsb.org/wp-content/uploads/P141118-1.pdf; Financial Stability Board, *Interest Rate Benchmark Reform—Overnight Risk-Free Rates and Term Rates* (July 12, 2018), http://www.fsb.org/wp-content/uploads/P120718.pdf; IOSCO, *Statement on Matters to Consider in the Use of Financial Benchmarks* (Jan. 5, 2018), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD589.pdf; IOSCO, *Principles for Financial Benchmarks* (July 2013), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

an interest rate on brokered deposits that is higher than the "national rate" established by the FDIC plus 75 basis points.[46] The "national rate" is defined under the Brokered Deposits Rule, with respect to deposits of similar size and maturity, as a simple average of rates offered by all insured depository institutions and branches for which data are available. Where the FDIC determines, at a bank's request and on the basis of available evidence, that the published national rate does not represent the prevailing rate in a particular market area, the bank will be permitted to offer the prevailing rate for deposits obtained from within that market area.

Although the FDIC has published guidance aimed at clarifying its approach to the calculation of applicable interest rate caps, the existing methodology is limited in certain respects and often produces an ineffective measure of "high rate" deposits, because the published rates that the FDIC relies upon are lower than the actual interest rates at which banks accept deposits after negotiation with depositors. These are an average of advertised rates, not the negotiated rates that are paid on actual deposit transactions. When banks advertise a deposit rate, that is often the starting point for a negotiation with large depositors, and the rate is negotiated up, not down. Thus—like the soon-to-be-abandoned LIBOR—the FDIC's national benchmark deposit rate is not based on actual transactional data and does not accurately reflect the current competitive market interest rates, with the error bias consistently being towards the low side. As illustrated below in Table 1, a recent independent tabulation of anonymized consumer account level data representing over 100 million accounts demonstrates the disparities between published rates and issued rates.

[46] 12 C.F.R. § 337.6(b).

Table 1

<table>
<tr><th rowspan="2">Deposit Products</th><th colspan="2">FDIC Weekly Rate Cap Information—Week of December 31, 2018 (Non Jumbo Deposits <$100,000)[47]</th><th colspan="3">Novantas CDA December 2018 All Bank Sample[48]</th></tr>
<tr><th>National Rate[49]</th><th>Rate Cap[50]</th><th>Total Portfolio</th><th>Balances Acquired in December 2018</th><th>% Balances Acquired in December 2018 Above 12/31/18 Rate Cap</th></tr>
<tr><td>Interest Checking</td><td>0.06</td><td>0.81</td><td>0.08</td><td>0.08</td><td>0%</td></tr>
<tr><td>Savings</td><td>0.09</td><td>0.84</td><td rowspan="2">0.56</td><td rowspan="2">1.43</td><td rowspan="2">76%</td></tr>
<tr><td>MMF</td><td>0.16</td><td>0.91</td></tr>
<tr><td>1 month CD</td><td>0.11</td><td>0.86</td><td rowspan="2">0.22</td><td rowspan="2">0.35</td><td rowspan="2">16%</td></tr>
<tr><td>3 month CD</td><td>0.20</td><td>0.95</td></tr>
<tr><td>6 month CD</td><td>0.34</td><td>1.09</td><td>0.90</td><td>1.29</td><td>54%</td></tr>
<tr><td>12 month CD</td><td>0.61</td><td>1.36</td><td>1.56</td><td>2.35</td><td>93%</td></tr>
<tr><td>24 month CD</td><td>0.81</td><td>1.56</td><td rowspan="2">1.57</td><td rowspan="2">2.45</td><td rowspan="2">88%</td></tr>
<tr><td>36 month CD</td><td>0.96</td><td>1.71</td></tr>
<tr><td>48 month CD</td><td>1.05</td><td>1.80</td><td rowspan="2">1.60</td><td rowspan="2">1.83</td><td rowspan="2">48%</td></tr>
<tr><td>60 month CD</td><td>1.25</td><td>2.00</td></tr>
</table>

[47] FDIC, Weekly National Rates and Rate Caps, https://www.fdic.gov/regulations/resources/rates/historical/2018-12-31.html.

[48] Novantas Comparative Deposit Analytics data as of December 31, 2018 based on consumer account level data from over 100 million accounts and over $1.2 trillion in deposits. Calculations reflect the following factors: a straight average across banks; acquisition rates are for new money only; savings and MMDA are combined; and CDs are split into 5 term buckets (0 - 5 months; 6 - 11 months; 12 - 18 months; 19 - 40 months; and 41 + months).

[49] National rates are calculated based on a simple average of rates paid (using annual percentage yield) by all insured depository institutions and branches for which data are available. Data used to calculate the national rates are gathered by RateWatch. Savings and interest checking account rates are based on the $2,500 product tier while MMFs and CDs are based on the $10,000 and $100,000 product tiers for non-jumbo and jumbo accounts, respectively. Account types and maturities listed above are those most commonly offered by the banks and branches for which data are available—with no fewer than 45,000 locations and as many as 81,000 locations reported. The deposit rates of credit unions are not included in the calculation.

[50] The rate cap is determined by adding 75 basis points to the national rate. To determine conformance with the Brokered Deposits Rule, compare rates offered by the institution, based on size and maturity of the deposit, to the rate caps. For accounts less than $100,000, use the applicable rate cap under the non-jumbo column, and for accounts $100,000 and over, use the rate caps under the jumbo column. Interpolation should be used for deposits with maturities not listed above.

As discussed above, the way in which the FDIC develops its national benchmark rate fails the global standards for interest rate benchmarks.[51] For the intended purpose of prohibiting undercapitalized banks from attracting funding by paying above-market interest rates, the national rate understatement may inadvertently prevent these banks from matching actual market rates and cause them to shrink. While that might be a good thing in some circumstances, it is not the stated objective of the statute or the Brokered Deposits Rule and may be destabilizing both for the institutions affected and for the financial system as a whole. To the extent that the FDIC or other regulators or market participants and analysts use the national market rates published by the FDIC under the Brokered Deposits Rule for other contractual, supervisory or analytic purposes, the error is compounded by using a benchmark rate derived from faulty data and applying it in the wrong contexts.

We offer below for the FDIC's consideration the following observations and recommendations regarding this interest rate setting methodology.

- The deposit rate average for purposes of the "national rate" calculation should be weighted to account for deposit balances (*i.e.*, actual observed flows).

- Available data sources should not reflect only listed or published rates, but should also reflect the rates of funded deposits as this more closely demonstrates the market rate for a deposit. Depositors negotiate rates upward from the advertised rates. That normal practice is not captured in the existing data used by the FDIC and results in an understatement of actual current interest rates on deposits.

- The methodology should address the calculation of a comparable deposit rate for "off tenor" CDs (CDs with a maturity that does not have an equivalent benchmark rate).

- The methodology should include an option for determining whether a deposit is a high-rate deposit based upon a minimum acceptable rate to which a spread would be applied for purposes of the determination—for example, the risk-free rate of return for U.S. Treasury bills, imputed interest rates on overnight and term repurchase agreements, financial issuer commercial paper rates, federal funds rates, and current yields on MMFs. This data is published based

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[51] *See generally*, Federal Reserve Bank of New York, *Introducing the Secured Overnight Funding Rate (SOFR)* (Nov. 2, 2017) (noting that SOFR benchmark rate is based on transactional data); IOSCO, *Principles for Financial Benchmarks, Final Report* (July 2013) (data used to construct benchmark should be based on rates that have been formed by the competitive forces of supply and demand and anchored by observable transactions entered into at arm's length in the market the benchmark measures); Financial Stability Board, *Interest rate benchmark reform – overnight risk-free rates and term rates* (July 12, 2018) (reference rates must be based on actual market transactions).

upon actual market transactions and may provide a deeper and more accurate picture of the current interest rate environment.

- The methodology should account for instances in which the bank-issued deposit has a tenor that is greater than the longest tenor of the benchmark rates, as interpolation would not be possible in such a situation.

- The FDIC should consider applying a variable spread to the applicable rate based on tenor of the deposit. The spread generally should be larger for longer-term deposits and smaller for shorter-term or non-term deposits. A variable-spread approach would be a disincentive for banks against issuing only short-term CDs. In general, yield curves are initially upward sloping with rates increasing less rapidly as tenor increases. Spreads against yield curves often increase as the term structure increases. A flat spread unbiased as to the term of a deposit assumes that investors would not differentiate the risk associated with term structures that vary significantly. Use of a variable spread would incentivize banks subject to the rate limits to diversify CD issuances across a range of short, medium and longer terms and thereby create more stable funding for bank balance sheets.

- The FDIC should clarify to what extent interpolation is allowable, and whether benchmark rates should be matched with the origination date of a deposit, in which case it is possible a "two way" interpolation would be necessary to match based both on tenor and origination date.

- The methodology should permit consideration of relationship pricing. Many banks use pricing matrices that account for the depth of customer relationship. Rather than at the account level, benchmarking should be calculated at a relationship level.

* * * * *

We appreciate the opportunity to provide these comments in response to the ANPR and we thank the FDIC for its consideration of the suggestions contained in this letter. We would be pleased to provide additional information if it would be useful to the FDIC in this regard.

Sincerely,

[redacted]

Arnold & Porter

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