From: Dan D. Graham <dgraham@fbandtbank.com>
Sent: Tuesday, April 23, 2019 3:56 PM
To: Comments
Subject: [EXTERNAL MESSAGE]Regarding: Unsafe and Unsound Banking Practices [Brokered Deposits] – RIN 3064-AE94
Attachments: FDIC Comment Letter - Unsafe and Unsound Banking Practices - Brokered Deposits - RIN 3064-AE94.pdf

Please see the attached comment letter from the Community Bankers Association of Illinois regarding: Unsafe and Unsound Banking Practices [Brokered Deposits] – RIN 3064-AE94. The management of Flora Bank & Trust fully supports the position put forth by the Community Bankers Association of Illinois.

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[redacted]

April 23, 2019

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

Regarding: Unsafe and Unsound Banking Practices [Brokered Deposits] – RIN 3064-AE94

Dear Mr. Feldman:

The Community Bankers Association of Illinois ("CBAI"), which proudly represents over 310 Illinois community banks, appreciates the opportunity to provide our observations and recommendations regarding the Federal Deposit Insurance Corporation's ("FDIC" of "Agency") Advance Notice of Proposed Rulemaking and Request for Comment ("ANPR") regarding Unsafe and Unsound Banking Practices [Brokered Deposits]. CBAI acknowledges the FDIC "is undertaking a comprehensive review of the regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than "well capitalized" ("National Rates" used in determining "Deposit Rate Caps" or "Rate Caps"). The Agency rightly notes that "[S]ince the statutory brokered deposit restrictions were put in place in 1989 and amended in 1991, the financial service industry has seen significant changes in technology, business models, and products. In addition, changes to the economic and interest rate environment have raised a number of issues relating to the interest rate restrictions and how the Rate Caps are calculated."

CBAI acknowledges the historic intent of the FDIC's brokered deposit [growth] restrictions and its concerns with how these deposits have been utilized by banks, particularly leading into the recent financial crisis. While we are not attempting to resolve the different viewpoints on the correlation between brokered deposits and bank failures in this letter, we are urging the FDIC to reexamine and modify the brokered deposit restrictions to solve the problems we have identified and avoid the harmful consequences of these regulations on community banks**. CBAI is particularly concerned about how the National Rates are being inappropriately calculated for Deposit Rate Caps purposes, and how even "well capitalized" banks are being adversely impacted by the application of the Rate Caps in the analysis of liquidity during safety and soundness examinations.**

General Observations

CBAI highlights the data presented in the ANPR (*History and Research*) which reveal the total of brokered deposits at 9/28/2018 was $985.73 billion. Only 35% of the nation's 4,704 banks under $1 billion in assets [community banks] even had brokered deposits while 90% of banks over $50 billion held these deposits; and the share of total brokered deposits for banks under $1 billion in assets [community banks] was 3.2% compared to 70.2% for banks over $50 billion. Clearly, this information should focus the FDIC's risk management efforts on the largest and most complicated financial institutions, and those institutions with the largest amount of brokered deposits which represent the greatest risk of loss to the DIF – not community banks.

There are two ways a bank can recover from not being "well capitalized" – quickly through a capital injection or by earning its way back over time. From a risk management standpoint, we understand the preference for a bank to quickly return to being "well capitalized" but that is not always possible to accomplish for every community bank. Community banks that are unable to recapitalize quickly should be given a reasonable opportunity to earn their way back to being

"well capitalized", with the support and close supervision of their regulators, and not be subject to significant barriers to their recovery from the Deposit Rate Caps regulations.

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The importance of successfully mitigating the harmful impact of Deposit Rate Caps cannot be overstated. The banking industry is now unfortunately characterized by an increasing concentration of assets in the largest and riskiest banks, an excessive regulatory burden which falls disproportionality hard on community banks, unfair competition from credit unions and Farm Credit System (with the support of their "cheerleader" regulators), and the prospect of new Special Purpose National Banks (fintechs) and other non-bank financial service providers not being subject to the same regulations as community banks. We are losing far too many community banks to consolidation from unnecessary regulatory burden and unfair competition which leaves many consumers and businesses without a community bank at the heart of their community. **CBAI believes the problems with and consequences of the Deposit Rate Caps are aggravating an already significant competitive imbalance against community banks and should be promptly addressed and mitigated by the FDIC.**

Specific Recommendations

<u>Interest Rate Restrictions</u>

The impact of the Deposit Rate Caps on community banks will vary depending on the economy, loan demand and the interest rate environment. The ANPR noted that up until 2009, the National Rates on which the Caps were calculated were linked to U.S. Treasuries and tracked closely with deposit rates. By 2009, certain Treasuries were low compared to deposit rates and the National Rates became artificially low. FDIC rulemaking addressed this problem and redefined the National Rates as simply the rates paid by all insured depository institutions and branches for which data is available. In the aftermath of the financial crisis, with stagnant growth, weak loan demand and interest rates at historic lows, the Rate Caps were an insignificant factor for many years. In the current more positive economic environment, however, with strong growth, loan demand, rising interest rates, and competition for deposits, the impact of the Caps has become severe and is harming community banks.

While there is no requirement in the regulations for the National Rate and Caps to closely follow other sources of funding for a bank, and investment choices for its customers, they logically should not deviate significantly. However, a comparison of the Rate Caps to similar term FHLB

Advances and U.S. Treasuries, from December 2015 and December 2018, reveal that the Caps do deviate significantly from these other funding/investment rates.

	12/2015	12/2018	Difference (bps)
FDIC Deposit Rate Caps			
6 Month	.88	1.09	.21
One Year	.97	1.36	.39
Two Years	1.13	1.56	.43
Five Years	1.56	2.00	.44
FHLB (Chicago) Advances			
6 Month	.69	2.69	2.00
One Year	.98	2.80	1.82
Two Years	1.27	2.73	1.46
Five Years	2.09	2.87	.78
U.S. Treasury Securities			
6 Month	.51	2.56	2.05
One Year	.66	2.63	1.97
Two Years	1.05	2.48	1.43
Five Years	1.73	2.51	.78

This comparative data proves that the Deposit Rate Caps do not reflect either the competitive realities of funding or the investment opportunities that community banks and their customers face on a daily basis. **CBAI believes this disparity prevents community banks from taking advantage of the positive economic environment and will impact their ability to return to being "well capitalized", which is managements' intention and should not be hindered by regulations.**

The FDIC has wisely chosen to modify the method of calculating the National Rates and Rate Caps in the past and should continue to refine the methodology in the future to not harm community bank's ability to attract and retain deposits. An examination of the chart in the ANPR, which tracked deposit Rate Caps using the National Average, Average Rates of the Top Ten Players, and the Rate Caps Calculated Using the 12-Month Treasury Rate, revealed reasonably close tracking of all of these rates over time but, depending on the date, each was the highest, in the middle, or the lowest rate at multiple time over the 10 year period reviewed. **CBAI recommends the logical choice for the average is to select, on a weekly basis going forward, whichever is the highest of National Rates (incorporating the recommendations in this comment letter) or U.S. Treasury Yield Curve Rates for similar maturities.**

The National Rates in calculating the Deposit Rate Caps includes both large and small banks. Because of their asset size and large branch networks the largest banks represent an estimated two-thirds of the rates included in determining the National Rates. As a result, the largest banks have an outsized impact on the calculation. In addition, community banks fund their operations through deposits to a much greater extent than the largest banks, so deposit restrictions are especially harmful to community banks. Also, the largest banks continue to enjoy a too-big-to-fail subsidy which allows them to offer lower deposit interest rates. All of these factors serve to depresses the National Rates and the Rate Caps which negatively impacts community banks. **CBAI recommends that because of the powerful influence of the largest banks and their branch networks, an individual bank should only be counted only once in calculating the National Rates regardless of the number of branch locations in the market**.

Promotional and negotiated deposit rates are more prevalent at community banks and are significantly higher than what is stated on their standard rate sheets. The calculation of National Rates ignores the reality of most community banks' operating environment by not considering these promotional and negotiated rates; and therefore, the resulting Rate Caps do not present a complete and accurate picture of the deposit rate landscape, are not competitive, and negatively impact community banks' ability to obtain new and retain existing deposits. **CBAI recommends promotional and negotiated rates be included in determining the National Rates.**

Credit unions are a large and growing segment of the financial services industry. There is almost an equal number of credit unions as there are banks. The average credit union is actually more similar to a community bank than the largest banks, yet their deposit interest rates are not included in calculating the National Rates. **CBAI recommends incorporating credit union deposit rate data in calculating National Rates which would more completely reflect the competitive reality of community banks' ability to attract and retain deposits.**

During safety and soundness examinations for even "well capitalized" banks, FDIC examiners are using the flawed Deposit Rate Caps as the benchmark in their analysis of bank liquidity. CBAI's objects to this practice on two grounds. First, it is inappropriate to impose a regulatory restriction that is only applicable to non-“well capitalized” banks on “well capitalized” banks. This practice is analogous to the many regulations designed to reign-in the risky behavior of the largest banks being applied to community banks – an improper practice referred to as “trickle-down” regulations. Second, the calculation of the National Rates is flawed for all of the reasons stated in this letter and therefore must result in inaccurate conclusions about a bank’s liquidity position and can perhaps even impact Liquidity its CAMELS rating. **CBAI urges the FDIC not to use the Deposit Rate Caps in the liquidity analysis of “well capitalized” community banks, or in the unfortunate event it continues this practice - to use National Rates that are appropriately calculated.**

CBAI acknowledges the concerns the FDIC has with banks that are not “well capitalized” and the Agency’s desire to control these institutions’ growth and risk to the DIF. However, a bank that is not “well capitalized” is already being closely monitored and more frequently examined both remotely and on-site by the FDIC and will likely be subject to monthly reporting requirements to comply with regulatory agreements. The Agency has ample opportunity and the regulatory tools available to assess the risks and dampen any unreasonable growth by a bank that would demonstrably impact its safety and soundness while still allowing it to attract and retain deposits, grow, earn income and build capital. **CBAI recommends the Deposit Rate Caps regulations be more tailored for community banks to further differentiate between the seriousness of capital problems.**

A community banker, whose bank is subject to the Deposit Rate Caps, recently stated that never in its history had the bank experienced liquidity problems until the regulators began to enforce the Deposit Rate Cap restrictions. **CBAI believes the goal of regulations should be to reasonably support and assist community banks that are recovering from performance issues and allow them to grow and prosper – not artificially cause liquidity problems when none existed before.**

Conclusion

CBAI appreciates the FDIC seeking comments as it comprehensively reviews its brokered deposit and interest rate regulations. The current problems and consequences of determining the National Rates for the Deposit Rate Caps are numerous and are impact capital-challenged community banks’ ability to grow, thrive and return to being “well capitalized”, and are also impacting "well capitalized" bank liquidity during safety and soundness examinations. **CBAI urges the FDIC to reexamine and modify the brokered deposit restrictions to avoid the harmful consequences of this regulation on community banks.**

Thank you for considering our observations and recommendations on this important issue. If you have any questions or require any additional information, please contact me at davids@cbai.com or (847) 909-8341.

Sincerely,

[redacted]

David G. Schroeder
Senior Vice President
Federal Governmental Relations