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

Dear Chairman McWilliams:

Thank you for the opportunity to comment as the FDIC studies how core and brokered deposits should be defined and administered in the future.

We believe that the FDIC's review of brokered deposits is timely because it is important to move away from the broad generalization of brokered deposits that currently exists, especially given that the financial system has evolved materially over the past 30 years. Rapid advances in technology are changing the landscape in every industry, and banking is no exception. The ability of consumers and businesses to use technology to gather information quickly, make choices and act upon them efficiently will only increase in the future. This evolution will impact the manner in which deposits are made as well as the traditional flow of deposits.

In that light, we strongly believe that the mere existence of a third party involved in the process of a customer making a deposit at a bank, in and of itself, regardless of the role and nature of that entity, has generally led to the characterization of the resulting deposit as brokered. We believe that various developments in the industry provide compelling reasons for the FDIC to characterize certain deposits as non-brokered, even when a third party plays a role.

In particular, we believe that the treatment of custodial deposits should be clarified in regulation as non-brokered deposits. Custodial deposits simply reduce the administrative burdens of a depositor opening accounts at multiple banks on their own and reconciling multiple statements each month. The use of a legal custodian by a depositor does not change the nature of the deposit at a depository. Custodial deposits have been, and remain, a very stable source of market cost deposits that are not interest rate sensitive. They are a highly efficient source of deposits for community and regional banks, and should be clarified to be non-brokered deposits.

As we will enumerate, custodial deposits have features that clearly differentiate them from traditional methodologies used to place deposits with banks, many of which should be considered brokered. The primary recommendation of this submission is that the FDIC should clarify that custodial deposits, as it did for reciprocal deposits (which is in fact a type of custodial deposit), should not be classified as brokered deposits.

Our secondary recommendation is that the FDIC consider moving away from the black and white classification of core versus brokered and instead use various key factors to establish the quality of a deposit from high to low. Today, certain deposits that are higher risk are not deemed as such, and are often considered core deposits. Other relatively stable deposits (e.g., ten-year certificates of deposit) that are sourced by a third party are frequently discouraged by regulators despite their long duration and fixed-rate, simply because of the involvement of a third party.

We believe a simple but effective deposit "rating" system would be highly beneficial to the banking system. Deposits that fall into higher numerical categories should be available for placement at well capitalized banks without any additional FDIC costs or charges adhering to them. The fact that a third party places or assists in the placement of the deposits should, in and of itself, not compromise the characterization of certain deposits as high quality.

BACKGROUND INFORMATION

StoneCastle Cash Management, LLC ("StoneCastle"), a wholly owned subsidiary of StoneCastle Partners, LLC, one of the largest investors in community banks during the past two decades, has developed a large network of relationships with community and regional banking institutions located throughout the United States. StoneCastle is an investment adviser registered with the Securities and Exchange Commission and offers cash management services as a fiduciary to its customers and acting as an administrator through its Federally Insured Cash Account ("FICA").

FICA allows institutions and high net worth customers to place a large deposit into interest bearing FDIC insured accounts at multiple banks. With the assistance of technology, FICA eases the significant burdens of accounting for the funds held at each bank. While possible, it would be an arduous task to directly open many accounts at many banks and subsequently expend a great deal of effort to monitor and reconcile each month. The vast majority of depositors won't take that route and continue to leave large deposit at the largest banks, preventing a significant source of liquidity from flowing to community banks because of these burdens.

FICA offers an alternative and depositors choose it as a convenient way to manage those burdens. They can open an account directly with a custodial bank that works with StoneCastle to administer the customer's directions to flows funds to the bank network noted above. Unfortunately, under the current FDIC rules, it is unclear whether such deposits would cause the third party custodian to be considered a deposit broker under existing banking laws, solely because that custodian is involved in the movement of such deposits of to and from insured depository institutions. Consequently, the deposits may be deemed to be brokered rather than core deposits, constraining the number of banks willing to hold such deposits and limiting aggregate deposit size at a time when community banks need more options to broaden their sources of deposits to fund loans in their local markets.

We feel that the current rules that define deposits as core or brokered are too narrowly focused on the mere existence of a third party in the process of a deposit account being opened at a bank, rather than the specific attributes and quality of the deposit. Let me share two examples to illustrate this:

Example A: A Fortune 500 company deposits $40MM at a large bank such as JP Morgan or one of the other largest banks in America. Companies like this often do so simply because it is administratively easy. Only very large banks regularly accept large balance deposits because of (A) their asset size and (B) the fact that the depositor takes comfort from public, investment grade credit ratings of those banks. FDIC rules would classify that $40 million deposit at JPM as "non-brokered". If the same Fortune 500 Company elects to go through the hassle of opening 160 accounts at 160 banks, depositing $250,000 at each, the FDIC would still deem this a set of "non-brokered" deposits. Practically though, it's much easier to make that single deposit at JP Morgan than establish 160 accounts at 160 banks and receive and monitor 160 statements. As a consequence of these impediments, large deposits flow to the largest banks rather than community banks.

However, if the same depositor hires a custodian, such as US Bank or Bank of New York to ease the burden illustrated above by opening a custodial account at each of the 160 banks and depositing $250,000 into 160 different community banks (each a "custodial deposit") on behalf of the depositor, the FDIC may penalize each community bank with a brokered deposit assessment fee and a categorization of "brokered deposits". This would be true despite the fact that these funds have the exact same high quality characteristics as the example cited where the depositor went to each of the 160 banks directly.

This very same $40 million deposit, the full amount classified as non-brokered for JPM, when routed through a custodial account to 160 community banks, will instead be classified as a "brokered deposit", with each community bank holding up to $250,000. This disparate treatment favors the largest banks, while disadvantaging community banks. One of the primary reasons this occurs is because the FDIC has not received guidance from Congress on how to categorize these custodial deposits. In our example, community banks who choose to participate in the FICA network do not pay a fee to a third party, have no special documentation or contracts with the depositor, and do not have to install or run any specialized systems or processes. Each $250,000 deposit is simply a regular deposit at the bank, with the bank paying the depositor the same interest rate it pays to its other customers; a rate that is set by each bank individually.

When such deposit is deemed brokered, it potentially creates four public policy issues:

(1) It harms the potential profitability of these smaller banks;

(2) It increases the rate charged to customers who borrow from community banks;

(3) It limits the amount of custodial deposits each community bank can hold; and

(4) It adds to the concentration of deposits at the largest banks, keeping them out of the community banks where they would be reinvested into their rural and inner-city communities. As you likely are aware, community banks represent 53% of all the small business loans made by banks despite having only 17% of the banks system's assets.

Example B: A Fortune 500 company opens an account and deposits funds in a bank after using a third party asset liability consultant to assist in the corporation's cash management functions. Here, again the deposit may be considered brokered under current rules. However, even if all attributes of the deposit were exactly the same, but the person advising the corporation is an employee rather than a consultant; the deposit would not be considered brokered. In fact, it is unlikely that the bank accepting the deposit would have enough information to determine if the account is brokered or not when it is opened since it won't know if the person acting on behalf of the depositor was a contractor or an employee.

Clearly the mere presence of an asset-liability consultant to the Fortune 500 Corporation does not, in and of itself, change the quality of the deposit in any way. As a result, if that same depositor was to open accounts at two banks, one using a third party, one an employee, the two banks could end up classifying one as brokered the other as core. In analogy, StoneCastle' s role as an asset-liability consultant to its institutional depositors does not change the nature or quality of the deposit made by these institutions, if they decided instead to make the deposits themselves, at each bank, rather than taking advantage of the administrative benefits of a Custodial Deposit.

BROKERED DEPOSITS

In § 337.6 Brokered Deposits, the definition of a Brokered Deposit is "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker." In addition, the definition of Deposit Broker is "(A) Any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions, or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties."

According to the definition, while extreme, if a corporation identified a bank in a region of the country other than its locale, and contracted with a law firm or financial professional to open the account for the bank, that party might be considered a deposit broker and consequently the deposit would be brokered. However, if an employee for the company traveled by air to visit the bank, it would not be considered a brokered deposit. We would submit that the presence of the third party in this situation does not, in and of itself, change the quality of the deposit or the nature of the relationship of the depositor to the bank and that the current framework for categorization of deposits as "brokered" or "core" are not sufficient for banks or the FDIC to determine the quality of the deposit. We would also submit that an important, but not the only factor, should be whether the bank is directly paying a fee to a third party for soliciting deposits.

We are mindful of concerns that have arisen in the past over the use of certain brokered deposits by banks to grow too quickly and might not be stable or to pay higher interest rates to obtain "hot money" deposits. Many banks that failed in the 1980's, 1990's, and in the financial crisis of 2008, relied heavily on higher risk brokered deposits. In response, Congress placed new restrictions on deposits obtained through a third party broker including preventing undercapitalized banks from accepting them. In the ensuing years, the nature of deposits placed with banks with the assistance of a third party has evolved considerably. The sophistication created by enhanced telephonic systems, the internet and mobile banking related networks has redefined the way in which the industry operates.

In the case of FICA, StoneCastle has developed proprietary technology and works with a custodial bank to enable community and regional banks to obtain stable deposits that would normally flow to large money center banks or outside the banking system to money market mutual funds. FICA eliminates the burdens of getting a large deposit, as in our examples above, to community banks and is accomplished with minimal administrative burden. The deposits earn interest at the same rate that the participating bank pays to its other deposit customers with no fees paid by the bank.

The advancements that StoneCastle utilizes in the FICA custodial deposit program, make it possible for large corporate, municipal and high net worth depositors to place certain of their core savings deposits in community banks, CDFIs and MDIs and helps to redistribute deposits away from money center banks, money market funds and United State Treasury securities back into community banks to promote lending in their local communities. These communities often comprise rural or inner cities and serve small business owners and borrowers in the agricultural industry. We would submit, after discussions with various state and federal banking regulators over the past 10 years, that custodial deposits do not give rise to the concerns of high risk brokered deposits.

CUSTODIAL DEPOSITS

StoneCastle developed its FICA custodial deposit program after numerous meetings and consultations with banking industry professionals, federal and state banking regulators and corporate depositors in order to deliver a program consistent with the needs and concerns of each of these constituencies. Unlike other deposit programs, depositors affirmatively choose to place their money with a FICA custodian bank. Each depositor signs an account opening agreement with the custodian bank, the same as they would do for any other traditional bank account. The custodian bank serves as an agent, administrator and fiduciary for the depositors' funds. Pursuant to directions from StoneCastle, as the depositors' asset/liability consultant, the custodian places the funds in up to hundreds of insured community and regional bank institutions, in increments of less than $250,000, so that the depositors' funds are fully FDIC insured. We refer to this deposit, divided into smaller FDIC insured amounts, held at multiple banks, as a "Custodial Deposit".

The funds are deposited by the custodian, in participating well capitalized community and regional banks. StoneCastle performs extensive due diligence on each prospective FICA Program bank before asking a bank if it wishes to participate in the FICA network. If a bank permits the custodian to open a deposit account, a standard money market or savings account is opened and the interest rate is set by the bank at a rate paid to other depositors at that bank. Depositors are not permitted to shop for rates among the banks but rather accept the rates paid by each bank individually. With over 850 banks in all 50 states in the network, a depositor will receive interest from each bank that will mathematically average rates across the banks in which their deposits are held.

As noted earlier, there are no fees, no contracts, no special processes, no technology or ongoing human resource involvement required by a bank and virtually no ongoing service requirements. Thus, FICA deposits are originated at a highly cost efficient basis and can be maintained at lower costs than other deposits. This can result in higher profits for the bank or lower loan costs for borrowers.

Because each bank sets its own limit for the amount of deposits it will receive and can change the rate or amount as warranted, it can utilize custodial deposits as part of its broader asset/liability management and contingent funding strategies. It also grants smaller banks access to funds from large institutional depositors, funds that ordinarily land at the nation's largest banks.

These deposits are not, in any way, similar to the "hot money" deposits we will discuss further below that have been synonymous with certain brokered deposit programs. Here, the banks are not hiring anyone to source deposits. Rather, custodial deposits are customer driven for convenience sake. Further, they are traditional overnight deposits, akin to traditional checking or

savings account deposits with no fixed maturity. These characteristics, among others, distinguish Custodial Deposits from those "hot money" programs which the FDIC should continue to take appropriate steps to identify and discourage.

The fact that the stable, overnight and market rate deposits brought in through Custodial Deposits would ordinarily flow to larger banks and can instead be deployed by smaller banks into their communities, should be a positive industry factor considered by the FDIC in assessing these deposits.

STABILITY

An important point to consider related to custodial deposits is increased stability compared with a single large corporate or municipal deposit at a bank. Because a $10 million custodial deposit is typically comprised of hundreds, thousands, or tens of thousands of underlying depositors, the withdrawal of any single depositor will only result in, at most, $250,000 being withdrawn from any given bank. By contrast, a single $10 million deposit at a bank from a corporate or municipal depositor, even using reciprocal deposits, would result in a large $10 million withdrawal if that single depositor decides or is required to withdraw the funds for other uses.

Stable funds are essential to a bank's ability to manage its balance sheet and deploy its resources most efficiently and the FDIC should consider the stability of deposits placed with banks with the assistance of third parties as a factor in determining how to classify deposits and whether such deposits should warrant additional financial costs or regulatory scrutiny for banks. Custodial Deposits provide banks with deposits that are relatively stable because of the nature of the customers, the source of the cash from those entities and the screening, monitoring and product features of them.

Depositors in custodial deposit programs do not typically deposit their day to day operating cash, which is subject to more variability due to day to day payroll and accounts payable needs. In our experience, custodial deposits come from core cash reserves, which represent the customer's longer term liquidity position and are only occasionally needed for expenditures. In fact, deposits are monitored daily to ensure that no individual customer is using the program as a more transitory account.

Custodial Deposit programs are structured in a manner that it is attractive to customers who seek safety and to place those core reserves and hold those over a long term but have them available when needed. Many of these depositors are institutions which, under law or internal policy, are limited in the types of deposits or investments they can make, and fully insured bank deposits are permissible and desirable. The alternative would be to ask a bank to collateralize a deposit with Treasury securities, a costly practice.

Another factor is assessing the stability of deposits is how withdrawals are handled which are currently limited to next day in custodial deposit programs like FICA. Depositors who choose to open a Custodial Deposit account are informed of the limited nature of withdrawals and participate in the program with the intent of keeping their funds on deposit for a longer term period, although balances may increase or decrease slightly over time, similar to balances from traditional retail and savings accounts.

Adding to the stability of the funds, cash is allocated among hundreds of banks. Therefore, the impact of any customer withdrawal on any single bank is mitigated as the withdrawal will never be funded from a single depository institution. Conversely, other programs may aggregate deposits across the fewest number of banks and have larger balances at any given bank (but in all cases, less than $250,000). Reciprocal Deposits, now classified as non brokered, expose banks to greater liquidity risk, as a $10 million deposit may not be renewed and could cause a $10 million liquidity shortfall. The same $10,000,000 in a custodial deposit will not affect a single bank by more than $250,000, reducing concentration risk to a single bank.

INTEREST RATES

One of the causes of volatility in bank deposits is rate shopping by depositors. Such rate shopping is available through various services and is as simple as a click on a virtual box to open, close or move deposits from bank to bank.

Banks who accept deposits through sources such as listing services which advertise and compete on interest rates over the internet will experience much more volatility since history shows that such depositors are likely to move their funds for a higher interest rate. Ironically this method of deposit taking, when paired with fixed rate advertising fees, is considered non-brokered under current FDIC listing service regulations, even though the deposits can be quite price sensitive and volatile. In the case where a bank posts its certificate of deposit rates on the internet, via a portal, and a customer deposits funds directly, these deposits are considered core simply because there is no third party assistance. Yet, a substantial percentage of those customers will move those funds to another bank once the certificate of deposit matures and they find a higher interest rate.

In a custodial deposit relationship, the depositor is not seeking the best rate of interest or a specific term for its deposit. The primary appeal of Custodial Deposits to customers is the safety of their funds and the benefit of a single bank account statement through the custodian bank on a large amount of insured deposits.

While interest rates are a consideration in approaching banks and in allocating customers' deposits, it is not the dispositive factor. In the case of any Custodial Deposit, the custodian accepts, on behalf of our customers, whatever rate a bank is offering to its other deposit customers. Neither StoneCastle, nor any custodian, negotiates or contractually binds a bank to a particular rate or rate formula. Customers are interested in the safety of their deposits first and understand that their rate will be "on market", but may not be equivalent to what they could obtain if they chose to selectively open individual accounts with high rate paying banks across the country. StoneCastle makes no guarantee to customers when they open an account, or at any time, as to what interest rate they will earn from any bank. Further, a depositor's funds are not withdrawn or reallocated from a bank if it lowers its interest rates after funds are allocated to that bank. Customers can not select the banks into which their funds are deposited (they are permitted to exclude certain banks for FDIC insurance reasons, which is typically done when a customer already has funds in a given bank and its FDIC insurance may be compromised if more money is deposited at such bank.)

Custodial Deposits provide no mechanism for rate shopping by depositors, nor does it induce any given bank to pay higher rates of interest on deposits. Thus, the deposits placed with banks under our program are not subject to the volatility associated with interest rate shopping as the funds are distributed across the entire network, unless otherwise constrained by any rule, law, or investor risk. With custodial deposits programs, the deposit customer expects to achieve the average interest rate across more than 850 banks, further supporting the stable nature of the custodial deposits for participating community banks.

OTHER ADVANTAGES OF CUSTODIAL DEPOSITS

One factor that has long been used in determining whether a deposit is core is whether the depositor is located in the same community as the bank and could have other relationships with the bank. While participants in Custodial Deposit programs may not be headquartered in the communities in which their funds are deposited, FICA deposits are often sourced from corporations, municipal entities, endowments and other institutional investors that have a presence in those communities.

Absent a custodial deposit program such as FICA, these depositors will often seek to deposit funds in the largest banks, due to the administrative ease of opening a single account. The banks that currently participate in most custodial deposit programs are smaller community and regional banks rather than large money center banks. These smaller banks represent approximately 98% of the number of banks in the United States but hold only 17% of the banking system's deposits.

The funds that these smaller banks receive through a custodial deposit program can supplement their balance sheets and allow them to help to meet the needs of their local customers, diversify their sources of funding and replace more volatile or expensive liabilities, such as FHLB advances or wholesale funding. Since all the deposits are fully insured they are more stable, unlike larger uninsured deposits which are first to flee in times of crisis. Therefore, Custodial Deposits can be critically important in times of ongoing economic growth or stress and, in our view, this should outweigh the fact that FICA Account depositors may or may not develop deeper relationships with these banks. Custodial deposits can also replace amounts that banks may lose to other non-bank vehicles such as money market accounts or mutual funds. Further, we note that, currently, deposits banks obtain, through "rate boards" or "listing services" that advertise to depositors directly on the internet funds that are considered core and yet those depositors are highly unlikely to develop other relationships with the depository bank.

Another advantage of Custodial Deposit programs is that they do not impose additional compliance or expense burdens on participating banks. The accounts are opened using the bank's regular account opening documents. The custodian is responsible for compliance with the Bank Secrecy Act and all anti-money laundering requirements, so the community bank does not have additional compliance burdens as a result of participating in FICA. The cost of acquiring and administering the accounts is minimal relative to other accounts. Since FICA depositors do not have access to these deposits via checking accounts or other easy access mechanisms, no individual client support and its expense is required of the community bank.

Last, under custodial deposit programs like FICA, amounts deposited in any single participating bank are limited to a small percentage of the bank's total deposits, usually under 3% but in no case over 10%. Therefore, even if a single custodial deposit program were to receive an unusually high amount of withdrawal requests in any given period, no participating bank would experience a significant decrease in their deposits, as the withdrawals would be made from a majority or all of the depository banks to satisfy each withdrawal requests.

CLASSIFYING DEPOSITS BY QUALITY

In our view, deposits should not be considered inherently brokered simply because a third party is involved with the bank deposit process. Brokered deposits constituted only about 18% of the deposits held in banks that have failed since 2004.

What should be evaluated is the nature of the brokered deposits and how banks utilize them, primarily related to uncontrolled loan growth. For example, if a local economy is growing at 5%, and a local bank is growing its loan book at 20%, one has to consider how this bank is outpacing the growth of its market. Typically, and historically, these fast growing banks tend to either (i) underprice loans to take them from other banks, or (ii) bend on credit standards and extend loans to speculative borrowers. Both result in financial stress and can create an unsafe and unsound financial institution.

For example, if a significant percentage of a bank's brokered time deposits have terms that expire simultaneously, there may not be replacement deposits readily available to the bank at expiration. This creates more volatility than a deposit opened under a Custodial Deposit program where the funds are actually sent to hundreds of community banks to spread the risk across the banking system, rather than a single bank in concentration. Conversely, if a bank properly manages its maturity ladders for its time deposits, the refinancing risk on liquidity will be significantly lower and the bank should pay a lower assessment for the reduced risk to the Deposit Insurance Fund.

We believe that concerns the FDIC may have about the role of brokered deposits in a bank failure could be mitigated by regulatory supervision of the manner in which a bank uses its brokered deposits, rather than by an absolute limit on such deposits. In our opinion, the majority of bank failures can be avoided by limiting loan growth rates above 20% per annum and by carefully monitoring banks that materially deviate from the composition of loans by loan category that the bank historically extended; this is known as "chasing yield" or "strategy drift."

Bank examiners should evaluate, among other factors, the pace of growth of brokered deposits by a bank, the related pace and types of lending, the concentration of such deposits on a bank's balance sheet and the timing of the maturity of such deposits. Another important factor should be an analysis of how such funds are deployed by the bank in its local community.

Custodial Deposits level the playing field between community banks and larger money center banks by allowing a custodian bank to break down large corporate, municipal and not for profit institutional deposits and distribute them to these smaller banks. Smaller banks rarely have an opportunity to solicit deposits from large reputable depositors because of their size. We believe that a custodial deposit program such as FICA provides an invaluable service by reallocating funds from larger banks and uninsured money market funds back to banks in smaller communities throughout the United States.

As we suggested in our opening comments, the difficulty with the current brokered deposit rules for banks is that it does not always draw the correct distinction between a higher quality deposit (one with longer duration and lower volatility of balance for a bank) and a lower quality deposit (one with shorter duration and higher volatility of balance for a bank). Therefore, our secondary recommendation is that as part of this timely review of brokered deposits, the FDIC move away from the broad generalization of brokered deposits that currently exists and move toward a more specific categorization that centers on the quality of deposits.

Given the evolution of the banking market it is wise for the FDIC to re-examine the definition of brokered deposits. As we have shown, using current rules, certain deposits that are higher risk are not deemed as such, and are considered core deposits. Other relatively stable deposits (e.g., custodial deposits like FICA or ten-year certificates of deposit) that are sourced by a third party are frequently discouraged by regulators despite their stability or fixed-rate because a third party is involved.

We recommend that the FDIC create more precise tools and a simple form of rating system to determine what is high quality and low quality of deposits in order to identify and differentiate abusive high risk practices from the mere presence of a third party in some way involved with a deposit and move away from the current definitions of core and brokered.

CONCLUSION

We recommend that the FDIC clarify that Custodial Deposits, like Reciprocal Deposits, should not be classified as brokered deposits. The fact that a third party custodian assists the depositor in making the deposit process to multiple banks more efficient, should not, in and of itself, compromise the characterization of such deposits as non-brokered and of high quality.

We also recommend that the FDIC consider ending the use of the terms “core” and “brokered” as the only means to define the quality of deposit liabilities of FDIC insured banks. Instead, the FDIC should adopt a system whereby a number of factors are analyzed to determine whether a deposit is of high or low quality.

Such factors should include those enumerated in this letter including deposit stability, cost of deposits to the banks and the benefits to the bank and the bank’s community of accepting the deposits versus other alternatives. Deposits that fall into higher numerical categories should be available for placement at well capitalized banks without any additional FDIC costs or charges adhering to them, today classified as “brokered deposits”.

We hope this letter is helpful to the FDIC as it completes its review. We appreciate the opportunity to be a part of that process.

Sincerely,

Joshua S. Siegel
Managing Principal
StoneCastle Cash Management, LLC