StateFarmBank®

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

Re: Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions

Via: http://www.fdic.gov/regulations/laws/federal/

State Farm Bank ("SFB") greatly appreciates the Federal Deposit Insurance Corporation's (the "FDIC") request for comments on all aspects of its regulatory approach to brokered deposits, in particular whether there are types of deposits that are currently considered brokered that should not be considered brokered.

This review provides an excellent opportunity to correct a costly and unwarranted reversal in FDIC policy in the immediate aftermath of the 2008 financial crisis. Specifically, the FDIC reversed its policy related to deposits marketed through non-employee, but exclusive agents of an insurance company engaged primarily in the sale of insurance products, where 1) the bank is an affiliate of the insurance company; and 2) the agents market exclusively to such insurer's bank affiliate. It is SFB's contention that agents in the circumstances described below satisfy the "primary purpose" exception to the statutory definition of "deposit broker" as that term is properly construed in context. Consequently, deposits facilitated by such agents should be treated as core deposits rather than brokered deposits.

1. Background

A. State Farm Bank and Its Use of the Agents

SFB and its use of State Farm agents is representative of the circumstances where the "primary purpose" exception should apply.

Since its establishment in 1999, SFB has provided deposit and loan services to its customers as authorized by Section 5(b)(I) and (c) of the Homeowners' Loan Act ("HOLA")[1]. Additionally, SFB offers a variety of deposit and loan products and services ") on a nationwide basis.

[1] See 12 U.S.C. § 1464(b)(I), (c), and 12 C.F.R. § 160.30

SFB's parent, State Farm Mutual Insurance Automobile Insurance Company ("State Farm"), headquartered in Bloomington, Illinois, is the largest insurer of automobiles and homes in the United States. State Farm and its affiliates comprise 11 property and casualty insurance companies, two life insurance companies and several noninsurance entities, including SFB. Although State Farm is a multiple-line insurance provider, its primary business focus is personal lines of insurance, and the vast majority of its customers are individuals and families meeting their needs for auto, home, and life insurance.

State Farm has approximately 60,000 employees. However, with respect to marketing of its products and services, State Farm relies almost entirely on agents who, with the exception of those undergoing training, are independent contractors ("State Farm Agent(s)"). State Farm Agents are bound by written agreement, with limited exceptions, to market State Farm products and services exclusively, including SFB.

SFB provides both State Farm and State Farm Agents with an opportunity to better meet customer needs and expectations. SFB does not maintain any branches or offices, but rather operates primarily as a virtual bank. SFB markets through the State Farm Agents, building on the extensive, long-term, and stable relationships between the State Farm Agents and State Farm's millions of insurance policyholders. In addition to agreeing to act exclusively on behalf of SFB, State Farm Agents must undergo extensive training that has been reviewed by the Office of the Controller (OCC) to market SFB products and services.[2] In order to complete this training successfully, the State Farm Agents must become fully familiar with SFB products and services and the laws and regulations applicable to all aspects of marketing those products and services.

State Farm Agents provide information to customers regarding SFB products and services by displaying product and service information and brochures in their offices, mailing marketing materials to State Farm customers and potential customers, and apprising customers and potential customers of the availability of SFB's products and services. With respect to deposit products in particular, the State Farm Agents perform ministerial functions to assist customers in completing applications for SFB's such products and transmitting the completed applications to SFB. Alternatively, an agent may refer customers to a Bank representative who will assist the customer in obtaining one or more deposit products or services. State Farm Agents do not accept any cash deposits or make any withdrawals on behalf of the customer.

Although State Farm Agents are independent contractors, all of the banking-related activities they conduct are subject to OCC regulation, examination, supervisory and enforcement authority - just as though those activities were being conducted by SFB (or its employees) itself. Indeed, under the Examination Parity and Year 2000 Readiness for Financial Institutions Act (the "Exam Parity Act"),[3] the OCC has explicit regulatory and examination authority over independent

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[2] Pursuant to the 2010 Dodd-Frank Act (Public Law 111–203) the Office of Thrift Supervision (OTS), which regulated federal saving banks, was abolished. All OTS powers and authorities over savings banks were transferred to the OCC. For purposes of this comment letter, except for specific OTS actions such as an interpretive letters, the successor agency OCC is referenced

[3] Pub. L. No. 105-164, 112 Stat. 32 (1998) (codified at 12 U.S.C. § 1464(d)(7)).

contractors in their performance of services on behalf of a federal savings association "to the same extent as if such services were being performed by [the federal savings association] on its own premises."[4] Moreover, the OCC also has direct examination and enforcement authority over these types of agents as "institution-affiliated parties."[5] In effect, the OCC deems agents in these circumstances to be the functional equivalent of operating subsidiaries of a bank - i.e., they function much like divisions or departments of the bank.[6] Similarly, when soliciting deposits, State Farm Agents perform marketing activities in essentially the same manner as would employees within a department or division of a bank.

B. Regulation of "Deposit Brokers" and "Brokered Deposits"

The Federal Deposit Insurance Act ("FDIA"), as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") and the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), imposes certain limitations on the acceptance of "brokered deposits" by insured depository institutions.

Specifically, as codified at 12 U.S.C. § 1831f ("Section 1831f"), the statute prohibits any insured depository institution that is not well capitalized from accepting funds through a "deposit broker," unless, in the case of an "adequately capitalized" institution, the institution obtains a waiver of the prohibition from the FDIC.[7] Insured federal savings associations ("thrifts") that accept brokered deposits must report those deposits in their Thrift Financial Reports ("TFRs"). Section 1831f defines the term "deposit broker" to include, in pertinent part:

> 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

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[4] Id. § 1464(d)(7)(D)(i).

[5] See 12 U.S.C. § 1464(d)(l)(A) and 12 U.S.C. § 1818.

[6] In an OTS opinion letter to SFB in 2004 (the "OTS 2004 Opinion"). The OTS stated:

> [T]he [Bank] controls and reviews the activities the Agents perform on behalf of the Association, and no other entity exercises effective operating control over the Agents' activities on behalf of the [Bank]. Where an association exercises sufficient control over an agent's performance of authorized banking activities, the agent, like an operating subsidiary of a federal savings association, will be subject to OTS regulation and supervision,... just as [such regulation and supervision] would apply to an operating subsidiary. See OTS Legal Op. P-2004-7, 2004 WL 3272094 (O.T.S. Oct. 25, 2004), available at https://www.occ.treas.gov/static/ots/legal-opinions/ots-lo-10-25-2004.pdf

That letter also noted the "OTS 's long-held view that because an operating subsidiary may only engage in activities permissible for its parent federal savings association and must be controlled and majority owned by the association, an operating subsidiary is the equivalent of a department or division of the parent federal savings association for regulatory and reporting purposes"); State Farm Bank, FSB v. Reardon, 539 F.3d 336, 346-47 & n.6 (6th Cir. 2008); State Farm Bank, F.S.B. v. Burke,445 F. Supp. 2d 207, 2 I 8-19 (D. Conn. 2006); State Farm Bank. F.S.B. v. District of Columbia, Civ. Action No. 05-611 (EGS), 640 F. Supp. 2d 17 (D.D.C. July 28, 2009).

[7] 12 U.S.C. § 1831f(a), (c).

of selling interests in those deposits to third parties.[8]

Section 1831f expressly *excludes* from the definition of "deposit broker," however, certain entities and individuals, including, *inter alia*:

- an employee of an insured depository institution, with respect to funds placed with the employing depository institution; ... [and]
- an agent or nominee whose primary purpose is not the placement of funds with depository institutions.[9]

II. Analysis

A. Insurance Agents with Exclusive Arrangements with a Bank are Not Deposit Brokers under the Primary Purpose Exception (Section 1831f)

In accordance with the exceptions outlined above, certain agents are not properly characterized as "deposit brokers" because they are "agent[s] whose primary purpose is not the placement of funds with depository institutions." 12 U.S.C. § 1831f (g)(2)(I); 12 C.F.R. § 337.6(a)(5)(ii)(I).[10] More specifically, it is our belief that where the primary purpose of agents is to market insurance products for an insurance company, and such agents' performance of marketing activities for a bank are largely an ancillary—or even negligible part of their business in selling insurance products and services.in terms of time, expense, and investment, devoted to marketing insurance products, the mere additional placement of funds with an affiliated bank is not the primary purpose of such agents..

We are well aware that the FDIC has, in certain of its interpretive letters, advanced and maintained the position that "primary purpose" means "primary intent," as opposed to "primary activity."[11] Under this interpretation, the agency has, in identifying an entity as a "deposit broker," deemed irrelevant the primary functions of the entity and the primary reasons for its existence, focusing solely on whether the entity has some intent to place funds with a depository

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[8] 12 U.S.C. § 183lt(g)(l). See also 12 C.F.R. § 337.6(a)(5)(i) (same).

[9] 12 U.S.C. § 1831f(g)(2). See also 12 C.F.R. § 337.6(a)(5)(ii) (same). At the same time, the statute also provides that, notwithstanding the first two of these exclusions, a ·'deposit broker" includes any insured depository institution that solicits deposits by offering rates of interest that are "significantly higher than the prevailing rates of interest in the institution's normal market area." 12 U.S.C. § 1831f(g)(3). The FDIC has interpreted "significantly higher" interest rates to mean more than 75 basis points over the prevailing rates offered by other insured depository institutions having the same type of charter in such depository institution's normal market area.

[10] Although, as noted, the Agents are functionally similar to employees of SFB in their performance of activities for SFB, they are not "employees" as that term is specially defined in Section 1831f(g) because, inter alia, their compensation is not "primarily in the form of a salary" and their office space is used for their insurance marketing activities for State Farm, not only for the benefit of SFB. 12 U.S.C. § 1831f(g)(2)(4).

[11] See, e.g., FDIC Interp. Ltr. 05-02, 2005 WL 1276372, at *l (Feb. 3, 2005); FDIC lnterp. Ltr. 90-21, 1990 WL 711344, at *1 (May 29, 1990).

institution. This has led the FDIC to an extremely narrow application of the "agent or nominee" exclusion, deeming it applicable only to an agent or nominee who places funds into a depository institution for a substantial purpose other than to obtain deposit insurance coverage for a customer or to provide the customer with a deposit-placement service."[12]

In reviewing the FDIC's stated reasoning for adopting this narrow interpretation, it is purported to be grounded in statutory interpretation. The agency has stated:

> Only by defining "primary purpose" in terms of intent can one construe the ... "agent or nominee" exclusion of 12 U.S.C. § 1831 f(g)(2)(1) ... in keeping with the previous exclusions (C) through (H). All of these previous exclusions omit from the category of deposit broker those who act in a fiduciary capacity, primarily intending the financial betterment of some trust, pension plan or employee benefit plan, and thus those who are without the primary purpose (intent) of placing funds with insured depository institutions. 12 U.S.C.A. § 337.6(a)(2)(B)(ii)(C) through (H).[13]

We understand that the exclusions set forth in paragraphs (C) through (H) of 12 U.S.C. § 1831f(g)(2) pertain to persons or entities that act in a fiduciary capacity, but we do not believe that the commonality among those other exclusions - only two of which use the term "primary purpose" - indicates that "primary purpose" means "primary intent" in the narrow sense suggested by the FDIC.[14] Rather, we believe that the text of 12 U.S.C. § 1831f(g)(2) indicates a much broader scope of the '"agent or nominee" exclusion.

Specifically, the two other exclusions that use the term "primary purpose" paragraphs (C) and (G) of 12 U .S.C. § 1831f(g)(2), are limited to entities or relationships that have "*not been established* for the primary purpose of placing funds with insured depository institutions."[15] The "purpose" or "intent" the statute refers to in the "deposit broker" context, therefore, does not appear to be the *intent of an entity* in placing particular funds in an insured depository institution, but rather the intent behind, or purpose of, establishing the entity and its relationship to the source of deposited funds. Accordingly, in our view, the text of 12 U.S.C. § 1831f(g)(2) plainly indicates that an agent whose business and customer relationships were not established for the primary purpose of placing funds with depository institutions is expressly excluded from the

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[12] FDIC Interp. Ltr. 05-02, 2005 WL 1276372, at *1.
[13] FDIC Interp. Ltr. 90-21, 1990 WL 711344, at *1
[14] Paragraphs (C) through (H) of 12 U.S.C. § 1831f(g)(2) exclude the following entities from the definition of "deposit broker": "(C) a trust department of an insured depository institution, if the trust in question has not been established for the primary purpose of placing funds with insured depository institutions; (D) the trustee of a pension or other employee benefit plan, with respect to funds of the plan; (E) a person acting as a plan administrator or an investment adviser in connection with a pension plan or other employee benefit plan provided that that person is performing managerial functions with respect to the plan; (F) the trustee of a testamentary account; (G) the trustee of an irrevocable trust (other than one described in paragraph (1)(B)), as long as the trust in question has not been established for the primary purpose of placing funds with insured depository institutions; [and] (H) a trustee or custodian of a pension or profit sharing plan qualified under section 40l(d) or 403(a) of Title 26."
[15] 12 U.S.C. § 183lf(g)(2)(C), (G) (emphasis added).

definition of "deposit broker." With respect to the agents in circumstances similar to those of SFB, who assist in the marketing of insurance products and services (not bank products or services), and whose customer relationships are established for the primary purposes of marketing those insurance products and services, the exclusion readily applies.

Beyond the statutory text itself, FIRREA's legislative history also does not appear to support the more narrow interpretation of 12 U.S.C. § 1831f(g)(2)(I) put forth by the FDIC. The FDIC has stated that "the definitions of brokered deposits and deposit broker in FIRREA are broad and far-reaching, and a glance through the legislative history on this subject shows that Congress intended them to be this way."[16] However, the FDIC has pointed to no specific statements in the legislative history that would suggest Congress meant to limit the "agent or nominee" exclusion to only those agents who place funds into a depository institution "for a substantial purpose other than to obtain deposit insurance coverage for a customer or to provide the customer with a deposit-placement service."[17] Indeed, we find nothing in FIRREA's legislative history that specifically discusses the "agent or nominee" exclusion.

What the legislative history of FIRREA does state about brokered deposits reveals why Congress found them troubling and meriting special regulation. As stated in the Congressional Conference Report on FIRREA:

> Failed institutions have a number of similar traits including inadequate board of director supervision; poor internal controls; poor underwriting and loan administration standards; and a reliance on brokered deposits or other highly volatile sources of funds. These problems are the result of poor management....
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> Many failed thrifts relied on volatile funding, such as brokered deposits controlled by a few individuals, which could be quickly withdrawn, paralyzing the institution. At one failed thrift, Jumbo Certificates of Deposit (usually deposits of $100,000 and over) made up 96 percent of total deposits. At another failed thrift, brokered deposits grew from 14% to 86% of all deposits in just one year. Because these funds are generally more expensive to obtain they cut into the interest margin earned on investments. Lower net interest margins encourage managers to take greater risks in order to maintain adequate earnings. Higher risks are all too often translated into higher failures.[18]

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[16] FDIC Interp. Ltr. 90-21, 1990 WL 711344, at *1.

[17] FDIC Interp. Ltr. 05-02, 2005 WL 1276372, at *1.

[18] H.R. Rep. 101-54(I) (1989) at 300, reprinted in 1989 U.S.C.C.A.N. 86, at **96. Congress also identified other factors associated with thrift failures, such as the presence of one dominating individual on the board of directors; poor loan documentation; inadequate credit analysis; and appraisal deficiencies. Id.

These statements identify Congress' principal concerns with respect to brokered deposits, but they do not speak to the definition of "deposit broker." It would appear a most reasonable interpretation of the statute is to conclude that the "agent or nominee" exclusion in 12 U.S.C. § 1831f(g)(2)(1) can and should apply wherever an agent or nominee does not function in relation to customers of a depository institution in a role or relationship that raises the risks typically associated with brokered deposits. For these reasons, we do not believe the FDIC's interpretation of the "agent or nominee" exclusion in 12 U.S.C. § 1831f(g)(2)(1) finds support in the text or legislative history of the statute.

Even assuming the FDIC is correct that the "agent or nominee" exclusion applied only to an agent who "places funds into a depository institution for a substantial purpose other than to obtain deposit insurance coverage for a customer or to provide the customer with a deposit-placement service," agents in circumstances such as those akin to agents of SFB should nevertheless qualify for the exclusion, because they in fact have such a distinct "substantial purpose." Insurance agents market bank products to enhance and solidify their relationships with their insurance customers. Performing banking-related services for insurance customers is an ancillary, but important means for agents to create goodwill and foster ongoing insurance customer relationships.[19] By facilitating customers' access to a bank's products and services, agents can generate good will and create stronger relationships with their insurance customers. Consequently, building customer relationships constitutes a "substantial purpose" for facilitating the placement of funds in a bank other than to obtain deposit insurance coverage for a customer or to provide the customer with a deposit placement service.[20]

B. Reinterpreting the Primary Purpose Exception Illustrated through the Lens of the Assessments Rule

As discussed above, in enacting the "brokered deposits" provision, Congress was primarily concerned with the volatility and higher interest rates generally associated with such deposits.[21] This same concern underlies the provision for special assessments on brokered deposits in the FDIC's Assessments Rule. As the FDIC stated in promulgating the final Assessments Rule:

> The FDIC is adding this new risk measure for a couple of reasons. A number of costly institution failures, including

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[19] Because of their exclusive agreements with State Farm and SFB, the agents are distinguishable from the insurance agents FDIC counsel found, in an interpretive letter issued June 29, 1995, to meet the definition of "deposit broker." See FDIC Interp. Ltr. 95-9 (June 29, 1995), 1995 WL 788897. As described in that letter, the insurance agents worked for a wholesale insurance company that a bank proposed to acquire. To retain the goodwill of the agents, the bank was prepared to offer the insurance agents an arrangement whereby the agents would be compensated for referring their customers to the bank for a variety of products and services, including deposit products. The letter did not suggest; however, that the relationship between the agents and the bank, or the relationship between the agents and the insurance company the bank planned to purchase, was exclusive. Thus, it appeared that--unlike State Farm Agents and SFB--the agents would derive no significant benefit other than fees by referring their customers to the bank. In light of this distinction, as well as the fact that the June 29, 1995 letter did not address the "agent or nominee" exclusion from the definition of "deposit broker," that letter is not instructive with respect to the characterization of deposits in SFB.

[21] *See* H.R. Rep. 101-54(I) (1989) at 300, reprinted in 1989-U.S.C.C.A.N. 86, at. **96.

[21] *See* H.R. Rep. 101-54(I) (1989) at 300, reprinted in 1989-U.S.C.C.A.N. 86, at. **96.

> some recent failures, involved rapid asset growth funded through brokered deposits ....
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> Significant reliance on brokered deposits tends to increase an institution's risk profile, particularly as the institution's financial condition weakens. Insured institutions - particularly weaker ones - typically pay higher rates of interest on brokered deposits. When an institution becomes noticeably weaker or its capital declines, the market or statutory restrictions may limit its ability to attract, renew or roll over these deposits, which can create significant liquidity challenges.[22]

We are unaware of any circumstances where volatility or higher interest rates are characteristics of the deposits of a bank affiliated with an insurance company where the insurer's and bank's exclusive agents, or the bank's relationship to such agents, would suggest that the agents would or could encourage deposit product volatility or higher interest rates. For example, where these exclusive relationships exist, banking referrals to insurance customers can only be made to the affiliated bank, regardless of interest rates paid by the bank or any other factor. This is in sharp contrast to the manner in which typical deposit brokers place deposits. Typical deposit brokers present a wide selection of deposit products from different depository institutions for their customers to choose from and offer their customers the opportunity to compare interest rates offered by different institutions. Deposits placed by such brokers could be volatile and could carry higher interest rates, because the depositors generally use the brokers to obtain the highest rates available, and they tend to move their deposits on the basis of rates. Thus, the concern about the volatility of brokered deposits, which is a principal underpinning of the Assessments Rule is not an issue with respect to the deposits a bank obtains with the assistance of the exclusive Agents, nor would it further the purposes of the underlying provisions of the Rule.

Furthermore, penalizing a bank affiliated with an insurance company for its use of exclusive agents to market its products and services by imposing "brokered deposit" assessments is flatly contrary to the critical federal objectives of expanding credit distribution channels and lowering the cost of credit.[23] Finally, it is of no minor significance that the FDIC abruptly changed its treatment of insurance agent facilitated deposits in the aftermath of the 2008 financial crisis. SFB views this change not only as an excessive reaction to the crisis, but as discussed above, both inconsistent with sound banking policy and governing law. In our situation, SFB commenced operations in March 1999, after a 17-month extensive review by the OTS and the FDIC of its charter and deposit insurance applications. This process included detailed descriptions of the role of State Farm Agents regarding, among other things, the marketing of deposit products and assisting customers in applying for the same.

From its inception until 2009, SFB's deposit accounts were reported and assessed as core deposits. Shortly after the failure of IndyMac Federal Bank, F.S.B., which was deemed to be heavily reliant on traditional brokered deposits, the FDIC took a sharply different approach to

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[22] Assessments Rule Notice, 74 Fed. Reg. at 9541.

[23] See, e.g., 2004 OTS Opinion Letter to State Farm Bank at 10.

these deposits. Although there had been no material changes in the manner in which State Farm Agents marketed and assisted customers in connection with deposit products, the FDIC decided to revisit SFB's use of State Farm Agents in initiating deposit accounts, and treated deposits that were previously deemed core, as brokered. FDIC's own 2011 study on core deposits recognized the stability of deposits obtained through referrals from affiliates engaged in other lines of business, including insurance, and concluded that "referrals from affiliates and their agents also appear to pose fewer of the problems that a deposit can pose compared to brokered deposits in general."[24] However, until this present review, the FDIC has been unwilling to revisit its 2009 reversal.

II. Conclusion.

For the reasons and legal analysis above, we respectfully request that in circumstances where customer deposits are placed with a bank affiliated with an insurance company with the assistance of insurance agents having an exclusive relationship with such insurer and affiliated bank, the FDIC should change its current treatment of such deposits. The agents should not be deemed deposit brokers and the deposits they assist with should be treated as core deposits.

State Farm Bank, F.S.B.

By: [redacted]
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[24] FDIC, Study on Core Deposits and Brokered Deposits at 56-57 (July 8, 2011), available at https://www.fdic.gov/regulations/reform/coredeposit-study.pdf.