BANK POLICY INSTITUTE

May 6, 2019

Via Electronic Mail

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

Re: Brokered Deposits (RIN 3064-AE94)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) advance notice of proposed rulemaking (ANPR)[2] addressing the FDIC's comprehensive review of its regulatory approach to brokered deposits. A fresh look at the brokered deposits framework is important and long overdue because of two major changes the financial services industry has experienced. The first is a revolution in technology, business practices and products since the FDIC's final brokered deposit regulations were issued in 1990[3] and the evolution over time of the FDIC staff's interpretive approach. The second is the expansion in the negative consequences of classification of deposits as brokered to include all banks and not just banks that are less than well capitalized.

Although the FDIC has provided guidance through the issuance of advisory opinions and frequently asked questions, the guidance in many cases does not accommodate market developments and technological advances in the delivery of financial services to customers, and, in certain cases, does not advance Congress' objectives. We believe that there is ample opportunity for the FDIC to clarify and significantly modernize its approach to brokered deposits through rulemaking, and our recommendations suggest a revised framework that would do so in a manner consistent with Congress' purpose in regulating brokered deposits and that promotes safety and soundness.

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[1] The Bank Policy Institute (BPI) is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

[2] 84 Fed. Reg. 2,366 (Feb. 6, 2019).

[3] FDIC, Unsafe and Unsound Banking Practices, Final Rule, 55 Fed. Reg. 39135 (Sep. 25, 1990).

I. Executive Summary.

Interpreting and implementing the language of Section 29 of the Federal Deposit Insurance Act (Section 29) is often complex, as in many cases Section 29 is made archaic by technological and business developments; it is therefore crucial that questions that arise under Section 29 are resolved through the prism of Congressional intent. The legislative intent of Section 29 is clear: to prevent so-called "hot money" from endangering insured depository institutions (IDIs) and the financial system by masking financial difficulties and enabling unsustainable, high-risk asset growth, particularly at banks that were undercapitalized.

Judged against this clear legislative intent, the FDIC's guidance is outdated and overbroad, resulting in the classification (or risk of classification) of a wide range of clearly stable deposits as brokered, even though such deposits have no connection to the gathering of "hot money" deposits at troubled institutions, which was the activity Congress targeted in enacting Section 29. Accordingly, our recommendations are designed to align the FDIC's guidance on brokered deposits with Congress' purpose in enacting Section 29. They allow the FDIC to remove stable deposits from the scope of those classified as brokered, while continuing to regulate classic "hot money" brokered deposits, with a particular focus on innovations in how banks gather deposits that have emerged subsequent to Section 29's adoption. Specifically, we recommend the following:

- The FDIC should not treat dual-hatted, dual and affiliate employees as "deposit brokers."
- The FDIC should revise its treatment of marketing and advertising relationships and referral arrangements to reflect innovations in technology and marketing methods.
- The FDIC should exclude affiliate-generated investment sweep deposits from classification as brokered.
- The FDIC should exclude deposits generated through operating subsidiaries from being classified as brokered.
- The FDIC should reconsider its treatment of deposits associated with prepaid cards.

In addition, the FDIC should address other negative consequences to well capitalized institutions that Congress did not intend to create when it implemented Section 29. Specifically, we recommend the following actions:

- The FDIC should support statutory changes that would treat fully-insured, long-term deposits as core deposits *regardless* of whether the deposits are brokered, and pending such legislation the FDIC should treat these deposits as core deposits for purposes of the FDIC's deposit insurance assessment calculations.
- The FDIC should revise Section 29's interest rate restrictions to reflect the actual market in which banks compete, and should not use interest rates as a proxy for risk in its supervision of IDIs.

II. Background.

Section 29, as implemented by the FDIC's regulations at 12 C.F.R. § 337.6, places restrictions on less than well capitalized IDIs accepting deposits that are obtained through "deposit brokers" and deemed to be "brokered deposits." Section 29 does not directly define the term "brokered deposits," but classifies a deposit as brokered if it has been obtained by or through a deposit broker. The FDIC's regulations likewise define "brokered deposit" as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker." "Deposit broker" is defined in Section 29 and in the FDIC's regulations as "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with [IDIs] or the business of placing deposits with [IDIs] for the purpose of selling interests in those deposits to third parties."[4]

We recognize the FDIC's concern that deposits classified as brokered may have resulted in greater losses for the Deposit Insurance Fund (DIF) than would have been the case if failed banks had not held brokered deposits.[5] We are not aware, however, of any granular analysis that has attempted to distinguish among the wide variety of deposits that are (or might be) classified as "brokered."[6] The types of deposits, as discussed below, that we recommend should not be classified as brokered, are not likely to result in greater losses for the DIF because they are the result of stable relationships between a bank and its depositor, and are not likely to precipitate bank failures or contravene any other Congressional purpose in enacting Section 29.

We believe that the changes we recommend in this letter would not only better align the FDIC rules with the legislative intent underlying Section 29, but would also address the substantial and unnecessary costs imposed on banks and their customers as the result of an excessively broad scope of the definition of "deposit broker," and by extension "brokered deposits." Banks may be deprived of, or restricted in obtaining, valuable sources of liquidity due to the substantial additional costs of a deposit being classified as brokered. These costs may include higher deposit insurance premiums, requirements to maintain higher levels of high-quality liquid assets, higher capital planning costs and general reputational damage. If the FDIC continues its overbroad view of brokered deposits, bank customers will be deprived of the convenience provided by modern deposit-gathering channels, which will constrain banks' lending capacity.

A. Congress' purpose in promulgating Section 29 of the FDIA was to require increased regulatory scrutiny of "hot money" deposits.

Although there is no statutory definition of a "brokered deposit," the legislative history demonstrates that Congress enacted Section 29 in response to the so-called "hot money" that exacerbated the savings and loan crisis of the 1980s, when troubled institutions with deteriorating loan portfolios and "regulators . . . breathing down [their] throat[s]" would buy funds through third-party brokers as their "only chance for survival."[7] Congress noted that during the savings and loan crisis:

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4 12 U.S.C. § 1831f(g)(1); 12 C.F.R. § 337.6(a)(5).

5 The ANPR states that of the 530 banks (excluding Washington Mutual) that failed and were put into receivership during the period 2007 – 2017, 47 (or about nine percent) relied heavily on brokered deposits (primarily DTC-listed master certificates of deposit for most of the banks) and caused losses to the DIF that triggered material loss reviews. 84 Fed. Reg. at 2,369 – 2,370. *See also* 84 Fed. Reg. at 2,388 (providing a statistical analysis of the FDIC's position that the use of brokered deposits results in higher loss rates to the DIF).

6 Such a granular analysis is necessary because the fact that certain brokered deposits may have caused a high degree of loss does not mean that all (or even most) of the types of deposits classified as brokered contributed to that higher level of loss.

7 Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (April 19, 1989).

> There [were] many ways to buy funds, but one way that is very much attributed to the difficulties of the organizations is their ability to go out and buy what they call brokered deposits. [To obtain brokered deposits, brokers will] go out and solicit . . . deposit investors and then go [offer them] to these bank and thrift institutions that have to have deposits to offset the runoff they have had in their core deposits, and these institutions issue certificates of deposit offering a return at a higher-than-market rate [because] they have to have the money.[8]

Senator Murkowski, one of the chief proponents of Section 29, noted that Section 29 was proposed in response to "[u]nsound institutions [that] financed their unrealistic growth by offering above market interest rates on CDs and marketing them nationwide through the use of a broker," and that these institutions used these "deposit proceeds to replace declining core deposits and make risky high yielding investments. As loans go into default, [these] institutions, no longer able to service the interest on the brokered deposits, return once again to the brokered deposit market to obtain liquidity."[9] The Senator also noted that Section 29 was intended to be a "*narrowly drawn* provision that specifically targets the *most flagrant abusers*."[10]

This legislative history demonstrates that Congress' principal concern was troubled institutions' reliance on "hot money" deposit brokers, *i.e.*, those brokers who, for the primary purpose of pecuniary gain based on the volume of deposits placed, actively placed deposits with higher-than-market interest rates on an unsolicited basis, with persons not necessarily having a previous relationship with the banking organization. In other words, these brokers were *engaged in the business of* (1) placing funds, or (2) facilitating the placement of funds. They were not acting to provide customers or potential customers with access to a range of banking and affiliate products, to generate banking relationships, provide access to demand deposit services or generate deposits that have the basic characteristics of core deposits. In the case of brokered deposits, the customer's relationship was with the deposit broker, who was seeking to place the funds at whatever IDI was then offering high interest rates, and not with an IDI selected by the customer.

B. The FDIC's guidance is outdated and results in the classification of far more sources of deposits as brokered than Congress intended.

Over the last nearly three decades, the FDIC has issued a number of advisory opinions, which the FDIC summarized in a series of frequently asked questions issued in 2015 and revised in 2016.[11] The vast majority of the interpretations on which the FAQs are based were issued in the late 1990s and early 2000s—prior to significant advances in business and banking practices and technology. Since the advent of diversified financial services firms, customers often prefer that banks provide a "complete package" of services or a "one-stop shop" experience that includes a number of products and services offered by the IDI and its affiliates, such as not only deposit and loan products, but asset management, broker-dealer services, and insurance products. Because of this transformation, including the development and widespread adoption of online, mobile and digital banking, and the resulting customer

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8 *Id.*

9 Insured Brokered Deposits and Federal Depository Institutions, Hearings before the Subcommittee on General Oversight and Government Investigations of the House Committee on Banking, Housing, and Urban Affairs at 8, Cmte. Print 101-28, 101st Cong., 1st Sess. (May 17, 1989) (remarks of Sen. Murkowski).

10 *Id.* at 10 (emphasis added).

11 FIL-42-2016, Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits (June 30, 2016, revised July 14, 2016) (referred to herein as the "FAQs").

demand for efficient, cost-effective access to banking and financial products and services, in many cases, customers do not open accounts with IDIs in person, but instead do so over the Internet or through other mobile channels.

Notwithstanding Congress' intended objective of Section 29, and the statutory language and legislative history that indicate the definition of "deposit broker" was intended to apply only to those entities *engaged in the business* of either (1) placing funds or (2) facilitating the placement of funds, the FAQs are drafted broadly and arguably capture in the definition of "deposit broker" virtually *any third party*—even an affiliated third party—with almost *any* connection to the depositor in question. For example, the FAQs provide: "When a third party takes *any* actions that connect an [IDI] with depositors or potential depositors, the third party may be 'facilitating the placement of deposits.' Hence, the third party may be a deposit broker."[12]

As a result, the scope of deposits the FDIC has indicated are "brokered" has been significantly expanded beyond what Congress envisioned. Although this overly broad interpretation of the definition of "deposit broker" has long been a concern for banks, in recent years the issue has become increasingly acute. Specifically, because the FDIC's regulations and guidance have not kept pace with technological innovation, market developments and consumer preferences, there is a significant risk that a large amount of deposits that are in fact stable could be classified as brokered simply because technology and business practices have enabled banks to implement more efficient methodologies for sourcing these deposits. These methodologies include some involvement of a third party, but the primary business of the third party is not the placement of deposits and/or its compensation is not tied to the balance of deposits placed or the balance of deposits in a client's account. In most cases, it is the IDI (and not the third party) that maintains a direct banking relationship with the depositor.

The consequence is that banks may forgo potential sources of stable deposit funding in order to avoid increasing the level of deposits they must report as brokered. This results in customers having fewer options for financial services and banks having less lending and earnings capacity. In addition, the lack of clarity has led to confusion and inconsistent treatment in the market regarding whether certain deposits are classified as brokered deposits.

C. An overbroad view of the classification of deposits as brokered results in significant adverse consequences for IDIs and customers.

The FDIC's broad interpretation of what constitutes brokered deposits has significantly expanded consequences for *any* institution that accepts deposits deemed to be brokered, not just those that are less than well capitalized. When Section 29 was enacted, the only real consequence to banks was what Congress intended—that is, to reduce the potential dangers of "hot money" by limiting the ability of less than well capitalized IDIs to accept these deposits and limiting the interest rate the bank could pay on deposits. However, the consequences of accepting brokered deposits are now much broader, and include adverse consequences that are entirely unrelated to the IDI's financial condition. None of these broader consequences is required or even contemplated by Section 29.

First, the amount of an IDI's brokered deposits can increase the IDI's deposit insurance assessment rate. Second, for a banking organization subject to the federal banking agencies' minimum Liquidity Coverage Ratio ("LCR")[13] requirement brokered deposits are automatically assumed to be volatile deposits and require the IDI to

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12 FAQs question B2 (emphasis added).

13 *See* 12 C.F.R. Part 329.

maintain an increased amount of high-quality liquid assets, even if such institutions are well capitalized.[14] Third, accepting brokered deposits requires IDIs to expend additional time and resources on capital and liquidity planning; for example, federal banking agency guidance indicates that IDIs that "rely upon" brokered deposits should incorporate PCA-related downgrade triggers into their contingency funding plans, because an IDI may not be able to renew or roll over existing brokered deposits or continue to accept brokered deposits upon such a downgrade and, consequently, may need to access other sources of funding.[15] Fourth, IDIs necessarily factor liquidity costs into the pricing of product offerings that would result in brokered deposits (*e.g.*, prepaid card products), preventing IDIs from offering competitive pricing compared to non-bank competitors, and thereby reducing the number and variety of products and pricing options available to consumers. Fifth, because of the previously discussed consequences that result from accepting "brokered deposits," an IDI often will choose to forgo stable sources of deposits that the FDIC may classify as brokered, reducing the IDI's lending capacity and earnings.

Although each of these consequences may be appropriate for deposits that are in fact volatile and unstable,[16] an overly inclusive definition of brokered deposits has the effect of penalizing banks for accepting certain deposits that are stable and share other characteristics with traditional "core" deposits. Indeed, because the FDIC's approach has had the effect of limiting a bank's access to stable deposit funding solely because of the manner in

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14 For example, brokered deposits for retail customers or counterparties that are not reciprocal brokered or brokered sweep deposits are assigned a 100 percent outflow rate if they mature within the LCR's 30-day window; reciprocal brokered deposits and brokered sweep deposits are assigned outflow rates of 10 percent, 25 percent and 40 percent depending, in part, on whether the entire amount of the deposit is covered by deposit insurance; but retail deposits that are not brokered deposits are assigned outflow rates of only three percent or 10 percent.

In addition, brokered deposits are assumed to be less stable under the proposed Net Stable Funding Ratio ("NSFR") requirement. Under the NSFR, brokered deposits generally receive lower Available Stable Funding ("ASF") factors than other deposits. For example, retail brokered deposits generally receive an ASF factor of 90 percent, 50 percent or zero percent depending on a number of factors including the remaining maturity of the deposit, while stable retail deposits that are not brokered are assigned an ASF factor of 95 percent regardless of maturity. *See* 81 Fed. Reg. 35,124 (June 1, 2016). Assigning lower ASF factors to brokered deposits would result in banks being required to hold additional stable funding to offset the decrease in the banks' total ASF, notwithstanding that many categories of brokered deposits behave in the same way as stable retail deposits or other types of deposits assigned higher ASF factors than similar brokered deposits.

We note that, under the LCR requirement, brokered sweep deposits are treated as volatile sources of funding even if they are excluded from the definition of "deposit broker" under Section 29 (*e.g.*, because of the primary purpose exception). The proposed NSFR shares definitions with the LCR and thus would similarly apply lower ASF factors to brokered sweep deposits. This treatment of sweep deposits results from a broader philosophy of treating all brokered deposits as risky and volatile sources of funding notwithstanding that, for reasons discussed in this letter, many of these deposits are in fact stable and do not implicate the concerns raised by Congress in enacting Section 29. For these reasons, the FDIC (and other regulators) should also revisit the treatment of brokered sweep deposits under the LCR and proposed NSFR.

15 *See* Interagency Policy Statement on Funding and Liquidity Risk Management (March 17, 2010), at 13, *available at* http://www.federalreserve.gov/boarddocs/srletters/2010/sr1006a1.pdf. This could also have the effect of creating a false alarm, forcing the IDI into remedial actions that are not merely unnecessary but that could precipitate undue marketplace concerns.

16 For example, in the adopting release for the LCR final rule, the banking agencies noted that "brokered deposits are more easily moved from one institution to another, as customers search for higher interest rates" and that "brokered deposits have the potential to exhibit greater volatility than funding from stable retail deposits." (79 Fed. Reg. 61,440, 61,491 (Oct. 10, 2014).)

which a bank's customer first comes into contact with the bank, banks elect not to take advantage of marketing or referral arrangements and other partnership opportunities that would generate a lasting, personal relationship with the depositor and more broadly deepen the customer's relationship with a financial services organization. For example, as discussed in greater detail below, banks may choose not to accept deposits referred by their broker-dealer or other affiliates because of the potential treatment of such deposits as "brokered," notwithstanding that these deposits are referred to the bank as part of a "one-stop," holistic financial services solution that provides greater convenience for consumers and strengthens the relationship between the bank and the depositor.[17] Similarly, banks may be reluctant or unwilling to partner with commercial firms to develop mobile applications or to market deposits through the Internet and other mobile channels, even though these efforts create direct customer relationships between the bank and the depositor and strengthen those relationships by providing better services to, and more convenience for, the bank's customers. Banks' ability to partner with other companies also may be limited. For example, offering consumers a centralized method for viewing balances and effectuating transactions across accounts may cause the deposits in the account to be deemed to be brokered if a third-party partner has continued access to deposit account or other information for purposes unrelated to the deposits (*e.g.*, marketing or data analytics).[18] These inefficiencies are particularly acute in light of innovations in how other financial products, such as loans, are offered and marketed to consumers, resulting in asymmetric customer experiences and a lack of transparency and convenience.

None of the relationships described above involves the true deposit "broker" that Congress was seeking to curtail. And none of these relationships produces the "hot money" that was the focus of Congressional concern.[19]

III. The FDIC should reconsider and modernize its treatment of various third parties that currently are or may be classified as deposit brokers as a result of the FDIC's historic interpretative positions.

The FDIC staff's interpretations of Section 29 have strayed far from Congress' original purpose. As part of its comprehensive review of its brokered deposits regulations, the FDIC should revise the regulations and guidance to accommodate technological developments and modern banking practices, and, more generally, to be consistent with the Congressional purpose underlying Section 29.[20] The FDIC has the flexibility under the existing statute to

17 Even the FDIC has recognized that deposits generated through affiliates are likely to be stable, and do not behave like volatile brokered deposits that the FDIC believes are more likely to leave for higher interest rates or when the bank is under stress. (*See infra* note 33 and accompanying text.)

18 *See, e.g.*, FDIC Advisory Opinion No. 93-30 (noting that a factor in determining if an affinity group is "facilitating" the placement of deposits, and is, therefore, a deposit broker, is whether the group "know[s] which members have made deposits with the [b]ank, . . . [or] keep[s] any records of the amounts, rates or maturities of the deposits"). It is not clear whether the FDIC would deem such continued access to be facilitating the placement of deposits through "active marketing" and, therefore, as resulting in brokered treatment. *See* FAQs question B8 (indicating that "active marketing" results in brokered deposits).

19 To ensure consistency across regulations, the FDIC (and other regulators) should reflect any changes to the FDIC's treatment of brokered deposits in other regulations that reference "brokered deposits."

20 We note that the FDIC has authority to revise its interpretations of Section 29, and will be afforded deference in doing so, as long as it provides a "reasoned analysis" for its revised positions. *See Motor Vehicle Manufacturers Ass'n of the United States v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983). The developments in technology and business practices that have occurred since Congress enacted Section 29 provide the FDIC with sufficient justification to revise its prior interpretations.

revisit its interpretations, and should (1) recognize that the involvement of a third party in placing, or facilitating the placement of, deposits does not cause that party to be a deposit broker where the party is not "engaged in the business" of a deposit broker, and (2) re-evaluate the FDIC's views of the statutory exceptions to the definition of "deposit broker," including the "primary purpose" exception, such that the exceptions are consistent with Congress' intent and thereby available for a broader array of activities of third parties. Unless those exceptions are so interpreted, the restrictions will not be "narrowly drawn."[21]

With respect to the definition of deposit broker, the FDIC states in the ANPR that a deposit broker is a third party who "is in the business of either (1) placing funds, or (2) facilitating the placement of funds . . . of another third party (such as its customers)."[22] We fully endorse this reading of Section 29 and the FDIC's regulatory definition, and believe that the words "engaged in the business of" in the statute and regulation should be given meaning.

In many cases, however, staff Advisory Opinions have seemingly ignored the important statutory concept that a deposit broker is one "engaged in the business" of placing deposits or facilitating the placement of deposits. For example, in a 2017 Advisory Opinion, after quoting the statutory and regulatory definition of "deposit broker," FDIC staff nonetheless stated, "Based on the information provided in your letters, the companies you describe appear to be placing or facilitating the placement of deposits at the Bank and would therefore meet the definition of deposit broker unless covered by one of the statutory or regulatory exceptions," apparently without any consideration of the statutory and regulatory element of the definition of a deposit broker as one "engaged in the business of."[23] Similarly, in a 2016 Advisory Opinion, after quoting the definition of "deposit broker," staff went on to state, "The term 'facilitating the placement of deposits' is interpreted broadly to include actions taken by third parties to connect [IDIs] with potential depositors."[24] This interpretation again appeared to disregard completely the important concept of a deposit broker as one *engaged in the business* of placing deposits or facilitating the placement of deposits.

The FDIC's interpretations have also expansively construed the term "facilitating" to include virtually any action that makes it easier for a customer to make a deposit unless the FDIC has taken a position to the contrary. In a 1992 Advisory Opinion, FDIC staff stated that "[Section 29] covers scenarios where the broker 'facilitates the placement of deposits' . . . . In common usage, the term 'facilitate' means 'to free from difficulty or impediment; to make easy or less difficult.'"[25] This interpretation is inconsistent with the legislative history of Section 29, which demonstrates that Congress intended Section 29 to apply not to those who take any action to make the placement of any deposit easier, but to those who are engaged in the business of facilitating the placement of "hot money" deposits. Literally applied, such an interpretation of Section 29 also leads to absurd results. For example, companies that provide ATMs for lease to banks make it easier for customers to make deposits by providing account access at any hour through the ATM. Similarly, the postal service makes it easier for customers to make deposits by transmitting mail-in deposits. Clearly, such entities are not deposit brokers. "Facilitate" must therefore be read more narrowly than the FDIC set forth in its 1992 Advisory Opinion, *i.e.*, it must be read to mean something other than simply "to make easy or less difficult." Based on the legislative history and rational statutory construction, the term

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21 *See supra* note 10 and accompanying text.

22 84 Fed. Reg. at 2,371.

23 FDIC, Advisory Opinion No. 17-02 (June 19, 2017).

24 FDIC, Advisory Opinion No. 16-01 (May 19, 2016).

25 FDIC, Advisory Opinion No. 92-79 (Nov. 10, 1992).

"engaged in the business of facilitating" is more properly read to refer to acting as something akin to a classic broker of deposits by actively steering clients to IDIs, with which such clients have no previous relationship, to place funds in high-interest-rate accounts, and not simply to taking any action that would make it easier for customers to place, or for banks to raise, deposits.

As a result of the FDIC's interpretations, the definition of "deposit broker" has historically been construed so broadly that any deposit to which any third party has any connection is potentially deemed to be brokered. For the reasons described above, this is inconsistent with both the plain statutory language and with the statute's purpose, and the FDIC should, as it did in describing a deposit broker in the ANPR, view only third parties that are *engaged in the business* of (1) placing or (2) facilitating the placement of deposits as deposit brokers.

In order to assure that the application of Section 29 would be limited "to the most flagrant abusers,"[26] Congress chose to exclude certain persons from the definition of deposit broker, including those persons acting as an agent or nominee and whose primary purpose is not the placement of deposits with IDIs. That is, Congress limited Section 29 to the type of "business" that exacerbated the savings and loan crisis, namely persons whose "primary" purpose was to place (or facilitate the placement of) "hot money" deposits. Notwithstanding the criticality of the primary purpose exception and the breadth and clarity of the statutory language, the FDIC has historically taken such a narrow view of its availability, with no apparent basis, as to render it largely unavailable. Indeed, in the 2015 version of the FAQs, the FDIC went so far as to expressly state this:

> [T]he primary purpose exception applies only infrequently and typically requires a specific request for a determination by the FDIC. On those rare occasions when [the primary purpose exception] may apply, the FDIC may also impose restrictions on the activity involved, routine reporting requirements, and regular monitoring. These conditions may be critical to the primary purpose exception determination.[27]

Although the FDIC revised the FAQs to state instead that "the FDIC considers each request to review and interpret [the primary purpose] exception on a case-by-case basis,"[28] the 2015 version of the FAQs appears to demonstrate an underlying FDIC view that was modified only after industry comment objecting to that original statement of policy as contrary to the statute and the FDIC's regulations.

Unfortunately, the change in wording did not produce any meaningful change in the FDIC's approach. The FAQs provide little guidance on the application of the primary purpose exception. In fact, other than narrow examples relating to prepaid cards used to deliver corporate rebates or funds to beneficiaries of government programs, all other guidance on the primary purpose exception in the FAQs describes circumstances where the exception is <u>not</u> available.[29] The ANPR notes that in determining whether a third party is "engaged in the business of" placing or facilitating the placement of deposits, and therefore within the definition of a deposit broker, staff considers whether the third party receives volume-based fees and whether the fees can be justified as solely compensation for administrative or similar services.[30] In then discussing the availability of the primary purpose

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26 *See supra* note 10 and accompanying text.

27 FIL-2-2015, Guidance on Identifying, Accepting and Reporting Brokered Deposits (Jan. 5, 2015) at question E6.

28 FAQs question E9.

29 *See* FAQs questions E10 through E14.

30 84 Fed. Reg. at 2,371.

exception, the ANPR notes that the staff considers exactly the same factors. Thus, the very factors that make a third party a deposit broker, in the staff's analysis, render the primary purpose exception unavailable, thereby eviscerating the exception. In our view, this is not a reasonable interpretation of the statute. For the reasons we discuss in more detail below, the FDIC's highly restrictive view of the primary purpose exception needs to be revisited.

We discuss below five issues of particular concern for BPI:

- the treatment of dual, dual-hatted and affiliate employees;
- the FDIC's treatment of marketing and advertising relationships and referral arrangements;
- classification of affiliate-generated sweep deposits;
- classification of deposits generated through operating subsidiaries; and
- treatment of deposits associated with prepaid card programs.

A. The FDIC should not treat dual-hatted, dual and affiliate employees as "deposit brokers."

Since the promulgation of Section 29 and much of the FDIC's related guidance, banks have greatly expanded their affiliations with non-bank financial companies, largely as a result of customer preference and convenience. Concomitantly, IDIs have increasingly shifted to the use of dual employees (individuals employed jointly by the IDI and an affiliate of the IDI),[31] dual-hatted employees (individuals employed exclusively by the IDI but who perform services for an affiliate of the IDI)[32] and/or affiliate employees (individuals employed exclusively by an affiliate of the IDI) (as permitted under applicable regulation) and frequently share office space with their affiliates. These arrangements allow IDIs and their affiliates to provide customers with a complete financial services experience as well as enabling those services to be provided in a more personally tailored and cost-efficient manner. For example, an IDI employee who is also licensed with an affiliate broker-dealer may sell securities to clients and recommend deposit products.

None of these three employee arrangements is covered by the basic definition of "deposit broker" in Section 29. Under the plain meaning of Section 29, the definition of "deposit broker" does not encompass deposits that result from customer assistance provided by dual or dual-hatted employees, or deposits referred from an affiliate employee, in connection with those employees' providing access to a full complement of banking and affiliate products, because such employees are not "engaged in the business" of either (1) placing or (2) facilitating the placement of deposits.

The Congressional and regulatory concerns with brokered deposits are inapplicable to the deposit relationships resulting from typical, ordinary-course customer interactions with dual, dual-hatted and affiliate employees. The deposit accounts that result from depositor interactions with such employees are generally due to the IDI's desire to establish a relationship, or to deepen an existing relationship, with the depositor. Indeed, as the FDIC noted in its 2011 Study, "[affiliate] referrals are *ancillary* to the affiliates' legitimate businesses and are usually based upon a relationship between the customer and the affiliate," and "because depositors have a relationship with

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31 *See* FAQs question E3.

32 *See* FAQs question E4.

an affiliate of the bank, these deposits may behave more like deposits where the bank itself has a relationship with the depositor, and thus may be more stable and less likely to leave for higher rates or when the bank is under stress."[33]

In the normal course, dual, dual-hatted and affiliate employees are not engaged in the business of an archetypal deposit broker, and, therefore, are not the "deposit brokers" envisioned by Congress. FDIC regulations could make it clear, however, that any departure from this norm would result in classification of the employee as a deposit broker. Stated differently, the general regulatory rule (or presumption) should follow the normal situation rather than the abnormal situation.

Excluding these arrangements from classification as brokered as a result of the basic definition of "deposit broker" cannot be voided by the fact that the literal language of the "employee" exception in Section 29 would not encompass most of these employment arrangements.[34] There is no indication in the statutory language or legislative history that the employee exception was actually intended to expand the definition of deposit broker by limiting the requirement that a deposit broker must be "engaged in the business" of either placing or facilitating the placement of deposits. Instead, the employee exception should be properly read as an exception that described the standard role of a bank employee at the time Section 29 was enacted.

If an exception were necessary for these types of affiliate employment arrangements (and the employee exception were not available, *i.e.*, because of the narrow definition of "employee"), the FDIC could apply the "primary purpose" exception to deposits placed by dual, dual-hatted and affiliate employees. Under Section 29, the term "deposit broker" does not include "an agent or nominee whose primary purpose is not the placement of funds with depository institutions." To qualify for the primary purpose exception, the person or entity placing deposits must satisfy two criteria: (1) the person or entity must be an "agent" or "nominee," and (2) the person's or entity's primary purpose must not be the placement of funds with depository institutions. Dual, dual-hatted and affiliate employees who place deposits on behalf, and at the instruction, of the customer as part of meeting the customer's broader financial needs, are, therefore, acting as the customer's agent with respect to such deposits.[35]

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33 2011 Study at 56-57 (emphasis added).

34 Section 29 contains an exception from the definition of deposit brokers for employees, but contains a narrow definition of employee, which, because employees of the IDI may not be employed exclusively by the IDI or may frequently share office space with the IDI's affiliates, may often render the employee exception inapplicable to the employee relationships described above. Under Section 29 and the FDIC's regulations, employees of IDIs are not deposit brokers with respect to deposits placed at the employing IDI, if the employee:

- is employed exclusively by the IDI;
- receives compensation that is primarily in the form of a salary;
- does not share his or her compensation with a deposit broker; and
- has a specific place of business that is used exclusively for the benefit of the IDI.

35 In some cases, such as in the case of an employee of an affiliate broker-dealer, there may be a formal agreement that explicitly sets forth an agency relationship.

In interpreting the "primary purpose" element of the exception, the FDIC has historically considered a number of factors. The FDIC has considered the structure of fees paid to the entity placing deposits, *i.e.*, whether fees are based (directly or indirectly) on the amount of deposits or the number of deposit accounts opened, and whether there is a formal or contractual agreement between the IDI and an entity to place or steer deposits to the IDI.[36] The ANPR notes that the FDIC has not considered the overall business purpose of the agent or the amount of revenue that the deposit placement activity generates, but instead has interpreted primary purpose to refer to the "primary intent" of the agent in placing the deposit, *i.e.*, whether the third party is placing a deposit for a substantial purpose other than to obtain deposit insurance coverage for a customer or provide a deposit-placement service to a customer.[37] In our view, this interpretation of the exception is overly narrow. Even assuming, however, a narrower reading of the exception, the primary purpose of dual, dual-hatted and affiliate employees is not the placement of deposits. These employees place deposits to serve customers' holistic banking needs and to provide customers and potential customers with access to a wide suite of banking and other financial services products, providing customers with information and solutions concerning a wide variety of financial products that may include an affiliate IDI's deposit offerings. As a result, the deposits generated through these arrangements serve to deepen the relationships between customers and the IDI and its affiliates, and do not exhibit the characteristics of "hot money" that Section 29 was intended to regulate.

Similarly, the FDIC staff's focus on fees is misguided in respect of employees. Compensation programs among different institutions vary widely and serve the organization's broader business purpose and culture. Scorecards of metrics tied to various relationships with a customer, referral fees or measures related to overall incentive compensation are just a few examples of compensation methodologies. In each of these cases, the primary purpose of the referral is the development and enhancement of the customer relationship, not the placement of deposits.

For these reasons, the FDIC should revise its regulations to clarify that dual, dual-hatted and affiliate employees are not engaged in the business of placing or facilitating the placement of deposits, *i.e.*, are not deposit brokers, unless they are employed by an affiliate whose primary business is the placement of deposits with IDIs.

B. The FDIC should revise its treatment of marketing and advertising relationships and referral arrangements to reflect innovations in technology and marketing methods.

IDIs frequently have the opportunity to work with third parties to market or assist with the marketing of their deposit products and to receive referrals. Under the FDIC's existing guidance, if the FDIC views the third party as taking an active role in assisting with deposit marketing, such deposits can frequently be deemed to be brokered unless an exception applies, particularly, the primary purpose exception. As an element of the highly restrictive approach to the primary purpose exception, the FDIC has suggested that this exception apparently is not available if the third party receives any volume-based fees[38] or markets deposits other than on a passive and indirect basis.[39]

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36 *See, e.g.*, 84 Fed. Reg. at 2,371.

37 *See, e.g.*, *id.* at 2,372; FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005).

38 *See, e.g.*, FAQs question B4 ("Some [IDIs] attempt to attract new depositors through advertising or referrals by third parties . . . in exchange for volume-based fees. In these cases the FDIC has taken the position that the third party is 'facilitating the placement of deposits' by connecting the [IDI] with new account holders. Hence, the third party is a deposit broker and the deposits would be brokered.").

39 FDIC, Advisory Opinion No. 93-71 (Oct. 1, 1993).

This approach ignores the basic statutory requirement that a deposit broker be "engaged in the business of" placing or facilitating the placement of deposits, and focuses entirely on compensation and the minutiae of marketing methods rather than the third party's actual business and the characteristics of the resulting deposits and relationships. In effect, the FDIC has conflated the very different concepts of marketing and brokerage, and thereby limited the opportunity for banks to establish long-term relationships built around deposits.

For example, in 1992, the FDIC staff found a deposit broker relationship to exist where affinity groups (i) endorsed an IDI's credit and deposit products, (ii) sold advertising space in their publications to the IDI at standard rates, (iii) allowed the IDI to include deposit solicitations in direct mailings to association members, (iv) placed brochure racks relating to the IDI's credit and deposit products in association offices, and (v) included information about the IDI's products in new member kits.[40] A 1993 Advisory Opinion issued in response to an "updated factual statement" regarding these same affinity groups refined the FDIC's guidance by focusing on placing brochure racks in the affinity group's offices and including information about the IDI's deposit products in new member kits. Because the FDIC deemed these activities to be "something other than 'passive and indirect' marketing activity," the associations were deemed to be deposit brokers because they facilitated the placement of deposits.[41] The FDIC later cited the 1993 Advisory Opinion as the source for its FAQ stating that production or distribution of an IDI's marketing materials could result in brokered deposits.[42]

These broad statements, effectively prohibiting any indirect referral or touchpoint, make it difficult or impossible to conclude that even the most tenuous connection between a potential customer and a third party does not at least raise the question of whether any resulting deposits are brokered. In each of these cases, the FDIC's guidance ignores that the depositor has created a stable, direct relationship with the IDI. In contrast to relationships with brokers of "hot money" deposits, a marketing or referral relationship results in direct relationships between an IDI and depositors, with the third party often having no ongoing relationship with the customer as it relates to the deposit accounts.

The FDIC notes in the ANPR that "in determining whether deposits placed through modern deposit placement arrangements are brokered, staff has looked to precedents involving the definition of 'deposit broker' and has attempted to consistently apply that analysis to these new products."[43] Unfortunately, this analysis has the effect of extending a very problematic and limited view of marketing relationships and reducing banks' ability to take advantage of modern methods of marketing and partnering with third parties to identify potential long-term, stable deposit customers. The concept in the existing guidance that marketing must be passive and indirect to avoid resulting in brokered deposits is, of course, nowhere found in Section 29. Ultimately, this constrains customer access to banking services and unfairly penalizes IDIs that use digital marketing methods and other marketing channels to highlight their services to potential customers.

40 FDIC, Advisory Opinion No. 92-79 (Nov. 10, 1992).

41 FDIC, Advisory Opinion No. 93-71 (Oct. 1, 1993). This Advisory Opinion also clarified that the selling of advertising space in membership publications at standard rates would not cause the affinity groups to be deposit brokers.

42 FAQs question B8 ("[An] endorsement cannot appear in promotional materials produced or distributed by the individual or the group [making the endorsement]. Rather, the endorsement must appear in promotional materials produced and distributed by the bank. Otherwise the individual or group providing the endorsement will be a deposit broker, and the deposits would be brokered.").

43 84 Fed. Reg. at 2,372.

Current technologies—including the Internet, mobile phones and social media—allow IDIs to reach new customers by marketing their products and services through the websites, applications, social media platforms and emails of marketing partners, advertisers and affinity groups. If the existing guidance is extended to deposits marketed using standard, current marketing methods, those deposits may be deemed brokered for three principal reasons:

- Internet advertising is based on pricing models such as cost-per-acquisition, which allows an IDI to generate cost savings by focusing advertising on those individuals with demonstrated or reasonably expected interest in the IDI's products and services, or residing in a relevant geographic market. These pricing models have no impact on the stability of the deposits generated. For example, IDIs can leverage a social media platform's data analytics capability to target their advertisements to a particular customer segment that may be more responsive to an IDI's products. In the cost-per-acquisition model, however, the deposits associated with these marketing channels may result in fees that are dependent on the number of accounts opened by a customer or the volume of deposits that result from customers clicking through to the IDI's website or mobile application;

- because the endorsement of the IDI is done through the marketer's or affinity group's website and/or email and by using the marketer's data or analytics, such endorsements may be viewed as "active" marketing, and, therefore as facilitating the placement of deposits; and

- if the marketing will be hosted on a marketer's website, or distributed through a podcast or other platform controlled by the marketer, many marketers will often seek to have a view on the style, look or messaging of a particular marketing campaign to provide visual and thematic consistency across the marketer's platform. Under the FDIC's existing guidance, particularly FAQs question B8, this could also be viewed as active, *i.e.*, unacceptable, marketing because the third party may be involved in the production process of the IDI's marketing materials.[44]

In these marketing arrangements, depositors establish and maintain their deposit relationships directly with the IDI. The third party is not involved in the deposit relationship other than to provide a marketing platform as described above, which represents marketing practices that have become standard in both the financial services industry and across the retail industry more generally. Nevertheless, for the reasons noted above, because of the FDIC's expansive guidance, many of these relationships could be viewed as resulting in brokered deposits.

In addition to the difficulty of applying the FDIC's guidance to modern marketing methods, banks face other difficulties in determining whether many marketing relationships result in brokered treatment. The FDIC has noted that "the most important factor used by the FDIC to determine when a particular affinity group is 'facilitating the placement of deposits'. . . has been whether the affinity group is engaged in active marketing on behalf of the bank."[45] Putting aside the question of whether the focus on "active marketing" is even appropriate, the FDIC has

[44] FAQs question B8 provides that an endorsement "must appear in promotional materials produced and distributed by the bank. Otherwise, the individual or group providing the endorsement will be a deposit broker . . . ." It is unclear from the FDIC's guidance what degree of involvement a third party may have in the production of a bank's advertising before that party would be deemed to be a deposit broker, thereby creating additional difficulty for banks in analyzing their marketing and referral relationships.

[45] 2011 Study at 24.

provided little guidance on what constitutes "active marketing" versus "passive marketing," which leaves IDIs with no clear method for evaluating potential marketing partnerships and referral opportunities.

The FDIC's historical broad reading of the definition of "deposit broker" has caused banks to classify other sources of stable deposits as brokered as well. For example, banks may market deposits through non-profit groups that sponsor financial education or other programs that refer participants to the bank to open deposit accounts. The non-profit group may or may not receive a fee, or may have other relationships or programs with the bank. Depending on the particular arrangement, banks may be required to treat these groups as generating brokered deposits. This is despite the fact that the deposit accounts are opened directly with the bank, because such groups may be engaged in what the FDIC may conclude would be deemed to be "active marketing" of the bank's deposit products.

Another example of traditional sources of stable deposits that may be inappropriately captured by the FDIC's approach to evaluating marketing relationships is campus programs in which banking organizations partner with colleges and universities to offer student deposit accounts. Depending on the nature of the marketing relationship with the college or university and the fee arrangements, these programs may also be inappropriately captured by the FDIC's restrictive interpretations. These programs are not, however, focused on *deposit* acquisition, but rather are mainly focused on *customer* acquisition, with the intent to develop deeper banking relationships with students for which the accounts opened often represent their first entry into the banking system. New banking relationships with students typically result in low balance demand deposit accounts offered not for purposes of attracting a large volume of deposits, but to establish a robust customer relationship with individuals entering the banking system for the first time. In the ordinary course of business, banks may also work with other third parties to help banks identify and reach consumers to introduce them to deposit products. Section 29 should not be interpreted in a way that impedes banks' ability to engage in customer outreach to establish stable, traditional relationships with new customers.

Going to first principles, the notion that a third party's advertising a bank's selection of account and deposit offerings results in that third party being a deposit broker simply as a result of fees tied to whether or not a customer opens a deposit account—irrespective of the third party's overall business[46] or its relationship with the bank or the potential bank customer—is misguided. This is particularly so when one considers the deposit brokers at which the legislation was directed; namely, brokers who primarily marketed high-interest-rate retail certificates of deposit and/or so-called "Master Certificates of Deposit."[47] As noted in the ANPR, the FDIC identifies three primary concerns as relevant to the restrictions on brokered deposits:

- Rapid growth (*i.e.*, "the extent to which deposits can be gathered quickly and used imprudently to expand risky assets or investments");

- Volatility (*i.e.*, "the extent to which deposits might flee if the institution becomes troubled or the customer finds a more appealing interest rate or terms elsewhere"); and

46 *See, e.g.*, 84 Fed. Reg. at 2,372; FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005) ("[T]he FDIC has taken the position that 'primary purpose' means 'primary intent.'").

47 *See* 84 Fed. Reg. at 2,368.

- Franchise value (*i.e.*, "the extent to which deposits will be attractive to the purchasers of failed banks, and therefore not contribute to losses to the DIF").[48]

None of these is implicated in the scenarios described above.

Moreover, such an interpretation of the definition of deposit broker would have the perverse effect of automatically capturing a third party website on which a bank advertises its deposit accounts in exchange for fees tied to the number of accounts opened if visitors to the website click through to the bank's website and open accounts, *but with no possible exception available*.[49] Because web advertising models frequently are based on a cost-per-acquisition model, such fees arguably can be viewed as volume-based, particularly if, as is often the case, the website's or bank's analytics allow for measurement of whether the customer ultimately opens a deposit account. Considering the purpose of Section 29, this simply is not a reasonable construction of the statute.

An analysis resulting in a determination that the types of marketing and referral relationships described above result in brokered deposit treatment is based on guidance that cannot be applied to modern marketing methods. Under existing FDIC guidance, active marketing may not include selling advertising space at standard rates.[50] In contrast, active marketing does include a third party placing posters and brochure racks relating to an IDI's deposit products in the third party's office or endorsing an IDI's products in a publication produced or distributed by the party providing the endorsement.[51] It simply is not possible to apply these interpretations to modern marketing practices in a logical and consistent manner. For example:

- There may be no standard, flat rate that marketers charge for Internet advertising, but, as described above, one of the "standard rates" instead is arguably also a volume-based fee.

- Mobile and Internet-based marketing partners often require retaining some level of creative or other input on advertisements that they host on their platforms, but, based on existing guidance, IDIs cannot be sure if the FDIC will view this as the marketing partner "producing and distributing"

48 *Id.* at 2,369.

49 The primary purpose exception is only available to an "agent or nominee," and it is difficult to see how the third-party website is an agent or nominee of the depositor.

50 *See* Advisory Opinion No. 93-71 (Oct. 1, 1993) ("We do not regard the selling of advertising space in membership publications to be direct marketing of the [IDI's] products, particularly because . . . the [affinity groups] charge the [IDI] standard rates for the advertisements.").

51 *See Id.* ("[P]ermitting [an IDI] to place posters and brochure racks in [affinity groups'] offices and including information and materials on [the IDI's] deposit products in new member packets may constitute something other than "passive and indirect" marketing activity for the IDI. . . . Thus, . . . [the affinity groups] are acting as "deposit brokers" within the meaning of [Section 29] in connection with their relationship with the [IDI] . . . ."); FAQs question B8 ("[T]he endorsement [provided by a person or group] cannot appear in promotional materials produced or distributed by the individual or the group. Rather the endorsement must appear in promotional materials produced and distributed by the bank. Otherwise, the individual or group providing the endorsement will be a deposit broker, and the deposits would be brokered.").

> the bank's promotional materials and, therefore, as facilitating the placement of deposits through "active marketing."[52]

Moreover, the FDIC should not expand its guidance to classify deposits raised through such marketing efforts as brokered unless necessary to effectuate Congressional purpose.

Marketing partners of the kind described above are not engaged in the business of facilitating the placement of deposits, but as an incident to their actual business may advertise or endorse a variety of products to their members or the public. Any facilitation of the placement of deposits is merely incidental to their actual businesses. In other words, unlike the business of the archetypal deposit brokers that Section 29 was intended to capture, the business of marketing partners is not primarily to connect depositors with IDIs or to facilitate the placement of deposits, particularly the "hot money," above-market-rate certificates of deposits that concerned Congress, and the selling of advertisement services to an IDI and/or distributing an IDI's marketing materials are activities that are merely incidental to the primary business of marketing partners.[53] As a result, such marketing partners cannot reasonably be considered to be engaged in the business of placing or facilitating the placement of deposits, and, therefore, are not "deposit brokers" within the meaning of Section 29. For these, and other reasons discussed above, rather than attempt to apply its outdated guidance to modern marketing practices, the FDIC should clarify the application of Section 29 to these modern relationships.

The FDIC should exclude marketing and advertising partners (including affinity groups) that simply market deposits on behalf of, or otherwise refer potential customers to, IDIs from the definition of "deposit broker," regardless of the fee arrangement, unless such partners are, in fact, engaged in the business of either (1) placing or (2) facilitating the placement of deposits. The FDIC should similarly narrow its interpretation of "facilitating" to exclude marketing and referral partnerships that result in the customer entering into a banking relationship directly with the IDI.

C. The FDIC should exclude affiliate-generated investment sweep deposits from classification as brokered.

A sweep account consists of free cash balances in investment accounts, frequently held by an affiliate of an IDI, that are swept into a deposit account with the IDI. These deposits are typically placed as part of providing customers with holistic banking and investment solutions, and help to create deeper relationships between financial services firms and their customers. Under existing guidance, the FDIC has permitted sweep deposits to affiliate IDIs to be classified as non-brokered if (i) the swept funds did not exceed 10 percent of the total assets in the investment

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52 *See supra* notes 43 – 44 and accompanying text. The FDIC's current guidance does not prevent IDIs from "actively" marketing their own deposits through neutral channels such as television and radio or through proprietary websites, applications and/or social media platforms, and at least some distribution of advertising produced by the IDI clearly does not result in the advertiser being deemed to be a deposit broker. (*See, e.g.*, FAQ D3 ("A similar analysis [that does not result in the treatment of deposits as brokered] applies to communications companies (such as radio or television stations of Internet Web sites) that run advertisements for [IDIs]. If the advertising platform is operated in a neutral manner, so that any [IDI] could run advertisements, the FDIC would not treat the communications company as a deposit broker.").) However, in some cases it may not be clear to what extent advertisers may be involved in the production and/or distribution of advertising before they would be treated as being engaged in the "active marketing" of the IDI's deposits and, therefore, as deposit brokers.

53 Indeed, the business of some marketing partners, particularly affinity groups, involves connecting members and the general public to a wide variety of financial, and even more so, non-financial services.

account for consecutive months or for more than three months during any 12-month period and (ii) the fees paid were a flat per-account fee and were not dependent on the volume of deposits.[54] In the Sweeps Opinion, the FDIC noted that sweep deposits meeting these conditions were not brokered because the primary purpose of the registered broker-dealer providing the sweep feature to customers was not to provide a deposit-placement service, but rather to facilitate the trading of securities. The Sweeps Opinion itself does not distinguish between affiliated and unaffiliated programs; the FDIC, however, has subsequently indicated that the application of the primary purpose exception to sweep deposits is limited to affiliate programs.[55]

The Sweeps Opinion addressed whether a broker-dealer offering sweep deposits in connection with brokerage and similar investment accounts qualify for the primary purpose exception, assuming that these entities are deposit brokers.[56] However, in our view, the FDIC should not treat broker-dealer affiliates that offer sweep features on investment accounts as deposit brokers because they are not engaged in the *business* of placing or facilitating the placement of deposits, but of broker-dealer and similar investment activities. These entities place deposits as part of a single activity that is incidental to their business of managing funds that are held for investment, and are not engaged in the business of placing deposits, as Congress understood that business for purposes of Section 29.

Even if the FDIC views entities as being engaged in the business of placing deposits, they should not be considered to be "deposit brokers" by reason of the primary purpose exception without imposing the restrictions of the FDIC's Sweeps Opinion. As discussed above, an important exception from the definition of "deposit broker" is the "primary purpose" exception, and, to qualify for the exception, the person or entity placing deposits must satisfy two criteria: (i) the person or entity must be an "agent" or "nominee," and (ii) the person's or entity's primary purpose must not be the placement of funds with depository institutions. Under the plain meaning of this exception, deposits that affiliates place through a sweep feature should not be classified as brokered. Affiliates that offer a sweep feature on their brokerage or similar investment accounts typically are indisputably acting in an agency capacity, as they make investments and conduct other activities at the instruction of their clients.

In interpreting the "primary purpose" element of the exception, the FDIC has not considered objective standards such as the agent's overall business purpose or the percentage of total revenue that the deposit placement activity generates, but has instead interpreted primary purpose subjectively to refer to the agent's "primary intent" in placing the deposit. This subjective approach to interpreting the statute has resulted in an overly narrow application, and the conditions placed on sweep deposits for such deposits not to be classified as brokered are unnecessary and cause some stable deposits to be classified as brokered. The FDIC should revisit this approach, and should consider the affiliate's overall business purpose and the overall relationship between the affiliate and the

54 *See* FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005) (hereinafter referred to as the "Sweeps Opinion").

55 *See, e.g.*, 84 Fed. Reg. at 2,372 ("[W]hen certain conditions are observed, the primary purpose of a broker-dealer in sweeping customer funds into deposit accounts at its affiliated IDI is to facilitate the customers' purchase and sale of securities. . . . The IDI is permitted to pay fees to the affiliated broker-dealer but the fees must be a flat fee . . . .").

56 *See* Sweeps Opinion ("A 'deposit broker' is 'any person engaged in the business of placing deposits, or facilitating the placement of deposits . . .'. This definition is subject to several exceptions, including [the primary purpose exception]. In this case, the issue is whether X satisfies the 'primary purpose exception.' If not, then the funds placed by X at the affiliated banks will be 'brokered deposits.'").

depositor in evaluating the availability of the primary purpose exception. A plain reading of the statute compels this conclusion.

A fundamental canon of statutory interpretation is that words should be interpreted as having their plain meaning unless they are otherwise defined.[57] There is substantial precedent for interpretation of "primary" as "first" or "foremost," but there can be no possible debate that term means at least "one of the most important" or "substantial."[58] Therefore, based on even the narrowest plain reading of the primary purpose exception, the exception must be available to third-party agents or nominees unless one of the most important purposes of their overall business is to place deposits with IDIs. The legislative history further indicates that the main or principal purpose must not merely be to place deposits with IDIs, but to place volatile, "hot money" deposits with IDIs, and that is clearly not the case with sweep deposits.

Brokerage and similar investment accounts are primarily designed to provide for securities to be bought and sold on a fully paid-in basis or on margin, and are not designed to provide a deposit-placement service. The sweep feature is ancillary to these benefits, and is only relevant to serve as a short-term investment vehicle for funds that are uninvested or unused. The sweep feature is specifically designed to provide a return on, and access to, funds awaiting investment. In addition, the interest rate structure on the deposit accounts into which funds are swept are based on overnight market rates, not above-market, long-term contractual rates found in brokered certificates of deposit, which are indicia of the "hot money" deposits Congress intended to capture under Section 29, and customers are not incentivized to place more funds into the deposit account as opposed to other investments available through the brokerage or similar investment account.

As a result, affiliate sweep programs serve to deepen and create long-lasting relationships between the depositor and the IDI and its affiliates, and, therefore, do not exhibit the volatility that characterizes the brokered deposits Congress intended to restrict.

For these reasons, the FDIC should revise its regulations to permit an IDI's affiliates to sweep funds from brokerage and other investment accounts to the affiliated IDI, in connection with an overall product offering related to an investment purpose other than the deposit account (such as a securities brokerage account) and regardless of the percentage of total assets in the investment account represented by the deposits or the fee structure, without classifying such deposits as brokered, where there is a primary relationship between the affiliated financial services provider and its customer other than the placement of the deposits and the deposit account is an integrated part of the overall financial services product offering.[59]

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57 *See Perrin* v. *United States*, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.") (citation omitted).

58 *See, e.g., Malat* v. *Riddell*, 383 U.S. 569, 572 (1966) ("We hold that, as used in § 1221(1) [of the Internal Revenue Code of 1954], 'primarily' means 'of first importance' or 'principal.'"); *Thomas* v. *United States*, 758 F.Supp. 529, 540 (E.D. Mo., 1991) ("Primary is defined as meaning of first importance or principally . . . ."); *Marshall* v. *Burger King Corp.*, 504 F.Supp. 404, 409 (E.D.N.Y., 1980) ("[P]rimary is much more plausibly interpreted in its usual sense as meaning chief, principal, or first of several functions."); *Koehring Co.* v. *Adams*, 452 F.Supp. 635, 638 (E.D. Wis., 1978) ("The plain and ordinary meaning of the word 'primarily' is 'first' or 'foremost.'").

59 The FDIC should also review and consider revisions to its treatment of affiliates more broadly. As discussed in connection with affiliate-generated sweep deposits, broader affiliate relationships that provide customers a holistic, "one-stop" shop approach to financial services serve to deepen relationships between the depositor and the IDI and its

D. The FDIC should exclude deposits generated through operating subsidiaries from being classified as brokered.

The FDIC's existing guidance creates regulatory uncertainty with respect to the treatment of deposits placed by operating subsidiaries. Section 29 and the FDIC's regulations exclude from the definition of deposit broker an IDI, "with respect to funds placed with that [IDI]." However, as the FDIC notes in the ANPR, "for some purposes the subsidiary is treated as part of the parent IDI (*e.g.*, certain financial reporting); whereas for other purposes—such as the Bank Merger Act and for receivership purposes—they are treated separately."[60] The FDIC's guidance has not clarified whether operating subsidiaries that place deposits under an exclusive relationship with their parent IDIs are excluded from the definition of "deposit broker" under the IDI exception.

The FDIC has the flexibility to, and should, apply the IDI exception to further the Congressional purpose underlying Section 29 and the basic concept of an operating subsidiary. Operating subsidiaries of an IDI are under the exclusive control of the parent IDI, engage only in activities permissible for an IDI and are treated as a division of the IDI for the vast array of regulatory purposes other than the limited exceptions noted in the ANPR, which are for extraordinary, non-operating events.[61] Because the activities of operating subsidiaries (including generating deposits for a parent IDI) are activities in which the IDI could engage directly, deposits placed by operating subsidiaries (and their employees) with the parent IDI are essentially deposits generated by the parent IDI itself. Any other treatment that would characterize deposits placed by operating subsidiaries as brokered deposits serves no substantive purpose. Such treatment unnecessarily penalizes IDIs solely for their choice of corporate form (which may have been selected for operational efficiencies or other benefits) to carry out certain activities, and not because the deposits represent volatile, "hot money" deposits. For these reasons, the FDIC should revise its regulations to clarify that operating subsidiaries of an IDI are not deposit brokers with respect to deposits placed with the parent IDI.

E. The FDIC should reconsider its treatment of deposits associated with prepaid cards.

To date, the FDIC has not issued an advisory opinion relating to whether deposits underlying prepaid cards would be treated as brokered deposits. Under FDIC guidance provided in the FAQs, however, the FDIC views almost all deposits placed in connection with prepaid card programs (other than cards issued under certain benefit

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affiliates. Having these multiple touchpoints with a single customer through affiliate relationships is likely to reduce the probability that the customer will leave the IDI during periods of stress or to seek higher interest rates. As a result, these relationships do not result in the volatile deposits that Congress intended Section 29 to restrict.

60 84 Fed. Reg. at 2,372.

61 *See, e.g.*, Office of the Comptroller of the Currency, Interpretative Letter No. 971 (Jan. 16, 2003) ("Because the activities of an operating subsidiary are limited to activities in which the parent bank could engage directly, an operating subsidiary is in practice a separately incorporated division or department of the parent bank. Thus, the OCC's standards in examining [operating subsidiaries] are the same standards that apply to OCC examinations of the Bank."); Board of Governors of the Federal Reserve System, FRB Interpretive Letter, 2000 WL 35539974, at *1 (Aug. 16, 2000) ("In 1968 the Board determined that . . . a state member bank may acquire the stock of an operations subsidiary, a company that engages only in activities in which the parent bank may engage directly . . . and subject to the same limitations as if the bank were engaging in the activities directly. The Board reasoned that such authority could reasonably be interpreted as within a bank's incidental powers to 'organize its operations in the manner that it believes best facilitates the performance thereof,' where the subsidiary essentially constitutes a separately incorporated division or department of the bank. The 1968 interpretation, therefore, . . . authorized state member banks to establish wholly owned operations subsidiaries, *since a wholly owned subsidiary is functionally indistinguishable from a division or department of the bank*.") (emphasis added).

plans or in connection with certain corporate rebate programs) as brokered.[62] Although the ANPR does not discuss the factors the FDIC considers when examining these relationships, based on the 2011 Study and the FAQs, it appears that the FDIC would generally determine prepaid deposits are not brokered only if the prepaid program is structured such that either (1) the IDI sells prepaid cards directly to the cardholders or (2) a third-party company places its own corporate funds with the IDI to be accessed by cardholders through cards that the company distributed as part of a rebate program.[63] In both cases, the FDIC appears to analyze whether a third-party agent or custodian is involved in placing the deposits.[64]

In the 2011 Study, the FDIC stated that "some [prepaid] deposits may qualify as brokered deposits while others may not."[65] The 2011 Study goes on to describe three scenarios, one of which results in brokered deposits.[66] The scenario that results in brokered deposits is described as a program that is structured such that a third-party card distributor acts as an agent for cardholders in placing or holding deposits at an IDI. The 2011 Study provided no legal analysis for this treatment, but simply concluded that this type of program would result in brokered deposits "unless the agent is covered by one of the exceptions to the definition of 'deposit broker' (such as the 'primary purpose' exception)."[67]

The FAQs assume the same conclusion as the 2011 Study, *i.e.*, that agents who distribute general purpose prepaid cards are deposit brokers, without providing any discussion of the issue or legal analysis of the reason for this result.[68] Even less credibly, the FAQs go on to state unequivocally that operators of general purpose prepaid card programs do not qualify for the primary purpose exception because "[t]he general purpose prepaid card and the deposit account are inseparable, in that the card is a device that provides access to the funds in the underlying

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62 *See* FAQs questions E10 – E13 (determining that general purpose prepaid card programs and certain programs involving a college's issuance of a prepaid debit card to its students result in the program manager being classified as a deposit broker).

63 2011 Study at 32; FAQs questions E13.

64 *See, e.g.*, 2011 Study at 32 ("In the absence of a third-party agent or custodian, the deposits held by the bank would not qualify as brokered deposits."); FAQ E13 ("[I]f a third party (not the corporation) is involved in the placement of the corporation's funds into the account at the [IDI], the third party would be a deposit broker."). The FDIC has also determined that certain deposits underlying funds disbursed to beneficiaries of government programs through prepaid cards are not brokered deposits. The primary purpose exception was determined to apply in these cases because the primary purpose of the government agency was "simply to discharge the government's legal obligations to the beneficiaries." FAQs question E14.

65 2011 Study at 32.

66 *Id.* According to the 2011 Study, the scenarios that do not result in brokered deposits include those where the IDI itself sells prepaid cards directly to cardholders or where a third party places its own corporate funds with the IDI to be accessed by cardholders when they use their cards at merchant point-of-sale terminals.

67 *Id.*

68 *See, e.g.*, FAQs questions E10 and E11, which discuss the application of the primary purpose exception to operators of prepaid card programs without ever addressing the necessary antecedent question of whether such parties are deposit brokers.

deposit account. Because of this relationship, prepaid card companies are not covered by the primary purpose exception."[69]

These interpretations of the "deposit broker" definition and the primary purpose exception are overbroad and exceedingly restrictive, respectively, and are not supported by either the plain language of the statute or the legislative history. In particular, the FAQs' interpretation of the primary purpose exception, *i.e.*, that the exception is not available where the deposit account is inseparable from the service being provided, is, for the reasons discussed below, inconsistent with the statutory language and the legislative history. Although the FDIC has never provided a public legal analysis for its conclusion that operators of general purpose prepaid card programs are deposit brokers, presumably this conclusion is a result of the FDIC's reading of the definition of "deposit broker," and the application of its interpretation of "facilitating the placement of deposits."[70] The Congressional purpose underlying Section 29 is to limit troubled institutions' ability to raise deposits through an archetypal deposit broker, thereby requiring the question of whether such prepaid card program managers are deposit brokers to be determined by whether they are *engaged in the business* of either (1) placing deposits, or (2) facilitating the placement of deposits.

Prepaid card program managers are not engaged in such business. Although one aspect of their business activities may result in connecting depositors to an IDI, deposits associated with prepaid cards are not connected to the type of business that Section 29 is intended to capture. Prepaid card program managers are not in the business of facilitating the placement of deposits, but of providing an innovative method by which customers can store their money and conduct transactions. These services are wholly unrelated to the business of providing deposit-placement services or obtaining FDIC insurance for customers.

Even if the FDIC were to determine that prepaid card program managers are in the business of placing or facilitating the placement of deposits, the primary purpose exception should generally apply under a plain reading of the exception. Prepaid card program managers are clearly acting in the capacity of an agent with respect to their customers, as they only deposit funds to "load" a card at the instruction of the owner of the funds. Furthermore, the primary purpose of prepaid card program managers is not to place, or facilitate the placement of, deposits. Their primary purpose is to provide customers who may not otherwise be able to access banking services with an alternative, secure method to store their money and make ordinary course payments.[71] Although a deposit account is necessary to provide this service, placement of the deposits is not the program manager's primary purpose.

Similarly, third parties offering prepaid cards tied to deposit accounts at a financial institution, including employers using prepaid cards for payroll purposes (including for unbanked or underbanked employees), should not be classified as "deposit brokers." Employers offering prepaid cards as an alternative to a traditional deposit account are not "engaged in the business of" (1) placing or (2) facilitating the placement of deposits. These employers are simply offering their employees an alternative way to access their wages—including the ability to use the prepaid card to pay bills and pay for goods and services. These prepaid cards can, in many ways, replicate the features of a

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69 FAQs question E11.

70 *See supra* notes 23 – 24 and accompanying text.

71 *See, e.g.,* FDIC, 2017 FDIC National Survey of Unbanked and Underbanked Households at 34 - 36, *available at* https://www.fdic.gov/householdsurvey/2017/2017report.pdf ("Some consumers use general purpose reloadable prepaid cards to address their financial transaction needs. . . . Use of prepaid cards in 2017 was most prevalent among unbanked households . . . . Overall, approximately half . . . of households that used prepaid cards in 2017 were either unbanked or underbanked . . . .").

demand deposit account, such as the ability to set up automatic bill payments. Prepaid cards provide an alternative that bridges the gap for consumers without access to traditional deposit accounts who need to access the banking system to receive payments and purchase goods and services. Customers, including, for example, both the employers who offer payroll cards and the employees who wish to use them, are benefitted by this alternative. Designating these deposits as brokered, and the resultant impact on the cost of funds, inappropriately inhibits financial institutions' ability to provide this service, at least at a reasonable cost.

The ANPR also notes that in examining prepaid deposit relationships, FDIC staff has not distinguished between "(1) acting with the purpose of placing deposits for other parties, and (2) acting with the purpose of enabling other parties to use deposits to make purchases."[72] The absence of such distinction is not tenable, particularly in light of Congress' purpose in enacting Section 29. First, a plain reading of the primary purpose exception requires the FDIC to distinguish between "acting with the purpose of placing deposits for other parties" and all other purposes. On its face, the primary purpose exception is available to agents and nominees unless their primary purpose is to place deposits with IDIs. Based on a plain reading of the statute, if the primary purpose of the third-party agent is any purpose other than the placement of funds with IDIs, then the primary purpose exception applies. Second, Congress' purpose was to restrict "hot money" that is volatile and used to fuel rapid growth. Deposits underlying prepaid cards exhibit none of the characteristics of "hot money." In fact, that the primary purpose of these relationships is to enable parties to make purchases (which the FDIC apparently recognizes based on the language of the ANPR) demonstrates that the deposits are not made by depositors seeking above-market interest rates, and the FDIC has provided no analysis to show that depositors would move their prepaid deposits in a stress event or in search of higher interest. For these reasons, the FDIC's views of deposits associated with prepaid cards, particularly those expressed in the FAQs, are overbroad and result in the misclassification of deposits underlying general purpose and other prepaid cards involving a third-party agent as brokered.

In addition, the classification of prepaid deposits as brokered has unintended negative consequences on unbanked and underbanked consumers who rely on prepaid cards to store money and gain access to a transaction account. Because of the negative consequences to IDIs of classifying deposits as brokered, IDIs may be unwilling to provide deposit accounts to prepaid card managers, or may be willing to do so only at a price that ultimately increases the fees and other costs paid by prepaid card users. This result would further limit the utilization of IDIs by unbanked and underbanked individuals, thereby limiting their ability to meet their economic needs safely and securely within the banking system.

Therefore, the FDIC should revise its regulations to clarify that prepaid card program managers are not entities engaged in the business of placing or facilitating the placement of deposits, and, therefore, are not "deposit brokers." Alternatively, the FDIC should revise its regulations to apply the primary purpose exception to prepaid card program managers, unless there is clear evidence that the program manager is acting with the primary purpose to place deposits with the IDI. As discussed above, the integral nature of a deposit account in a prepaid debit card program does not make the account the primary purpose. Rather, it is an incidental feature.

IV. The FDIC should support statutory changes that would treat fully-insured, long-term deposits as core deposits regardless of whether the deposits are brokered, and pending such legislation the FDIC should treat these deposits as core deposits for purposes of the FDIC's deposit insurance assessment calculations.

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[72] 84 Fed. Reg. at 2,374.

Fully-insured deposits with a remaining term to maturity of more than one year, regardless of whether they are brokered deposits, can be a stable source of funding and are an important asset-liability management tool for some banks. These long-term brokered deposits allow banks to access deposit markets outside their geographic footprint to fund the bank's upcoming needs and match assets and liabilities, particularly with respect to maturities. Importantly, because long-term deposits have a remaining term to maturity of more than one year, they cannot result in near-term liquidity stress for a bank. Moreover, these deposits generally cannot be withdrawn prior to maturity and, therefore, cannot be transferred to another institution to chase higher interest rates or if the bank were to become troubled. The FDIC itself has recognized that:

> The duration of a deposit can present or mitigate the problem of a deposit leaving a bank for higher rates or when the bank is under stress. The longer a deposit's remaining time to maturity and the stricter the limitations on early withdrawal, the less likely it is to be withdrawn when the institution is under stress.[73]

In addition, we are not aware of any FDIC analysis of the effect of remaining term to maturity on the correlation between brokered deposits and bank failure. An analysis undertaken for one of BPI's members of 377 banks that failed between January 1, 2008, and December 31, 2011, shows, using publicly available data as of December 31, 2007, that failed banks' brokered deposits primarily comprised deposits with a remaining term to maturity of less than one year, with these short-term deposits equaling over 70% of the brokered deposits held by the failed institutions.

With respect to the other concerns expressed by the FDIC in the ANPR, namely rapid growth and franchise value, long-term, fully-insured deposits are not likely to fund rapid growth of high-risk assets and are likely to have significant franchise value. Although brokered deposits, including long-term deposits, can be raised quickly (which is an important element of their usefulness as an asset-liability management tool), the enhanced supervisory and regulatory framework that was implemented following the financial crisis creates an environment in which a bank cannot easily use such deposits to fund high-risk assets. As noted in the ANPR, Congress was concerned with brokered deposits because "(1) [s]uch deposits could facilitate a bank's rapid growth in *risky assets without adequate controls* [and] (2) once problems arose, a problem bank could use such deposits to fund additional risky assets to attempt to 'grow out' of its problems . . . ."[74] However, banks today are subject to a number of capital, liquidity and risk management requirements that did not exist at the time Section 29 was enacted, including, for example, requirements to maintain appropriate levels of capital against the bank's risk-weighted assets and to establish robust risk management policies that are designed to prevent taking risks that are not commensurate with the bank's size and sophistication (including the risky lending that brokered deposits were used to fund during the savings and loan crisis). Therefore, banks are discouraged from using long-term brokered deposits to fund rapid growth of high-risk assets, and any potential risk to the DIF of raising long-term brokered deposits is substantially mitigated. In addition, because long-term brokered deposits are stable sources of funding, they likely would maintain significant franchise value at bank failure, particularly compared to short-term deposits that are not as stable. The FDIC's view of long-term brokered deposits should be revised to recognize that such deposits generally are not used to fund rapid growth of high-risk assets, but as an efficient and effective asset-liability management tool, subject to a robust regulatory and supervisory framework.

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73 2011 Study at 51.

74 84 Fed. Reg. at 2,366 (emphasis added).

We recognize that excluding long-term brokered deposits from treatment as brokered under Section 29 would require a statutory change, and urge the FDIC to undertake a full, data-based examination of the effects of such deposits, particularly as compared to short-term brokered deposits that apparently contributed to, or are at least correlated with, bank failure at much greater rates than long-term brokered deposits (if the latter contributed to bank failure at all). If the results of such examination prove our hypothesis, as we expect it would, that long-term brokered deposits are not connected to bank failure, we urge the FDIC to support statutory changes that would exclude long-term, fully-insured deposits from Section 29's restrictions.

At a minimum, the FDIC should revise its deposit insurance assessment calculations under 12 C.F.R. Part 327 that penalize long-term brokered deposits. Currently, the FDIC's deposit insurance assessments penalize long-term brokered deposits in three provisions: (i) the Core Deposits to Total Liabilities ratio in section 327.9(b), as further described in Appendix A to Subpart A of 12 C.F.R. Part 327; (ii) the brokered deposit adjustment in section 327.16(e)(3); and (iii) the Brokered Deposit Ratio in section 327.16(a)(1). Because long-term brokered deposits are not volatile, are not likely to be used to fund rapid growth of high-risk assets and likely retain significant franchise value at bank failure, they are not likely to cause more harm to the DIF than stable, non-brokered certificates of deposit with similar maturities. As a result, the FDIC should not penalize such deposits by treating them as brokered for purposes of the above provisions, even if such deposits would be "brokered" under Section 29 and the FDIC's implementing regulations as they stand today. Therefore, the FDIC should amend its deposit insurance assessment regulations to (i) treat brokered deposits with a remaining term to maturity of more than one year as core deposits for purposes of the Core Deposits to Total Liabilities ratio, (ii) exclude such deposits from the brokered deposit adjustment and (iii) deduct such deposits from brokered deposits for purposes of the Brokered Deposit Ratio.

V. The FDIC should revise Section 29's interest rate restrictions to reflect the actual market in which banks compete, and should not use interest rates as a proxy for risk in its supervision of IDIs.

Under Section 29, as implemented by the FDIC's regulations at 12 C.F.R. § 337.6(b), an IDI that is adequately capitalized is prohibited from soliciting deposits by offering rates of interest that are "significantly higher than the prevailing rates of interest on deposits offered by other [IDIs] in such [IDI's] normal market area."[75] As noted in the ANPR, the purpose of this restriction is to prevent institutions from "avoiding the prohibition against the acceptance of brokered deposits by soliciting deposits internally through 'money desk operations'."[76] Section 29 does not define a number of terms that are critical to interpreting the interest rate restriction, including "national rate," "significantly higher" and "market area." These terms are defined, however, under the FDIC's regulations, which provide that an IDI's market rate is presumed to be the national rate,[77] and that the national rate is "a simple average

75 12 U.S.C. § 1831f(g)(3). An IDI that is undercapitalized is also prohibited from soliciting deposits "by offering rates of interest that are significantly higher than the prevailing rates of interest on insured deposits . . . in the market area in which such deposits would otherwise be accepted." 12 U.S.C. § 1831f(h).

76 84 Fed. Reg. at 2374.

77 12 C. F.R. § 337.6(f).

of rates paid by all [IDIs] and branches for which data are available."[78] A rate is "significantly higher" than another rate if it exceeds the second rate by more than 75 basis points.[79]

The FDIC currently calculates the national rate using data gathered by RateWatch, and posts the rate to the FDIC's website each week. RateWatch conducts a survey of the interest rates offered on various deposit products by IDIs. According to the FDIC, the information is collected from between 45,000 and 81,000 locations.[80] The FDIC's calculation of the national rate has become outdated, and does not represent a true market rate. For example, as the FDIC has acknowledged in its ANPR, "because the national rate is an average for all banks and branches, the largest banks with large numbers of branches have had a disproportional effect on average interest rates."[81] Small but important market segments must use this skewed average as the baseline for determining whether the interest rate offered in those segments is "significantly higher" than the market rate. The FDIC's regulations provide a mechanism for the FDIC to determine that a bank's market rate is higher than the national rate, but this determination is based solely on limited geographical factors, and does not consider the actual market in which a bank competes.[82]

The FDIC's current approach to the national rate calculation has consequences even for healthy, well capitalized institutions. We are concerned that examination and supervisory staff will take (or already takes) the view that a bank that is offering interest rates that are "significantly higher" than the national rate (*i.e.*, more than 75 basis points above the national rate) is funding its operations with "high risk," volatile deposits.[83] We are also concerned that supervisory staff may require a bank's liquidity stress tests to account for this "high risk" funding, and will require the bank to hold increased amounts of liquidity against it. The underlying rationale for the interest rate restrictions is to prevent a bank from circumventing the brokered deposits restrictions by funding rapid growth through volatile deposits that it raises through its own money desk operations, and should not be used as a supervisory tool to penalize well capitalized banks for raising deposits in a manner that is permitted by both Section 29 and the FDIC's regulations. Furthermore, the offering of an interest rate that is more than 75 basis points above the national rate is not necessarily indicative of an unsafe or unsound practice, but is a reflection of an outdated national rate calculation, and may simply result from competition in the bank's actual market. As a result, the FDIC's method for calculating the national rate creates unnecessary regulatory stigma for well capitalized institutions where such supervisory concerns are not warranted.

For the foregoing reasons, the FDIC should revise its calculation of the national rate to consider the actual market in which an IDI competes.

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78 12 C.F.R. § 337.6(b)(2)(ii)(B).

79 *See e.g.*, 12 CFR 337.6(b)(2)(ii); 84 Fed. Reg. at 2374.

80 FDIC's Weekly National Rates and Rate Cap – Weekly Update, note 1, *available at* https://www.fdic.gov/regulations/resources/rates/index.html.

81 84 Fed. Reg. at 2,375.

82 12 C.F.R. § 337.6(f) ("A market is any readily defined geographical area . . . .").

83 For example, the FDIC has made public statements that indicate it considers "high-rate" deposits to be "potentially non-stable funding sources" that contribute to a "a risk-building environment." FDIC, *Underwriting Trends and Other Highlights from the FDIC's Credit and Consumer Products/Services Survey*, 14 SUPERVISORY INSIGHTS, Winter 2017, at 18, *available at* https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin17/si-winter-2017.pdf.

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The Bank Policy Institute appreciates the opportunity to provide its comments, and would welcome the opportunity to discuss them further with you. If you have any questions, please contact the undersigned by phone at (202) 589-2424 or by email at *Dafina.Stewart@bpi.com*.

Respectfully submitted,

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