CONSUMER BANKERS ASSOCIATION

The Voice of the Retail Banking Industry

May 7, 2019

VIA ELECTRONIC SUBMISSION

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Re: RIN 3064-AE94
Email: comments@FDIC.gov

Re: Advance Notice of Proposed Rulemaking Regarding Brokered Deposits and Interest Rate Restrictions/ RIN 3064-AE94

Dear Mr. Feldman:

The Consumer Bankers Association ("CBA" or "the Association")[1] appreciates the opportunity to offer our views on the Federal Deposit Insurance Corporation's ("FDIC") Advance Notice of Proposed Rulemaking (the "ANPR") concerning the FDIC's regulatory approach to "brokered deposits" and the interest rate limitations applicable to banks that are less than "well-capitalized," as those terms are defined and interpreted under Section 29 of the Federal Deposit Insurance Act (the "FDI Act" or "Section 29").[2]

The Association believes the agency's regulatory approach to brokered deposits must be modernized to allow banks to better serve their customers and remain competitive in today's financial services landscape. Since the FDIC's brokered deposit restrictions were last amended in 1991, legal developments, consumer preferences and technological advances have drastically transformed the business models, products, and delivery channels that support the banking industry, as well as the types of deposits banks gather to fund their activities.

[1] The Consumer Bankers Association is the only national trade association focused exclusively on retail banking. Established in 1919, the Association is now a leading voice in the banking industry and Washington, representing members who employ nearly two million Americans, extend roughly $3 trillion in consumer loans, and provide $270 billion in small business loans.

[2] *See* 12 U.S.C. § 1831f and 12 C.F.R. § 337.6 (the "Brokered Deposits Rule").

Banks today are at a competitive disadvantage through overly broad interpretation of brokered deposit rules. The FDIC's outdated interpretations of and restrictions on brokered-deposit activities unfairly discourage and penalize institutions utilizing brokered deposits, even if these institutions are adequately capitalized. More concerning, the FDIC's broad interpretation of what constitutes a brokered deposit captures many types of deposits that do not possess risky or "hot money" features, thereby restricting legitimate banking activity and subjecting the industry and market to potentially higher deposit insurance premiums, Liquidity Coverage Ratio requirements and added resources needed to track and monitor brokered deposits; ultimately affecting product availability and pricing for consumers.

Our members encourage the FDIC to revisit its interpretations of what constitutes a deposit broker (and thus a brokered deposit) and to more widely permit banks to accept stable and low volatility deposits outside their geographic footprint or with the involvement of third parties without running afoul of brokered deposit restrictions. Further, we urge the FDIC to rethink the calculation of a "national" interest rate restriction to ensure the rate represents activities of small, medium, large, and online banks, and is not skewed heavily towards a single bank model: operating the largest number of branches.

Discussion

I. The FDIC's brokered deposit rules and interpretations are outdated and do not account for changes to federal securities and banking laws.

Pursuant to the Gramm-Leach-Bliley Act ("GLBA"),[3] federal securities and banking laws mandate certain activities formerly conducted within a bank now be conducted by a broker-dealer or other affiliate. Whereas a bank could act as a broker for securities transactions in 1989, a bank today transfers these activities from banking subsidiaries to broker dealers registered by the Securities and Exchange Commission ("SEC") pursuant to the GLBA. To the extent banks are presently required by law to conduct activities using a licensed broker-dealer, the brokered deposit rules should not operate to punish institutions for outsourcing these activities to a third-party in accordance with the GLBA.

Additionally, many federal laws, including the Fair Credit Reporting Act ("FCRA"), the Bank Secrecy Act ("BSA"), and the Financial Industry Regulatory Authority Rule 2111(a) ("the Suitability Requirement") permit or require financial institutions to share customer transaction and experience information with affiliates. Nonetheless, according to the FDIC's FAQs, ongoing communications are indicative of a deposit broker's "continued involvement" and therefore require deposits gathered from the so-called deposit broker to be categorized as brokered.[4] Financial institutions have many reasons to share customer transaction and experience information with affiliates (including compliance with federal laws), therefore, information-sharing with affiliates should not be a determinative factor for whether the FDIC considers a deposit brokered. The FDIC should resolve this catch-22 and rethink its current approach by not considering information sharing as a factor for whether deposits are brokered.

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[3] Pub. L. No. 106-102, 113 Stat. 1338 (1999).

[4] FDIC Advisory Opinion 15-01 (April 16, 2014).

II. <u>Banks are less likely today to acquire core deposits through branch banking networks but are more likely to gather brokered deposits while serving a geographically dispersed customer base.</u>

Since brokered deposit restrictions were initially put in place, the number of banks has steadily declined from 12,715 in 1989 to 4,918 in 2017 and customers increasingly prefer to use internet and mobile devices to deposit, withdraw, and transfer funds over visiting a bank branch.[5] According to a recent FDIC survey, in a recent five year period, the proportion of banked households that use mobile banking to access their accounts increased from 23.2 percent in 2013 to 40.4 percent in 2017.[6] The share of banked households using online methods increased to 63 percent over the same time period.[7] Further, according to a 2017 Shopper Survey conducted by Novantas Research, 54% of consumer participants shopped for their bank exclusively in digital channels.[8]

As reflected by these trends, the essence of a "sticky" customer relationship is no longer driven solely by the frequency with which a customer visits a branch, but also the ease with which a customer can deposit, withdraw and transfer funds, locate information about his/her account, and search for bank products using digital channels. Often, the best way for a bank to provide customers with a seamless, integrated, and holistic banking experience is to partner with third parties and leverage affiliate relationships. However, because banks' technology driven platforms, products, marketing, and delivery channels are facilitated by third parties, it is increasingly difficult for financial institutions to provide customers with an online banking experience without exposure to brokered deposit rules. Accordingly, many banks today hold brokered deposits that are not risky "hot money" deposits, but nevertheless are captured by the FDIC's expansive definition and interpretation of brokered deposit activity.

Considering the significant shift in consumer preference away from branch-based banking to online and mobile banking, the FDIC's brokered deposit rules should be revised to account for the resulting shift from core deposits to alternative funding sources as a significant source of stable funding. In particular, the FDIC should ensure that brokered deposit rules do not negatively affect banks that respond to consumer-driven changes to online and mobile products and delivery channels. If a customer uses technology to perform all of the affirmative steps he/she would in a branch, the transaction is akin to a customer depositing core deposits in a branch, meaning the transaction should not be treated as brokered simply because a third party technology platform "facilitates" the customer's placement of his/her deposits with the financial institution.

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[5] https://banks.data.fdic.gov/explore/historical/

[6] Jelena McWilliams, Chairman Federal Deposit Insurance Corporation, *Fintech and the New Financial Landscape (*Federal Reserve Bank of Philadelphia, Philadelphia, PA, November 13, 2018)(copy on file with the FDIC https://www.fdic.gov/news/news/speeches/spnov1318.pdf).

[7] *Id.*

[8] https://www.consumerbankers.com/cba-education/white-papers/novantas-%E2%80%93-2017-omni-channel-shopper-survey-digital-inflection-point

III. <u>Some types of deposits that are currently considered brokered are not risky or share similar attributes to core deposits and therefore should not be considered brokered.</u>

For example, deposits gathered from affiliate referrals, particularly non-maturity accounts, are less volatile than CDs, are unlikely sources for rapid growth, and may create franchise value but nonetheless receive the same regulatory scrutiny as "risky" brokered deposits simply because these deposits involve a third party. Similarly, general purpose prepaid cards are considered brokered even though these funds are not "hot money" funds likely to disappear during bank downturns. To the contrary, these funds are often held in a trust for the benefit of cardholders, subject to prior written regulatory approval, and are stable, non-volatile funds that should not be subject to the same rigorous scrutiny as "hot money" brokered deposits.

CBA urges the FDIC to enumerate presumptions that certain categories of deposits, including but not limited to prepaid accounts, campus cards, affiliate referrals for non-maturity accounts, deposits of customers of bank subsidiaries, deposits for investment advisor client accounts, affiliate deposit sweep programs, and sweep deposits of unaffiliated broker-dealers that satisfy the requirements of FDIC Advisory Opinion No. 05-02, and certain marketing relationships, are not brokered deposits. Alternatively, while a complicated factor test would not be useful to our members, the Association suggests the FDIC promulgate a rule which uses the three guiding principles set forth in the FDIC's 2011 Study on Core and Brokered Deposits to determine whether a deposit is a brokered deposit: 1) whether the deposits are used to fund rapid, risky growth; 2) whether the deposits are volatile; and 3) whether the deposits lower the bank's franchise value.

More specifically, we urge the FDIC to reconsider treating the following types of brokered deposits as core deposits:

a. Prepaid Accounts

Prepaid accounts and mobile wallets should not be considered brokered deposits. Funds supporting prepaid accounts and deposited into a bank are generally held in trust in pooled accounts for the benefit of each individual cardholder. Companies in the prepaid distribution chain, or companies that use prepaid accounts to disburse their own funds are not engaged in the business of placing deposits. Instead, these participants facilitate payments to consumers, including wages and benefits, and facilitate consumers' access to their own funds through point of sale transactions, online purchases and ATM withdrawals. Unlike "hot money" deposits, deposits collected through prepaid card programs are stable at the aggregate portfolio level and lack the rapid growth and volatility features that Section 29 was intended to restrict. The FDIC should revise its current regulations and guidance regarding brokered deposits to provide that companies in the prepaid distribution chain and companies that use prepaid accounts are not deposit brokers.

b. Campus Cards

Campus card programs allow students, faculty and staff access to deposit accounts and serve as campus identification cards or co-branded debit cards. These programs are optional, require that the customer open the account directly with the bank, have no fee and typically have added benefits including the convenience of one card for various campus-related activities. Campus cards are typically low balance accounts that enable banks to build and retain customer relationships; characteristics more similar to core deposits than "hot money." The FDIC should exempt these stable funds from consideration as brokered deposits.

c. Deposits of Customers of Banking Subsidiaries

Prior to 1989, banks routinely acted as brokers and investment advisors for their clients. Due to regulatory changes enacted since then, banks are no longer directly in this business, but nevertheless still need these offerings to satisfy consumer demand. When banks outsource these activities to their subsidiaries, the FDICs' interpretations of brokered deposit activities should not penalize banks for including their required subsidiaries in transactions, on an ongoing basis, to fulfill their client's financial needs. The deposits of a customer of a bank's operating subsidiary also should not be considered brokered, as these types of deposits do not share the characteristics of "hot money" deposits Section 29 was intended to restrict. The FDIC should view the deposits of bank operating subsidiary customers the same as other intra-bank deposits. Considering the forgoing reasons, we submit that operating subsidiaries are extensions of parent banks and are not as deposit brokers, therefore, the FDIC should not interpret these deposits as brokered.

d. Deposits for Investment Adviser Client Accounts

The FDIC's approach to deposits for investment advisor client accounts is inconsistent with the legislative intent of Section 29. The SEC prohibits investment advisers from maintaining custody of their client assets and requires these assets to be placed in the custody of a bank, trust company or securities-broker-dealer. Thus, investment advisers act as fiduciaries and agents for their clients for the purpose of investing the clients' assets. Generally, investment advisers are not compensated for their selection of specific funds, and investment advisers behave similarly to the trust department of a bank. Accordingly, we request the FDIC establish clear criteria within the Brokered Deposits rule to clarify when an intermediary performing a service or operation function for a bank places a deposit with the bank in an agency capacity is eligible to rely upon the "primary purpose" exception, including in connection with investment advisory or other financial services.

e. Affiliate Deposit Sweep Programs Should be Excluded from Requirements of FDIC Advisory Opinion No. 05-02

Affiliates are under a common ownership and do not engage in excessive rate deals in order to attract deposits. In fact, affiliate deposit sweep programs are stable and counter cyclical; they do not have the risk characteristics that the brokered deposit rules seek to mitigate. Years of experience supports the fact that significant shifts in affiliate deposit sweep activity is driven by countercyclical market activity, not the chasing of yield. Moreover, the FDIC's 2011 Study on Core and Brokered Deposits states "the FDIC recognizes in the examination process that sweep deposits from affiliates can be a stable source of funding for financially sound institutions offering a market rate."

While the FDIC's Advisory Opinion exempts affiliate sweep programs under the Primary Purpose Exception, the exception is cumbersome and unduly restrictive. First, it requires significant periodic reporting. Second, it requires banks to manage the ratio of Assets Under Management, which during a market correction period could place banks at risk. Third, the flat fee compensation requirement is outdated and unnecessary in part because Regulation W's arm's-length requirement already prevents banks from overpaying an affiliate. Fourth, the requirement that a bank request approval for every agreement update or program change is overly complex and burdensome. These requirements are unduly punitive given the stable and countercyclical nature of affiliate sweep programs

f. Sweep Deposits of Unaffiliated Broker-Dealers that Otherwise Meet Requirements of FDIC Advisory Opinion No. 05-02

FDIC Advisory Opinion No. 05-02 addressed an arrangement where the free credit balances of certain brokerage accounts were swept by a broker dealer into deposit accounts at affiliated depository institutions. The FDIC determined that such deposits would not be treated as brokered provided that (1) the funds into bank deposits do not exceed 10 percent of the total balances of the brokerage accounts; (2) this limitation is calculated and applied on a monthly basis and shall not be exceeded in consecutive months or for a period of three months during any 12-month period; and (3) the bank provides the FDIC with monthly reports reflecting these monthly calculations and will make available daily calculations upon request.[9]

However, in the FDIC's 2011 Report to Congress, the agency concluded that deposit sweeps from unaffiliated broker-dealers are more volatile and more likely contribute to rapid growth as compared to deposit sweeps from affiliate broker-dealers. The FDIC reached this conclusion despite a lack of supporting evidence and against commentary and data suggesting that unaffiliated deposit sweeps are generally stable, low-cost forms of funding with high customer retention rates. In addition, CBA member banks believe that the requirement, "funds into bank deposits do not exceed 10 percent of the total balances of the brokerage accounts," is archaic and makes the rule less operable for banks. CBA urges the FDIC to increase this threshold to 25 percent "of the total balances of the brokerage accounts." Moreover, we request the FDIC clarify that broker-dealers are permitted to sweep cash balances of brokerage accounts into deposit accounts at unaffiliated depository institutions provided the other qualifications established in Advisory Opinion No. 05-02 are satisfied.

g. Brokered Dealer Custodial Sweeps

Section 29 of the FDI Act and the Brokered Deposits Rule do not impose an application and approval process requirement or a reporting requirement on banks as a condition to rely on the primary purpose exception.

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[9] *See* FDIC Advisory Opinion 05-02 (February 3, 2005).

Therefore, we also urge the FDIC to codify into the Brokered Deposits rule its sweep deposit interpretation set forth in Advisory Opinion No. 05-02. The FDIC should remove any requirement that a bank obtain a separate letter of approval to facilitate any sweep deposit arrangement. The FDIC's requirement for each bank to obtain its own determination letter is inefficient (with costly time delays as long as a year) and is not required by Section 29.

IV. The definition of brokered deposits is overly broad and confusing, providing the FDIC unfettered discretion to determine whether certain deposits must be classified as brokered deposits.

Because the definition of a brokered deposit is overly broad, any person who merely facilitates the placement of deposits is considered a deposit broker and the underlying funds are subject to the FDIC's brokered deposit rules. The FDIC is often asked to clarify on a case-by-case basis whether a specific activity is subject to brokered deposits restrictions; a time-consuming process for both the agency and the industry that only leads to inconsistent interpretations issued in FAQs, Advisory Opinions, and other informal guidance documents. Further, to the extent case-by-case determinations are difficult to reconcile against one another, are not widely shared, and are not easily discoverable, significant uncertainty exists in determining the types of deposits the FDIC considers to be brokered deposits.

V. The FDIC's interest rate restrictions on brokered deposits are tethered to problematic methodology used to calculate "national" interest rate caps that are not representative of the true national market.

Our members believe the national rate cap calculation is a flawed model. The national rate cap calculation is based on a brick and mortar banking model that is not representative of true market rates because many banks today are not reliant on or do not use a branch network. Specifically, the rate cap calculations do not account for online bank models that lack a geographic presence. A further problem is that the average national interest rate is based on what the largest banks with the most branches pay; a lower rate than what smaller banks may offer to stay competitive. Treasury yields have become significantly higher than the average national interest rates on a deposit, meaning CDs provide an unappealing low return on investment for consumers compared to other investment alternatives that are not restricted by the national rate cap.

For purposes of determining a national standard, CBA recommends the survey include only the highest rate offering from each financial institution. The number of branches of one institution in a market does not enhance or diminish the consumer's options. For example, if a bank has 20 branch locations in a marketplace, the institution's offer should only be counted once as it represents only one option despite the number of branches. Moreover, considering the accessibility of internet financial services, the FDIC's national rate for brokered deposits should also consider the presence of online financial institutions in every market. To be more accurate and functional for banks, the calculation must properly include promotional offering rates and should not include multiple locations or branches for any one bank. Conversely, the calculation should also include offering rates paid by credit unions, since banks routinely compete against credit unions for deposits. Regardless, if the FDIC cannot eliminate the current obvious weaknesses in the calculation methodology, the national rate should not be used for either evaluation of funding risk or establishing the maximum rates that less than well capitalized banks can pay on deposits.

Further, the FDIC should evaluate the ways its outdated interpretation of brokered deposit activity may contribute to a bank's stress or failure by restricting important funding sources. For example, if a "well capitalized" bank is reliant upon a large percentage of brokered deposits as a result of its innovative partnerships, and the bank later becomes an "adequately capitalized bank," the FDIC's restrictions on accepting brokered deposits and the interest rates assessed to these deposits may create a sudden funding crisis for the bank.

VI. The FDIC should consider alternatives to address Section 29's interest rate restrictions for less than well capitalized institutions.

The FDIC's interest rate restrictions may further limit problem banks. The FDIC's method for calculating a high-rate deposit is archaic and not consistent with the current rate environment. Pursuant to the FDIC's standards, the rate cap is determined by adding 75bps to "the average national rate."[10] The national rate is calculated based on a simple average of rates paid by all insured depository institutions and branches for which data is available.

FDIC bank examiners routinely use the high-rate definition in well-run, non-problem banks to assess their funding risk and to assign the "L" (Liquidity") rating in their CAMEL score. Examiners routinely group deposits in excess of the established rate caps and label the aggregated deposits as a potentially volatile funding source.

Conclusion

Brokered deposit restrictions must not serve as barriers for banks competing in today's technologically driven and innovative world. As consumer preferences for digital channels evolve, so too must the regulatory approach to brokered deposits. Many banks no longer rely solely on core deposits from branches for funding and must be permitted to more widely utilize alternate funding sources without incurring higher deposit insurance premiums, interest rate restrictions, and restrictions on accepting non-core deposits. While some types of brokered deposits may present "hot money" risks, the FDIC's brokered deposit restrictions ought to be narrowly tailored to scrutinize truly risky, "hot money" deposits rather than broadly capturing every type of deposit that might be considered brokered.

[10] 12 C.F.R. § 337.6(b)(3)(ii) (1992).

Should you have questions or wish to discuss these comments, please contact Jenna Stewart, Senior Regulatory Counsel at (202)552-6366 or jstewart@consumerbankers.com or Andre Cotten, Regulatory Counsel at (202)552-6360 or acotten@consumerbankers.com.

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