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May 20, 2020

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

Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions
Comments on Notice of Proposed Rulemaking
RIN 3064-AE94

Ladies and Gentlemen:

In response to the Notice of Proposed Rulemaking ("NPRM") issued by the Federal Deposit Insurance Corporation ("FDIC") seeking comment on proposed significant changes to its regulations governing brokered deposits ("Proposed Rule"),[1] we are submitting this letter on behalf of our clients who participate in the national brokered certificate of deposit ("Brokered CD") market ("Brokered CD Market"). Our clients include broker-dealers registered with the Securities and Exchange Commission ("SEC") that engage in offering CDs issued by depository institutions at which deposits are insured by the FDIC ("IDIs").

Since 1992 Seward & Kissel has provided comments to the FDIC on various FDIC policies and proposals related to brokered deposits,[2] including in response to the FDIC's December 18, 2018 Advance Notice of Proposed Rulemaking ("ANPR")[3] ("ANPR Comments") that preceded the NPRM. We attach our ANPR Comments to this letter and incorporate them in full herein.

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[1] FDIC, Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Rate Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020) (hereinafter, "NPRM").
[2] *See, e.g.*, Ltr. from Seward & Kissel to FDIC, Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Mar. 22, 2016); Ltr. from Seward & Kissel to FDIC, Proposal to Amend Brokered Deposit Adjustment (Jan. 3, 2011); Ltr. from Seward & Kissel to FDIC, Deposit Premium Assessment Rate (Dec. 17, 2008); Ltr. from Seward & Kissel to FDIC, Legislative History of the Brokered Deposit Provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Feb. 18, 1992).
[3] FDIC, Advance Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019) (hereinafter, "ANPR").

The Brokered CD Market has been in continuous operation for over 30 years and serves as an important, stable and integral source of term deposit funding for IDIs. Likewise, the Brokered CD Market remains a key savings tool for countless numbers of individuals who can purchase CDs in $1,000 denominations through their broker and hold the CDs in their account with their broker. Brokers maintain a secondary market for CDs that permits owners to liquidate their CDs prior to maturity without necessitating a withdrawal of funds from the IDI that issued the CDs.

Despite the importance of the Brokered CD Market to both IDI's and individual savers, the FDIC continues to perpetuate material underlying misconceptions concerning Brokered CDs and the Brokered CD Market. We addressed many of these misconceptions in our ANPR Comments. While the Proposed Rule does not directly alter the regulatory framework governing the Brokered CD Market, we will again address those misconceptions in this letter.

To clarify the evidentiary foundation of the FDIC's characterization of the Brokered CD Market, we submitted a request under the Freedom of Information Act ("FOIA Request") for "copies of all reports, studies, analyses, memoranda, data, or other written records" supporting the assertions about Brokered CDs contained in the NPRM, quoting from the NPRM itself. As discussed below, our FOIA Request was denied because it was "overbroad and ambiguous" and sought "confidential and privileged information", despite the fact that it merely requested the data and analysis to support assertions made by the FDIC in the NPRM.

1. NPRM Description of Brokered CDs

The NPRM mischaracterizes Brokered CDs and the Brokered CD Market. For example, the NPRM describes Brokered CDs in the following way:

> [B]rokered CDs are issued in wholesale amounts by a bank seeking to place funds under certain terms and sold through a registered broker-dealer to investors, typically in fully-insured amounts. The brokers subdivide the bank-issued ''master CD'' and alter the terms of the original CD before selling the new CDs to its brokerage customers. These brokered CDs are (in most cases) held in book entry form at the Depository Trust Corporation (''DTC'') and use the CUSIP system for identification and trading in a primary and secondary market.[4]

The NPRM continues, asserting that:

> Brokered CD products are marketed to customers as a way to increase FDIC deposit insurance coverage and increase yield. One historical form of brokered CDs is CD participations, where a broker dealer purchases a CD issued by a bank and sells the interests in the CD to its customers.[5]

[4] NPRM at 7458.
[5] NPRM at 7460.

Finally, the NPRM asserts that:

> [B]rokered CDs are often used by bank customers searching for relatively high yields on their insured deposits, and as such these deposits may be less stable and more subject to deposit interest rate competition.[6]

The NPRM thus describes a process through which a broker-dealer places deposits at an IDI and then "issues" fractional interests in a Master Certificate of Deposit ("Master Certificate") to its retail customers and, in the process, changes the terms of the CD. In other words, according to the NPRM the broker-dealer issues "participation interests" in the CD to its retail customers. The NPRM further mischaracterizes the Brokered CD Market by claiming Brokered CDs are high yield products and constitute volatile deposits.

2. Brokered CD Market and Master Certificates

The Brokered CD Market, with current Brokered CDs outstanding totaling nearly $500 billion,[7] is deep, liquid, and has been a continuous and stable source of liquidity for IDIs since the mid-1980s, including through the financial crisis of 2008-09 and the current COVID-19 crisis.

Brokers do not "subdivide," "fractionalize," or "sell interests" in CDs as (i) the NPRM states, (ii) the FDIC claimed in the ANPR, or (iii) referenced in the definition of "deposit broker" in Section 29 of the Federal Deposit Insurance Act ("FDI Act"). Moreover, brokers do not change the terms of the CDs when offered to the broker's customers. The terms of each CD are reflected on the IDI's books and are enforceable according to those terms by each CD holder.

What the FDIC describes in the NPRM is a "participation interest," a widely accepted term of art within the financial industry that means an undivided interest in an instrument or pool of assets. Holders of a participation interest have no direct claim against the issuer or issuers of the underlying obligations. Such interests would be securities issued by the broker and subject to registration with the SEC and would not qualify for "pass-through" deposit insurance.

The process of issuing Brokered CDs is as follows. An IDI wishing to obtain funding in the Brokered CD Market contacts one or more brokers to determine the best current market pricing, and then enters into an agreement with the broker establishing the terms of the CDs (i.e., maturity, interest rate, etc.), offering period and the number of CDs that may be sold. CDs are offered to the broker's customers in denominations of $1,000.

Upon completion of a CD offering, an IDI issues a Master Certificate, a negotiable instrument representing a specified number of individual CDs, in denominations of $1,000. The Master Certificates are held (with few exceptions) by The Depository Trust Company ("DTC") as subcustodian for the brokers. The CDs are recorded on the books of the IDI in the name of

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[6] NPRM at 7464.

[7] Data from the Depository Trust Company.

DTC, in a manner designed to permit the "pass-through" of deposit insurance to the broker's customers. The broker maintains records of the CDs held by its customers and these records are submitted to the FDIC in the event of the failure of the IDI.[8]

Each CD is an individual deposit obligation of the IDI. A customer can move his or her CDs from an account at one broker to an account at another broker and trade them individually in a secondary market maintained by the broker. Unlike a participation interest, each $1,000 CD can be directly enforced by the holder directly against the issuing IDI. Rules of DTC prohibit it from holding instruments that are "fractionalized" or "participated".

Pursuant to a 2010 Financial Institution Letter issued by the FDIC staff, an arrangement resulting in the issuance of participation or fractional interests would not be eligible for pass-through insurance because the owners of such interests would have claims against the broker, not the issuing IDI.[9] In order for the holder of a CD to be eligible for pass-through insurance, the holder has to be the owner of the deposit account with ownership rights enforceable against the issuing IDI.

We further note that broker-dealer programs that automatically deposit, or "sweep," funds awaiting investment in customers' brokerage accounts into money market deposit accounts or demand deposit accounts at IDIs could offer "participation" interests in a pool of assets if such sweep programs are not correctly designed. Thus, the "participation" concept is not unique to Brokered CDs. This is consistent with Section 29 of the FDI Act which references "selling interests" in "deposits," not just CDs.

3. Brokered CDs are Not "High Yield" or Volatile

The NPRM reiterates the FDIC's long-stated belief that Brokered CDs are volatile because depositors use them to seek higher yields. However, as explained in detail in our ANPR Comments, the empirical evidence does not support the FDIC's assertions.

Our ANPR Comments included a 4.5-year study finding that the "all-in cost" (interest rate plus fees to brokers) of Brokered CDs from April 2014 through January 2019 was virtually always lower for every CD maturity than the interest rates, without fees, posted on the listing service for the same CD maturity,[10] and was often only marginally higher than Treasury security yields.

Moreover, approximately 34% of CDs in the retail Brokered CD Market have maturities of one year and longer, empirically demonstrating the stability of these deposits. Indeed, Brokered CDs with call provisions can be issued in maturities of up to 20 years.

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[8] *See generally* Paul T. Clark, Just Passing Through: A History and Critical Analysis of FDIC Insurance of Deposits Held by Brokers and Other Custodians, 32 Boston Univ. Rev. Bank. & Fin. Law 99 (2013), for a more complete description of the book entry recordkeeping system used for Brokered CDs.

[9] Financial Institution Letter: Guidance on Deposit Placement and Collection Activities, FIL-29-2010 (June 7, 2010).

[10] 3-month rates are unavailable.

Data from the 2008 financial crisis further demonstrates the stability of Brokered CDs. During the crisis, deposits at the two banks owned by Lehman Brothers Holdings – each of which had brokered deposits that were over 98% of their total deposits – were stable despite the failure of the top tier holding company. Despite the banks being precluded from accepting new brokered deposits after the bankruptcy filing of the parent company, during the subsequent three-month period only 4.7% of the brokered deposits at each bank ran off – run-off attributable to maturing time deposits.[11]

In light of this data, which we have presented to the FDIC on several occasions, it was surprising to find that the NPRM nonetheless repeated, without adducing supporting evidence, that Brokered CDs are "volatile" and "high-yield." To better understand the evidentiary basis of this claim, we filed our FOIA Request seeking any reports, studies, analyses, memoranda, data, or other written records supporting the quoted statements from the NPRM. Our FOIA Request and subsequent appeal were denied for being overly broad and burdensome.

In other words, when asked to provide any support for its public statements about Brokered CDs contained in a request for public comment subject to the Administrative Procedures Act, the FDIC claimed an exemption from the FOIA and declined to produce any support.

Since the FDIC has not presented supporting evidence in the ANPR, the NPRM, in response to our FOIA Request or in any other public document, the obvious conclusion is that the FDIC has no such evidence to support its characterization of Brokered CDs and the Brokered CD Market.

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Thank you for the opportunity to submit these comments. We would be happy to meet with you to discuss the information in this letter.

Sincerely,

[redacted]

Paul T. Clark

[redacted]

Casey J. Jennings

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[11] Data are derived from Call Reports.