June 9, 2020

Robert E. Feldman
Executive Secretary
ATTN: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, RIN 3064–AE94, 85 Fed. Reg. 7453 (Feb. 10, 2020) ("Proposal" or "Release")

Dear Mr. Feldman:

Better Markets[1] appreciates the opportunity to comment on the proposed rulemaking captioned above Proposal, issued by the Federal Deposit Insurance Corporation ("FDIC"), regarding amendments to the rules governing brokered deposits.

The Proposal would create huge new loopholes in the restrictions on brokered deposits that Congress found it necessary to impose decades ago. It would thereby allow much more "hot money" to be placed with insured depository institutions ("IDIs"), threatening the safety and soundness of banks, and by extension, the deposit insurance fund ("DIF"). At the same time, the Proposal fails to provide any credible justification for this dangerous de-regulatory approach. The FDIC attempts to defend the Proposal by claiming it is necessary to "modernize" the FDIC's brokered deposit regulations in light of changes in technologies and business models that have occurred since those rules were first adopted.[2] But the FDIC fails to provide any credible evidence that regulatory relief is actually necessary for either banks or deposit brokers. Nor does the FDIC offer any credible evidence that the Proposal would confer any other benefits, as the FDIC admits it knows virtually nothing about the impact that the rule would have.

In short, the Proposal threatens new risks to the banking system without a plausible justification; conflicts with the FDIC's primary duty to protect bank stability and the DIF; and serves as a prime example of irrational rulemaking under the Administrative Procedure Act

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 Release at 7453.

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("APA"). Better Markets therefore opposes the Proposal and urges the FDIC to withdraw it.[3] If the FDIC is determined to proceed with this rulemaking, then it should, at a minimum, make numerous changes to limit the risks that it poses, as argued below.[4]

BACKGROUND

As noted in the ANPR, the FDIC's concerns about brokered deposits date back to at least the 1970's, when it observed in its Division of Bank Supervision Manual that use of brokered deposits had led to abuses in banking and contributed to bank failures.[5] The FDIC's concerns about brokered deposits were realized with the high-profile failure of Penn Square Bank. Penn Square's dramatic growth from $30 million in assets in 1977 to $436 million in assets at the time of its failure in 1982, was fueled by brokered deposits.[6] The FDIC and other banking agencies recognized that brokered deposits allowed banks such as Penn Square to grow rapidly (which often leads to investments in riskier assets), and that the use of brokered deposits contributed to unsafe banking practices by allowing weak banks to secure potentially destabilizing funding in a "gamble for resurrection" and an attempt to grow their way out of instability.[7] Accordingly, in 1984, the regulators issued a final rule that restricted the ability of brokers to obtain full deposit insurance coverage for the deposits they placed.[8] However, that rule was challenged in the D.C. Circuit and struck down.[9]

The D.C. Circuit's decision was consequential. Without any restrictions on their use, brokered deposits were a significant contributor to the savings and loan crisis in the 1980's, a crisis that would eventually cost taxpayers $150 billion.[10] As a result of the role brokered deposits

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[3] So flawed is the Proposal that FDIC Director Martin J. Gruenberg voted against it, warning that the important prudential safeguards surrounding brokered deposits should not be weakened. *See* Statement of Martin J. Gruenberg, Member, FDIC Board of Directors, Notice of Proposed Rulemaking on Brokered Deposits (Dec. 12, 2019).

[4] The Proposal follows an advanced notice of proposed rulemaking ("ANPR") issued in 2019, in which the FDIC sought broad input on its brokered deposit rules, as well as its interest rate restrictions. Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019). Better Markets filed a comment letter in response to the ANPR, which is incorporated herein. *See* Comment Letter of Better Markets to FDIC regarding Brokered Deposits (May 7, 2019), https://bettermarkets.com/rulemaking/better-markets-comment-letter-fdic-brokered-deposits-and-interest-rate-restrictions.

[5] ANPR at 2367.

[6] *Id.*

[7] *Id.*

[8] Generally speaking, brokers solicited deposits from investors, the total of which exceeded the then-applicable deposit insurance limit of $100,000 per account, placed the aggregate deposit in an account at a bank, and notified the bank that the deposits were being held on behalf of the individual investors. The 1984 rule provided that the insurance limit applied *per broker*, rather than per investor.

[9] *FAIC Sec., Inc. v. United States*, 768 F.2d 352 (D.C. Cir. 1985).

[10] William M. Isaac, *BankThink: A Cautionary Tale on Brokered Deposits*, AMERICAN BANKER (Nov. 9, 2018), https://www.americanbanker.com/opinion/a-cautionary-tale-on-brokered-deposits.

played in the savings and loan crisis, Congress acted to restrict certain banks' use of brokered deposits, first with the Financial Institutions Reform, Recovery, and Enforcement Act of 1989,[11] and again with the Federal Deposit Insurance Corporation Act of 1991.[12] The statute and FDIC regulations define a "deposit broker" as:

> Any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties; and . . . An agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan.[13]

Under the 1989 statutory framework, and to this day, "undercapitalized" banks are prohibited from accepting brokered deposits in all circumstances.[14] Those banks that are only "adequately capitalized" must receive a waiver from the FDIC before they can accept brokered deposits. "Well capitalized" banks face no restrictions on their ability to accept brokered deposits.

The 2008 financial crisis provided fresh evidence of the need to maintain if not increase limits on the placement of brokered deposits with IDIs.[15] Accordingly, Section 1506 of the Dodd-Frank Act required the FDIC to conduct a study on core deposits and brokered deposits, and to include in that study any legislative recommendations to address concerns relating to these types of bank deposits. The FDIC released that study in July 2011 ("Dodd-Frank Study").[16] That study, based on the FDIC's own experience and an exhaustive review of the literature, confirmed the inherent riskiness of brokered deposits as a funding source—the use of brokered deposits was associated with rapid growth, investment in riskier assets, increased risk of bank failure, and increased loss in the event of bank failure.

Notably, the study assessed the riskiness of certain new types of products that had developed as a result of technological change, such as broker-dealer sweep accounts and reciprocal deposits, and which fit the decades-old definition of brokered deposits. It concluded that, to varying degrees, these products posed risks similar to more traditional brokered deposit products.

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[11] Pub. L. 101-73, Aug. 9, 1989, 103 Stat. 183.

[12] Pub. L. 102-242, Dec. 19, 1991, 105 Stat. 2236.

[13] 12 U.S.C. § 1831f; 12 C.F.R. § 337.6.

[14] Congress also imposed interest rate restrictions to prevent banks from offering significantly above market interest rates as a means to avoid restrictions on brokered deposits.

[15] *See* Advance Notice of Proposed Rulemaking: Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019) (reviewing the history of problems associated with brokered deposits, including data from the 2008 financial crisis showing that failed banks which had relied on brokered deposits represented a disproportionately high percentage of the losses to the DIF).

[16] FDIC, Study on Core Deposits and Brokered Deposits (July 8, 2011), https://www.fdic.gov/regulations/reform/coredeposit-study.pdf.

Accordingly, despite technological changes and the emergence of new products that did not exist when the definition of "deposit broker" was originally drafted, the FDIC recommended that no changes be made to the statutory definition of deposit broker, because that definition remained "sufficiently flexible" to address differences in various brokered deposit products, including products that did not exist when the definition was originally drafted. The FDIC noted that the statute "served a useful purpose" during the 2008 financial crisis by preventing "failing banks from trying to grow out of trouble by taking on greater risk and limiting FDIC losses at failure."[17] The FDIC's own updated analysis in the 2019 ANPR confirmed the continued threats posed by brokered deposits.

As of December 31, 2019, only 0.3% of banks are less than well-capitalized and thus subject to restrictions on accepting brokered deposits.[18] However, in times of financial and economic stress, banks are likely to see their capitalizations levels fall. This trend can incentivize weaker banks to attempt to grow out of distress by taking excessive risks funded through brokered deposits—a strategy that in the long run heightens the risk of bank failure and claims on the DIF. Therefore, during such periods, it is especially important that the restrictions on brokered deposits for the less than well-capitalized banks remain fully intact. Today, of course, we face extraordinary economic distress and unprecedented uncertainty. It is the worst possible time to weaken the brokered deposit rules, and doing so now will pose an unnecessary and especially serious threat to the strength of the banking system and the DIF.

SUMMARY OF PROPOSAL

In general, the Proposal would expand the current exceptions from the definition of "deposit broker." Specifically, it would (1) provide guidance on the meaning of the phrase "engaged in the business of placing deposits;" (2) amend the definition of deposit broker by specifying the types of activities that would constitute "facilitating the placement of deposits;" (3) expand the exception for insured depository institutions by amending it to include wholly owned subsidiaries that meet certain criteria; (4) expand the exception for agents whose "primary purpose" is not placing funds with depository institutions by creating three new categories of exempt activity; and (5) establish an application process for those seeking to invoke the primary purpose exception.

We note that under the current regulatory framework, the term "brokered deposit" is defined in terms of "deposit brokers." The statute defines "brokered deposit" to mean "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker."[19] Thus, the Proposal is consequential because by exempting more activity from the scope of the ***deposit broker*** definition, it will exempt more deposits from the category of ***brokered deposits*** and from the restrictions set forth in Section 29 of the Federal Deposit Insurance Act.

[17] Dodd-Frank Study at 59.
[18] FDIC Quarterly Banking Profile: Fourth Quarter 2019, https://www.fdic.gov/bank/analytical/qbp/2018dec/qbp.pdf.
[19] 12 U.S.C. § 337.6(a)(2).

Moreover, the Proposal provides no meaningful analysis of the types of increased deposit funding this will facilitate and whether such funding will have the same destabilizing characteristics that originally prompted Congress to impose limits on brokered deposits.

Explaining the definition of "engaged in the business of placing deposits."

The Proposal does not amend this element of the "deposit broker" definition, but it does attempt to clarify the meaning of the core phrase "engaged in the business of placing deposits." The motive for this clarification and its precise meaning remains somewhat unclear. The Release explains that—

> The FDIC would view a person to be *engaged in the business of placing deposits* if that person has a business relationship with its customers, and as part of that relationship, places deposits on behalf of the customer (*e.g.* acting as custodian or agent for the underlying depositor).[20]

The Release goes on to reiterate that any person placing deposits at IDIs on behalf of a depositor, "as part of its business relationship with that depositor," fits the definition of a "deposit broker."

Amending and clarifying the definition of "engaged in the business of facilitating the placement of deposits."

The current definition of "deposit broker" also encompasses those who are engaged in the business of ***facilitating*** the placement of deposits with IDIs.[21] The Proposal would amend the rule by specifying the specific activities that would cause a person to be engaged in the business of "facilitating the placement of deposits." The Release states that the test is met where a person—

- directly or indirectly shares any third-party information with the IDI;
- has legal authority, contractual or otherwise, to close the account or move the third party's funds to another insured depository institution;
- provides assistance or is involved in setting rates, fees, terms, or conditions for the deposit account; or,
- is acting, directly or indirectly, with respect to the placement of deposits, as an intermediary between a third party that is placing deposits on behalf of a depositor and an IDI, other than in a purely administrative capacity.[22]

Notably, the Release explains that these activities would be exhaustive, not merely illustrative. Moreover, under the Proposal, the rule would retain no catchall language preserving the flexible meaning of the word "facilitating."

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[20] Release at 7457.
[21] 12 U.S.C. 1831f(g)(1).
[22] Release at 7457.

Extending the exception for IDIs to their wholly-owned subsidiaries.

Currently, an IDI is exempt from the definition of a "deposit broker" with respect to funds placed at that institution, the so-called "IDI Exception." [23] The Proposal would broaden the IDI exception to include subsidiaries of an IDI if the following conditions are met:

- the subsidiary is a wholly owned operating subsidiary of the IDI, meaning that the IDI owns 100% of the subsidiary's outstanding stock;
- the subsidiary places deposits of retail customers exclusively with the parent IDI; and
- the subsidiary engages only in activities permissible for the parent IDI.

Expanding the primary purpose exception in three ways.

Currently, a person falls outside the deposit broker definition if that person is "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."[24] Historically, the FDIC has narrowly construed this exception, with FDIC staff focusing on "whether the agent's placement of deposits is for a substantial purpose other than (1) to provide deposit insurance, or (2) for a deposit-placement service."[25] The Proposal would expand the availability of the primary purpose exception. Specifically, the primary purpose exception would be available to exclude an agent or nominee (together, "agent") from being considered a deposit broker, subject to an application process, if:

- less than 25% of the total assets that the agent has under management for its customers in a particular business line is placed at IDIs;
- the agent places depositors' funds into transactional accounts for the purpose of enabling payments; or
- the agent otherwise demonstrates that the primary purpose of the agent is something other than the placement of funds at IDIs.[26]

Establishing application and reporting requirements.

The Proposal would establish new application procedures for those seeking to rely on the three new primary purpose exceptions. If an application is approved, deposits placed or facilitated by that party would be considered non-brokered for a particular business line. Furthermore, successful applicants would be subject to ongoing reporting requirements, although they are not specified in the Release.[27] The Release indicates that the reporting requirements will be handled

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[23] 12 U.S.C. 1831f(g)(2)(A).

[24] 12 U.S.C. 1831f(g)(2)(I).

[25] Release at 7459.

[26] Release at 7460. The Release specifies that deposit placements of brokered CDs and deposit placements for the purposes of encouraging savings, maximizing yield, or providing deposit insurance would not meet the primary purpose exception. *Id.*

[27] Release at 7462.

on a case-by-case basis and described "as part of the written approval for a primary purpose exception."[28]

COMMENTS

1. The Proposal does not provide an adequate justification for loosening the restrictions on brokered deposits.

As noted above, brokered deposits have a history of contributing to bank failures and threatening the DIF, as they did during the savings and loan crisis of the 1980s and again during the 2008 financial crisis. For that reason, they have been subject to various statutory restrictions since 1989 and also regulated by the FDIC under its rules. More recently, the FDIC's 2011 study, conducted in accordance with the Dodd-Frank Act, and the ANPR, confirmed that brokered deposits are associated with rapid bank growth, bank investments in riskier assets, increased risk of bank failure, and increased losses in the event that a bank does fail.

As the regulator primarily responsible for supervising IDIs and safeguarding the DIF, and as a federal agency subject to the rulemaking requirements of the Administrative Procedure Act ("APA"), the FDIC has a duty to provide a persuasive justification before relaxing regulations specifically designed to protect IDI stability and the DIF. However, as discussed below, while the Proposal clearly poses new risks to bank stability and the DIF, it fails to provide any showing of a compelling need for regulatory relief or any other justification that might counterbalance the significant danger that it presents.

The Proposal will undoubtedly heighten the well-known risks already associated with brokered deposits, because its principal effect will be to enable less than well-capitalized banks—including even ***under***capitalized banks—to accept substantially more deposits of the type that are currently prohibited as "brokered."[29] It appears the Proposal is intended not only to facilitate the acceptance of deposits currently restricted as "brokered deposits" but also to actively encourage greater use of them by less than well-capitalized banks by removing the "stigma" associated with this source of bank funding.[30] As the current pandemic and the resulting economic crisis unfold, generating enormous uncertainty about the resiliency of our banks and our entire financial system, these risks loom especially large.

The Proposal pays little heed to these concerns, instead simply focusing on a supposed need to adapt to technological innovation in financial products and services. For example, the Proposal claims that it seeks to ensure "that the classification of a deposit as brokered appropriately reflects changes in the banking landscape since 1989."[31] It expands on this rationale by observing that "in recent times, banks collaborate with third parties, including financial technology

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[28] Release at 7462.
[29] Release at 7465.
[30] Release at 7464.
[31] Release at 7453.

companies, for a variety of business purposes including access to deposits. Moreover, banks are increasingly relying on new technologies to engage and interact with their customers."[32]

But for a host of reasons, this desire to accommodate new technologies, and to help promote new business models that are profitable for banks and other companies, is not a sufficient justification for these expansive and risk-enhancing amendments to the rules on brokered deposits.

First, it is not the duty of the FDIC to foster innovation in the financial sector or cater to emerging businesses in finance. Rather, its purpose is to protect the DIF and the stability of our nation's banks. Any efforts to revise the brokered deposit regulations must prioritize stability in the banking sector, not the profit motives of banks and third parties.[33]

Second, the Release provides no showing of any ***need*** for expanded access to banks by emerging technologies in finance. The Release makes very clear that the vast majority of banks—all but 16 out of the 5,319 IDIs that exist—require no relief from the limits on brokered deposits because they are well-capitalized.[34] Therefore, they face no impediments under the current rules governing brokered deposits in accommodating novel technology-based banking practices. In short, the Release offers no evidence whatsoever that this vast collection of IDIs is now failing to meet the needs of innovators in finance.

Third, apart from the failure to establish any real need for reform, the Release musters no credible evidence that the Proposal would confer any other benefits. It lists a number of possible advantages that might follow from the Proposal, but in each case, they are framed in purely speculative terms along with acknowledgments that these benefits simply cannot be accurately estimated. For example, the Release speculates that the Proposal ***might*** benefit the unbanked, increase funds available for lending to consumers, spur the third-party deposit placement industry, reduce DIF assessments, and even improve bank liquidity planning.[35] At the same time, however, the Release admits that it is impossible to predict or reliably estimate any of these effects.[36] More generally, in fact, the Release concedes that it cannot determine or even reliably estimate the overall impact of the Proposal. For example, it avows that "the amount of deposits currently reported as brokered that may be re-designated as non-brokered as a result of the rule" cannot be reliably estimated with the information currently available to the FDIC.[37] And because the FDIC

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32 Release at 7453.

33 *See* Brokered Deposits in the Fintech Age, FDIC Event (Dec. 11, 2019) (Statement of Dennis M. Kelleher) (further arguing that while competition and innovation in banking and finance can be desirable goals, tailoring regulations to achieve these objectives must be predicated on concrete evidence and analysis showing that adjustments are warranted and possible without posing risks to banks and the financial system).

34 Release at 7464; Release at 7453 (noting that well-capitalized IDIs "are not restricted from accepting deposits from a deposit broker").

35 Release at 7463-65.

36 Release at 7463-65.

37 Release at 7464.

knows so little about the impact of the Proposal, it cannot meaningfully evaluate either the benefits ***or*** the harms that might follow from it.

Finally, even if it were necessary, appropriate, and possible to carefully adjust the brokered deposit regulations for the limited purpose of accommodating certain new technology-based business practices, without the attendant risks, the Proposal does not achieve that goal. As discussed below, for example, the new "less than 25% of assets under management" test for identifying deposit placements entitled to the "primary purpose" exception is an indiscriminate standard that would allow huge amounts of money to pour into IDIs. And it would do so without identifying and restricting deposit placements associated with business practices or models that could pose the very same threats to banks and the DIF classically associated with brokered deposits.

All of these defects in the Proposal, along with those described below, represent a classic case of arbitrary and capricious rulemaking, in violation of the APA. It is axiomatic that when engaged in rulemaking, an agency must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[38] Conversely, the agency may not rely on factors "which Congress has not intended it to consider."[39] And agency actions that are based too heavily on speculation rather than evidence are likely to be deemed arbitrary and capricious.[40]

The Proposal runs afoul of all these principles: (1) it virtually ignores the real threat of harm to banks and the DIF that the Proposal would create; (2) it turns a blind eye to the fact that there is no evidence of any need to change the brokered deposits rule; (3) it gives wholly inappropriate weight to the financial industry's desire for regulatory accommodation, a factor that lies outside the FDIC's statutory mission and mandate; (4) it relies far too heavily on speculation about the possible benefits of the Proposal, admitting that the FDIC knows almost nothing about the likely impact of the rule; (5) it assembles a collection of proposed rule changes that are not reasonably designed to narrowly achieve the aspirational benefits, such as they are, identified in the Proposal; and (6) it draws the extraordinarily irrational inference or "connection" that suddenly relaxing the restrictions on brokered deposits—during a pandemic and economic calamity, no less—will serve the public interest and fulfill Congress's intent. This is unacceptable rulemaking, in clear violation of the law, and it makes the Proposal vulnerable to legal challenge.[41]

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[38] *See Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 103 S. Ct. 2856, 2866 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

[39] *See State Farm*, 103 S. Ct. at 2867.

[40] *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014).

[41] The Proposal violates yet another canon of administrative law by failing adequately to explain the agency's clear change in position on the regulation of brokered deposits. The law clearly provides that when an agency departs from a prior position, it must "display awareness that it ***is*** changing position" and "must show that there are good reasons for the new policy." *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasis in original). Moreover, when a "new policy rests upon factual findings that contradict those which underlay [an agency's] prior policy," the

2. The interpretation of "engaged in the business of placing deposits" is unclear.

While the Proposal would not amend the definition of "engaged in the business of placing deposits," it nevertheless offers a short but perplexing interpretation of the phrase:

> The FDIC would view a person to be *engaged in the business of placing deposits* if that person ***has a business relationship*** with its customers, ***and as part*** of that relationship, places deposits on behalf of the customer (*e.g.* acting as custodian or agent for the underlying depositor).[42]

The Release goes on to reiterate that any person placing deposits at IDIs on behalf of a depositor "***as part*** of its business relationship with that depositor" fits the definition of a "deposit broker."

This language raises a concern because the Release includes no explanation as to why the FDIC felt it necessary to offer this interpretation or what it actually means. We urge the FDIC to clarify the purpose and meaning of this interpretation of the "engaged in business" element.

3. The proposed revision to the definition of "engaged in the business of facilitating the placement of deposits" is unnecessary and unduly restrictive.

Currently, the statutory definition of deposit broker encompasses not only those who engage in the business of placing deposits, but also those who engage in the business of ***facilitating*** the placement of deposits.[43] The meaning of the word "facilitate" is exceptionally broad, encompassing any activity that makes something "easier" or helps to "bring [it] about."[44] It thus covers a wide range of activities that enable a particular result, in this case the placement of deposits.

Congress clearly chose the word deliberately to cast a wide net over the types of activities that should be regarded as brokering deposits and to prevent evasion of the brokered deposit provisions that Congress deemed necessary to protect the stability of banks and the DIF.[45] In

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agency must "provide a more detailed justification than what would suffice for a new policy created on a blank slate." *Id.* The Proposal violates these principles. The FDIC has a long history of acknowledging the threats posed by brokered deposits and subjecting them to regulation. It now proposes to essentially reverse its position by creating massive new loopholes in the safeguards that Congress and the agency itself have long considered necessary and appropriate. Yet in the Release, the FDIC fails to acknowledge this substantial shift in position or to justify it with the requisite factual findings the law requires when an agency pivots away from its prior approach to a problem.

42 Release at 7457 (first emphasis in original; second and third emphases added).

43 12 U.S.C. 1831f(g)(1) (emphasis added).

44 Merriam-Webster Online Dictionary, https://www.merriam-webster.com/dictionary/facilitate (last accessed May 14, 2020).

45 *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (citations omitted) (articulating the presumption that "that a legislature says in a statute what it means and means in a statute what it says").

keeping with this Congressional intent, the FDIC has historically, through its staff interpretations, broadly interpreted the word "facilitating" to include "any actions taken by third parties to connect insured depository institutions with potential depositors."[46]

The Proposal sets forth a new four-part definition of this element, as described in the summary of the Proposal set forth above. The essential problem with this approach is that the FDIC intends these definitional elements of "facilitating" activity to be exhaustive. In other words, any activities that fall outside those categories of behavior would ***not*** be considered "facilitating the placement of deposits," even though they might still satisfy the general, ordinary, and broad definition of "facilitating." As the Release explains:

> Ultimately, the FDIC believes that if the person is not engaged in any of the activities above [describing the four new types of conduct in the Proposal], then the needs of the depositor are the primary drivers of the selection of a bank, and therefore the person is not facilitating the placement of brokered deposits.[47]

As a threshold point, a person's singular focus on serving the "needs of the depositor" can hardly serve as a reliable indicator that an agent is doing something other than facilitating the placement of deposits. To the contrary, the risks associated with brokered deposits often arise precisely because an agent is focused on satisfying the depositor's perceived need or desire for more yield and more deposit insurance.

Setting aside this flawed rationale, the Proposal also errs because it needlessly eliminates the important breadth and flexibility of the existing rule governing acts that facilitate the placing of deposits. This approach conflicts with Congress's intent that the statute capture a broad range of enabling behavior. The solution is simple: The FDIC can retain the new descriptions of "facilitative" activity but it must make clear in the rule that they serve only as examples or illustrations and that the rule will continue to encompass "any ***other*** activity that facilitates the placement of deposits."

4. **<u>The proposed exception for subsidiaries of IDIs must not be broadened to include affiliates or others.</u>**

Currently, the IDI exception to the definition of a deposit broker provides that an IDI is not considered a deposit broker with respect to funds placed with that IDI. In other words, a bank will not be considered a deposit broker with respect to funds placed with itself. The Proposal would expand this exception by allowing a subsidiary of an IDI to qualify, provided that the subsidiary

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46 Release at 7457.
47 Release at 7457.

is (1) wholly-owned by the parent IDI; (2) only places deposits with the parent IDI; and (3) only engages in activities permissible for the parent IDI.[48]

While any expansion of an appropriately narrow exception raises concerns, in this case, the proposed change appears to be reasonable. A subsidiary that meets the conditions of the Proposal would be wholly owned by the parent IDI, would not be involved in placing deposits with any other banks, and would only be engaging in activities that are permissible for the parent. Equating the subsidiary with the parent, provided these conditions are met, does not appear to violate the letter or spirit of the original exception for IDIs themselves.

We caution, however, that the exception should not be further broadened. For example, the FDIC has, to its credit, rejected calls from some commenters that the rule also exempt "affiliates" of an IDI from the definition of deposit brokers. Affiliates represent a much larger class of entities, which are fundamentally distinct from wholly owned subsidiaries. And by definition, affiliates would not be subject to the protective conditions set forth in the Proposal governing ownership and scope of activity. The FDIC should remain firm and decline to broaden the types of entities entitled to benefit from the IDI exception.

5. **The proposal to expand access to the primary purpose exception is deeply flawed.**

The Proposal would vastly expand the "primary purpose" exception in three new provisions, one allowing an agent to place up to 25% of assets under management with IDIs; another allowing the placement of unlimited deposits provided the agent's purpose is to enable transactions or payments; and a third catchall provision governed simply by the test that the primary purpose of the agent is not the placement of deposits at IDIs.

These proposals are a mistake. They rest on flawed premises, rely on bright-line quantitative measures that are far too generous, and virtually invite evasion by creating a mechanism that will allow anyone to apply for permission to circumvent the brokered deposit restrictions. These proposals have the potential to significantly expand the amount of brokered deposits that may be placed with IDIs, as the Release concedes: "[T]his proposed amendment to the primary purpose exception would expand the number of entities that meet the exception" to the definition of "deposit broker."[49] Moreover, under these proposed "primary purpose" provisions, there will be no assurance that the newly-exempted deposits will align with the stated purpose of the Proposal, which is only to provide the flexibility necessary to accommodate new financial technologies that benefit savers and consumers seeking access to banking products and services.

[48] Release at 7459.
[49] Release at 7459.

Exempting deposit placements of up to 25% of assets under management creates a huge loophole with no credible rationale.

The most troubling of the three amendments to the primary purpose exception is the proposal to allow up to 25% of an agent's customer funds under management to be placed with IDIs without regarding them as brokered deposits. The Release explains that—

> Through this rulemaking, the FDIC proposes that the primary purpose of an agent's or nominee's business relationship with its customers will not be considered to be the placement of funds, subject to an application process, if less that 25 percent of the total assets that the agent or nominee has under management for its customers, in a particular business line, is placed at depository institutions.[50]

This test is flawed on at least three levels. First, its impact is potentially huge. It could allow nearly limitless amounts of funds to be poured into IDIs indiscriminately, without regard to whether they represent the type of "hot money" in search of elevated returns that originally triggered the limitations on brokered deposits. Given that many asset managers hold vast sums of money for their clients, up to trillions of dollars, the 25% limit would allow them to place similarly vast sums with IDIs. In short, it would tear a huge hole in the rule.

Second, this is a flawed approach because it entirely ignores the nature of the deposits and the impact they may have on IDIs. The Proposal rests on the misconception that the focus of the primary purpose ***exception*** should be on the nature of the relationship between the agent and its customers. The Release articulates this misguided principle as follows:

> The FDIC is proposing to set forth regulatory changes to the primary purpose exception. Specifically, the FDIC is proposing that the application of the primary purpose exception be ***based on the relationship between the agent or nominee and its customers.***[51]

But the real focus of the primary purpose exception must instead be on the primary purpose of the ***deposits*** and the potentially destabilizing impact they may have on the receiving ***IDIs***. Only then can the primary purpose exception be properly applied in accordance with its underlying rationale. The Proposal shuns this approach, opting instead for an indiscriminate, bright-line test. It will open the door to a potentially huge increase in the number of third parties who can engage in deposit placements at IDIs with absolutely no consideration of whether this will increase risks to IDIs or the DIF. It is hard to read this as anything other than the FDIC subordinating its primary duty to protect the DIF in the interest of creating new business opportunities for third-party nonbank firms.[52]

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[50] Release at 7459.

[51] Release at 7459 (emphasis added).

[52] As a general proposition, we endorse the FDIC's decision at least to require those seeking to invoke the primary purpose exception to file applications. However, we also note that the application

Third and finally, even if we were to accept the untenable proposition that the focus of the primary purpose exception should be on the relationship between agents and their customers, the FDIC has failed to justify the particular bright-line test set forth in the Proposal. The Release provides no substantive or data-driven justification for the extraordinarily high 25% threshold, other than the conclusory statement that the "FDIC believes that if 75% or more of the customer assets under management of the third-party is not being placed at a depository institutions," then the primary purpose exception is met.[53] This is insufficient. Determining the "primary purpose" of a relationship between agents and their clients is necessarily a functional inquiry, and the primary purpose of an agent cannot be conclusively determined based on an arbitrary percentage of the assets under management that are placed with IDIs. The FDIC should abandon this provision.

The transactional exception is unclear and may foster evasion.

The proposed exception for deposit placements that enable transactions is a more appropriately tailored provision, since it is limited to agents placing deposits into specific types of accounts (transactional accounts) for a specific purpose (enabling payments). Indeed, the framing of this provision reflects our point above: that the primary purpose of the ***deposits***, and not the primary purpose of the ***relationship*** between agent and customer, should determine the applicability of the primary purpose exception.

Nevertheless, the proposal raises two concerns. First, the substance of the proposal on this exception is unclear. While the Release couches the exception in terms of deposits to "transactional accounts" for the purpose of "enabling payments," it does not define those terms or provide concrete examples. This lack of clarity makes it impossible to know exactly what type of situation is contemplated in the Proposal. As a result, it prevents fully informed comment from the public. Moreover, if this portion of the Proposal is finalized, its vague terms are likely to foster evasion or, at a minimum, deprive the industry of clear guidance.

Second, this exception raises the additional risk of evasion by design. The Release itself candidly acknowledges this threat:

> The FDIC does not intend for this exception to capture all third parties that place deposits into accounts that have transaction features and does not intend to create

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process, as set forth in the Proposal, would do little to address our concerns. For example, with respect to the "less than 25% of assets under management" test, the application would require only the most basic information, such as the amount of assets under management and the percentage that the agent places with IDIs, all without an explanation of purpose. At a minimum, any final rule should strengthen the application process for the "less than 25% of assets" exception to require sufficiently detailed information to determine the precise purpose of the assets that the agent places with IDIs.

[53] Release at 7459.

> an incentive for deposit brokers to move customers from time deposits to transaction accounts in order to evade brokered deposit restrictions.[54]

As the FDIC recognizes, "transaction accounts" could be used to exempt what are in fact traditional brokered deposits from the regulatory framework. Another variation on this threat is that deposit brokers might place deposits initially into transaction accounts for some period of time, to benefit from the exception, and then transfer them to other types of accounts to garner the benefits classically associated with brokered deposits. The application process may mitigate this threat to some extent, but not entirely. Therefore, any final rule must at a minimum include an anti-evasion provision.[55]

The catchall exception is unnecessary and also unwise.

The Proposal would allow any agent not meeting either the "less than 25% of assets under management test" or the transactional purpose test nevertheless to apply for the primary purpose exception. This is provision is flawed first and foremost because such a broad and open-ended exception has no justification, and the Release provides none.

It is also unwise in light of two additional concerns. First, the Release makes clear that even an agent that ***fails*** the "less than 25% of assets under management" test would still be eligible for the primary purpose exception under this catchall provision. Thus, the catchall renders an already dreadfully broad exception—the 25% rule—even more meaningless by allowing the FDIC to disregard it entirely.

Second, the Release suggests that the FDIC would interpret and administer this exception in a way that allows for an enormous amount of deposits to be placed with IDIs. For example, the

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54 Release at 7459.

55 The FDIC's approach appears to be aimed in part at making the primary purpose exception more broadly available for prepaid card programs. This represents a change in position for the FDIC, which had previously determined that the primary purpose exception often did not apply to prepaid card programs. *See* FDIC, Identifying, Accepting, and Reporting Brokered Deposits Frequently Asked Questions (Jul. 30, 2016), https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf. Under the Proposal, however, a typical prepaid card program would seem to qualify for the exception. However, the proposed approach cannot pass muster without a much more robust explanation from the FDIC on how its new approach is consistent with the statutory purposes of the brokered deposit regime. Specifically, it seems that prepaid card programs could pose the same risks that led Congress to regulate brokered deposits in the first place. For example, a bank could seek to fuel rapid asset growth by partnering with prepaid card programs to grow its deposit base. Similarly, prepaid card programs could represent "hot money" that might be withdrawn from an IDI rapidly if, for example, a partnership with a prepaid card program were to expire without renewal. What evidence does the FDIC have that prepaid card programs, and other deposits enabled by this expansion of the primary purpose exception, would not fuel dangerous asset growth or serve as a volatile, unstable source of funding? The Release provides no answers to these questions.

Release explains that one factor bearing on eligibility for the exception would be the "revenue structure for the agent."[56] It goes on to say that if the agent receives a ***majority*** of its revenue from its deposit placement activity, rather than from other services it offers, then it would not likely meet the primary purpose exemption. In other words, an agent that earns fully ***half*** of its revenue from placing deposits—and perhaps even more—could still be viewed as an agent whose primary purpose was ***not*** placing deposits. That is irrational on its face.[57]

6. <u>The application process must be more rigorous.</u>

We believe that the application process offers at least some safeguards against abuse of the three expanded primary purpose exceptions. However, the approach is flawed for a number of reasons. Establishing a case-by-case application process to assess possible exceptions to the rule is a poor substitute for designing a strong and clear rule in the first instance. It will increase the likelihood of ad hoc and inconsistent determinations that may not be in the public interest; it will make enforcement of the rule more difficult, particularly given the vagueness and breadth of the exceptions noted above; and it will undermine transparency and the public's right to see how the rule is being applied. Of particular concern, as noted above, the application requirements do not adequately safeguard against abuse of the "less than 25% of assets under management" test, and they should be strengthened accordingly.

Beyond that, and in response to some of the questions in the Release, we urge the FDIC to adopt the following changes in the application process:

- The FDIC should make all decisions on applications immediately public, in the interest of transparency;

- The FDIC should require that all applications include copies of the relevant contracts, not just "descriptions" of the "deposit placement arrangements between all parties involved."[58]

- Finally, and critically important, the FDIC should require that all applications include an attestation as to their accuracy, from the CFO, CEO, or equivalent high-level executive, and violations of this requirement should be subject to stringent penalties.

7. <u>The reporting requirement must be subjected to notice and comment.</u>

The Release states that agents meeting the primary purpose exception, and IDIs who apply on behalf of agents, would need to provide reports to the FDIC, and if applicable, to the IDI's

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[56] Release at 7460.

[57] We strongly approve of the FDIC's decision to hold firm against any relaxation in the treatment of brokered CDs as brokered deposits. Release at 7460. The FDIC should maintain this resolve.

[58] *See, e.g.,* Release at 7461 and 7462.

primary federal regulator.[59] This is an appropriate requirement, at least in principle. However, the Release also notes that the FDIC "will describe the reporting requirements, including the frequency and any calculation methodology, as part of its written approval for a primary purpose exception."[60]

This is unacceptable for a number of reasons. First, this approach violates the APA by failing to provide the public with adequate notice of the Proposal's requirements and a meaningful opportunity to comment. In interpreting the APA's notice-and-comment requirements,[61] the courts have repeatedly held that "[t]he opportunity for comment must be a meaningful opportunity," and that agencies must provide "enough time with enough information to comment and for the agency to consider and respond to the comments."[62] The proposed reporting requirements, such as they are, fail this test. And there is certainly no hint in the Release that the FDIC is relying on any form of emergency exception to the normal notice and comment requirements under the APA, nor could it legitimately invoke such provisions.

In addition, under the Proposal, there will be no uniform, standard set of reporting requirements imposed on those who win the right to rely on the expansive new primary purpose exceptions. This ad hoc approach not only lacks transparency and robs the public of its right to understand and comment on an important regulatory requirement, it also creates uncertainty, leaves the FDIC will total discretion over the reporting obligations, and creates the possibility of disparate treatment among applicants. This is unacceptable.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

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[59] Release at 7462.

[60] Release at 7462.

[61] 5 U.S.C. § 553.

[62] *Prometheus Radio Project v. F.C.C.*, 652 F.3d 431, 450 (3d Cir. 2011); *Florida Power & Light Co. v. U.S.*, 846 F.2d 765, 771 (D.C. Cir. 1988) (affirming that the APA's notice provisions require agencies "not only [to] give adequate time for comments, but also must provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully").

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