tbs TOTAL BANK SOLUTIONS

May 7, 2019

To FDIC Web Site at http://www.fdic.gov/regulations/laws/federal

Mr. Robert E. Feldman, Executive Secretary
Attn: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: RIN 3064-AE94 – ANPR for Comment re 12 C.F.R. Part 337, Unsafe and Unsound Banking Practices (Brokered Deposits); Comprehensive Review of Regulatory Approach to Brokered Deposits

Ladies and Gentlemen:

Total Financial Solutions, LLC, d/b/a Total Bank Solutions ("**TBS**"), applauds the FDIC for issuing the Advance Notice of Public Rulemaking ("**ANPR**")[1] to solicit public comment to initiate a comprehensive review of the FDIC's regulatory approach to brokered deposits.

TBS commends the FDIC for recognizing that a comprehensive review of its brokered deposit and interest rate regulations is warranted because of amendments to the relevant statutory provisions in 2018, as well as significant changes, since adoption of the regulations, in: technology; business models; the economic environment; and products affected by these regulations. TBS believes that in its rules and interpretations of its rules, the FDIC has caused the definition of "brokered deposit" to become unnecessarily expansive, particularly with respect to reciprocal deposits, and to "deposit sweep programs" pursuant to which idle funds awaiting investment are automatically transferred to a deposit account at an insured depository institution (a "**Sweep Bank**") from accounts of customers ("**Customers**") at a financial institution ("**Source Institution**") pursuant to an agreement governing the Customer's account at the Source Institution. Not only does the FDIC have the authority to correct this problem, it has an obligation to appropriately tailor its regulations to do so.

I. ABOUT TBS

Founded in 2004, TBS is a privately held financial technology firm located in Hackensack, NJ. Leveraging proprietary technology, TBS sponsors and administers its Insured Deposit Sweep ("**IDS**")

[1] Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019)

Program, by which idle funds awaiting investment in Customers' accounts at broker-dealers, trust companies, commercial bank trust departments and other Source Institutions are swept daily to deposit accounts at FDIC insured depository institutions that are Sweep Banks for the IDS Program in amounts such that each Customer's funds in the deposit accounts are fully insured by the FDIC. The IDS Program is designed to provide Customers with the benefit of FDIC insurance for idle Customer funds awaiting investment, to provide Source Institutions with a safe means for managing such funds, and to provide Sweep Banks with a stable, diversified and cost-effective source of deposit funding.

TBS offers its *Bank Monitor* on-line subscription service to provide client Source Institutions the ability to conduct due diligence and ongoing surveillance of the safety and soundness of all FDIC insured depository institutions. *Bank Monitor* provides analysis and support for risk surveillance, compliance testing and investment research. Subscribers to this service are not limited to TBS's IDS Program Source Institutions; other firms interested in monitoring the financial condition of insured depository institutions also subscribe to the service.

II. EXECUTIVE SUMMARY

A. Focus of TBS's Comments.

As the FDIC acknowledges in the ANPR, Section 29 ("**Section 29**") of the Federal Deposit Insurance Act ("**FDI Act**")[2] does not directly define the term "brokered deposit." Under paragraph (a) of Section 29, a "brokered deposit" consists of "funds obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts." In its regulations, the FDIC expanded the term in a nuanced way by defining it to include "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker."[3] Section 29 provides nine statutory exclusions to the definition of "deposit broker," also reflected in the definition of "deposit broker" in Section 337.6(a)(5)(ii)(A) through (I)[4] of the FDIC's regulations. TBS's comments focus on the third and ninth of those exclusions:

> (C) a trust department of an insured depository institution, if the trust in question has not been established for the primary purpose of placing funds with insured depository institutions (the "**Trust Management Exclusion**");[5] and
>
> (I) an agent or nominee whose primary purpose is not the placement of funds with depository institutions (the "**Primary Purpose Exclusion**").[6]

---

[2] 12 U.S.C. § 1831f, as amended by Section 202 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174 (enacted May 24, 2018) ("**Section 202**").

[3] 12 C.F.R. § 337.6(a)(2)

[4] 12 C.F.R. § 337 6(a)(5)(ii)(A) through (I).

[5] 12 U.S.C. § 1831f(g)(2)(C).

[6] 12 U.S.C. § 1831f(g)(2)(I).

TBS's comments will also focus on the limited exception for reciprocal deposits in Section 29(i) of the FDI Act, added by Section 202 in 2018.

In the ANPR, the FDIC asks for responses to five questions relating to brokered deposits, including, "Are there types of deposits that are currently considered brokered that should not be considered brokered?"

TBS responds to this question as follows. There are deposits that currently are considered brokered that should not be considered brokered; but, more importantly, the treatment of brokered deposits under the Assessment Rule in Part 327 of the FDIC's regulations (the "**FDIC Assessments Rule**"),[7] and the Liquidity Coverage Ratio: Liquidity Risk Measurement Standards (Part 329 of the FDIC's regulations) (the "**LCR Rule**"),[8] inappropriately stigmatizes the prudent use of brokered deposits by healthy banks. To address these concerns, TBS urges the FDIC to make the following changes to FDIC regulations:

1. Amend paragraph (a)(5)(ii) of Section 337.6 of the FDIC's regulations (the "**FDIC Brokered Deposit Rule**")[9] to incorporate the provisions of Advisory Opinion 05-02 ("**Advisory Opinion 05-02**"),[10] which allows a broker-dealer to sweep customers' funds to deposit accounts at a bank subject to specific conditions, but in a way that eliminates the inefficient and time-consuming requirement that each bank obtain its own letter of approval;

2. Amend paragraph (a)(5)(ii)(C) of the FDIC Brokered Deposit Rule to incorporate the provisions of Advisory Opinion 93-47 ("**Advisory Opinion 93-47**"),[11] which allows a separately incorporated trust company affiliate of a bank to sweep deposits to affiliated and nonaffiliated banks to the same extent as the trust department of a bank, with such sweeps being excluded from being considered brokered under the Primary Purpose Exclusion, and rescind Advisory Opinion 92-51 ("**Advisory Opinion 92-51**")[12] to the extent it causes a sweep deposit to be a brokered deposit if a trust department or trust company takes any fee in connection with the sweep;

---

[7] 12 C.F.R. Part 327.
[8] 12 C F.R. Part 329; see also identical Federal Reserve Board and OCC regulations at 12 C F R. Parts 249 and 50, respectively
[9] 12 C.F.R. § 337.6.
[10] FDIC Advisory Opinion No. 05-02, *Are Funds Held in "Cash Management Accounts' Viewed as Brokered Deposits by the FDIC?* (Feb. 3, 2005).
[11] FDIC Advisory Opinion No 93-47, *Whether Independent Trust Company Which Conducts Activities On Behalf of Affiliated Bank Must Register as Deposit Broker* (July 21, 1993).
[12] FDIC Advisory Opinion No 92-51, *Extent to Which Trust Department of Bank Is Subject to Registration Requirements Imposed by New Brokered Deposit Prohibitions* (Aug. 3, 1992).

3. For sweep deposits of broker-dealers and trust companies that are brokered deposits for purposes of Section 29 and the FDIC Brokered Deposit Rule:
    a. Amend applicable provisions of the FDIC Assessments Rule to exclude sweep and reciprocal deposits (including those that exceed the volume restrictions of Section 29(i)(1) of the FDI Act) entirely from punitive treatment, or significantly reduce their impact on assessments paid by insured depository institution (for all banks, or at least for well capitalized banks);
        - For example, amend 12 C.F.R. § 327.16(a)(1)(ii)(A) to deduct sweep deposits in addition to reciprocal deposits from brokered deposits for purposes of calculating the Brokered Deposit Ratio; and

    b. Amend the FDIC's LCR Rule (and encourage the OCC and Federal Reserve Board to amend their LCR Rules) to exclude sweep and reciprocal deposits (including those that exceed the volume restrictions of Section 29(i)(1) of the FDI Act) entirely from the restrictions on brokered deposits in the LCR Rule;
        - Specifically, amend paragraph 32(g)(7) and eliminate paragraph 32(g)(8) of the interagency LCR Rule regarding the calculation of outflow amounts so that banks may use the same 10% weight for calculating outflow of brokered sweep deposits regardless of whether they are sourced from affiliated or nonaffiliated financial institutions for all banks, or at least for well capitalized banks.

4. Amend the Uniform Bank Performance Report ("**UBPR**") to include insured sweep deposits, and reciprocal deposits that exceed the volume restrictions of Section 29(i)(1) of the FDI Act, in the definition of "core deposits" for analytical and examination purposes.

B. The FDIC Has Broad Authority to Define the Term "Deposit Broker" and to Create Exclusions.

The term "deposit broker" is defined in Section 29(g)(1) of the FDI Act[13] as:

> **(A)** 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
>
> **(B)** 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] 12 U.S.C. § 1831f(g)(1).

As noted above, Section 29(g)(2) creates nine statutory exclusions from the definition of "deposit broker," the last of which excludes, "an agent or nominee whose **primary purpose** is not the placement of funds with depository institutions."[14] (Emphasis added.) The FDIC has issued Frequently Asked Questions ("**FDIC FAQs**")[15] and numerous Advisory Opinions that effectively define the terms "placing," "placement," and "for the purpose of" within Section 29(g)(1). A February 28, 2019 comment to the ANPR from the American Bankers Association included a memorandum from the Jones Day law firm ("**Jones Day Memo**") that noted that staff of the FDIC has issued more than 80 separate and distinct public advisory opinions regarding brokered deposits, of which more than 60 interpret the words Congress used in defining "deposit broker" and in describing the arrangements that are covered by and excluded from the scope of this definition.[16]

The statutory exclusions are a floor – the FDIC must implement at least those exclusions, but nothing in the FDI Act precludes the FDIC from creating additional exclusions by regulation. Certainly, the FDIC is free to refrain from using brokered deposits as a factor in other regulations, such as its Part 327 Assessments rule, and to modify the definition of "deposit broker" and create additional exclusions, for purposes of such other rules.

C. <u>Deposit Sweeps and Reciprocal Deposits Should Be Regulated Differently Than Other Brokered Deposits</u>.

1. <u>Deposit Sweeps and Reciprocal Deposits Do Not Present the Same Risks as Other Brokered Deposits</u>.

Congress added Section 29 to the FDI Act in 1989 to restrict "troubled institutions" (those not meeting minimum capital requirements) from (1) accepting deposits from a deposit broker without a waiver, and (2) soliciting deposits by offering rates of interest that were significantly higher than prevailing rates.[17] The FDIC's focus changed in 2009, when it revised Part 327 of the FDIC's regulations regarding Assessments by making "brokered deposits," as defined for purposes of Section 29, a factor in the assessment paid by banks, whether or not troubled, merely because the FDIC had become concerned that banks could misuse brokered deposits and potentially become troubled. In other words, the FDIC exceeded Congressional intent by extending regulatory restrictions on the use of brokered deposits even by well-capitalized insured institutions that were not otherwise subject to the restrictions of Section 29.

---

[14] 12 U.S C. § 1831f(g)(2)(I).

[15] FDIC Financial Institution Letter 42-2016, "*Identifying, Accepting and Reporting Brokered Deposits Frequently Asked Questions*" (June 30, 2016), available at https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf.

[16] Letter dated February 28, 2019, from Robert S. Nichols, President and CEO of the American Bankers Association, to the Honorable Jelena McWilliams, attaching a Memorandum dated February 25, 2019, from Lisa M. Ledbetter of Jones Day; available at https://www.fdic.gov/regulations/laws/federal/2019/2019-unsafe-and-unsound-banking-practices-3064-ae94-c-016.pdf.

[17] ANPR, 84 Fed. Reg. at 2366, citing PL 101-73, August 9, 1989, 103 Stat 183.

In response to the proposals to issue the FDIC Assessments Rule and LCR Rule, commenters pointed out that deposit sweep programs and reciprocal deposits do not present the same risks as other forms of brokered deposits. The FDIC rejected that view, however, without presenting any quantitative analysis or other substantial evidence of the need for or appropriateness of restrictions or adverse consequences on such deposit programs.

TBS believes the FDIC has not yet presented sufficient evidence demonstrating that deposit sweeps and reciprocal deposits present the risks to the Deposit Insurance Fund and the solvency of insured depository institutions that the FDIC and Congress have identified with other brokered deposits generally.

2. Deposit Sweeps Impose Market Discipline on Banks that Accept Them that Reduces Risk to the Banks and the Deposit Insurance Fund.

Empirical evidence supports TBS's position that Sweep Banks are subject to market discipline that makes them operate more safely and soundly than institutions that do not accept such deposits ("**Non-Sweep Banks**"). As shown in Section III.C.1 below, whether measured over the 2006-2018 or 2011-2018 time period, Sweep Banks that have accepted sweep deposits have been less than half as likely to have ever become less than well capitalized, than banks that have not accepted sweep deposits, and more than three times less likely to become less than well capitalized than banks that accept other forms of brokered deposits. **In fact, data presented in Section III.C.1 indicates that Sweep Banks operate at least as safely as banks that accept no brokered deposits.**

This evidence demonstrates that the FDIC has not appropriately tailored its regulations, consistent with standards established by recent federal case law and by Presidential Executive Order 13772 ("**E.O. 13772**"),[18] issued on February 3, 2017. Adopting the changes suggested by TBS would be consistent with appropriate tailoring.

III. COMMENT

A. Standards the FDIC Should Apply to Rulemaking Regarding Brokered Deposits.

1. E.O. 13772 as a Framework for Analysis.

The FDIC should apply E.O. 13772 as a framework for analyzing how it can improve its implementation of Section 29. Section 1 of E.O. 13772 establishes seven principles for the regulation of the financial system (the "**Core Principles**"), including the following five:

---

[18] *Presidential Executive Order on Core Principles for Regulating the United States Financial System*, https //www.whitehouse gov/presidential-actions/presidential-executive-order-core-principles-regulating-united-states-financial-system

(a) Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;

(b) Prevent taxpayer-funded bailouts;

(c) Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry; . . . .

(f) Make regulation efficient, effective, and appropriately tailored; and

(g) Restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

In the context of the regulation of brokered deposits, we summarize these five Core Principles as follows:

> The FDIC is required to conduct a rigorous regulatory analysis and appropriately tailor the regulations to impose only those restrictions necessary to preserve safety and soundness of insured institutions and the banking system, without unnecessarily restricting customers' financial decisions, or the ability of institutions to manage their own liquidity.

2. <u>The Core Principles Incorporate Judicially Established Standards for Decision-Making by Federal Administrative Agencies</u>.

The Core Principles, particularly the expectation that agencies will conduct rigorous regulatory impact analyses and will appropriately tailor regulations, effectively incorporate the requirement that agencies engage in reasoned decision-making established by the U.S. Supreme Court in *Michigan v. EPA*, 135 S. Ct. 2699, 192 L.Ed.2d 674 (2015). In that case, the Court stated:

> Federal administrative agencies are required to engage in "reasoned decision making."[19] . . . "Not only must an agency's decreed result be within the scope of its lawful authority, but the process by which it reaches that result must be logical and rational." *Ibid.* It follows that agency action is lawful only if it rests "on a consideration of the relevant factors."[20]

The Court went on to say:

> One does not need to open up a dictionary in order to realize the capaciousness of [the phrase "appropriate and necessary"]. In particular, "appropriate" is "the classic broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant

[19] Citing *Allentown Mack Sales & Service, Inc v NLRB*, 522 U.S 359, 374 (1998).
[20] 135 S. Ct. at 2706, citing *Motor Vehicle Mfrs Assn. of United States, Inc v State Farm Mutual Automobile Ins Co*, 463 U.S. 29, 43 (1983).

> factors."[21] Although this term leaves agencies with flexibility, an agency may not "entirely fai[l] to consider an important aspect of the problem" when deciding whether regulation is appropriate.[22]

While *Michigan v. EPA* addressed rules issued by the Environmental Protection Agency over power plants, a federal court has had the opportunity to apply the case to financial system regulation. In *MetLife, Inc. v. FSOC*, 177 F. Supp. 3d 219 (D.C.D.C. 2016), the United States District Court for the District of Columbia relied on *Michigan v. EPA* in overturning the decision by the Financial Stability Oversight Council ("**FSOC**") to designate MetLife, Inc., pursuant to the Dodd–Frank Act, as a nonbank financial company subject to enhanced supervision by the Federal Reserve Board under enhanced prudential standards, on the grounds that MetLife's material financial distress could pose a threat to financial stability of the United States. The District Court ruled that the FSOC was arbitrary and capricious in "purposefully" omitting consideration of arguments made by MetLife, finding that "FSOC assumed the upside benefits of designation . . . but not the downside costs of its decision." 177 F. Supp. 3d at 220. The court concluded that the failure to quantify the impact of factors the agency assumed in rebutting factual analyses submitted by MetLife was an intentional refusal to engage that rendered FSOC's decision arbitrary and capricious. 177 F. Supp. 3d at 237-238.[23]

B. Purpose of the Brokered Deposit Restrictions.

In Section II of the ANPR,[24] the FDIC identifies the following concerns of bank regulators and Congress as having led to enactment of statutory restrictions:

1. Brokered deposits "could facilitate a bank's rapid growth in risky assets without adequate controls";
2. "A problem bank could use brokered deposits to fund additional risky assets to attempt to 'grow out' of its problems, a strategy that increased losses to the deposit insurance fund when the institution failed;" and
3. "Brokered and high rate deposits [lumped together] were sometimes volatile because deposit brokers (on behalf of customers), or the customers themselves, were often drawn to high rates and were prone to leave the bank when they found a better rate or they became aware of problems at the bank." (Emphasis added.)

The Jones Day Memo comprehensively reviewed the legislative history of Section 29, and concluded that the definition of "deposit broker" in FDIC regulations and interpretations has expanded well beyond Congress's original intent. That letter cites instances in which Senator Frank H. Murkowski

---

[21] Citing *White Stallion Energy Center, LLC v EPA*, 748 F.3d 1222, 1266 (D.C. Cir. 2014, opinion of Kavanaugh, J)
[22] Citing *State Farm*, 463 U S. at 43.
[23] FSOC and MetLife's joint motion to vacate the court's determination that FSOC is required to consider direct and indirect costs was denied by the court. See Order of February 28, 2018 (Civ. Action No.15-cv-45 (RMC)).
[24] 84 Fed Reg. at 2366.

(R-AK), one of the sponsors of the legislation, testified that the restrictions on brokered deposits were intended to cover only troubled banks.[25]

The FDIC began to deviate from the legislative purpose of Section 29 when it adopted the revised FDIC Assessments Rule in 2009, which expanded the focus of brokered deposit regulation by extending the scope of its coverage to non-troubled banks. While the FDIC has produced evidence that an increased use of general brokered deposits correlates to an increased risk of failure, it has never adequately responded to industry comments that deposit sweeps and reciprocal deposit arrangements are a subset of brokered deposits that do not meaningfully correlate to such risks.[26]

In fact, the ANPR notes that:

> [H]istorically, most institutions that use brokered and higher-rate deposits have done so in a prudent manner and appropriately measure, monitor, and control risks associated with brokered deposits. . . . Nonetheless, the FDIC also recognizes that institutions sometimes are concerned that the use of brokered deposits can have other regulatory consequences, such as implications for deposit insurance pricing in certain circumstances, or may be viewed negatively by investors or other stakeholders.[27]

C. **The Statutory Exceptions Are Not Sufficient with Respect to Deposit Sweep Arrangements**.

1. **Market Discipline Causes Banks that Accept Sweep Deposits to Operate More Soundly.**

Because sweep deposits from unaffiliated broker-dealers and trust companies are treated as brokered deposits, Section 29 permits only well capitalized banks (and adequately capitalized banks with prior FDIC approval) to accept such sweeps. Moreover, Source Institutions do not want their Customers' funds to be rendered inaccessible even temporarily during a receivership, so they monitor the condition of Sweep Banks. Sweep Banks are aware that they are being monitored by the Source Institutions and manage themselves to avoid becoming less than well capitalized, as demonstrated by the data presented below. Source Institutions are sophisticated custodians that themselves or with assistance from sweep program administrators are able and willing to exercise more discipline over Sweep Banks than depositors of other types of brokered deposits exercise over banks in which they place deposits.

---

[25] Jones Day Memo, pp 3-5 and 22-23.

[26] As the FDIC noted in the ANPR, "the brokered deposit ratio is one of several financial measures used to determine assessment rates for small banks. For new small banks in Risk Categories II, III, and IV, and large and highly complex institutions that are not well capitalized, or that are not CAMELS composite 1- or 2-rated, brokered deposits can increase a bank's assessment rate through the brokered deposit adjustment" pursuant to Section 327.16 of the FDIC Assessments Rule (12 C.F.R § 327.16). In addition, the level of brokered deposits affects the calculation of an insured depository institution's "total net cash outflow" for purposes of the LCR Rule. See Section 329.32(g) of the FDIC's regulations and corresponding sections of the OCC's and Federal Reserve Board's LCR Rules. 12 C.F.R. § 329.32(g); see also 12 C.F.R. § 249 32(g) and 12 C.F R. § 50 32(g). *See also* FDIC FAQs, question A5

[27] ANPR, 84 Fed. Reg. at 2366.

The following table summarizes the distribution of banks that are “well capitalized”, “adequately capitalized” and less than “adequately capitalized” under the Prompt Corrective Action (“**PCA**”) capital regime[28] among Sweep Banks[29] and Non-Sweep Banks,[30] and breaks those totals down for the 2006-2018 and 2011-2018 time periods.

Sweep Banks vs Non-Sweep Banks

	2006 - 2018			2011 - 2018		
PCA Category of Sweep Banks	# of banks	% of total		# of banks	% of total	
Well Capitalized	209	91.7%		222	97.4%	
Adequately Capitalized	14	6.1%	8.3%	3	1.3%	2.6%
< Adequately Capitalized	5	2.2%		3	1.3%	
Total	228	100.0%		228	100.0%	
PCA Category of Non-Sweep Banks With No Brokered Deposits						
Well Capitalized	3079	92.6%		2974	94.0%	
Adequately Capitalized	119	3.6%	7.4%	62	2.0%	6.0%
< Adequately Capitalized	125	3.8%		126	4.0%	
Total	3323	100.0%		3162	100.0%	
PCA category of Non-Sweep Banks With Brokered Deposits						
Well Capitalized	4534	79.1%		3808	90.6%	
Adequately Capitalized	506	8.8%	20.9%	149	3.6%	9.4%
< Adequately Capitalized	695	12.1%		245	5.8%	
Total	5735	100.0%		4202	100.0%	

Of 228 insured banks that have accepted sweep deposits since 2006, only 8.3% of those banks have ever been less than well capitalized. On the other hand, of 9,058 insured banks that have not accepted

[28] See 12 C.F R. § 324.403(b)

[29] Sweep Banks in the table include insured depository institutions that participate in TBS’s IDS Program and those identified in the following websites as participating in other insured deposit sweep programs (excluding insured branches of foreign banks):

https //www.tiaa.org/public/pdf/pershing_fj_termsconditions.pdf;
https://www.pershing com/_global-assets/pdf/intermedium-interlink-bank-list.pdf;
https://www.raymondjames.com/wealth-management/advice-products-and-services/banking-and-lending-services/cash-management/cash-sweeps/raymond-james-bank-deposit-program/participating-banks;
https://www aspiration.com/program-banks/;
https //www.opco.com/wealth-management/investments/advantage-bank-deposit-program.aspx,
https://www.bbtscottstringfellow.com/accounts-services/insured-deposit-program;
https://axosclearing.com/insured-deposit-program-banks/;
https://www.edwardjones com/disclosures/account-features-terms/saving-spending-borrowing/insured-bank-deposit/index.html,
https //www.securitiesamerica.com/bank-deposit-sweep-program/pershing-icap-bank-list.

[30] Total number of banks and data regarding prompt corrective action capital categories derived from banks’ Reports of Condition available on the FFIEC Central Data Repository’s Public Data Distribution website.

sweep deposits since 2006, 16% have been less than well capitalized. Of the 228 insured banks that have accepted sweep deposits since 2011 (*i.e.*, after adoption of the Dodd-Frank Act and three years after the financial crisis that led to its adoption), only 2.6% of those banks have been less than well capitalized. On the other hand, of 7,364 insured banks that have not accepted sweep deposits since 2011, 7.9% have been less than well capitalized.

Moreover, virtually the same percentage of Sweep Banks (8.3%) became less than well capitalized since 2006 as the percentage of banks that never accepted any brokered deposits (7.4%); while 20.9% of Non-Sweep Banks that accepted other types of brokered deposits became less than well capitalized. For the period from 2011 through 2018, 2.6% of Sweep Banks became less than well capitalized – even less than the 6.0% of Non-Sweep Banks that took no brokered deposits that became less than well capitalized, and substantially less than the 9.4% of Non-Sweep Banks that took other types of brokered deposits.

In other words:

- Banks that have accepted sweep deposits have been less than half as likely to ever have become less than well capitalized than banks that have not accepted sweep deposits;
- Since 2006 Sweep Banks have become increasingly stronger relative to Non-Sweep Banks in that the percentage of banks below well capitalized has dropped from 8.3% to 2.6% during the period (a drop of 68.7%), whereas Non-Sweep Banks have dropped from 16.0% to 7.9% (a drop of 50.6%); and
- Sweep Banks exhibit performance substantially more like (or better than) banks that never take brokered deposits; the data shows that Non-Sweep Banks that took brokered deposits other than sweep deposits became less than well capitalized almost three times as often as Sweep Banks.

TBS is unaware of any data demonstrating that sweep deposits have contributed to high rates of insured depository institution asset growth.

Although the Statistical Analysis in Appendix 2 to the ANPR devotes seven pages to a largely inconclusive analysis about reciprocal deposits[31], there is no mention of sweep deposits in that analysis. TBS assumes the reason for this is that "the analysis summarized in [Appendix 2] uses data from FDIC's Failure Transaction Database, Call Reports/TFRs, and supervisory CAMELS ratings" and that the FDIC has never collected this data with respect to sweep deposits, notwithstanding the industry's repeated comments to the FDIC starting in 2008.[32]

---

[31] 84 Fed. Reg. at 2389-2395.

[32] The ANPR reports that, "[a]s of September 30, 2018, these 28 insured depository institutions [that have received approval to take sweeps from affiliated broker-dealers in the manner reflected in Advisory Opinion 05-02 so that they are excluded from brokered deposits] reported $724 billion as the average amount of funds swept from the institutions' affiliated broker dealers for September 2018." 84 Fed. Reg. at 2369. There is no data for sweeps to banks that have not received such approval that would be considered brokered deposits.

Source Institutions – whether they are broker-dealers, trust companies, or other financial institutions – do not want their Customers' funds to get tied up in a bank receivership. They typically establish eligibility criteria for banks to which they will sweep deposits and along with sweep plan administrators, such as TBS, monitor for continued conformance with those criteria, with a view to identifying trends that might predict when a bank would cease to be well capitalized.[33] Banks that utilize sweep deposits as part of their funding strategy are aware of these expectations. The difference between sweep deposits and other forms of brokered deposits is that sweeps are used as a routine, long-term funding strategy, not as a vehicle to fuel rapid growth. The data presented in the table above is consistent with the conclusion that Sweep Banks manage themselves prudently to meet deposit sweep program administrators' expectations that they remain well capitalized and, therefore, eligible to receive sweep deposits.

Given (i) the data supporting the positive effects on safety and soundness of the market discipline imposed on Sweep Banks, (ii) the absence of evidence that sweep deposits present a substantial risk to the Deposit Insurance Fund or the banking system, and (iii) the inefficiencies that the unnecessary restrictions on these arrangements pose to broker-dealers, trust companies, and their Customers, TBS believes that sweep deposits, whether or not from an affiliated financial institution, should be excluded from the restrictions on brokered deposits in the FDIC Assessments and LCR Rules.

For reasons discussed in Section III.E below, the FDIC and the other federal bank regulatory agencies should amend paragraph 32(g)(7) and eliminate paragraph 32(g)(8) of their LCR Rules regarding the calculation of outflow amounts so that banks may use the same 10% weight for calculating outflow of brokered sweep deposits regardless of whether they are sourced from affiliated or nonaffiliated financial institutions.[34] The FDIC should also codify Advisory Opinion 05-02 into its regulations and

---

[33] While only TBS has access to its proprietary *Bank Monitor* tool to meet these expectations, other sweep administrators also have procedures to meet these expectations For example, another sweep administrator firm, StoneCastle Cash Management, states that it "reviews each bank in its network and monitors those banks on a quarterly basis Management is keenly aware that headline risk to a failed bank could cause stress on the franchise and ultimately FICA's future viability." Kroll Bond Rating Agency, *StoneCastle Federally Insured Cash Account*, (Feb. 21, 2018), p. 9, available at https.//www.krollbondratings.com/show_report/8823.

[34] FDIC 12 C.F.R. § 329.32(g)(7) and (8); FRB: 12 C.F.R. § 249.32(g)(7) and (8); and OCC: 12 C.F.R. § 50.32(g)(7) and (8) currently read

> **(7)** 10 percent of all brokered sweep deposits at the FDIC-supervised institution provided by a retail customer or counterparty
>
> > **(i)** That are deposited in accordance with a contract between the retail customer or counterparty and the FDIC-supervised institution, a controlled subsidiary of the FDIC-supervised institution, or a company that is a controlled subsidiary of the same top-tier company of which the FDIC-supervised institution is a controlled subsidiary; and [(ii) omitted] . . .
>
> **(8)** 25 percent of all brokered sweep deposits at the FDIC-supervised institution provided by a retail customer or counterparty·
>
> > **(i)** That are not deposited in accordance with a contract between the retail customer or counterparty and the FDIC-supervised institution, a controlled subsidiary of the FDIC-supervised institution, or a company that is controlled

eliminate the inefficient and time-consuming requirement that each bank obtain its own letter of approval; there is no rational basis for the creation of such an application process.

2. Sweeps of Funds from Trust Accounts at Separately Incorporated Trust Companies Should Not Be Treated Less Favorably than Sweeps of Funds from Accounts at Broker-Dealers.

The Trust Management exclusion from the definition of "deposit broker" exempts deposits placed by a trust department of an insured depository institution, if the trust in question has not been established for the primary purpose of placing funds with insured depository institutions.[35]

The issue here is that independent trust companies need to prudentially invest the funds of their trust customers subject to the same duties as trust departments of insured depository institutions, and, in any event, the funds must be deposited by the trust companies in insured depository institutions until they are invested more permanently.

While the market discipline that TBS demonstrated above is imposed on banks that accept sweep deposits from such trust companies as brokered deposits may justify the continued treatment of such sweeps as brokered deposits under the Brokered Deposit Rule, TBS sees no reason that they should be treated differently for purposes of the FDIC Assessments and LCR Rules. An insured depository institution could utilize its know-your-customer processes under the Bank Secrecy Act to create a process for making a reasonable determination that a trust company is not establishing trusts for the primary purpose of placing funds with insured depository institutions. Such an exemption would eliminate an unfair and unnecessary disincentive for banks to accept deposits from independent trust companies.

In Advisory Opinion 93-47, the FDIC acknowledged that "a trust company affiliated with a bank and serving essentially the same function as a trust department for that bank would be excluded from the definition of deposit broker pursuant to [the primary purpose exception in] 12 C.F.R. § 337.6(a)(5)(ii)(I), so long as the trust or other fiduciary relationship in question has not been established for the primary purpose of placing funds with insured depository institutions." Advisory Opinion 93-47 should be incorporated into Section 337.6(a)(5)(ii)(C) of the FDIC Brokered Deposit Rule.

FDIC Advisory Opinion 92-51, applicable to trust departments of banks under the Trust Management Exclusion, sets out three tests for determining whether the fiduciary relationship was created for the "primary purpose of placing funds with depository institutions," and, therefore, causes any funds deposited from a trust account resulting from that relationship to be treated as brokered:

---

subsidiary of the same top-tier company of which the FDIC-supervised institution is a controlled subsidiary; and [(ii) omitted].

[35] 12 U.S.C. § 1831f(g)(2)(C)

1. *Fees received.* If the depository institution receives a fee for its account from the depository institution with which its trust department places the funds of a trust, the trust department [or affiliated trust company] is a deposit broker as to that trust.

2. *"But for" test.* If the trust would not have been established but for the purpose of placing funds in an insured depository institution, the trust department [or affiliated trust company] is a deposit broker as to that trust.

3. *Substantial purpose test.* If there is no substantial purpose for the trust other than the placement of funds in insured depository institutions, the trust department [or affiliated trust company] is a deposit broker as to that trust.

While TBS understands the imposition of the "but for" and "substantial purpose" tests, even the Primary Purpose Exclusion has not been read by the FDIC to require that a broker-dealer receive **no** fees, as is clear from Advisory Opinion 05-02. Therefore, there is no justification for an absolute prohibition on a bank or trust company receiving some fee in connection with sweeping deposits to a bank, if for no other reason than that the trust company will be required to assist the bank in complying with the FDIC's Part 370 regulations (Recordkeeping for Timely Deposit Insurance Determination),[36] which become effective next year.

3. <u>Brokered Sweep Deposits Should Not Be Excluded from Core Deposits</u>.

Effective with the March 31, 2011 UBPR, the FFIEC revised the definition of core deposits to, among other things, exclude brokered deposits even if fully insured by the FDIC.[37] TBS believes that this action added to the stigma attached by some analysts – and federal bank examiners – to the use of brokered deposits by even well capitalized banks, no matter how prudently such deposits are used. This makes banks reluctant to accept sweep deposits even when such acceptance would not have any adverse consequences under the FDIC Assessments Rule or LCR Rule and the cost of such funds would be well within the bank's funding strategy. Given the demonstrated salient impact of sweep deposits, the FDIC should not discourage well capitalized banks from accepting them. Accepting sweep deposits is a funding strategy that has been used effectively and without apparent harm by banks eligible to receive them; discouraging their use because some banks have abused other forms of brokered deposits to fuel unsafe asset strategies would be like discouraging baseball because bats are sometimes used as weapons. The FDIC should encourage the FFIEC to reinstate such deposits into the definition of "core deposits" in the UBPR.

---

[36] 12 C.F.R. Part 370.

[37] See 84 Fed Reg. at 2379. The term "Core Deposits" is defined in several sections of the Liquidity and Funding section of the UBPR User's Guide, available at https://cdr.ffiec.gov/CDRDownload/CDR/UserGuide/v98/FFIEC%20UBPR%20User%20Guide%20Liquidity%20&%20Funding--Page%2010_2019-04-10.PDF.

D. The Statutory Exceptions Are Not Sufficient with Respect to Reciprocal Deposit Arrangements.

The addition of paragraph (i) to Section 29 in 2018 merely exempted a limited volume of reciprocal deposits from inclusion as "brokered deposits." Since the term "reciprocal deposit" is defined in Section 327.8(q) of the FDIC's Assessments Rule, and "reciprocal deposits" are discretely included in that rule as a factor in determining the amount of an insured depository institution's assessments, it is not clear that reciprocal deposits excepted by Section 29(i) are excepted from inclusion in Part 327. Unless such a clarification is made, the intent of Congress in providing the exemption for reciprocal deposits from the term "brokered deposits" will be thwarted. They should be excluded, of course; but so should reciprocal deposits exceeding the volume restrictions of Section 29(i)(1).

E. In Prior Rulemakings, the FDIC Has Not Appropriately Tailored Restrictions on Brokered Deposits with Respect to Cash Sweeps and Reciprocal Deposits.

In the course of issuing recent rules that impacted brokered deposits, the FDIC has rejected industry comments pointing out that brokered sweep deposits possess qualities that make them more stable than other forms of brokered deposits, and those qualitative differences justify treating sweep deposits more favorably than other forms of brokered deposits. The FDIC has rejected these comments without any evidence of the rigorous regulatory impact analysis or appropriate tailoring now anticipated by the Core Principles.

The FDIC's failure to substantiate its differences with the industry about brokered sweep deposits is of particular concern given that this issue surfaced as early as 2009, in connection with the FDIC's rulemaking with respect to its Assessments Rule. In issuing the revised Assessments Rule in 2009, the FDIC stated:

> The FDIC also received several comments arguing that brokered deposits that consist of balances swept into an insured institution by a nondepository institution, such as balances swept into an insured institution from a brokerage account at a broker-dealer, should be excluded from the adjusted brokered deposit ratio. Commenters argued that these sweep accounts are stable, relationship-based accounts. Commenters also stated that the aggregate flows in and out of the sweep accounts tend to offset one another and are thus predictable. Some commenters differentiated between sweeps from affiliated brokerage firms and those from non-affiliated firms. These commenters argued that broker-dealer affiliated sweeps are not rate-sensitive accounts and are not designed to compete with the high rates of interest paid by other insured institutions and, therefore, do not raise the same concerns as other brokered deposits about the high cost of funding of risky banks. The commenters maintained that these accounts are typically used for idle investment funds or as a safe investment and are designed to better manage excess cash. Some commenters suggested that bankers would be willing to separately report sweep balances from an affiliated brokerage.

> Some commenters supported excluding brokered deposits swept from *unaffiliated* brokerages through a sweep program, since the deposits have the characteristics of core deposits and are not driven by yield. According to the commenters, there is no price competition; deposits from unaffiliated brokerages are used for the convenience and safety of the customer.

74 Fed. Reg. 9525, 9532 (Mar. 4, 2009).

More recently, in responding to comments to the interagency LCR Rule, the federal bank regulatory agencies based their rejection of comments that outflow rates applied to fully-insured brokered sweep and reciprocal deposits should be lowered to be more consistent with the fully insured rate of 3 percent to unsecured stable retail deposits, and that outflow rates applicable to partially insured brokered deposits were too high, by stating the following beliefs:

- "During a period of significant market volatility and distress, customers may be more likely to purchase or sell securities and withdraw funds from such accounts;"
- "[C]ustomers would be more likely to withdraw funds from their ancillary accounts, such as the brokered sweep accounts, prior to depleting resources in accounts used for day-to-day transactions;" and
- Reciprocal deposits, like other brokered deposits, present elevated liquidity risks. During periods of material financial distress or an idiosyncratic event involving a particular institution, depositors or program operators may terminate their relationships with a banking organization, resulting in a significant loss of funding.[38]

Although brokered sweep and reciprocal deposits had been utilized for more than a decade at the time of publication of the final rule, the FDIC and the other agencies rejected these comments without any data to support their beliefs.

The agencies acknowledged a comment that, "while banking organizations are required to report their total brokered deposits on the Consolidated Report of Condition and Income (Call Report), there is no breakdown by type of deposit account [and] that banking organizations currently do not report the information necessary for a comprehensive examination of the brokered deposit market and its component parts." The agencies responded that they, "believe a conservative approach to setting brokered deposit outflow rates for the purposes of the LCR is appropriate in light of **limited available data**, the findings of the FDIC Brokered Deposit Study showing that increased reliance on brokered deposit rates is correlated with higher overall risk, and the strong incentives third party brokers have to provide the highest possible returns for their clients by seeking accounts paying the highest interest rates[; and that] the assumptions and provisions of § __.32(g) are consistent with the available sources of information, including the FDIC Brokered Deposit Study. . . ." (Emphasis added.) This response constituted an abject refusal to even consider appropriate tailoring of the rules to different types of brokered deposits that exhibit different risk characteristics.[39]

---

[38] 79 Fed. Reg. 61,439, 61,492-93 (Oct 10, 2014).
[39] Id. at 61,494.

By enacting Section 202, Congress legislated how reciprocal deposits would be treated for purposes of Section 29 and the FDIC's Brokered Deposit Rule. Nothing in Section 202, however, prevents the FDIC or other agencies from amending the Assessments Rule and the LCR Rule to eliminate the punitive treatment accorded to such deposits, whether within or in excess of the $5 billion volume restriction established in Section 202, or from restoring such deposits to "core deposit" status in the UBPR. Indeed, it would be inconsistent with Congressional intent for the agencies not to recognize that in enacting the exemption for reciprocal deposits from the definition of brokered deposits, Congress implicitly endorsed the stable nature of reciprocal deposits. At a minimum, therefore, the restrictions imposed on reciprocal deposits in the Assessments and LCR Rules should be eliminated for banks that are well capitalized.

IV. CONCLUSION

Based on the foregoing, TBS urges the FDIC to take the following actions to appropriately tailor its rules with respect to brokered sweep deposits and reciprocal deposits:

1. Amend paragraph (a)(5)(ii) of Section 337.6 of the Brokered Deposit Rule to incorporate the provisions of Advisory Opinion 05-02, which allows a broker-dealer to sweep customers' funds to deposit accounts at an insured bank subject to specific conditions, but eliminate the inefficient and time-consuming requirement that each bank obtain its own letter of approval;

2. Amend paragraph (a)(5)(ii)(C) of the FDIC Brokered Deposit Rule to incorporate the provisions of Advisory Opinion 93-47, which allows a separately incorporated sister trust company affiliate of a bank to sweep deposits to affiliated and nonaffiliated banks to the same extent as the trust department of a bank, with such sweeps being excluded from being considered brokered under the Primary Purpose Exclusion, but rescind Advisory Opinion 92-51 to the extent it causes a sweep to be a brokered deposit if a trust department or trust company takes any fee in connection with the sweep;

3. For sweep deposits of broker-dealers and trust companies that <u>are</u> brokered deposits for purposes of Section 29 and the FDIC Brokered Deposit Rule:
   a. Amend applicable provisions of the FDIC Assessments Rule to exclude sweep and reciprocal deposits (including those that exceed the volume restrictions of Section 29(i)(1) of the FDI Act) entirely from punitive treatment, or significantly reduce their impact on assessments paid by insured depository institution (for all banks, or at least for well capitalized banks);
      - For example, amend 12 C.F.R. § 327.16(a)(1)(ii)(A) to deduct sweep deposits in addition to reciprocal deposits from brokered deposits for purposes of calculating the Brokered Deposit Ratio; and

   b. Amend the FDIC's LCR Rule (and encourage the OCC and Federal Reserve Board to amend their LCR Rules) to exclude sweep and reciprocal deposits (including those that exceed the volume restrictions of Section 29(i)(1) of the FDI Act) entirely from the restrictions on brokered deposits in the LCR Rule;

- Specifically, amend paragraph 32(g)(7) and eliminate paragraph 32(g)(8) of the interagency LCR Rule regarding the calculation of outflow amounts so that banks may use the same 10% weight for calculating outflow of brokered sweep deposits regardless of whether they are sourced from affiliated or nonaffiliated financial institutions for all banks, or at least for well capitalized banks.

4. Amend the UBPR to include insured sweep deposits and reciprocal deposits that exceed the volume restrictions of Section 29(i)(1) of the FDI Act in the definition of "core deposits" for analytical and examination purposes.

TBS thanks the FDIC for its consideration of these comments, and would be delighted to respond to any request to provide further information about the matters discussed in this letter to assist the FDIC as it performs the rigorous analysis appropriate for these issues. If you have questions about these comments, please direct them to the undersigned at (201) 498-7073, or by email to mkadish@totalbanksolutions.com.

Sincerely,

[redacted]

Michael L. Kadish
Managing Director and Senior Counsel

cc: The Honorable Jelena McWilliams
Chairman, Federal Deposit Insurance Corporation

The Honorable Martin J. Gruenberg
Director, Federal Deposit Insurance Corporation

The Honorable Kathleen Kraninger
Director, Consumer Financial Protection Bureau

The Honorable Joseph M. Otting
Comptroller of the Currency

Eric A. Pierce
CEO, Total Bank Solutions