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May 7, 2019

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
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

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the advance notice of proposed rulemaking (ANPR) concerning *Brokered Deposits and Interest Rate Restrictions*. As the ANPR points out, the financial services industry has seen significant changes in technology, business models, and products since the statutory brokered deposit restrictions were enacted in 1989 and 1991. The key reason why the FDIC is issuing this ANPR is to seek public comment on the impact of these changes and determine what changes need to be made to the brokered deposit regulations.

ICBA commends the FDIC for taking the initiative to review its interpretations of Section 29 of the Federal Deposit Insurance Act (FDI Act), as well as its restrictions on interest rates, and address the key question of how can we improve the regulation of brokered deposits and at the same time, implement the legislative goals of Section 29. We believe that significant changes in technology, business models and products among community banks necessitate a review of the FDIC's approach to brokered deposits. Our comment letter will first address the brokered deposit issues generally and then will address our specific concerns regarding interest rate restrictions on brokered deposits.

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 52,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 760,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$4.9 trillion in assets, \$3.9 trillion in deposits, and \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

Brokered Deposits and Community Banks

Although an important source of funding for the banking system as a whole, brokered deposits still represent a minority of total deposits in our banking system. As noted in the ANPR, as of September 30, 2018, 2221 insured depository institutions held brokered deposits totaling \$986 billion. This is equal to about 8 percent of the \$12.3 trillion in industry domestic deposits. Furthermore, brokered deposits are concentrated in a small number of banks. One hundred institutions held almost 90 percent of the \$986 billion brokered deposits in the banking system.

Since 2009 when institutions began reporting total reciprocal brokered deposits, much of the brokered deposits held by community banks have been reciprocal deposits resulting from reciprocal deposit arrangements managed by third party sponsors. However, the recently passed Economic Growth, Regulatory Reform, and Consumer Protection Act which was strongly supported by ICBA greatly reduced the percentage of reciprocal deposits that are classified as brokered deposits. Under Section 202 of the Act, well capitalized and well rated institutions are not required to treat such reciprocal deposits as brokered deposits up to the lesser of 20 percent of total liabilities, or \$5 billion. As of March 30, 2018, the last reporting quarter before the Act took effect, reciprocal deposits of \$48.5 billion were reported. As of September 30, 2018, brokered reciprocal deposits had dramatically fallen to \$13.7 billion demonstrating the impact of the Act.

Despite the decline of brokered reciprocal deposits, as of September 30, 2018, community bank usage of brokered deposits has continued at a healthy pace with 2095 insured depository institutions with assets up to \$10 billion reporting a total of approximately \$121 billion of brokered deposits on their call reports. As the graphs indicate in the appendices to the ANPR, community bank usage of insured brokered deposits peaked around the time of the economic downturn and then experienced a significant downturn from 2009-2012 due to the dramatic decline in interest rates coupled with significant new restrictions on the use of brokered deposits by banks classified as adequately capitalized. Currently, brokered deposits make up a lower share of deposit funding for banks with assets less than \$10 billion than for banks in other major asset groups.

These statistics indicate that while community banks rely on brokered deposits as an important source of funding, they are using brokered and higher-rate deposits in a prudent manner and are appropriately measuring, monitoring and controlling the risk associated with those accounts. Whether they are using master certificates of deposits, listing service deposits, reciprocal deposits, rewards programs, or prepaid cards, community banks are using innovative ways to gather brokered deposits to fund lending to their local communities. This is despite the fact that there still remains an unfortunate stigma surrounding brokered deposits that they were the cause of many of the community bank failures during the recent downturn. Also, under the FDIC's assessment rules, for banks with assets less than \$10 billion, brokered deposits can increase a bank's assessment rate if the bank's ratio of brokered deposits to total assets exceeds 10 percent.

Brokered deposits can be a stable source of funding and a cost-effective way for community banks to meet their funding needs provided the risks of holding these accounts are managed properly. Unfortunately, the current deposit broker rules and FDIC staff interpretations of Section 29 make it difficult for community banks to attract these deposits and, in some instances, to work with third party service providers to expand their deposit product offerings.

ICBA Comments Concerning Interpretations of “Deposit Broker”

Section 29 of the Federal Deposit Insurance Act (FDI Act) which was added by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) does not directly define a “brokered deposit.” If it did, the law would be a lot clearer and perhaps there would not be such a need for so many agency interpretations of what is or is not a brokered deposit.² Instead, the FDI Act defines a “deposit broker” for purposes of the FIRREA restrictions. Thus, the meaning of the term “brokered deposit” turns upon the definition of “deposit broker.”

Section 29 and the FDIC’s implementing regulation define the term “deposit broker” to include “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...”

This definition of “deposit broker” has led to uncertainty and confusion in the banking industry. According to a recent analysis performed by a Washington law firm³, since the enactment of FIRREA, staff of the FDIC have issued more than 80 separate public advisory opinions regarding brokered deposits and over 60 of these opinions interpret the words “deposit broker.” Unfortunately, the majority of these opinions construe the definition of “deposit broker” very expansively while the exclusions to the definition of “deposit broker” are interpreted narrowly. The most prevalent answer in the FDIC’s “Frequently Asked Questions”⁴ concerning brokered deposits is “yes” that the deposits in question are indeed brokered deposits.

As ICBA noted in its joint trade association comment letter to the FDIC dated December 28, 2015⁵, the legislative history of Section 29 indicates that the statutory definition of “deposit broker”--someone engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions-- was intended to capture the typical deposit broker of that era when FIRREA was enacted. In other words, it described someone who was not employed by the bank and who, primarily for direct pecuniary gain tied to the volume of

² For instance, if the law placed restrictions on “highly volatile funding” rather than on deposits from a “deposit broker” and allowed the bank regulators to define (with examples) “highly volatile funding,” we believe it would be clearer.

³ See the opinion of Jones Day submitted as part of a comment letter to the FDIC by the American Bankers Association dated February 28, 2019.

⁴ See FDIC FIL-42-2016, “Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits” (June 30, 2016).

⁵ See Comment Letter to the FDIC dated December 28, 2015 regarding FIL 51-2015 from ICBA, ABA, The Clearing House, Financial Services Roundtable and Institute of International Bankers.

deposits placed, actively marketed deposit products on an unsolicited basis to persons having no previous relationship with the banking organization. Typically, a deposit broker was not working to provide customers or potential customers of a bank with access to banking products or to create or deepen customer relationships with the bank. Often a deposit broker's success was dependent on luring depositors with high interest rates, assuring that the deposits would have a significant degree of volatility.

We believe that the FDIC has sometimes overlooked this legislative history in its interpretations. Furthermore, there have been times that the FDIC has detached the requirement of being "in the business of" from the concept of "facilitating the placement of deposits," contrary to the statutory language. This has led the FDIC to interpret Section 29 very expansively to mean that any action of any third party that helps a bank attract new deposit customers constitutes a facilitation of deposits and is therefore a brokered deposit. We have maintained, for example, that dual and affiliated employees who may provide a package of nonbanking and deposit products and services to customers, and who are not paid commissions or fees that are explicitly tied to the volume of deposits placed or raised, are not engaged in the business of placing deposits or the business of facilitating such placement.

We also believe that in most instances, federal or state agencies using debit cards or prepaid cards to deliver funds to the beneficiaries of government programs should not be considered "deposit brokers." In order to be a deposit broker, a person or entity must be "engaged in the business of" placing deposits or "engaged in the business of" facilitating such placement. We do not believe that government agencies that deliver funds via debit or prepaid cards as part of benefits programs are "in the business of" placing or facilitating deposits.

In the area of transaction accounts including reward-based checking accounts, we have said that this is a source of stable funding and should rarely be considered brokered deposits. In contrast to certificates of deposit, where a depositor makes a fixed, often one-time, placement of funds at a bank, a traditional transaction account is usually the product of a direct and ongoing relationship between the bank and its depositor, involving deposits and withdrawals by the depositor to meet the depositor's transactional needs. As a result, most transactional account customers have a direct, ongoing relationship with the bank, and all deposits from these relationships result in consistent, stable funding for the bank. Furthermore, even where the depositor is introduced to a bank through the mediation of a deposit broker, subsequent deposits placed solely by the depositor through the use of their transactional accounts should not be deemed brokered where the deposit broker does not continue its mediation or placement of deposits.

Multi-service relationships where the depositor has another relationship with the bank should also rarely be considered a brokered deposit. Therefore, deposits (such as a checking or savings deposit, CD, MMA, etc.) associated with an individual customer who has another ongoing bona fide financial services relationship with the bank should not be considered to be a brokered deposit.

In short, we believe that the FDIC must reconsider its interpretations and its regulations regarding brokered deposits to better align banking regulation with modern banking practices

and the industry's evolving marketplace realities. An inappropriate expansive definition of "deposit broker" hinders community banks' ability to grow and fund the lending needed to serve their communities. We also believe the FDIC should focus more of its attention on the asset side of the bank rather than the liability side, since it is more likely that aggressive lending and poor underwriting will cause bank failures than the use of brokered deposits.

Section 29 and Interest Rate Restrictions on Brokered Deposits

In addition to restricting the acceptance of brokered deposits by less than well-capitalized insured depository institutions, Section 29 of the FDI Act also prohibits such banks from paying rates that significantly exceed those in their normal market area or the national rate as established by the FDIC by regulation. Recognizing that competition for deposit pricing has become increasingly national in scope and also the fact that it is hard to determine prevailing rates in market areas, the FDIC established in 2009 a presumption that the prevailing rate in all market areas is the FDIC national rate cap.

In 1992 when the brokered deposit rate caps were first established, the FDIC pegged the national rate caps to 120 percent of the current yield on similar maturity U.S. Treasury obligations or, in the case of any deposit at least half of which is uninsured, 130 percent of such applicable yield. Until 2009, using the Treasury rates was an effective method since they closely tracked interest rates on deposits. But then the economic downturn came, and Treasury rates reached nearly zero. As a result, the national rate caps forced a number of banks to offer unreasonably low rates on deposits, thereby restricting access even to market-rate funding.

The FDIC addressed the problem by redefining the national rate caps, for deposits of similar size and maturity, to be a "simple average of rates paid by all insured depository institutions and branches for which data is available." Currently, the FDIC uses a private firm to survey all insured depository institutions and their branches on the interest rates they pay. It adds 75 basis points to that average to determine the national rate caps. The FDIC has national rate caps for certificates of deposit of differing maturities, interest checking accounts, money market accounts and savings accounts. These are published weekly on the FDIC website at <https://www.fdic.gov/regulations/resources/rates/>.

The major problem with the FDIC's national rate caps is that they are not even close to current Treasury yields nor to what community banks must pay to obtain deposits through a listing service or third-party broker. For example, the current yield on a one-year Treasury obligation is 2.39%, whereas the current national rate cap for a one-year non-jumbo CD is 1.48%, nearly a 100 basis point difference. Furthermore, community banks must pay close to 2.7% to obtain a one-year certificate of deposit through a listing service.

Another problem is that the national rate caps are based on a survey of deposit products at all bank branches. Because the nation's largest banks have nationwide branch networks with identical deposit products and prices, they tilt the scales on the FDIC's calculation heavily in their favor. Meanwhile, branchless and rapidly growing web-based banks such as Ally and Goldman Sachs are underrepresented, contributing as much to the calculation as the smallest community banks.

The national rate caps also miss promotional rates for non-standard products, such as 13- or 19-month CDs. The rates on these products can be 150 to 200 basis points higher than standard rate offerings, yet they are excluded from the FDIC's calculation. The same goes for deposit rates at credit unions, which are a primary competitor for many community banks, and non-interest accommodations such as discounts on bank services. Some deposit products also include a one-time cash payment for opening up a deposit account or airline miles, none of which is reflected in the national rate caps.

ICBA is concerned that this faulty methodology could lead to a liquidity crisis of its own making for many banks. When the economic upswing eventually comes to an end—for whatever reason—regulators will likely react with CAMELS rating downgrades and even regulatory orders for some community banks, leading to de facto less-than-well capitalized designations. These actions will in turn restrict the rates affected banks can pay on deposits, likely resulting in a shedding of depositors, a true liquidity crisis for many institutions, and failures that could have a ripple effect and pose a needless drain on the Deposit Insurance Fund. Ultimately, the rate cap's procyclical impact on FDIC-insured institutions could create a self-fulfilling prophecy.

ICBA recommends that the national rate caps be based on the greater of (1) the original pre-2009 restrictions which was 120 percent of the current yield on similar maturity U.S. Treasury obligations (or, in the case of any deposit at least half of which is uninsured, 130 percent of such applicable yield), or (2) the current system with some significant modifications, which would be an average of rates paid by all insured depository institutions, plus 100 basis points rather than the current 75 basis points. The average of the rates paid by all insured depository institutions should be based on one entry per bank, rather the current per-branch system, and should include credit union rates. And rather than relying on standard CD maturity terms, the national rate caps should incorporate a series of maturity ranges to include both traditional and promotional products to provide a more accurate assessment.

We believe this new national rate cap standard—an amalgam of both the pre-and post-2009 restrictions on brokered deposits—would work well in both a low interest rate environment as we had experienced for so many years after the economic downturn, as well as in a normal or a high interest rate environment. Under any interest rate scenario, the national rate caps would never be lower than (1) 120 percent of the current yield on U.S. Treasury obligations or (2) 100 basis points over what banks are currently paying on their deposits. This new standard would also address the distortions created by megabank branch networks and non-traditional deposit incentives while offering a fairer assessment of the deposit rates that financial service competitors offer.

Finally, we urge the FDIC to stick to enforcing the national rate caps on less-than-well-capitalized banks. Community bankers report that regulators are bringing up the national rate caps during exams of well-capitalized banks, claiming that deposits paying in excess of the rate cap are “volatile funding” and insisting that the banks explain what will happen to their deposits if they are suddenly downgraded. We believe this is a misapplication of brokered deposit policy and inconsistent with the goals of Section 29 of the FDI Act which are to restrict brokered deposits at troubled institutions, not those that are well-capitalized.

Conclusion

Again, we commend the FDIC for taking the initiative of issuing this ANPR and reviewing its brokered deposit regulation. Although brokered deposits are an important source of funding for community banks, we believe they are using them in a prudent manner and are appropriately measuring, monitoring and controlling the risks associated with those accounts. Brokered deposits can be a stable source of funding and a cost-effective way for community banks to meet their funding needs. There is an undeserved stigma surrounding brokered deposits that needs to be dispelled.

In our view, the FDIC has interpreted too expansively the definition of “deposit broker” under Section 29 of the FDI Act and too narrowly the statutory exceptions. In some cases, this has hindered the ability of community banks to innovate and to partner with third parties in order to attract brokered deposits. For instance, in most instances, federal or state agencies using debit cards or prepaid cards to deliver funds to the beneficiaries of government programs should not be considered “deposit brokers.” In the area of transaction accounts, including reward-based checking accounts, we have said that this is a source of stable funding and should rarely be considered brokered deposits.

As we have noted, there are many problems with the FDIC’s national rate restrictions, but the biggest flaw is that they are not even close to current Treasury yields, nor to what community banks must pay to obtain deposits through a listing service or third-party broker. We recommend the national rate caps be based on the greater of (1) the previous standard, which was 120 percent of the current yield on similar maturity U.S. Treasury obligations, or (2) the new standard which is an average of rates paid by all insured depository institutions, plus 100 basis points rather than the current 75 basis point addition. We also urge that the survey of rates be conducted on a per-bank basis and include promotional rates as well as credit union rates. Furthermore, we strongly believe the FDIC should not enforce its brokered deposit policy on well capitalized banks.

ICBA appreciates the opportunity to comment on this proposed rulemaking concerning *Brokered Deposits and Interest Rate Restrictions*. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 821-4431 or Chris.Cole@icba.org.

Sincerely,


Christopher Cole
Executive Vice President and Senior Regulatory Counsel