May 7, 2019

Robert Feldman, Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

To Whom It May Concern,

Below I have provided comments to the "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions" (RIN 3064-AE94). I appreciate the FDIC soliciting feedback regarding these important matters.

Are there specific changes that have occurred in the financial services industry since the brokered deposits regulation was adopted that the FDIC should be cognizant of as it reviews the regulation?

The brokered deposits regulation has been a stagnant component of an otherwise rapidly changing and evolving financial services industry. First, technology has revolutionized the industry. The last ten to fifteen years have seen dramatic change due to technological advancements which have re-shaped both the customer experience and the operating environment for the banking industry. No longer is a bank's market defined by a geographic boundary around a physical branch location. No longer are customers limited to placing deposits at a bank which is located in their hometown. No longer do customers have to complete paperwork in a branch location to open an account. Thanks to technology, banks' costs of operations have become more efficient and customers have greater choice, resulting in relatively higher yields. In short, technology has made the market for insured, interest-bearing deposits much more competitive.

While technology has enabled competition, the playing field is not always level for community banks when they compete against large banks for deposits that exceed the $250,000 insured amount. While the Great Recession manifest in fears of large banks becoming too big to fail, they have continued to grow since the Dodd Frank legislation was enacted. Today, large depositors don't concern themselves with placing accounts at the nation's biggest banks because their perception is that those banks will not be permitted to fail. Quite frankly, they are correct to assume such as the entire FDIC fund is less than 4% of JP Morgan Chase's balance sheet, and the average historical cost of a failed bank is closer to 33% of its assets (as published by the FDIC's CFR in 2015).

As the FDIC reviews the regulation, it needs to address the reality of the un-level playing field meeting the competitive environment. It can be argued that in order for community banks to survive these challenges in addition to regulatory complexity and non-bank competition that they will need to be able to have even greater access to efficient and stable sources of wholesale funding such as brokered deposits.

Are there statutory changes that warrant consideration from Congress?

The fears around brokered deposits and the potential for FDIC fund losses by the potential abuse of them are short-sighted. It's like passing legislation to limit the use of gasoline because some people might use it to drive at excess speeds. The overwhelming percentage of losses to the FDIC fund stem from poor asset quality. Less common losses would come from poor management of interest rate risk, liquidity, and fraud. Use of brokered deposits can only exacerbate losses in cases where all of the required mechanisms for monitoring banks' health are flawed or inadequate. This includes all of the following: bank regulator's oversight including guidance on concentrations; bank external audit; bank internal audit; independent loan review; etc. Given this reality I would recommend that Congress eliminate the restrictions around the use of brokered deposits by banks. To mitigate the risk of the abuse of the tool that is brokered deposits, Congress could authorize the bank regulatory agencies to establish growth limits for banks that are undercapitalized and/or have asset quality problems. Forcing such a bank to shed brokered deposits would only serve to create greater liquidity risks.

Should the methodology used to calculate the national rate be changed?

While I am not privy to the FDIC's exact methodology for determining national rates (which utilizes a third-party survey of banks), based on my research I believe that today there exists fundamental flaws in this calculation.

- ***Simple Average Versus Weighted Average*** – Purportedly, the calculation is based on a simple average of rates using branch locations for banks versus determining a rate for each bank and then applying a weighted average based on deposits. In this manner, the rates paid by a $75 million bank in a rural area impact the national rate as much as an $80 billion internet-based bank that conducts business nationwide. Everyone knows that internet-based banks such as Ally and Synchrony offer higher rates than "local" players, are gaining market share, and are now a formidable competitor for banks everywhere. To fail to properly weight their impact on the national rate calculation speaks to the inability of the regulatory community to adapt to a changing world.
- ***Failure To Survey The Best Rates Available To Consumers*** – This is perhaps the most egregious flaw within the current system of calculating a national rate. The survey only captures the "standard sheet" rates offered by banks: 1, 3, 6, 12, 24, 36, 48, & 60 month CD terms, plus basic savings and money market rates. Virtually all banks attempt to minimize their cost of funds by offering more competitive CD rates on "irregular" terms, such as 11, 14, 19, or 26 months. The theory being that for those customers who don't take time to evaluate renewal options, the irregular term defaults to the nearest sheet rate upon renewal. As an example, at INSBANK less than 25% of CD customers choose to auto-renew as most contact the bank to determine what the best available rates and terms are. All banks know that some portion of depositors will not take the time to seek competitive offers, so they optimize their cost funding with this pricing methodology. To prove this point I would enter last week's FDIC national rates as exhibit A. The average of the 12 and 24 month national Jumbo rate is 0.82%. To anyone in financial services that sounds absurd as it's more than 150 basis points below Fed Funds in a flat curve environment. To compare and contrast, the current portfolio average of time deposits for the $1 to $3 billion bank peer group set is 1.42%. It should be pointed out that the 1.42% is inclusive of legacy deposits that have yet to re-price based on recent Fed rate increases, even further illustrating the problem. Additionally a check of many websites for current rate offers reveals rate options MUCH higher than that which the FDIC has determined to be the national average. For example, Wells Fargo has a 1.44% sheet rate for a 12-month CD, while it's offering a 19-month special rate of 2.57% (which it discloses will renew on a 12-month rate). In

addition to standard CD's, hybrid products such as step-CD's and other unique deposit accounts are not considered in the survey.

I would also suggest the following alternatives for resolving the rate cap issue on a long term basis.

- ***Eliminate Rate Caps*** – It can be argued that regulators have ample tools at their disposal to minimize the risk of banks' paying excess rates on deposits. Capital requirements and other limitations in informal and formal agreements have the impact of limiting growth which restricts the need for growth of further deposit funding.
- ***Utilize Actual Rates for All CD and Money Market Accounts*** – As enumerated earlier, the current methodology fails to capture actual rates and terms provided to customers. Calculating national rates off of call report data would be fairly simple and very accurate, as opposed to paying a third-party to conduct a flawed survey. Banks would group CD terms that would pick up all maturities, rather than select "standard" terms. For instance, a 12 month national rate would be calculated as the weighted average of all CD's between 7 months 18 months; the 24 month term would be 19 to 30 months, etc. Money market rates would be even easier to calculate, aggregating total cost of savings accounts against outstanding balances reported in the call report.
- ***Replace Rate Caps with Growth Restrictions on Banks that are Under-Capitalized or Have Serious Asset Quality Issues*** – Banks do not fail because of over-priced deposit accounts, and concerns about deposit rates in some ways can have unintended consequences. As a bank's condition deteriorates, instability of a deposit portfolio can lead to a liquidity crisis and a premature demise of the institution. The goal for all stakeholders should be maximizing opportunities for augmenting capital to restore a bank to a healthy condition. Other things being equal, a growth limit essentially puts a cap on the potential loss to the FDIC.

The various flaws of the current national rate calculation underscore the need for legislation and regulation to be updated to reflect the realities of a changing financial services landscape. At a time when banks' traditional lines of business are threatened by a variety of non-bank, technology-driven competitors, the national rate issue serves as an example of why regulators need to be more forward-looking in their purview of the banking industry. Their failure to do so will manifest in accelerated consolidation of the industry, and concentration of banking assets into a few, large institutions. This would be particularly bad for consumers, small businesses, and rural and other under-served markets where community banks are a critical component of local economic activity.

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