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NAIB
Nati l Associ i Industri l Bankers

May 7, 2019

Robert E Feldman
Executive Secretary
Attention: Comments
550 17th Street NW
Washington DC 20429

VIA EMAIL comments@fdic.gov

Re: Unsafe and Unsound Banking Practices-Brokered Deposits
RIN 3064-AE94

Dear Mr. Feldman:

We appreciate the opportunity to submit the following comments and recommendations regarding the regulations and policies governing the use of brokered deposits in response to the Advance Notice of Proposed Rulemaking (the "ANPR") issued by the Federal Deposit Insurance Corporation's ("FDIC") pursuant to a comprehensive review of the regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well-capitalized. This review is both timely and critically important for the proper development of regulations and the banking industry in the future.

The National Association of Industrial Bankers[1] and the Utah Bankers Association[2] are sending this letter jointly on behalf of our member banks, which have a vital interest in this matter.

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[1] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in California, Nevada and Utah.

[2] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

RECOMMENDATIONS

On behalf of our member banks which include all types and sizes of bank charters, we respectfully submit the following recommendations:

1. ***Use objective and comprehensive studies to create policies regarding brokered deposits***. As a public entity, the FDIC has an obligation to conduct unbiased comprehensive studies, but past studies only examined the extent to which brokered deposits were held by failed banks and found from that fact alone a "correlation" between brokered deposits and failures. The reality is that core deposits are more strongly correlated to bank failures than brokered deposits. Most failed banks held no brokered deposits while all held core deposits and most failed banks held a majority of core deposits. FDIC studies ignore the following important elements: how brokered deposits are used by all banks, how successful banks use brokered deposits, and the role brokered deposits will play in future banking models such as branchless banks. None of the FDIC studies acknowledges that branchless banks have developed safely for over 30 years and that many of the best capitalized and most profitable branchless banks have relied entirely, or nearly entirely, on brokered deposits. Fairness demands that the studies used by FDIC to develop policy consider all aspects of brokered deposits' use and examine successes including the related cost benefits.

2. ***Utilize data relating to cost benefits in addition to costs of failures to set deposit premiums.*** FDIC has unfairly set insurance premiums for banks that hold high percentages of brokered and wholesale deposits without analyzing the cost benefits and failure risks of those banks.

3. ***Adopt more reasonable standards for classifying deposits as brokered.*** Current FDIC practice basically utilizes a very constricted definition of core deposit and classifies everything else as brokered or wholesale and higher risk. This is arbitrary and essentially nullifies some of the statutory exceptions such as the primary purpose of the party placing the deposits. An entity such as a plan administrator of a retirement fund, health savings program, or education fund administrator is not primarily in the business of placing deposits for beneficiaries of those plans.

4. ***Adapt policies to market conditions and support the development of new safe and sound banking models.*** FDIC studies of brokered deposits do not mention market forces shaping financial services and new models designed to best serve those markets. Market conditions alone determine whether banks can succeed. Electronic banking has resulted in extensive market segmentation and has enabled the development of safe and efficient branchless banks to deliver standardized products such as credit cards nationally. No valid reason exists for policies designed to block the development of such banks and other new banks that can operate safely and soundly.

5. ***Revise formulas for calculating interest rate limits for brokered deposits.*** As will be discussed in more detail below, rates on brokered deposits tend to be higher than deposits offered by traditional banks in a particular local area, but brokered deposits are actually less costly to a branchless bank because of savings from not having branches. This substantive difference is not reflected in the current method for calculating rate caps, which caps the rates for brokered deposit at the rate offered for core deposits in the bank's local community. This causes the caps to be significantly below the prevailing rate for brokered deposits generally. This methodology should be changed to match prevailing rates for like deposits and would not increase risks for the FDIC.

6. ***Permit applications for branchless and other banks that will rely on brokered deposits for funding.*** Since 2008, applicants have been told that plans to organize a bank which rely on brokered deposits would not be approved. Applicants and existing banks should be required to have robust liquidity plans but there is no justification for excluding brokered deposits when they can be used safely. Existing banks have proven that branchless banks can operate safely and soundly while relying on brokered deposits for most of their funding.

7. ***Revise policy goals to include benefits to the national economy.*** As a public entity, the FDIC should prioritize benefits to the economy when developing policies. Today, credit is a primary driver of the economy and the economy will work better to the extent credit is supplied by stable and well regulated banks. To that end, the FDIC should facilitate the formation of all kinds of safe and sound banks.

INTRODUCTION & BACKGROUND

Over the past nearly 40 years, brokered deposits have developed into the most cost effective and stable source of funding for banks. They are particularly important for the development of branchless banks and other new, safe and growing banking models. Policies restricting their use by existing banks and prohibiting new bank applications that would utilize brokered deposits are outdated and unjustified. Objective reviews of brokered deposits demonstrate the safe and beneficial uses of brokered deposits by both branchless banks and traditional banks that are diversifying funding strategies as customers migrate to mobile banking and other electronic ways to bank.

Brokered deposits emerged as a source of funding for banks in the 1980s, at about the same time as the development of electronic banking such as credit cards, interbank transaction networks and ATMs. The collapse of the savings and loan industry due to losses caused by inflation was another significant event during that time.

Brokered deposits garnered a bad reputation when used by crooks who gained control of a poorly regulated failing thrift to rapidly grow it while they looted it. A common saying at the time was "the best way to rob a bank is to own it." Those incidents largely ended as the S&L crisis and inflation ran their course and regulators developed new tools to keep the crooks out. Although these were isolated incidents and rarely repeated, critics of brokered deposits focus on this history while ignoring how other banks successfully relied on these deposits and how brokered deposits have matured and are used today.

From the beginning, brokered deposits played a more constructive and beneficial role in the development of electronic banking, a role that is growing as a safe and cost-effective way to fund a bank. Delivering financial services electronically eliminates the need for branches, which significantly reduces expenses. It also facilitates specialization by making it possible to deliver a large volume of products and services to a national market. This led to the development of the first branchless banks, many of which issued credit cards.

Operating without branches requires different funding strategies than a traditional bank. Traditional retail deposits (often referred to as "core deposits") are mostly acquired directly from depositors at branches that must offer a broad array of products and services to attract customers. Brokered deposits provide a means to acquire deposits at a lower cost without branches and facilitates the development of specialized business models.

Another advantage of brokered deposits is the ability to better coordinate deposit inflows and outflows with loan demand and cash flows (often called "match funding"), which adds to their cost savings. Core deposits flow in and out of a bank for reasons unrelated to loan demand, which makes it necessary to hold more liquidity and reduces a bank's profits. Match funding makes it possible to bring in deposits just as they are needed to fund loans and links the terms of the CDs to loan repayments. That has the added benefit of virtually eliminating rate risk - the problem that caused the collapse of the S&Ls and is important enough to warrant a separate CAMELS rating ("S" refers to rate sensitivity). Banks with these lower cost structures are able to pass much of those savings to their borrowers.

As a result, branchless banks have become one of the strongest trends in banking today. The FDIC approved the first branchless banks in the 1980s. The viability of the branchless model has become well established in the intervening years. Branchless banks, including many of our members based in Utah, have consistently been among the best capitalized and most profitable group of banks in the nation. During the Great Recession, only one branchless bank failed compared to 529 traditional banks. Based solely on their now nearly 35-year record, branchless banks using brokered deposits present the lowest risk of failure of all banks insured by the FDIC. It is noteworthy that this record has not been acknowledged or analyzed in any report issued by the FDIC during that period.

Brokered deposits also acquired a reputation as "hot money" when they first developed. That means high rate and volatile, sought by people shopping for rates who would pull the deposit as soon as another bank offered a higher rate. That may have been at least partially correct when brokered deposits first emerged and needed to become established. Another factor was that the crooks in the S&Ls didn't care about rates. They just wanted to bring in money to misappropriate.

But as used by branchless banks, brokered deposits have developed into the least costly and most stable deposits available to a bank. Today, brokered deposits are comparable to government securities and are mostly sought by depositors seeking safety. Most are CDs that by contract cannot be withdrawn before maturity unless the depositor dies or is placed in the care of a conservator. All-in funding costs after deducting the savings from not having branches are usually significantly below core deposits as evidenced by much better efficiency ratios reported by most branchless banks.

The stability of these deposits is evidenced by the fact that there have been no instances of a run on brokered deposits. On the other hand, there were instances during the last recession of banks failing due to a classic run by core depositors.

The supply of brokered deposits has always proven sufficient and actually rises in a downturn as people pull money from stocks and bonds and flee to safety. The main liquidity risk with brokered deposits is if a bank's capital ratio falls below well capitalized. Such a bank can still take new brokered deposits and roll brokered CDs if the bank is adequately capitalized and obtains regulatory approval, but such approvals have been rare and short term and the rate caps that apply in that situation are unworkably low as currently calculated. Calculated differently to compare like kinds of deposits, those rate caps would still prevent an adequately capitalized bank from loading up on high cost funds. A bank that is below adequately capitalized cannot take new brokered deposits or roll over brokered CDs and can fail without other funding options such as the ability to sell or securitize loans or draw on lines of credit.

This requires banks that rely on brokered deposits to have robust and diverse funding plans, which is a good practice. It also incents branchless banks to maintain a substantial capital cushion above the threshold to qualify as well capitalized. This is one reason why branchless banks have consistently been among the best capitalized banks insured by the FDIC. Their stronger efficiency ratios resulting from cost savings also enable branchless banks to achieve above average profitability despite lower leverage.

Despite this record, in 2008, without notice or ever acknowledging that it adopted a new policy that reversed a longstanding policy followed since the 1980s, the FDIC began to tell applicants that banks using brokered deposits would not be approved. It also began pressuring existing banks using brokered deposits to transition to other sources of funding regardless of how well brokered deposits were working.

Prior to that time, the FDIC approved several applications for branchless banks that relied on brokered deposits and, as already mentioned, those banks generally operated profitably throughout the recession while 529 traditional banks failed. Some branchless banks with diversified parent companies were able to obtain additional capital and grow during the recession by capturing business shed by other banks that were shrinking in order to raise capital ratios. These were among the most successful banks during the worst economic downturn since the Great Depression. Again, it is noteworthy that no FDIC study, including the research described in the Advanced Notice of Proposed Rulemaking (ANPR), acknowledge this or analyze the factors underlying this success.

The policy restricting the use of brokered deposits by new bank applicants most negatively affects the development of branchless banks, which is the policy's primary purpose. Statements by former chairman Martin Gruenberg confirm that this was the intent. He has told staff that deposit insurance was only intended for traditional banks and not newer kinds of banks. He has also said in private meetings with bankers that the FDIC should only insure banks with three primary characteristics: (1) serving a limited geographic area, (2) gathering deposits at branches and (3) only lend to longstanding customers.

Another example of this restrictive policy was classifying every deposit not made directly by a customer as brokered by default. This largely invalidated the exemptions listed in the statute. As described in more detail below, that extreme form of classification ignores the substantive differences in deposits and can only be understood as being designed to inhibit the development of new banking models. It should be noted that the statute defines a brokered deposit, provides exemptions and all other deposits are just deposits. The FDIC's policy since 2008 has turned this on its head and adopted a highly restrictive definition of "core", which is not mentioned in the statute, then classifying all other deposits as brokered. To follow the standards set forth in the statute, the FDIC should follow the definitions in the statute and reasonably interpret the exemptions, especially the primary purpose exemption.

Fairer standards would be based on an analysis of how true brokered deposits differ from other deposits. We believe the key distinction is whether the depositor or the bank initiates the deposit. It should not matter if an individual directs the administrator or custodian of his or her IRA account to deposit money in federally insured CDs. In substance, there is no meaningful difference if the individual deposited the money directly into the same bank. The real difference is if the bank initiates the deposits by contacting a broker and specifying amounts and terms of deposits to be supplied by the broker. That is classic "real time inventory management." As described in more detail below, the important point is that deposits initiated by deposits flow in and out according to the needs of the individual depositors and that deposit base determines the bank's lending capacity, although that is becoming less important due to the development of secondary markets for loans and participations. With brokered deposits, capital sufficiency alone determines the bank's credit capacity. That is the sole reason why restraints on brokered deposits are justified when a bank ceases to be well capitalized.

The narrative in the ANPR describing a purported statistical link between the use of brokered deposits and failed banks is further evidence of the FDIC's unfairly restrictive policy. The ANPR itself clearly shows that brokered deposits played no significant role in the 530 banks that failed between 2008 and 2015. Chart 6 in the ANPR shows that more than half of those banks held no brokered deposits and almost all of the remainder held a majority of core deposits. Only 2.27% of the failed banks held a majority of brokered deposits and only one held between 90 and 100% brokered deposits. Additionally, the ANPR says the study could not identify any reason why brokered deposits played a role in the failure of the few banks that held them. Instead, these banks failed because of mismanagement and loan losses. The vast majority of the bad loans were funded with core deposits. Nothing in the data presented in the ANPR demonstrates any material risk to the FDIC from the use of brokered deposits.

Page 19 of the ANPR lists three main problems with brokered deposits:

- *Rapid growth – the ANPR says brokered deposits "can be gathered quickly and used imprudently to expand risky assets or investments."* The efficiency of brokered deposits is undisputed, but that is a benefit more than a risk. Deposits of any kind pose a risk if they are used to make bad loans and preventing that is one of the most fundamental responsibilities of boards and regulators. Other FDIC studies of bank failures in the Great Recession make clear that the real problems causing banks to fail were risky and poor-quality loans. More precisely, a recent report by the FDIC inspector general found that the primary cause of failures in the Great Recession was bank CEOs who refused to believe that ADC and CRE lending was perilous even in overheated markets and then concealed their bank's deteriorating condition as loan losses mounted. If regulators cannot control such practices mass failures are inevitable regardless of how the loans are funded or how fast the problem grows. The clear lesson of the failures during the Recession is the need to increase oversight of CRE and ADC lending, particularly in hot housing markets.

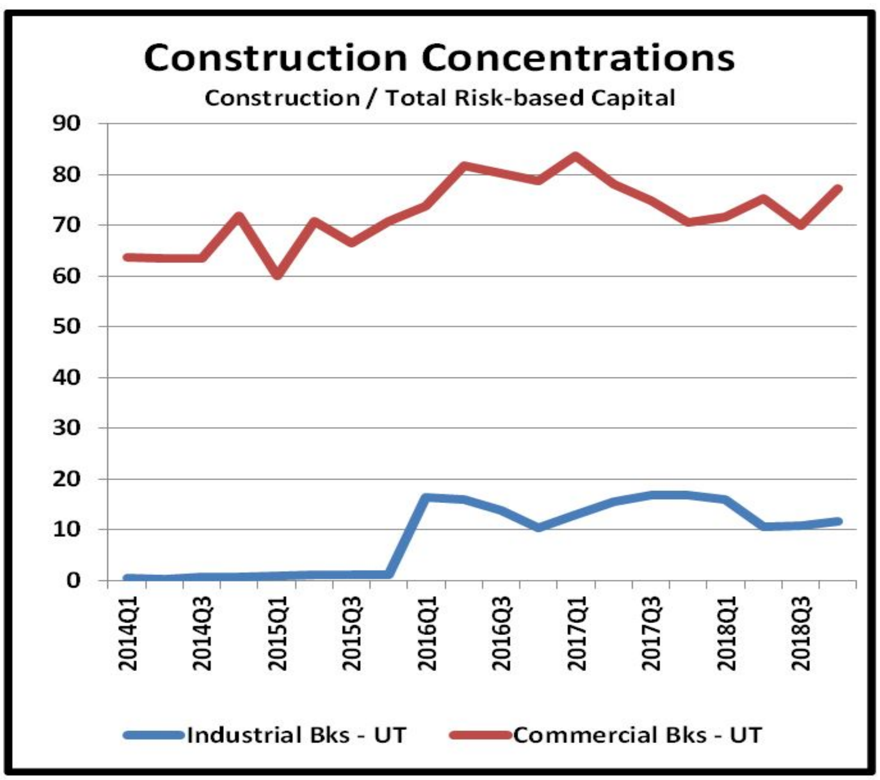
- *Volatility – As stated in the ANPR, "deposits might flee if the institution becomes troubled or the customer finds a more appealing interest rate or terms elsewhere."* This is completely at odds with the facts. Today brokered deposits are the most stable and cost effective deposits available to a bank. Rates are close to government securities and FHLB borrowings. There is no record of rapid withdrawals of brokered deposits in the past 30 years at any bank but there have been cases of banks failing from runs by core depositors without any brokered deposits leaving the bank. Barnes Bank in Utah is a good example. It failed in 2010 after core depositors withdrew 15% of the bank's total deposits in a 10 day run. About a third of the bank's deposits were brokered and none of those deposits were withdrawn. Another example of the superior stability of brokered deposits is Woodlands Commercial Bank, which was a wholly owned industrial bank subsidiary of Lehman Brothers. Despite all of the national publicity about the collapse of its parent, the bank's loans were high quality and it was able to conduct a controlled liquidation after the parent declared bankruptcy. The bank only held brokered deposits, all of which were held to maturity and paid in full without FDIC assistance as loans matched to the terms of the deposits were repaid. If the bank had held core deposits it would have been more likely to fail due to a run caused by panic relating to the parent.

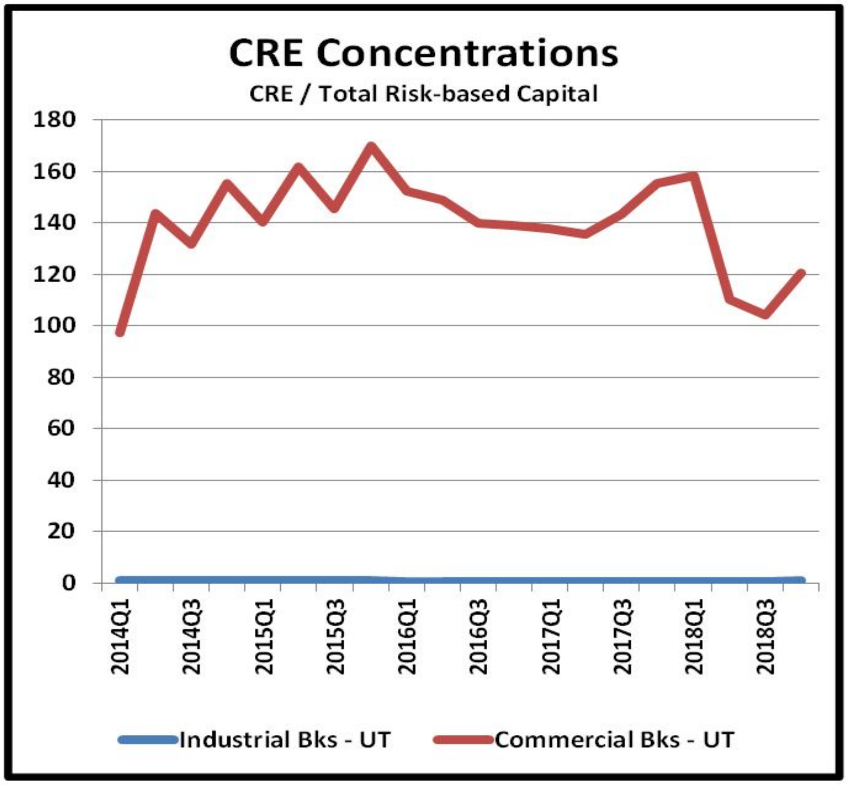
- *Franchise Value* – This relates to the FDIC's ability to sell a failed bank intact to a healthy bank and the premium the healthy bank may pay for the failed bank's core deposits. However, this is a minor issue at most. Today, the premium for core deposits- even when purchased from a healthy bank- is only one to two percent. The ANPR does not discuss whether a failed bank holding large amounts of impaired CRE and ADC loans had any franchise value during the Great Recession. It may well be the case that franchise value was insignificant during the Great Recession due to the uncertainty about the value of ADC and CRE loans held by failed banks. Since an acquiring bank would have to book the acquired assets at current market value, it probably made more sense for the FDIC to hold those assets until the markets recovered. Additionally, many of the failed banks were relatively new so they had fewer established long term customer relationships for another bank to acquire. The ANPR does not mention any specific instance where the FDIC could not sell a failed bank because it held brokered deposits nor does it provide any analysis of the net cost to the FDIC when it had to pay out brokered deposits compared to selling core deposits. It is reasonable to assume that the ANPR would have examined such cases if any had occurred.

It is also worth noting that today many brokered deposits would have value to an acquirer, especially long-term CDs paying very low interest rates which were acquired by banks when rates were at record lows.

Furthermore, the cost of paying out deposits is ultimately offset by the sale of assets and any added risk in paying out brokered deposits can be fully mitigated by adjusting deposit insurance premiums. The FDIC already increased insurance premiums for banks holding larger amounts of brokered deposits across the board. Objections by the affected banks that the increases did not consider actual risks have been ignored and rejected without explanation. A fair analysis must also include the benefit of the premiums paid by branchless banks, which have the lowest failure risk. As a public entity, the FDIC has a responsibility to conduct a more balanced analysis of risks in setting premiums. In any event, adjusting rates for increased risks, real or not, is a solution that undercuts any claim that brokered deposits must be prohibited or restricted due to the risks outweighing the benefits.

Another critical omission in the ANPR is not describing how brokered deposits correlate with healthy banks after highlighting "correlations" with failed banks. The ANPR claimed that the risk of failure rose with the percentage of brokered deposits and other wholesale funds a bank held. But that related only to community banks concentrated in CRE and ADC loans in overheated housing markets. Directly contradicting that statement is the fact that branchless banks—many of which rely almost entirely on brokered deposits—had the lowest failure rates and maintained the highest capital and profit ratios during the Great Recession. Additionally the following charts from the Utah Department of Financial Institutions show that Utah industrial banks, most of which rely on brokered deposits, hold virtually no CRE or ADC loans.





This is typical of branchless banks generally. Community banks are the primary CRE and ADC lenders. CRE and ADC loans require careful underwriting on a case by case basis by loan officers familiar with the economic conditions in the area where the building or lots will be developed. These loans accordingly cost the bank more to underwrite because they are not amenable to approval or denial based solely on credit scores. Loans, such as credit cards, that can be safely approved or denied solely on credit scores are more economically provided by a branchless bank that can offer rewards for using a card.

Other FDIC studies have reached similar conclusions about the causes of bank failures during the Great Recession. One recent study cited in the ANPR was published by the FDIC in December 2017 titled Crisis and Response: An FDIC History, 2008 to 2013 (CR Study).

The main finding of the CR Study, which it repeats multiple times, is that the 530 bank failures that occurred since 2008 were caused almost entirely by poor lending practices by banks concentrated in CRE and ADC loans in areas with overheated housing markets that collapsed in 2008. In terms of correlations, most of those banks held only core deposits and virtually all held a majority of core deposits and were owned by a traditional bank holding company that was unable to recapitalize the bank. Those correlations are unquestionably far more consistent with failure than the use of brokered deposits.

The CR Study describes extraordinary actions taken by the FDIC, the Federal Reserve and the Treasury Department during the Great Recession to stabilize banks and prevent runs on checking accounts (by temporarily insuring all deposits without limit), savings accounts (by raising the insurance limit to $250,000), guaranteeing money market funds (which were not insured) and guaranteeing holding company debts (which had never been guaranteed in the past). Importantly, no actions were taken *or needed* to prevent runs on brokered deposits or to limit rates on brokered deposits held by well capitalized banks.

Another glaring omission in the ANPR is a description of how brokered deposits are used today. They are not used to fund CRE and ADC lending at community banks to any significant degree. Many banks including community banks acquired some long term brokered CDs (often ten year terms) when rates were at historic lows. If rates rise in the future the market value of those deposits will increase in tandem and will have value if the bank fails.

In terms of funding strategies, trends relating to the decreasing use of branches and how increasingly popular mobile banking systems affect core deposits present more risks to banks and the FDIC than brokered deposits. Due to market segmentation made possible by electronic banking, cross marketing has become less important and depositor relationships play less of a role in originating loans. At least one of the largest banks has concluded that most of its traditional checking accounts now represent a net loss to the bank because the customers obtain credit and other financial services elsewhere. Younger customers especially are demanding more mobile banking options. Many of those younger customers have never set foot in a bank branch and can't imagine why they would need to do so in the future. Bank of America reported that in 2012, 65% of customer deposits were made at a teller window but by 2017 that number had dropped to 30%. As the Wall Street Journal reported in February 2018:

> Banks are closing branches at the fastest pace in decades, as they leave less profitable regions and fewer customers use tellers for routine transactions.
>
> The number of branches in the U.S. shrank by more than 1,700 in the 12 months ended in June 2017, the biggest decline on record, according to a Wall Street Journal analysis of federal data.

The conclusions of this article were confirmed by the Federal Reserve Bank of St. Louis in its *On the Economy Blog,* February 26, 2018:

> More recently, changing consumer preferences and improvements in financial technology have further spurred the reduction in branches. Customers increasingly use ATMs, online banking and mobile apps to conduct routine banking business, meaning banks can close less profitable branches without sacrificing market share.
>
> It seems inevitable that this long-term trend in branch closings will continue as consumer preferences evolve and financial technology becomes further ingrained in credit and payment services.

As reported in many additional articles, some of the largest traditional banks have responded to these trends by scaling down branches, developing mobile banking options to retain tech savvy customers and reduce the operational costs of checking accounts, and using brokered deposits to replace many of their core deposits.[3] Today, the largest banks (over $10 billion) hold most of the brokered deposits (87%) and are competing vigorously to lead the market in new deposit and transactional technologies. More ominously for smaller banks, the location of branches no longer makes any difference to depositors using mobile apps any more than it affects their choice of credit cards. Being able to use these apps anywhere matters the most. Leading the market with this technology is crucial to the future of many banks.

These trends have less of an effect on community banks and rural banks, but the trends are clear and potentially disruptive and must be closely followed by all bankers. New technologies, many of which could be very disruptive, are developing rapidly and very few banks really know how they will fund themselves in the future. It is possible that most banks will be increasingly funded with personal checking and prepaid accounts utilizing mobile banking apps, savings accessed over the Internet and brokered deposits. Many branches will close and others will increasingly become operations and service centers with decreasing interactions with depositors. Banks in some urban areas have so few face-to-face interactions with depositors that the location of branches is now determined by convenience for the people who work there and proximity to loan customers who may need to meet periodically with a loan officer.

These trends are emerging now but how far they will impact all banking in the future is uncertain. Even community banks may end up following the same trends as larger banks and grow increasingly reliant on brokered deposits in the future, at least to a degree. Many community banks have taken some brokered deposits, especially long term CDs, while interest rates are at historic lows and are highly unlikely to fall further in the future. For now, no bank can confidently say it will have no interest in utilizing brokered deposits and other wholesale deposits in the future.

Economics are another important factor driving the development of branchless banks. Savings from not having a branch network enable most branchless banks to significantly increase ROA and ROE and achieve efficiency ratios well below banks with branches. That is not the result of higher leverage. Utah branchless banks have consistently maintained higher capital ratios than the median for banks with branches and still achieve higher ROA and ROE.

One of the main advantages of technology is enabling banks and other lenders to segment the market. Traditional banks relied on a "full service" business model that attempted to provide for all of their customers' financial needs. That is important for attracting customers to use branches. Cross marketing is the key to that model. Technology now enables lenders to specialize and sell products and services in high volumes and through scale achieve profits that makes cross marketing unnecessary. Credit cards is a good example. In 2017, ten banks issued over 88% of all credit cards

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[3] U.S. Bancorp to Cut Up to 450 Branches Amid Digital Shift, *Wall Street Journal*, April 18, 2019; B of A gives itself five years to save branch banking, *American Banker,* March 10, 2017; Banks Shutter 1,700 Branches in Fastest Decline on Record, *Wall Street Journal,* February 5, 2018; Why Are Banks Shuttering Branches?, *Federal Reserve Bank of St. Louis,* February 26, 2018; US bank branch closures reach another high in 2018, *S&P Global Market Intelligence,* January 18, 2019.

used in the U.S. Four of those were branchless. The others mostly operate as branchless divisions within a large bank. The scale and efficiency of this model enables these banks to offer rewards and other incentives that even tax advantaged credit unions cannot match. Most community and regional banks no longer try to compete for this business and only offer credit cards as an accommodation for those customers who still prefer dealing with a full service bank and are not primarily looking for rewards.

This branchless model is now spreading to other common kinds of financial products and services. Branchless banks such as Synchrony and Comenity primarily finance sales at stores and medical offices with both revolving and closed end credit. Other branchless banks finance equipment leases, home improvements, auto loans, power sports equipment loans, education loans and fleet fuel purchases. While almost all industrial banks operate as branchless banks, that model is also found among national banks, state commercial banks, and federal savings banks. Product offerings include commercial and consumer credit. Because of the efficiency and superior profitability of this model, it will increasingly become the platform for offering standardized and generic products like credit cards while smaller banks such as community banks will continue to provide loans requiring more customization such as CRE and ADC loans.

For these reasons, the branchless model will play an increasingly prominent role in the future of banking and it would be a serious mistake for the FDIC to continue trying to block it. A bank can only succeed serving the needs and convenience of its customers. The market, not regulators, determines needs and convenience. Customers whose needs are not met by banks will just as easily seek the services they desire outside of the regulated bank segment. Effective regulations must be adapted to the business models that best serve what the market demands. That means the FDIC should be developing policies and standards that will help branchless banks and banks taking brokered deposits to continue operating safely and soundly. In that regard, it is worth repeating that no FDIC studies cited in connection with brokered deposits mention or analyze these market trends.

The policy of restricting the use of brokered deposits in every way possible is unjustified for other important reasons.

The FDIC's authority as a regulator is derived from and limited by the laws that Congress enacts. Since 1982, federal law has expressly authorized industrial banks to qualify for federal deposit insurance[4] and has allowed well capitalized banks to hold brokered deposits without limitation. Congress has considered changes to these laws and studied the status of industrial banks on multiple occasions and has decided each time not to restrict the development of federally insured industrial banks and branchless banks. Nothing in the implementing statutes authorizes the FDIC to selectively block otherwise qualified banks from relying on brokered deposits as a funding strategy and no such restrictions were imposed prior to 2008. The only thing that occurred to explain this very important policy change was a new chairman.

Nor does the legislative history support this policy. The ABA recently released a report covering the legislative history of Section 29 of the FDI Act. The report quoted

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[4] Section 3(a)(1)(A) and (2) of Federal Deposit Insurance Act, 12 U.S.C. Section 1813(a).

statements by the sponsors of that law saying there was no intent to restrict the use of brokered deposits by banks that are well capitalized. The target of the law is failing banks that misuse brokered deposits, not those that use them responsibly.

Based on this history, the only reasonable restriction on the use of brokered deposits by new banks is that they must develop credible plans to be well capitalized at the outset and thereafter, a policy currently applied to all new bank applicants including community banks. It does not provide a valid basis for prohibiting brokered deposits by any new applicant regardless of the strength of its funding plan.

Nor is this practice justified on public policy grounds. The primary purpose of federal deposit insurance is to help stabilize the banking system. Initially, that meant stopping depositor runs during the Great Depression. Since then, the FDIC's role has evolved into acting as a regulator to help ensure that depositors have safe places to put their money and that banks—which serve as the backbone of the nation's economy—are financially and legally sound. No credible reason for blocking the development of new bank models has been articulated—indeed the policy has not been publicly acknowledged—nor is there any good reason to say Congress never intended, or should support, limiting federal deposit insurance only to banks using the traditional local geography, branch and cross sell model.

Another public policy issue is the importance of banks compared to other financial services companies and the economic risks resulting from a policy of excluding financial institutions that utilize a non traditional business model from qualifying as a bank when they could operate more stably and profitably, and could be regulated more effectively as a bank.

A good example is credit cards. As mentioned above, issuing credit cards is a paradigm of branchless banking. Credit cards generally remained profitable during the Great Recession even though delinquencies and charge-offs rose. Along with debit cards and prepaid cards, credit cards now constitute the primary way people pay for things. Because credit, debit and prepaid cards are almost all issued by banks, they are very closely regulated and funded with low cost deposits including a significant proportion of brokered deposits. If credit cards were not issued by banks, issuers would have to rely on capital, warehouse lines of credit and securitizations to fund the accounts. That would make the funding less stable and more expensive. If they were not banks, some and perhaps many, major credit card issuers could have depleted their liquidity during the Great Recession as securitization markets collapsed and banks cut back warehouse lines in order to raise capital ratios. That, in turn, would have severely disrupted the payments system and dramatically inflamed the general sense of panic developing as other well known financial institutions failed. As the primary components of the payments system today, it is imperative that credit cards and debit cards remain part of the banking system.

This same model is being increasingly adopted by other banks offering products and services that can be offered in a standardized way and delivered electronically across a broad, often national, market, including auto loans, equipment leasing, retail sales, small business loans, other commercial loans, home improvement loans, home equity loans, student loans and factoring. If not impeded, this will lead to a group of stable and well regulated lenders to supply much of the credit needed to support the economy, which should be one of the FDIC's primary goals.

Banks should also be the preferred form of credit provider because deposits enable a bank to hold loans and obtain interest income. Non bank lenders mostly originate credit for sale to investors. Those institutions typically rely on fee income and must constantly originate new credits or die. That limits their ability to scale down lending in an economic downturn. The need to continue lending regardless of market conditions can create bubbles and is the main reason why the housing markets became so overheated prior to the Great Recession. Banks, on the other hand, can adapt to downturns in the economy and maintain prudent lending standards even when loan volumes decline because the bank still has interest income from the loans it funded with deposits. This is why as a matter of public policy the FDIC should encourage and facilitate the formation of new banks, especially branchless banks that are more efficient and adaptable in varied economic conditions.

REQUEST FOR COMMENTS

We would first note that revising the policies designed to inhibit any use of brokered deposits would dramatically affect all of the answers below. Reasonable policies implementing the requirements of Section 29 are what our members request. Remove the current stigma and the excessive consequences when a deposit is classified, rightly or wrongly, as brokered, and the issues will become much more manageable. It becomes a capitalization issue only. With that, we respond to the specific questions in the ANPR as follows:

- *Are there ways the FDIC can improve its implementation of Section 29 of the FDI Act while continuing to protect the safety and soundness of the banking system? If so, how?*

Definitely, yes. It can begin by reexamining the risk of using brokered deposits by fairly evaluating each bank's business model and overall funding strategies. Branchless banks using brokered deposits to serve a thriving market can be among the safest and strongest banks insured.

The epidemic of bank failures during the Great Recession was clearly and almost entirely the result of banks primarily engaged in CRE and ADC lending becoming too reliant on overheated housing markets for their loans. Some of those were new banks still trying to establish themselves in their communities. Community banks still play a vital role in serving those markets but they must be closely supervised to avoid becoming too exposed to overheated markets and from contributing to the excess capacity. Brokered deposits may have played a small role in the pace of this overdevelopment, but the excess capacity was the problem, not the deposits, and that kind of problem can happen and cause failures even if brokered deposits are not utilized at all.

The most important action the FDIC needs to take to fulfill its legal responsibilities and bring its policies into harmony with the banking markets is to change the unjustified and abusive policy of blocking all brokered deposits.

Another important action is to change the policy of classifying virtually any deposit made with the assistance of a third party as brokered. During the past several years, the FDIC has increasingly classified any deposit as brokered if it was not made personally by a depositor at a branch. This is another way to block the development of non traditional bank models.

In substance, this policy has expanded the concept of brokerage far beyond its original intent to the point where it no longer makes sense.

For example, an individual may have money in an IRA brokerage account and other money to deposit. She may direct her IRA custodian to deposit her retirement funds in certain bank issued CDs. She could also deposit her other money in the same CDs by sending the money directly from her checking account. Under current policies, the money coming from her retirement account would be a brokered deposit and her other money would not. In substance there is no difference in the decision to make each deposit. The risk associated with each deposit is exactly the same.

The original deposit brokers offered premium rates to attract deposits that the broker would then market to banks. That is the paradigm of a "primary purpose" mentioned in Section 29. In that scenario, brokered deposits can be obtained in large amounts with a phone call. When the depositor initiates the deposit, the flow of money is slower, comparable to retail deposits. As described in more detail below, deposits made by a party administering funds beneficially owned by another person and acting at the direction of the person who owns the money (such as a person who self directs his or her IRA account) should not be classified as brokered.. There is no difference in substance if an individual researches rates then directly deposits money into a bank versus directing a custodian of funds to deposit money the person beneficially owns into the same bank. The only effect of that policy is to severely constrict the definition of a core deposit, not mitigate any risk.

As mentioned above, even that matters little if it only means the bank must be well capitalized to accept the deposit.

A broader issue is the risk caused by adopting policies that would restrict development of new banking models in a market that is rapidly changing in response to market trends. The FDIC, no less than the banks themselves, must follow the market to remain viable.

- *Are there types of deposits that are considered brokered that should not be considered brokered? If so, why?*

This is perhaps the key question to achieve real reform and workable policies regarding brokered deposits.

The main criticism of brokered deposits is that they change the basic dynamic of banking.

Before electronic banking, a bank's operations were primarily driven by its deposit base. That provided the money to lend and determined the supply of credit. If loan demand exceeded deposits, some borrowers had to look elsewhere or do without.

Absent the ability to sell loans or participations, that is still the basic operational model of a bank that maintains branches and relies on core deposits.

True brokered deposits shift that dynamic to the credit side. A bank can obtain from a broker all the deposits it needs to fund all the loans it wants to make at any point in time. In that context, the deposit base does not serve as a constraint on excessive growth. Instead, capital ratios and credit underwriting standards are the main check and balance. The ability to obtain brokered deposits in any amount just as they are needed to fund loans, and to serve all creditworthy borrowers up to the limits of the bank's capital, enables a bank to more efficiently and completely serve the needs of its customers, but it presents a size risk if the bank's products and services are mismanaged. That is why it is appropriate to prohibit banks that are not well capitalized from taking brokered deposits without prior regulatory approval.

The primary distinction there is who initiates the placement of a deposit.

If the depositor or the depositor's agent, representative or administrator initiates the deposit, the dynamic is essentially the same as an individual delivering cash to a teller at a branch. Why should it matter if a depositor has the assistance of a third party in placing a deposit? The reason for making the deposit is the same. The deposits flow in and out of the bank according to the depositor's needs. Loan demand is driven by different forces and ebbs and flows on its own. Management's job is to coordinate the two.

In contrast, a true brokered deposit is initiated by the bank. Deposits are a commodity acquired from a broker whose business is to gather deposits in the same way a full service securities broker obtains stock for an investor or a commodities broker intermediates between buyers and sellers of raw materials.

This leads to the following conclusions:

- A brokered deposit should be defined as a deposit initiated by the bank.
- All other deposits are just deposits or they could be classified as core deposits.
- Brokered deposits should require regulatory approval if a bank is not well capitalized.

It might be argued that credit standards should be subject to closer supervision if a bank uses brokered deposits, but that should be a priority regardless of the deposits used by any bank.

The key to avoiding failures of branchless banks is to ensure their loan programs are carefully managed and they remain well capitalized. Our members support that fully. At this point in time, the branchless model has demonstrated above average strength and versatility.

As the epidemic failures in the Great Recession revealed, the main cause of failures in all banks is an unrealistic or unreasonable belief by management that loans or market conditions present less risks than they do. Another factor is approving new banks to serve markets that are overheating. Those banks might eventually understand the risks but must still make loans in order to become established. For those banks, a big risk is not seeing the market overextension until after they have opened and are beginning to grow. That clearly happened to many of the banks that failed in the Great Recession.

The FDIC could fashion better policies by abandoning use of the term "core" deposit and instead classify deposits as brokered when they qualify as such and otherwise just treat all deposits the same. The term "core" is not found in any statute and its use is not otherwise mandated. In practice it is used to create a preferred class of deposits and to implement policies designed to restrict the development of new banking models such as branchless banks. Another option would be to classify any deposit placed by the depositor as core regardless of the role of a third party in facilitating the placement on behalf of the depositor.

Reforming these policies will require changing how the FDIC interprets the statutory exemptions. For the past several years, the FDIC has largely ignored the exemptions. If a deposit wasn't received directly from the depositor without the assistance of a third party, it was presumptively brokered and a bank or administrator or mutual fund manager had to apply to the FDIC for confirmation that the deposit would be exempt. We believe this is beyond any statutory intent, and the result has substantially chilled the development of new methods of depositing money in an account, which has been the intent of those policies.

The interpretation of "primary purpose" provides a good example.

The role of a custodian of an IRA is not primarily to place deposits although it will place retirement funds into deposits if directed to do so by a beneficiary with a right to choose. It may also place deposits on its own discretion as part of an investment strategy. But even then, its primary role is administering retirement money. It places deposits for the same reasons an insurance company invests its reserves.

One key test for a primary purpose should be if the person facilitating placement of a deposit is paid a fee by the bank. That is a key feature of a classic deposit broker. In contrast, a securities broker or mutual fund is paid a fee by the owner of the funds. The needs of the depositor drive the selection of a bank in those instances. In the case of true brokerage, the needs of the bank drive the process. That is the key distinction that should be used to define a brokered deposit. All other deposits should just be classified as deposits.

- *Are there types of deposits that are not considered brokered that should be considered brokered? If so, please explain why?*

As stated above, we believe the definition of brokered deposit has been applied too broadly. We have not identified any deposits that should be classified as brokered that currently are not.

- *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? If so, please explain.*

Yes. See discussion above relating to electronic banking and the decline or transformation of the role of branches.

- *Do institutions currently have sufficient clarity regarding who is or who is not a deposit broker and what is or is not a brokered deposit? Are there ways the FDIC can provide additional clarity through updates to the brokered deposit regulation, consistent with the statute and the policy considerations described above?*

  The main issue is abuse of the definition rather than lack of clarity.

It is clear enough under current policies that if it isn't core it's probably brokered. The ambiguity is what is core? Cash given to a teller is clearly core. What about cash electronically deposited to a customer's account by his or her employer? The employer and the employer's bank are both third parties and the employer's bank is paid a fee for transferring the money. Is that brokered? That is where the confusion lies. It would work much better to instead focus on what is a broker and define that as a business that primary gathers money to fill a bank's orders for deposits and receives a fee paid by the bank.

- *Are there areas where changes might be warranted but could not be effectuated under the current statute? Are there any statutory changes that might be warranted by Congress?*

The current statute only requires that banks that utilize brokered deposits maintain a well-capitalized status. The main issues are unacknowledged and restrictive practices by the FDIC. In addition to the practices related to approving new banks, these practices include unjustly increasing the deposit insurance assessment of banks that utilize brokered deposits and unwarranted increased scrutiny by examiners. The main changes needed to resolve those practices only require administrative action to discontinue those policies.

One change in the law that Congress might consider is to remove the requirement that only a bank that is adequately capitalized can seek regulatory approval to take new brokered deposits. There are instances where a bank may go through a period where its capital falls below adequately capitalized but it has reasonable chances of returning to an adequately or well capitalized condition. It is reasonable to let that type of bank take new brokered deposits with prior regulatory approval if the regulator determines that the bank is reasonably likely to recover from a temporary capital impairment. That would still avoid the risk of a failing bank loading up on new deposits while avoiding the unnecessary failure of a bank reliant on brokered deposits because of a temporary problem.

- *Should the FDIC make changes to the call report instructions so that the agency can gather more granular information about types of brokered deposits?*

  No. Lack of detail is not a significant issue.

- *Rate caps generally.*

Rather than respond to the specific questions relating to rate caps for adequately capitalized banks, we would offer the general observation that the rate caps often bear no relationship to the rates offered by competitors for the types of deposits the bank offers. Rates on deposits offered by traditional banks are almost always below the rates for brokered deposits or deposits offered through a listing service on the Internet or through a direct solicitation by a branchless bank. For example, a branchless bank currently advertises savings accounts with a 2.10% yield.[5] The ad shows a comparison to the "national average" of 0.10%. The ad states that the "national average" is "accurate as of 3/20/2019 as published in the FDIC's Weekly National Rates and Rate Caps." There is little point in advertising a savings account paying 0.85% APR (0.1% plus 75 basis points maximum increase allowed by law) on a listing service where other banks offer 2.1% on similar terms. In those cases, 2.1% is the norm, not 0.85%. It would obviously help to calculate average rates for the type of deposit the bank would offer. Otherwise, the national rate cap effectively prohibits an adequately capitalized bank from competing for new brokered deposits, or virtually any kind of deposits, even if authorized to do so.

CONCLUSION

The record of branchless banks using brokered and other wholesale deposits over the past 35 years clearly shows that those deposits present no significant risk to the insurance fund when used prudently. The FDIC must update its current policies to reflect how brokered deposits are used today and how market trends will affect funding strategies in the future. Regulations and policies also need to be better aligned with the intent of Section 29 of the FDI Act. We support the activities of the FDIC that respond to the changing dynamics of financial services in the 21st Century, while maintaining its commitment to protecting Americans.

We appreciate the opportunity to provide perspectives and judgements based upon facts and practical experiences by our member banks. Please let us know how we can be of further assistance.

Sincerely,

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[5] Mailed ad by American Express Bank, N.A. Accounts have "no fees, FDIC insured, no minimum balance."