



May 7, 2019

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Federal Deposit Insurance Corporation
Comments of Middlesex Federal Savings, F.A. in Response to Advance Notice of
Proposed Rulemaking and Request for Comment [RIN 3064-AE94]

Dear Executive Secretary Feldman,

This comment letter is submitted by Middlesex Federal Savings, F.A. (the "Bank") in response to the Advanced Notice of Proposed Rulemaking, "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions," published by the Federal Deposit Insurance Corporation ("FDIC") in the Federal Register on February 6, 2019 (the "ANPR").¹ We welcome this opportunity to submit our comments.

As the FDIC notes in the ANPR, brokered deposits became a concern among bank regulators and Congress before any statutory restrictions were put in place, and this concern "arose because: (1) [s]uch deposits could facilitate a bank's rapid growth in risky assets without adequate controls; (2) once problems arose, a problem bank could use such deposits to fund additional risky assets to attempt to 'grow out' of its problems ...; and (3) brokered deposits and high-rate deposits 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."² While we agree that the brokered deposit statute, Section 29 of the Federal Deposit Insurance Act, 12 U.S.C. 1831f ("Section 29"), and its related regulation at 12 C.F.R. § 337.6 (the "Regulation") serve an important purpose in limiting unsafe and unsound practices among depository institutions, we also believe that Congress clearly intended Section 29 to be narrow in scope and to only address arrangements in which these concerns were clearly implicated.

¹ 84 Fed. Reg. 2,366 (Feb. 6, 2019).

² *Id.* at 2366.

We also agree with the FDIC's observation in the ANPR that there have been "significant changes in technology, business models, the economic environment, and products" since the brokered deposit regulations were first adopted.³ We therefore believe that the FDIC can and should interpret Section 29 so as to allow depository institutions to work with third parties to provide innovative banking platforms to the bank's customers and thereby take full advantage of the significant changes in technology and products, without that third party being treated as a deposit broker.

Middlesex Federal Savings, F.A.

The Bank is a federal mutual savings association. The Bank was established in 1890 as a Massachusetts cooperative bank and converted to a federal savings association in 1937. It is headquartered in Somerville, Massachusetts and has three branches, each located in Middlesex County, Massachusetts, and approximately \$413 million in assets. The Bank accepts deposits and provides a range of retail and commercial banking products and services to its customers. These include residential mortgage loan and commercial loan products, online and mobile banking, business banking accounts, and Individual Retirement Accounts.

In October 2017, the Bank entered into a relationship with Novo Platform Inc., a Delaware corporation ("Novo"). Novo is a well regarded fintech startup company that has developed and operates an online platform that delivers financial tools, products, and services to small businesses. Through the Novo application, business customers can apply for a demand deposit account and, once the account is approved by the Bank, transact business with the account. Bank customers may make initial and subsequent deposits by creating and transmitting check images to the Bank, or a customer may authorize the Bank to initiate an automated clearing house (ACH) debit to the customer's account with another bank to fund the new account. These are substantially the same methods of deposit that the Bank offers to its other customers through its core processor. Novo does not receive deposits from the Bank's customers.

Those business customers use the Novo platform's financial tools to analyze their financial transactions and link their Bank accounts to other third-party financial products and services.

The Bank and Novo share certain fee income and costs associated with the deposit accounts in the manner described in their contract. The Bank also pays Novo a flat monthly fee in consideration of the costs and expenses incurred by Novo in connection with maintaining the platform, linking the platform to the Bank's core processor, and providing related technical support.

³ *Id.*

The Bank entered into its relationship with Novo in order to more effectively reach and serve small business entrepreneurs, which the Bank views as an important and growing segment of the commercial banking market. Through the Novo platform, the Bank is able to reach new customers by leveraging Novo's innovative technology and functionality, which are designed to appeal to business customers. In that way, Novo provides technology and services to the Bank's small business customers that are not available through the Bank's core processor, Connecticut Online Computer Center, Inc. The Bank offers and provides its standard products and services to customers that open a deposit account through the Novo platform, including Bank-issued debit cards, bill payment services, automated clearing house services, and wire transfer services. Novo and the Bank contemplate that the Novo platform may be expanded in the future to include additional banking products and services, such as loan products and additional deposit products. The Novo relationship benefits the Bank in numerous ways. The Novo relationship helps the Bank to reduce its cost of funds, diversify its funding sources, and expand its customer base. The Bank is also able to expand its relationship with its existing business customers by offering the Novo technologies and functions.

Section 29 History and Narrow Congressional Intent

Congress was very clear when enacting Section 29 that it was intended to be narrow in scope. Over the next five years, Congress further narrowed Section 29.

The brokered deposit amendment to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 was authored by Senator Frank H. Murkowski (R-AK). During a hearing on the amendment before the Subcommittee on General Oversight and Investigations of the Committee on Banking, Finance and Urban Affairs, Senator Murkowski said the following:

"The goal of this provision is to prevent the flagrant abuse of the deposit insurance system by troubled institutions that take excessive risks and leave the taxpayers to suffer the consequences. By preventing troubled institutions from using brokered deposits – unless permitted to do so by the FDIC – we accomplish this goal and create accountability on the part of the FDIC.⁴

. . . In summary, this amendment is designed to rein in the abuses of brokered deposits by troubled institutions and to create accountability on the part of Federal regulators. This is a not a blanket prohibition on the use of brokered deposits, but a narrowly drawn provision that specifically

⁴ Testimony of Hon. Frank H. Murkowski, U.S. Senator from the State of Alaska, "Insured Brokered Deposits and Federal Depository Institutions," Hearing before the Subcommittee on General Oversight and Investigations of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 101st Congress, 1st Sess., 7 (May 17, 1989) (emphasis added); see also *id.* at 71 (written testimony). The purpose of this hearing was to update the record on brokered deposits following a prior hearing by the House General Oversight Subcommittee during the 99th Congress on July 16, 1985.

targets the most flagrant abusers. A provision intended to protect the taxpayers of this country.⁵

The language of Section 29 also supports the conclusion that Congress did not intend every third party that assists a bank in any way with its deposit activities to be treated as a deposit broker. Section 29 defines “deposit broker” as “any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties.”⁶

Section 29 lists nine specific exclusions to the definition of deposit broker. Perhaps the most important of those exclusions, and clearly the broadest of the exclusions, is for “an agent or nominee whose primary purpose is not the placement of funds with depository institutions.”⁷ Despite the breadth of this exclusion, the FDIC historically has applied it narrowly. This approach by the FDIC might have been appropriate many years ago, but in today’s environment it unduly limits a depository institution’s ability to work in collaboration with third party technology providers to expand the institution’s product and service offerings. Technology today is transforming banking and the delivery of financial services beyond the capabilities of our traditional core providers. If community-based financial institutions like Middlesex Federal are to survive and prosper, they must have the ability to work closely with third party technology providers like Novo to meet the competitive challenges of trillion dollar financial institutions with in-house state-of-the-art technology capabilities.

Other Considerations

A depository institution clearly can offer its products and services electronically, including via the Internet.⁸ However, institutions wanting to take advantage of these technologies can be faced with the difficult choice of developing or purchasing the technology and incurring those costs, or contracting with technology and online platform providers and potentially incurring increased deposit insurance assessments if that provider’s systems somehow make it easier for the institution to acquire deposits. Smaller depository institutions with limited resources, such as the Bank, might have no economically viable choice other than to contract with a third party technology provider, putting the institution at a competitive disadvantage solely because of deposit insurance costs. The FDIC’s current interpretations of the meaning of deposit broker

⁵ *Id.* at 9-10 (emphasis added); *see also id.* at 74 (written testimony).

⁶ Section 29 does not define “brokered deposit,” but the Regulation defines the term as any deposit that is “obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.”

⁷ 12 U.S.C. § 1831f(g)(2)(I).

⁸ For example, a federal savings association “may use, or participate with other to use, electronic means or facilities to perform any function, or provide any product or service, as part of an authorized activity. Electronic means or facilities include, but are not limited to ... the internet, telephones, and other similar electronic devices.” 12 C.F.R. § 155.200(a).

and brokered deposit impede bank innovation and hinder banks' ability to leverage technology to obtain deposits.

We also note that the Liquidity Coverage Ratio ("LCR") regulations adopted by the FDIC in 2014 consider "stable retail deposits" to include retail deposits that are entirely covered by deposit insurance if either (1) the deposit is held in a "transactional account" or (2) the "depositor that holds the account has another established relationship with the FDIC-supervised institution...." The established relationship could be another deposit account, loan, bill payment service, or any other service provided to the depositor, so long as the bank can demonstrate that the relationship would make the withdrawal of the deposit "highly unlikely during a liquidity stress event."⁹

Possible New Approaches

We respectfully submit that the FDIC can and should interpret Section 29 so as to allow and encourage depository institutions to contract with third parties for technology services, Internet platform services, and account processing services, without those third parties automatically being treated as deposit brokers.

One possible approach would be to exclude from the definition of deposit broker any provider of technology, Internet platform, or account processing services (collectively "Technology Services") so long as (1) the depository institution is authorized by applicable law to provide such Technology Services directly, (2) the provider does not receive deposits on behalf of the depository institution, (3) the deposit accounts obtained through the Technology Services are only individual transactional deposit accounts (defined below), (4) the interest rate paid on such deposits is reasonably equivalent to or less than the average rate paid by the institution on all of its similar accounts, and (5) the depository institution enters into deposit account contracts with each resulting deposit customer. For these purposes, "individual transactional deposit account" would include a transactional deposit account offered on an individual basis directly to the depositor rather than a bulk or wholesale deposit in which the third party acquires a large deposit and sells or otherwise distributes pieces of that large deposit to multiple depositors.

Another approach would be to exclude all "relationship deposit accounts" from the definition of brokered deposit, defined as transactional deposit accounts where the depositor obtains at least one other banking service from the institution, such as a debit card, another deposit account, a loan, a bill payment service, automated clearing house services, or wire transfer services. This would be consistent with the regulatory recognition, as reflected in the LCR regulations, that such deposits are stable and do not present liquidity risks.

Either of these approaches would ensure that the arrangement does not raise the fundamental concerns intended by Congress to be addressed by Section 29: (1) that the deposits would facilitate a bank's rapid growth in risky assets without adequate controls; (2) that a bank could


⁹ See, e.g., 12 C.F.R. § 329.3 (FDIC regulation).

use the deposits to fund additional risky assets to attempt to grow out of its problems; and (3) that the deposit customers would be "rate shoppers" that open accounts due to the high interest rates offered by a bank.

Conclusion

We appreciate your thoughtful consideration of this important topic and our opportunity to provide these comments.

Sincerely,



John R. Wiseman
President and Chief Executive Officer
Middlesex Federal Savings, F.A.

CC: Thomas Curry, Partner, Nutter McClennen & Fish LLP
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