November 21, 2024

VIA E-MAIL ONLY

James P. Sheesley,
Assistant Executive Secretary,
Attention: Comments—RIN 3064–AF99
Federal Deposit Insurance Corporation,
550 17th Street NW,
Washington, DC 20429

RE: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; RIN 3064–AF99

To Whom It May Concern,

The Wisconsin Bankers Association (WBA) is the largest financial trade association in Wisconsin, representing nearly 200 state and nationally chartered banks, savings banks, and savings and loan associations of all sizes located in Wisconsin, their branches, and over 30,000 employees. WBA appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) proposed revisions to its regulations relating to brokered deposits restrictions (proposal).

On December 15, 2020, FDIC adopted a final rule that established a new framework for analyzing whether certain deposit arrangements qualify as brokered deposits (2020 Final Rule). FDIC has proposed amendments to the 2020 Final Rule to revise the definition of ''deposit broker,'' and amend the analysis of the ''primary purpose'' exception to the ''deposit broker'' definition. The proposal would also amend two of the designated business relationships under the primary purpose exception and make changes to the notice and application process for the primary purpose exception.

The proposal is based upon a mischaracterization of brokered deposit risk. Brokered deposit risk was more than adequately considered in FDIC's thorough review process when modernizing its regulatory framework in the 2020 Final Rule. Despite this, in the proposal, FDIC expresses sudden concern for brokered deposits. However, FDIC fails to present any rationale to justify the revisions proposed.

This perspective is not only inappropriate in today's market, but also as already mentioned, was considered and addressed in the 2020 Final Rule. In a larger sense, this perspective mischaracterizes brokered deposits as the problem, when the risk is in the problematic scenarios arising from rapid growth of risky assets and attempts to "grow out" of those scenarios. WBA believes FDIC should focus its risk mitigation efforts on the broader problems, rather than target brokered deposits. Furthermore, the proposal is based upon insufficient data and review. For the reasons discussed below, WBA recommends that FDIC withdraw the proposal.

Background

Section 29 of the Federal Deposit Insurance Act (Section 29) was enacted by Congress in 1989, as part of the Financial Institutions Reform, Recovery, and Enforcement Act. Section 29 sets restrictions on the acceptance of brokered deposits by institutions with weakened capital positions. Congress intended to prevent troubled institutions from holding funds placed by third

parties whose primary business is “placing deposits or facilitating the placement of deposits of third parties” with insured depository institutions.

Congress adopted Section 29 in connection with the savings and loan crisis of the 1980s, after emerging electronic technologies made brokered deposits possible. Many savings and loans relied on funding through a new financial product developed in the 1960s: the certificate of deposit. Certificates of deposit were bundled for investors by third parties, which became known as brokered deposits. Brokered deposits were then new products, considered unstable and highly rate sensitive. Ultimately, institutions that depended on this type of funding were more expensive for the federal deposit insurance agencies to resolve in the event of failure.

Initial concern centered around brokered deposits contributing to irresponsible asset growth at some institutions. Section 29 was intended to make the resolution of failed Insured Depository Institutions (IDI) less costly by restricting weak institutions from holding brokered deposits. FDIC sought to regulate brokered deposits by limiting the deposit insurance available for such deposits. The regulation, first proposed in 1983, was ultimately enjoined by the courts on grounds that the rule exceeded agency authority. Congress adapted the FDIC’s language but significantly restricted the scope of application. Despite this enjoiner and the narrowing of the provision’s scope by Congress, FDIC continued to rely on concepts contained within the earlier rule. FDIC expanded who is considered a deposit broker, narrowly interpreted exceptions, and applied restrictions beyond the focus of Congress. Specifically, this resulted in inappropriate classification of certain entities as deposit brokers, such as: social media platforms, fintech partners (such as apps/application programming interfaces), bank affiliates and subsidiaries, and homeowners associations.

In 2019, FDIC undertook a review of its brokered deposit regulations, to refine “deposit broker” which, ultimately, addressed the inappropriate classification of certain entities as deposit brokers. This review resulted in the 2020 Final Rule, which revised FDIC’s regulations to become consistent with modern technologies, business models, and products. More specifically, after thorough review and analysis, FDIC decided to revise its deposit insurance regulation to refine “deposit broker” to a more workable definition and modernize its approach.

The proposal would reverse many of the changes made in the 2020 Final Rule. It would expand the type of deposits classified as brokered and cause the brokered deposit regulations to become “de facto” regulations for well-capitalized IDIs. This expansion of the brokered deposit regulations will stretch the regulations well beyond the intent of the law.

Discussion

FDIC should not change the 2020 Final Rule’s approach without sufficient rationale. FDIC engaged in extensive public information gathering during the process leading up to the 2020 Final Rule. Nothing has changed to cause doubt of that process, FDIC’s information, or factual findings nor has FDIC brought any evidence in the proposal to reject those findings.

The proposal emphasizes the role of brokered deposits in risks associated with rapid growth, such as their potential for quick and imprudent use to fund risky assets or investments, exposure to operational, liquidity, and legal risk, and ultimately, exposure of the DIF to increased losses. However, while FDIC’s prior studies reflected that rapid asset growth is a significant contributor to a bank’s failure, FDIC fails to properly explain why the proposed changes to its brokered deposit regulations address that risk. While FDIC does attempt to provide rationale for the change, it fails to relate brokered deposits directly to the issues the proposal seeks to address. Rather, all of the issues presented were already addressed in the 2020 Final Rule.

For example, in its proposal, FDIC points to the decline in the amount of brokered deposits reported following the 2020 Final Rule. FDIC explains that "this is because, in large part, the changes made by the 2020 Final Rule have narrowed the types of deposit related activities that are considered brokered; in the FDIC's view, this narrowing is problematic because these deposits continue to present the same risks as before the 2020 Final Rule."

This result is precisely one of the stated objectives of the 2020 Final Rule. FDIC's prior interpretation of deposit broker included any third party, being, generally, "any person" engaged in "placing deposits…of third parties," and draws no further distinction. Because this interpretation hinges on the involvement of any third party, many modern deposits were scooped into this definition, despite being some of the most stable. Penalizing these deposits is harmful both to IDIs and their customers. FDIC also considered the importance of carving out certain deposits as not "brokered." For example, relationship deposits, which would include those generated from subsidiaries and affiliates of an IDI, and other deposits involving a direct, continuing relationship between a customer and an insured depository institution should not be considered "brokered."

WBA has found that these deposits are among the most stable. Such deposits should be expressly excluded from consideration as "brokered," even if an unaffiliated third-party is involved in the origination of the deposit or maintains an ongoing relationship with the depositor independent of the deposit relationship. WBA has found little evidence that relationship deposits gathered through the normal course of providing banking services through affiliates or marketing partners pose enhanced risk to safety and soundness or the deposit insurance fund. FDIC issued the 2020 Final Rule in recognition of these benefits, such as confidence in access to funding sources no longer defined as brokered deposits, availability of new banking relationships with other firms, and reclassification of subsidiaries.

These considerations were a part of the 2020 Final Rule and based upon an extensive review process. FDIC not only disregards the information gathered to form the 2020 Final Rule but also fails to provide sufficient new data or analysis to justify the proposal. Instead, FDIC draws conclusory statements such recognition that ''historically, most institutions that use brokered deposits have done so in a prudent manner and appropriately measure, monitor, and control risks associated with brokered deposits…however, an IDI's use of brokered deposits often raises its risk profile…" In the proposal, FDIC briefly reflects on the history of troubled institutions. However, it doesn't base any of the proposal's conclusions on these reflections. These reflections were, however, analyzed more fully as part of the 2020 Final Rule. In short, the proposal relies upon loose concepts to overturn the 2020 Final Rule which has already addressed those exact concepts in far greater detail and subjected to a more appropriate level of analysis. If FDIC disagrees with the conclusions it reached in 2020, it must explain why, rather than simply disregard prior conclusions drawn from deliberate information gathering without any new findings or explanation.

In addition, FDIC fails to consider the considerable reliance by IDIs upon the 2020 Final Rule. Since finalization, many IDIs have modified systems, policies, and procedures to comply with the changes. Reversing these provisions would not only disrupt business, but also impose significant costs on many business relationships, without any adequate rationale provided by FDIC. As identified and discussed in more detail within other comments shared by the industry, WBA anticipates these relationships include:

- Relationships between well-capitalized IDIs and technology platforms that provide a range of services to homeowners' associations, including the placement of funds with IDIs,

- Sweep programs between well-capitalized IDIs and broker/dealers that often are based upon a primary purpose other than deposit placement,
- Partnerships with fintechs that enable well-capitalized IDIs, especially smaller IDIs, to provide deposit and other banking products and services to consumers and businesses, and
- Marketing agreements between well-capitalized IDIs and third parties, including retail merchants, advertising platforms, and non-profits such as universities, which introduce the well-capitalized IDI to the third party's audience for the provision of deposit and other banking products and services.

These types of arrangements provide well-capitalized institutions with a stable source of funding, and a needed service for consumers and businesses. They are not the types of arrangements Section 29 was designed to restrict. FDIC proposes no rationale basis for classifying the deposits obtained through these relationships as brokered, instead relying only on the fact that they involve a third party.

Furthermore, FDIC fails to consider the broader negative impact of the proposal. A fundamental role of IDIs is to provide financial services including deposit taking, lending, access to payments system, wealth management, trust and custody services and cash management services. Modern technology, including an increasing diversity of financial affiliations, and the creation of and growth in online and mobile banking, allows IDIs to offer these services, gather stable deposits and obtain access to potential depositors via new mechanisms. WBA members are eager to meet customer needs by playing this role. In order to make this possible, it is imperative that FDIC ensure it maintains a focus on the original purpose of Section 29 and not penalize IDIs for engaging in practices that are well within the bounds of an IDI's normal course of business, including responding to evolving customer preferences and enhancing diversification and resilience in bank funding.

This was closely considered by the 2020 Final Rule, which recognized how technologies and marketplace developments have caused business relationships to evolve. Those changes facilitated those relationships, while acknowledging the implications of brokered deposits, and managing and avoiding undue risk. The 2020 Final Rule has also encouraged new relationships among IDIs, consumers, and other businesses. FDIC observed in the preamble to the 2020 Final Rule that "unbanked or underbanked customers, for example, may benefit from increased ease of access to deposit placement services because IDIs would be more willing to accept deposits that would be no longer considered brokered under the final rule. Additionally, to the extent that the rule supports greater utilization of deposits currently classified as brokered deposits, but classified as non-brokered under the rule, it could increase the funds available to insured depository institutions for lending to U.S. consumers."

Since the 2020 Final rule, IDIs have been able to provide these benefits to their customers through newly permissible methods for marketing relationships with merchants. These relationships help introduce underbanked consumers to the industry. This presents a unique avenue to present the consumer the opportunity to build savings, learn greater financial responsibility, receive interest on deposits as compared to holding cash, and establish an organized financial life to enhance stability and personal prosperity. IDIs benefit by the introduction to new customer relationships and stable deposits from those customers who learn about them from a merchant. Shutting down this avenue of introducing consumers to banking would neither increase financial soundness of IDIs nor render any societal value. Instead, the changes made in the proposal would negate the benefits of the 2020 Final Rule for unbanked and underbanked consumers without any offsetting benefit and would reverse progress made since 2020 in lessening the divide between consumer spending and personal savings.

As a final example, the proposal would amend the ‘‘deposit broker’’ definition by revising the ‘‘engaged in the business of placing deposits’’ (‘‘placing’’) and ‘‘engaged in the business of facilitating the placement of deposits’’ (‘‘facilitating’’) prongs. The revised ‘‘deposit broker’’ definition would (1) combine the ‘‘placing’’ and ‘‘facilitating’’ prongs, (2) remove the term ‘‘matchmaking activities’’ and replace it with a deposit allocation provision, and (3) add a new factor related to fees. Specifically, the proposal would provide that a person is engaged in the business of placing or facilitating the placement of deposits of third parties if that person engages in certain activities, including when the person has a relationship or arrangement with an IDI or customer where the IDI, or the customer, pays the person a fee or provides other remuneration in exchange for or related to the placement of deposits.

This change is another example of a reversal of a policy adopted through the well-informed 2020 Final Rulemaking process which would cause deposits gathered under many existing marketing and referral relationships to be classified as “brokered,” without an adequate explanation for why the change is needed. This arbitrary change would inappropriately and unreasonably reclassify a number of relationships as “brokered” regardless of the stability of such deposits.

Conclusion

WBA requests that FDIC withdraw the proposal. The proposal is based upon an outdated view of brokered deposits and markets, which has already been addressed by the 2020 Final Rule. The changes proposed would negatively impact upon the banking industry, not reflect public interest, and are based upon insufficient data and analysis.

Once again, WBA appreciates the opportunity to comment.

Respectfully,

Rose Oswald Poels
President/CEO