Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

COMMENT LETTER

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Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Docket No. RIN 3064-AE94

Re: *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*

Dear Mr. Feldman,

The Conference of State Bank Supervisors[1] ("CSBS" or "state regulators") appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) notice of proposed rulemaking to revise its regulations relating to the brokered deposits restrictions that apply to less than well capitalized insured depository institutions ("IDIs"). While CSBS welcomes many aspects of the proposed revisions to the brokered deposit rules, we believe the proposed rule should take additional steps to reduce the negative impact on liquidity when a bank becomes less than well-capitalized under the prompt corrective action ("PCA") rules to minimize the so-called liquidity "cliff effect" created by brokered deposit restrictions.

As detailed below, we believe that applicable law affords the FDIC sufficient flexibility to allow for adequately capitalized institutions to renew and rollover brokered deposits held before the institution became less than well capitalized under PCA. This treatment is particularly appropriate for institutions that become less than well capitalized solely because they are subject to a formal agreement with a capital maintenance provision.

CSBS continues to believe that if properly utilized, brokered deposits can be a source of supplemental funding for banks, particularly in rural areas or markets which increasingly lack ample local deposits to meet the legitimate credit needs of the community. Brokered deposits can provide important supplemental funding sources for banks to provide critical credit to agricultural customers and small businesses.

We believe there are regulatory and supervisory solutions which can address any elevated risk associated with deposit growth or the use of brokered deposits, while permitting the prudent use of the brokered deposit funding channel. Inappropriate use of brokered deposits—such as to fund excessive loan growth outside of the bank's

market—can and should be addressed through the supervisory process rather than through anticipatory, proscriptive regulation.

Acceptance of Maturity Brokered Deposits for Purposes of the Brokered Deposits Restrictions The immediate prohibition on accepting, renewing or rolling over brokered deposits and the resulting liquidity "cliff effect" is an unintended consequence of the PCA framework tying brokered deposit restrictions to capital adequacy.[2] In a recent speech, FDIC Chairman Jelena McWilliams seemed to echo this sentiment in suggesting how the brokered deposit restrictions could be redesigned to reduce unintended consequences.[3] Ultimately, however, the Chairman related that these changes would require Congress to holistically review and advance legislation to amend the brokered deposit statute, section 29 of the FDIA (12 USC 1831f).

While Congress revisiting the structure and design of the brokered deposit statute may be warranted, CSBS respectfully submits that, in the interim and without any legislative changes, the brokered deposit statute affords enough flexibility for the FDIC to make needed improvements to the brokered deposit regulations. Though the proposed rule would redefine what acceptance means with respect to non-maturity brokered deposits, given the composition of brokered deposits outstanding, we believe that revising the meaning of acceptance with respect to maturity brokered deposits is equally important.

Section 29(a) prohibits an IDI that is not well capitalized from accepting brokered deposits without obtaining a waiver under section 29(c). Section 29(b) provides that "renewal" and "rollover" of brokered deposits by "troubled institutions" shall be treated as "acceptance" of brokered deposits for purposes of this prohibition. However, notably, Section 29 does not define what qualifies as a "troubled institution".

CSBS believes that the meaning of "troubled institutions" in section 29(b) is not so clearly or restrictively defined as to exclude adequately capitalized IDIs. So interpreted, the prohibition on acceptance of brokered deposits would not prohibit the renewal and rollover of brokered deposits by adequately capitalized IDIs. As a result, under this interpretation, an adequately capitalized IDI would be allowed to renew or roll over brokered deposits accounts it holds at the time it becomes less than well capitalized (without obtaining a waiver) while prohibiting the acceptance of new brokered deposit accounts after that time.

Since section 29 does not define "troubled institutions" its meaning is susceptible to and permits multiple reasonable interpretations. Although "troubled institutions" could reasonably be interpreted as including adequately capitalized institutions (and this is in fact how the FDIC has interpreted the term since the enactment of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)), the regulatory context in which FDICIA was enacted supports an equally reasonable interpretation that the term does not include an adequately capitalized institution.

Prior to FDICIA, "troubled institutions" referred to IDIs that failed to meet the minimum capital requirements (i.e. undercapitalized IDIs).[4] Further, in enacting FDICIA, Congress specifically replaced the term "troubled institution" with "institution that is not well capitalized" in section 29(a) and 29(c), while retaining the term "troubled institution" in section 29(b). In implementing FDICIA, the FDIC applied the expanded definition of "acceptance" in section 29(b) as covering all "institutions that are not well capitalized" and not only "troubled institutions", even though, at the time, "troubled institutions" was understood to refer to undercapitalized institutions, not adequately capitalized institutions.

CSBS believes that the pre-FDICIA definition of "troubled institution", coupled with the retention of the term in section 29b, makes it more than reasonable to interpret "troubled institution" to refer to undercapitalized IDIs, not adequately capitalized IDIs. As a result, we believe the FDIC has a clear statutory basis and interpretive room to not apply the expanded definition of acceptance (to include renewal and roll over) to adequately

capitalized institutions.

Under this interpretation:

- "accepting" brokered deposits would not include renewing and rolling over brokered deposits by adequately capitalized IDIs, so
- the section 29(a) prohibition should only apply to accepting new brokered deposits, and
- a section 29(c) waiver would only be needed to accept new brokered deposits, and not to renew or roll over existing brokered deposits.

CSBS believes that adopting this interpretation would significantly improve the design of the brokered deposit restrictions by helping to smooth out the cliff effect created by tying these restrictions to the PCA framework. This interpretation is particularly appropriate for institutions that become less than well capitalized solely because they are subject to a formal agreement with a capital maintenance provision.

It is important to note that adopting this interpretation would not foreclose the FDIC from using its general regulatory and supervisory authority to impose appropriate conditions on renewing and rolling over existing brokered deposits by IDIs. CSBS has long advocated that the brokered deposit rules should allow for a "glide path" that would allow institutions that become less than well capitalized to gradually reduce their reliance on brokered deposits over time.[5] We believe any conditions imposed on the renewal and rollover of brokered deposits could be designed to allow for such a glide path.

In short, CSBS believes the brokered deposits statute affords the FDIC sufficient flexibility to improve the design of the brokered deposit restrictions to eliminate the cliff effect faced by institutions that become less than well capitalized. While legislative changes to the brokered deposit statute would certainly be welcome, we encourage the FDIC to use the interpretive room afforded by the current statute towards this end.

Conclusion

We continue to believe a regulatory approach that allows less than well-capitalized institutions to gradually reduce their reliance on brokered deposit funding over time will allow banks to prudently meet local loan demand, improve competition in the deposit market and protect the DIF. Ultimately, state bank regulators continue to believe that the FDIC's regulatory approach to brokered deposits can be adjusted in a manner that adequately protects the DIF while ensuring prudent access to diversified sources of funding.

Sincerely,

John Ryan
President & CEO

Footnotes

[1] CSBS is the nationwide organization of state regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and examination resource development.
[2] For more information on the liquidity 'cliff effect', *see generally* Lorenzo Bini Smaghi, Basel III and Monetary

Policy, *International Banking Conference*, September 29, 2010.
[3] "Brokered Deposits in the Fintech Age" – Jelena McWilliams
[4] *See* 57 Fed. Reg. 23933 (June 5, 1992) (stating that, prior to the enactment of FDICIA, "[a] 'troubled' institution was defined by statute to mean any insured depository institution that did not meet the minimum capital requirements applicable with respect to such institution (*i.e.*, an 'undercapitalized' institution)."
[5] CSBS has previously suggested that the FDIC could require banks to develop a plan to unwind their brokered deposit positions over 12 to 24 months. This would allow the bank to reduce its dependence on brokered deposits in an orderly manner and avoid a liquidity crunch as the bank works to enhance capital and reduce its risk profile.

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