Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

COMMENT LETTER

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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*

Dear Sir,

The Conference of State Bank Supervisors1 ("CSBS") provides the following comments on the Federal Deposit Insurance Corporation's ("FDIC") notice of proposed rulemaking entitled "Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions" ("Proposal").2 The Proposal would significantly alter the FDIC's brokered deposits regulations, with widespread impacts to insured depository institutions ("IDIs") and a wide array of financial services entities.

The FDIC has eschewed a sound and responsible rulemaking process by issuing a far-reaching, disruptive Proposal without sufficient policy rationale, analysis of current data, or meaningful opportunity for public comment. Consequently, the Proposal is flawed and should be rescinded in its entirety.

I. The Proposal would needlessly disrupt an important source of bank funding and cause other complications.

The Proposal would cause a significant portion of deposits to be newly categorized as brokered by simultaneously expanding the definition of deposit broker and narrowing exemptions from that definition. Beyond significantly impacting bank funding strategies,3 the proposed changes would have important ancillary effects on covered institutions, including increases in deposit insurance assessments4 and more punitive treatment under liquidity regulations such as the Liquidity Coverage Ratio5 and Net Stable Funding Ratio.6

The FDIC provides only a rudimentary overview of the brokered deposits landscape in connection with the Proposal, noting that as of Q4 2023, brokered deposits at all IDIs are 22.5% higher than the quarter before the

2020 Final Rule7 took effect. Additionally, the FDIC lists over 130 entities that are currently exempt from being deposit brokers under the primary purpose exception ("PPE") whose businesses may be dependent on that exemption. Although unclear, presumably many, if not most, of the deposits by these entities will now also be considered brokered. Beyond that, the FDIC provides little additional data or analysis regarding the Proposal's impacts.

Perhaps most puzzling is that the FDIC recently issued at least two closely related Requests for Information that could have informed whether there was need for targeted adjustments to its brokered deposits regulations,8 and yet issued this Proposal without the benefit of analyzing that data.

II. The Proposal lacks appropriate tailoring, sufficient policy rationale, and supporting data.

Instead of tailoring regulatory changes to a specific brokered deposit type's underlying risk, the Proposal adopts a "one-size-fits all" approach that treats all manner of brokered deposits as high risk. For example, exclusive deposit relationships, currently exempt under the PPE, are often a key component of a bank's business plan. Those exclusive deposit relationships, governed by contracts, can prove stickier than what have been traditionally referred to as "core deposits," and yet under this Proposal, those deposits are considered "hot money."

Different third-party arrangements present different and bespoke funding characteristics and risks. These differences impact the behavior of the underlying deposits for funding and liquidity purposes and related bank risk management practices and models, something state regulators are sensitive to, and which we expect will be reflected in industry feedback.

Significantly changing the definition of deposit broker and eliminating the exemptions promulgated through the 2020 Final Rule after such a short period and with no discernable rationale is destabilizing and disruptive. It creates regulatory uncertainty that would likely reduce economic growth. It also penalizes institutions for business decisions and strategies executed based on their reasonable expectations that the government would maintain its carefully curated policy decisions. This type of policy whiplash can only be justified by data that clearly demonstrates the previously adopted approach has introduced unanticipated and uncontrolled risks, and the proposed adjustments should be carefully tailored to address those specific risks. This Proposal falls far short of that standard.

III. The FDIC's rulemaking is rushed and fails to address existing weaknesses in the brokered deposits framework.

In recognition of the outsized impact that brokered deposit regulations can have on bank business models, when the FDIC last finalized changes to its brokered deposits regulations in December 2020 it followed an iterative and deliberative process that provided significant opportunities for public comment that spanned two years.9 In this case, the FDIC has chosen expediency in lieu of a rigorous, fact-based, and data-driven rulemaking approach.

The Proposal also fails to address weaknesses in the brokered deposit framework, including the liquidity "cliff effect" when an institution with brokered deposits becomes less than well capitalized under the Prompt Corrective Action ("PCA") framework,[10] and the recharacterization of reciprocal deposits as brokered when a bank loses "agent institution" status. Any future brokered deposit rulemaking should address these foundational issues and incorporate feedback from stakeholders regarding how deposits flow through the modern banking system.

Conclusion

The Proposal is flawed and should be rescinded in its entirety. The FDIC should only pursue future revisions to the brokered deposits regulations if supported by the data it is in the process of collecting and warranted by market developments. Any future brokered deposits rulemaking should address the PCA "cliff effect," rectify the consequences of reclassifying reciprocal deposits as brokered deposits, and tailor regulatory changes to the underlying risks of specific brokered deposit types.

Sincerely,
/s/
Karen K. Lawson
Executive Vice President, Policy & Supervision

Endnotes

1 CSBS is the nationwide organization of state banking and financial regulators from all 50 states, the District of Columbia, and the U.S. territories.

2 FDIC, Notice of Proposed Rulemaking, *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*, 89 Fed. Reg. 68244 (Aug. 23, 2024).

3 In a recent survey of community banks, CSBS found that 49% of community bank respondents use, and plan to continue using, brokered deposits. *See* CSBS Annual Survey of Community Banks (Oct. 2-3, 2024).

4 *See* FDIC, Assessment Methodology & Rates (Nov. 12, 2024).

5 12 C.F.R. § 329.10.

6 12 C.F.R. § 329.104.

7 FDIC, Final Rule, *Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions*, 86 Fed. Reg. 6742 (Jan. 22, 2021).

8 The FDIC has an open Request for Information ("RFI") on deposits and has recently concluded an interagency RFI on bank-fintech arrangements. Both RFIs could provide critical, timely data and information that might inform potential revisions. *See* FDIC, Request for Information, *Request for Information on Deposits*, 89 Fed. Reg. 63946 (Aug. 6, 2024); *see* also OCC, FRB, and FDIC, Request for Information, *Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses*, 89 Fed. Reg. 61577 (July 31, 2024).

9 *See* FDIC, Advance Notice of Proposed Rulemaking, *Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions*, 84 Fed. Reg. 2366 (Feb. 6, 2019); *see* also FDIC, Notice of Proposed Rulemaking, *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*, 85 Fed. Reg. 7453 (Feb. 10, 2020).

10 12 U.S.C. § 1831o. State regulators have raised the PCA "cliff effect" on several occasions: *see* CSBS, Comment Letter to FDIC, *Re: Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions* (May 6, 2019); *see* also CSBS, Comment Letter to FDIC, Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (Apr. 24, 2020).

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