



CONFERENCE OF STATE BANK SUPERVISORS

VIA E-Mail

May 6, 2019

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 and Interest Rate Restrictions*

Dear Mr. Feldman,

The Conference of State Bank Supervisors¹ (“CSBS” or “state regulators”) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation’s (FDIC) advanced notice of proposed rulemaking on the regulatory approach to brokered deposits and interest rate caps applicable to institutions that are less than well-capitalized under the Prompt Corrective Action (PCA) framework. CSBS supports changes to the current regulatory approach to tailor the impact on liquidity when a bank becomes less than well-capitalized under PCA and minimize the liquidity “cliff effect”². We also support changes to the method for calculating the deposit rate cap to ensure it is reasonable and appropriate.

If properly utilized, brokered deposits can be a source of supplemental funding for banks in rural areas or markets which 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. It is true that some institutions have used this vehicle to enable additional risk taking at cost to the Deposit Insurance Fund (DIF); however, we believe there are regulatory and supervisory solutions which can address the elevated risk while permitting the prudent use of the funding channel. Inappropriate use of brokered deposits—such as to fund excessive loan growth outside of the

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.

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

To mitigate the liquidity risk created when an institution with brokered deposits becomes less than well-capitalized under PCA, state regulators believe that banks should be allowed to reduce their reliance on brokered deposits over time. While the FDIC has generally viewed brokered deposit waivers as increasing the risk to the DIF, a more gradual reduction would potentially reduce risk by placing the bank on a “glide path” for easing its dependence on brokered deposits. An immediate prohibition to renew or issue brokered deposits creates an unnecessary strain on liquidity, destabilizing the institution, and actually increases the risk to the DIF by forcing a bank to liquidate its best assets.

Instead, 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. We believe that Section 29 of the Federal Deposit Insurance Act provides the FDIC with enough flexibility to adopt this approach.³ Finally, to provide a clear, reliable framework for the industry, this “glide path” approach should be incorporated in regulation.

State regulators also believe the current methodology for determining the national interest rate cap renders institutions subject to rate restrictions unable to reasonably compete for deposits. In light of the current rising rate environment, we believe it may be appropriate to return to the former approach defining the national rate by linking it to the current yield on U.S. Treasury obligations with comparable maturities. To ensure that the methodology does not become obsolete due to future fluctuations in market rates, the FDIC could set the rate cap at the higher of 75 basis points above: (a) the normal market area rate as determined under the FDIC's current methodology (the current approach), or (b) 120 to 130 percent of the current yield on similar maturity U.S. Treasury obligations depending on the extent to which the deposit is insured (the prior approach). Theoretically, the former should generally allow for a higher rate cap in a falling rate environment while the latter should allow for a higher rate cap in a rising rate environment.

Other adjustments to the methodology for calculating the interest rate cap may be appropriate. In particular, the current methodology heavily weights the branch networks of large banks over the actual local market due to each branch being factored into the calculation. Branches of the same institution do not directly compete with one another. In factoring every branch into the national rate cap calculation, the methodology over-weights the large national institutions

³ For instance, the inherent circularity of 12 U.S.C. 1831f(g)(3) and its focus on “solicitation” which (as opposed to “acceptance”) need not necessarily include the renewal and rolling over of brokered deposits affords the FDIC with sufficient flexibility to allow for institutions to gradually reduce their reliance on brokered deposits accepted prior to becoming adequately capitalized under PCA.

which generally offer much lower rates. Further, the methodology is even more flawed as out-of-area institutions that post their rates on the internet are a significant source of competition for community banks. An updated “branchless” interest rate cap methodology could improve the appropriateness of the interest rate cap and make this restriction more reasonably manageable for a struggling institution. We also encourage the FDIC to consider the impact credit unions have upon the prevailing rates in an institution’s normal market area. A single credit union can skew rates in the institution’s normal market area significantly, which can result in the national rate being considerably different than actual rates in the institution’s market area.

Conclusion

We believe a regulatory approach that allows less than well-capitalized institutions to gradually reduce their reliance on brokered deposit funding over time and certain revisions to the interest rate cap calculation will allow banks to prudently meet local loan demand, improve competition in the deposit market and protect the DIF. The financial crisis and subsequent economic recession exposed significant risks and fragilities in our financial system. To address these issues, regulatory policy must not only focus on enhancing risk management, but also on identifying weaknesses in regulatory and supervisory approaches. Ultimately, state bank regulators 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,

A handwritten signature in black ink, appearing to read "John W. Ryan". The signature is fluid and cursive, with the first name "John" being the most prominent.

John Ryan
President & CEO