KASASA

October 16, 2024

James P. Sheesley
Assistant Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington D.C. 20429
(comments@fdic.gov)

Re: Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions RIN 3064-AF99

Dear Mr. Sheesley,

Thank you for opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC's") proposed rulemaking ("Proposal") [1] regarding potential revisions to the agency's brokered deposit restrictions ("the 2020 Final Rule").

Section 29 of the Federal Deposit Insurance Act ("FDI Act") is a narrowly drawn provision designed to prevent less than well-capitalized insured depository institutions ("IDIs") from obtaining funding that could be withdrawn quickly, leaving the IDI, the Deposit Insurance Fund ("Fund" or "DIF"), and taxpayers exposed. The statute limits financially troubled institutions from receiving deposits through a third party when that third party owns and controls the depositor relationship and has the legal authority to independently move the depositor's funds among one or more IDIs.

We recognize the challenges associated with implementing Section 29 of the FDI Act via the 2020 Final Rule. Properly assessing the regulatory risks of every third-party deposit arrangement is a prodigious task. Banks, especially community banks operating in small towns, routinely partner with third parties to help them secure the funding they need to support their communities and to deliver the innovative financial products, services, and digital banking experiences consumers and small businesses desire. Even though these third parties bear little resemblance to the traditional deposit brokers originally contemplated by Congress, the statute places enormous pressure on the agency's evaluation processes as each deposit arrangement and structure must be thoroughly examined and opined upon by Staff.

Recognizing the number of deposits reported as brokered has declined significantly since the 2020 Final Rule was put in place and, considering the 2022 collapse of crypto company Voyager; the high-profile bank failures of 2023; and the recent bankruptcy of Synapse Financial Technologies, Inc., we understand majority leadership's motivations for revisiting the 2020 Final Rule.

That said, during this proposed rulemaking, we believe prudent safety and soundness regulatory protections must be balanced with the ability for IDIs to use third party resources to help them compete in today's rapidly evolving and fiercely competitive financial services marketplace.

Kasasa, Ltd. ("Kasasa") is a third-party service provider whose mission is to help community financial institutions compete with financial technology ("fintech") providers and our nation's large regional and global systemically important banks. Kasasa supports hundreds of community financial institutions across all 50 states, by providing professional banking services; digital enablement technologies; and innovative retail offerings (collectively "Services") that help IDIs attract and retain customers; improve executional efficiencies; and reduce operational expenses.

Kasasa does not build, own or control any depositor relationship. Kasasa does not receive or place any depositor funds with insured depository institutions. Kasasa does not have any authority to close any deposit account or move any depositor's funds. Kasasa is not involved in negotiating or setting rates, fees, terms or conditions of any deposit

[1] 85 Fed. Reg. "Proposal" (Aug. 23, 2024).

account at any insured depository institution. Kasasa does not propose or determine deposit allocations at any insured depository institution. And Kasasa does not receive any compensation for any deposits residing at any IDI.

Our Services enable IDIs to establish singularly sourced, direct relationships, that the institution owns and controls, with individual depositors who live and work within the IDI's local community. As you will see in the Recommendations Section of this letter, these customers utilize a wide range of banking services (e.g., direct deposit, online bill pay, debit card, online banking, loans) from their financial institution, and their associated deposits serve as a low-cost, locally sourced, stable source of funds upon which the IDI can safely, soundly and profitably operate its business.

We believe independent, singularly sourced, directly established, individual depositor relationships, that are owned and controlled by the insured depository institution, advance the interests of the FDIC.

We believe deposits residing in singularly acquired consumer transaction accounts that are (a) entirely covered by deposit insurance; (b) opened by an individual, (c) held in the name of that same individual; (d) used monthly by that same individual to make payments to, and receive funds from, third parties; and (e) with respect to which only that same individual is recognized by the insured depository institution as being authorized to close that account and designate withdrawals or payments be made from the account should be expressly excluded from the "brokered deposit" definition.

Similarly, we believe deposits residing in singularly acquired reward-based checking and savings accounts that are (a) entirely covered by deposit insurance; (b) opened by an individual, (c) held in the name of that same individual; (d) used monthly by that same individual to make payments, receive funds, conduct transactions, reach savings goals and earn rewards as a function of satisfying banking activities established by the IDI and (e) with respect to which only that same individual is recognized by the insured depository institution as being authorized to close that account and designate withdrawals or payments be made from the account should be expressly excluded from the "brokered deposit" definition.

We also believe third parties who assist insured depository institutions establish independent, individually sourced, direct depositor relationships, where the insured depository institution owns and controls the deposit relationship, and the IDI's core processor is the system of record for the institution's deposit accounts, should be expressly excluded from the "deposit broker" definition.

Kasasa greatly appreciates the FDIC's engagement on this issue of primary importance to the community banks we serve. We are grateful for the collaborative discussions we have had with the FDIC on this topic over the past twelve (12) years and we are hopeful that a reasoned final rule will emerge to help community banks not only survive but thrive, as they serve small and rural communities that are often overlooked or abandoned by fintech providers and large financial institutions.

CONCERNS

If the Proposal is adopted as currently written, we fear the following negative outcomes:

Community Banks and Small Businesses Will Be Harmed:

The Proposal will result in more deposits being deemed to be "brokered" as <u>any</u> third party who performs <u>any</u> services or receives <u>any</u> compensation in support of an IDI's deposit gathering and/or retention activities will be presumed to be a deposit broker, and fewer third-party deposit arrangements will receive a primary purpose exception from the FDIC.

The 2020 Final Rule helps community banks access the diverse funding they need to serve their communities. Operating in remote areas often means limited access to direct customer deposits so preserving access to an array of funding sources is essential for rural institutions. If access to brokered deposits is restricted, local banks will be forced to reduce their lending activities and small businesses will be forced to bank with urban-based institutions who are less committed to our nation's rural communities. Farmers depend on community banks because they understand the unique needs and challenges of agriculture. Small businesses depend on community banks because they understand what it takes to open a new business, hire staff, purchase inventory, manufacture goods and provide services. Small towns depend on community banks to support its local non-profits, provide student scholarships, sponsor youth sports and engage in other local activities that improve the quality of life within the community.

We respectfully ask the FDIC to leave the current 2020 Final Rule in place and/or work with Congress to replace Section 29 of the FDI Act with an asset growth cap so community banks can continue to access the diverse funding they need to keep our nation's small towns and rural communities vibrant.

Banks and Consumers Will Be Adversely Impacted:

While brokered deposit restrictions technically apply only to banks that are less than well capitalized, the use of these funds negatively impacts all banks. Even well-capitalized banks are discouraged from holding brokered deposits because they subject the institution to higher insurance assessments; adverse treatment under liquidity and capital regulations; increased scrutiny from bank examiners; and negative ratings by credit agencies.

In addition to having to restructure their liabilities; recalculate specific regulatory ratios; discontinue their reliance on current 2020 Final Rule exceptions, banks will be required to absorb the cost of changing its internal systems, policies, procedures and reporting mechanisms associated with its brokered deposit activities. Institutions will also be required to expend more time, money and effort to apply for a primary purpose exception for each of its third-party deposit arrangements. Such exceptions will, in turn, be more difficult to obtain and will be subject to more onerous application and notification processes as the FDIC's subjective evaluation criteria will provide Staff with wide latitude to deny such exceptions.

Consumers who utilize deposit placement services will be forced to reevaluate their financial strategies as institutions will cease offering, change the rates, or alter the terms of their deposit services to avoid having to report the funds as brokered. Consumers may very well consider moving their deposits out of the banking system entirely and into money market mutual funds and / or other investments.

There Will Be a Chilling Effect on Third Party Partnerships:

As currently written, the Proposal will affect any third party who is directly or indirectly involved in any deposit gathering or deposit provisioning activities. Such entities will face an uphill battle arguing they are not deposit brokers since the FDIC has publicly stated, via the Supplemental Information's reference of Synapse, that all "embedded finance platforms", "middleware providers" and "fintech aggregators" would be treated as deposit brokers since their activities "facilitate" the placement of deposits at one or more insured depository institutions.

Third parties will be required to discontinue their reliance on current 2020 Final Rule exceptions; absorb the cost of changing internal systems, policies, procedures and reporting mechanisms related to their deposit gathering or placement activities and alter their business models, including changes to fees and revenue streams to adhere to the Proposal no renumeration requirements. Additionally, third parties may be asked to share or absorb the cost of each IDI's primary purpose exception application.

Many IDIs will discontinue their third-party partnerships to avoid having to report funds as brokered deposits.

The Proposal Could Create Safety & Soundness Concerns & Other Unintended Consequences:

As FDIC Vice Chairman Travis Hill noted in his statement on the Proposal, "[t]he term 'brokered deposits' encompasses many different types of deposits with very different characteristics and risks." [2] To continue to arbitrarily place these varied and nuanced arrangements into one ever-expanding bucket could, ironically, decrease the safety and soundness of banks by restricting their access to certain funding sources that are actually, in practice, less volatile than many of those that fall in the ever-shrinking "core deposit" bucket.

[2] Statement by FDIC Vice Chairman Travis Hill on the Notice of Proposed Rulemaking on Brokered Deposit Restrictions (July 30,2024)

Vice Chairman Hill believes the Proposal is a poor use of the FDIC's time and resources. We agree. It is also a poor use of banks' time and resources. Community banks must make tradeoffs every day and concentrating on a regulatory concern that is, at best, "generally correlated" with financial, operational and reputational risks, is not a prudent use of these institutions' limited resources. Time and money and focus would be better spent enhancing liquidity, improving third-party risk management practices and executing on the institution's holistic funding strategies. Absent of this discipline, banks risk missing the forest for the trees.

Additionally, the Proposal could negatively impact underbanked consumers' by disincentivizing banks from pursuing funding sources that enable them to meet the needs of these individuals.

The Proposal Feels Excessive

The Proposal comes on the heels of several related regulatory actions, including:

- A joint statement by the FDIC, Federal Reserve and OCC regarding bank arrangements with third parties to deliver deposit products. [3]

- An interagency request for information by the FDIC, Federal Reserve and OCC on bank-fintech arrangements involving banking products and services distributed to consumers and businesses. [4]

- An FDIC request for information seeking input on the characteristics that affect the stability and franchise value of different types of deposits. [5]

Coming just four years after the 2020 Final Rule, it is hard not to view this initiative (as well as other rules proposed on the same day) as a game of political boomerang and regulatory weaponization. And it is odd that the Proposal was introduced this late in an election cycle as it will be subject to reversal or challenge depending on the results of the election. Further, the Proposal could be susceptible to a judicial challenge under the Administrative Procedure Act in a world where courts no longer automatically defer to administrative agencies post the Supreme Court's rule in the *Loper Bright Enterprises et al v. Raimondo* case.

COMMENTS:

While we understand the FDIC's motivations for revisiting the 2020 Final Rule, we believe the Proposal needs to be revised for the following reasons:

The Agency Does Not Provide Adequate Evidence to Support the Proposed Revisions:

Citing a variety of internal and external studies, the FDIC states that a significant reliance on brokered deposits increases an insured depository institution's risk profile, particularly as its financial condition weakens. The agency's analysis shows that a bank's use of brokered deposits is, in general, *correlated* with higher levels of asset growth; higher levels of nonperforming loans; a lower proportion of core deposit funding; a higher probability of bank failure and higher losses to the Fund upon an institution's failure. (*emphasis added)*

The reliance on "*correlated*" data to support the Proposal is flawed. That is, the suggestion that there is a "causational" relationship between a troubled bank's use of brokered deposits and the bank's failure is misguided.

We believe it is prudent to question statistical correlation studies that directly relate one event to another. For example, in my home state of Connecticut, it would be very easy to show a correlation between the appearance of daffodils and the disappearance of snow in the Spring. But is it valid to conclude that the emergence of daffodils causes the snow to disappear?

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[3] Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services (July 25,2024)
[4] Bank-Fintech Arrangements: Request for Information on Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses. (July 25, 2024)
[5] FDIC: Request for Information on Deposits (July 30, 2024)

It is our belief that without proper management oversight and regulatory supervision, a financial institution determined to grow quickly is going to find the deposits it needs to fund that growth one way or another. The problem is not so much where an institution gets its funding, the problem is what they do with the money when they get it. Rather than focusing on the liability side of the balance sheet as the current brokered deposit rule tries to do, the FDIC's focus should be on the asset side of the balance sheet. The real culprit is imprudent growth, not the source of the funding.

Whether a deposit is obtained via the involvement of a third party is not the key test in determining the potential failure of an institution nor is it the determining factor of assessing the risk those deposits present to the Fund.

One need only to look at the anecdotes the FDIC cites within the Proposal to underscore our perspectives:

- Silicon Valley Bank ("SVB") did not fail because of a heavy reliance on brokered deposits. In fact, when the institution failed, not a single one of its deposits was reported as brokered. SVB failed because it relied heavily on a large, concentrated, close network of uninsured depositors who initiated a run on the bank when the institution's troubled financial status became known. [6]

- Similarly, First Republic reported less than seven percent (7%) of its deposits were brokered when it failed. It too, among other things, failed because of a heavy reliance on uninsured deposits. [7]

- Synapse's collapse had nothing to do with brokered deposits. The company failed because of poor management and the lack of proper operational controls. Furthermore, the banks the company supported are not failing; and there is no risk to the Fund.

The Proposal does not address the role brokered deposits played at several other banks that were reported to have large outflows of deposits during March and April of 2023. Additionally, the Proposal does not provide evidence that the anecdotes it references are emblematic of broader industry trends.

Furthermore, by concurrently issuing its Request for Information ("RFI") on deposits the FDIC is essentially admitting its current data on the composition and behavior of IDI deposits is incomplete. The RFI requests information on deposits not currently reported to help the agency evaluate how specific types of deposits in relationship to one another, including during periods of stress; assess how changes in reporting may help the FDIC in carrying out its responsibilities; inform analysis of potential deposit insurance reforms; improve risk sensitivity in deposit insurance pricing; and enhance the data available to analysts and the public.

The requested data is exactly the type of information the FDIC should be providing the industry to support the changes the agency is seeking to make with the Proposal.

Without making the requisite data available to the public, it will be difficult for industry participants to provide meaningful comments on the Proposal or to determine if the proposed changes address the FDIC's stated need for the rulemaking.

In summary, we are concerned that the proposed rulemaking is based on limited industry incidents not broad trends and on information that does not reflect current deposit dynamics.

As FDIC Director Jonathan McKernan acknowledged in his July 30, 2024, dissenting comments, the Proposal articulates the potential risks associated with the misuse of brokered deposits, but it does not offer any evidence that some of the deposits the Proposal would classify as brokered actually present the same or similar risks. [8]

The Proposal Does Not Sufficiently Balance Current Regulatory Policy

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[6] Remarks by Vice Chairman Travis Hill at the American Enterprise Institute "Reflections on Bank Regulatory and Resolution Issues." FDIC (July 24, 2024)
[7] BankBeat: "FDIC's Proposed Brokered Deposit Changes Hurt Community Banks." By Reid Thomas. (August 13, 2024
[8] Statement by Jonathan McKernan. Director, FDIC, Board of Directors on Proposed Brokered Deposit Restrictions (July 30, 2024)

As pointed out by Vice Chairman Hill in his American Enterprise Institute speech, while the Proposal is discouraging the use of brokered deposits that may be experiencing funding stress, the federal banking agencies have, at the same time, been trying to encourage more discount window borrowing for the same purpose even though discount window borrowing suffers from a greater stigma. This makes us scratch our heads.

The Proposed "Compensation Prong" Is Overly Broad and Unclear:

Within the Proposal, the FDIC states that since the 2020 Final Rule was implemented, it has observed deposits that were obtained by IDIs through referrals from third parties who receive fees or other remuneration in exchange for such referrals often "share characteristics with deposits the FDIC has historically observed as constituting a brokered deposit," such as being "more likely to leave the IDI if another IDI were to offer more favorable terms or pay a higher fee." [9]

Accordingly, the FDIC believes that fees and other remuneration are important considerations in determining whether a person is acting as a deposit broker. The agency states the amount, nature, and purpose of the fees paid for the placement of third-party deposits are relevant to understanding the nature of the relationship that exists between the IDI, the depositor, and the third-party intermediary.

As such, the FDIC is seeking to expand the definition of a "deposit broker" by adding a new "Compensation Prong."

In the Supplementary Information, the FDIC states that a person is "engaged in the business of placing or facilitating the placement of deposits of third parties" if "[t]he 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." (emphasis added).* [10]

Further discussion within the Proposal makes it clear that <u>all</u> third-party fees would now be captured by this new prong including fees for administrative services provided in connection with the deposit placement arrangement.

Unfortunately, the Proposal does not clearly define what constitutes a "relationship or arrangement," nor does it identify what activities are "related to the placement of deposits" nor what tasks will be categorized as "administrative services."

If read literally, the proposed prong could potentially capture <u>any</u> third party that receives <u>any</u> compensation, from <u>anyone</u>, for <u>any</u> service that assists <u>any</u> insured depository institution gather and/or retain <u>any</u> deposits.

As FDIC Vice Chairman Travis Hill notes in his July 30, 2024, dissenting statement, "[t]his is a broad, sweeping criterion that—if applied literally and consistently—would capture a wide range of businesses that have any involvement in deposit arrangements."

We share Vice Chairman Hill's concern regarding the extremely broad net this new prong casts. We offer the following example of an unintended consequence this new provision introduces:

- *Refer-A-Friend Programs:*

  Refer-a-friend programs are an example of the types of services this wide net will inappropriately ensnare.

  In simple terms, refer-a-friend programs reward customers when they refer a friend, a colleague, or a family member to the bank, and the referred individual opens and funds an account.

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[9] Proposal, Page 34.
[10] Proposal, Page 32.

These programs are effective because they encourage loyal customers to proactively promote their institution and because personal recommendations are highly trusted. A Nielsen study found that 92% of people consider referrals the most reliable and influential form of marketing. [11]

These programs are also extremely cost-effective. Research shows that the average cost to acquire a new depositor relationship ranges from $250 to $400. However, the average cost to obtain a referred individual ranges between $110 and $175. This cost is dramatically lower than the industry average and, unlike other marketing strategies where expenses are incurred without a guarantee of a new account, these rewards are only paid after the new account is opened. [12]

According to The Financial Brand, about 30% of insured depository institutions use refer-a-friend programs.

Successful referral programs have several common characteristics: (a) participation is easy; (b) the referral instructions are simple and clear; (b) the referral process is seamless; (c) the rewards are meaningful and "double sided" where both parties benefit; (d) the program features a variety of potential rewards (e.g., cash bonus, gift cards; discounts); (e) the rewards are uncapped; (f) the program taps into social media channels (e.g.; Facebook, X, text messaging); (g) the institution educates and actively promotes the program to its customers and (h) the referral lifecycle is automated so participants can track their activities and, (i) software is in place measure the program's success (e.g., referral rate; conversion rate; cost per acquisition and lifetime value of the referred accountholder, etc.).

Programs that rely on manual, hands-on staff interactions are likely to fail. As such, many insured depository institutions utilize and pay third parties to administer these programs.

Unfortunately, under the proposed new Compensation Prong, any deposit garnered through a refer-a-friend program will have to be reported as brokered if the institution pays <u>any</u> fees to its customers or to the provider who administers the program.

Prohibiting refer-a-friend programs seems counterproductive to the FDIC's goals as actively engaged, satisfied, and loyal bank customers who refer other individual depositors to their institution are less likely to abandon their bank or move their funds if the institution begins to experience financial difficulties.

If the FDIC feels the compensation received by an individual within a refer-a-friend program represents a systemic incentive for the individual to introduce a large number of consumers to a financially troubled institution, the FDIC could "cap" the total amount of individuals a current customer can refer to a single institution. We respectfully suggest such a cap be established at one hundred and fifty (150) individuals (the "Dunbar Rule") as this figure is believed to represent the total number of people a single individual can know well and have a meaningful human relationship with.

We <u>believe</u> it is the FDIC's intent to capture fees that may serve as <u>robust incentives</u> for third parties to place or move depositor funds at or to one or more insured depository institutions.

We <u>do not</u> believe it is the FDIC's intention to prohibit banks from paying loyal, satisfied customers a nominal bonus in exchange for personal referrals that result in new relationships being directly established between the referred consumer and the insured depository institution. The referring individual (a) has no legal authority to close the referred individual's account or move the referred individual's funds; (b) is not involved in negotiating or setting rates, fees, terms or conditions of the referred individual's account; and (c) is not proposing or determining an allocation of the referred individual's funds. As such, these types of marketing programs should be expressly excluded from the "Compensation Prong" and the "deposit broker" definition.

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[11] Exploding Topics: 22+ Referral Marketing Statistics. By Josh Howarth (November 14, 2023)
[12] The Financial Brand: Customer Referral Programs: Simplify or Die

We also believe it is the FDIC intention to limit the scope of what constitutes “administrative fees” solely to compensation received for services directly associated with the actual placement of the deposits at an IDI (e.g., transfer fees) and not to other management or processing services provided by third parties.

For example, per FDIC Advisory Opinion 15-02 (June 6, 2014), the compensation Kasasa receives from our clients in consideration for our monthly administration, management, calculation, tracking and distribution of account rewards (“Reward Servicing Fees”) have nothing to do with nor are they related to the placement of deposits. These fees are compensation for the analysis our software performs to identify, calculate and distribute account rewards based on an accountholder’s banking behaviors.

Kasasa does not receive any funds from any depositor; has no legal authority to close a deposit account or move a depositor’s funds; is not involved in negotiating or setting rates, fees, terms or conditions of an individual’s account; is not proposing or determining an allocation of depositor funds among any insured depository institutions and our platform is not the system of record for any depositor, deposit or banking transaction, the institution’s core processor is.

As such, the Reward Servicing Fees and the monthly software license fees we receive should not be captured by the proposed “Compensation Prong” and Kasasa should not be deemed to be a deposit broker because it receives such fees.

Given the modern ways consumers interact with their bank and the services IDIs commonly use in today’s technology-driven deposit gathering activities (e.g., search engine optimization, geolocation, artificial intelligence, pattern identification, online account opening, identity verification, fraud detection, digital document delivery, voice recognition, etc.), prohibiting third parties from receiving compensation for services they provide is punitive to industry participants and will put smaller, less sophisticated institutions at a market disadvantage.

The world has gone “phygital” and community banks will not survive unless they are able to partner with third parties to help them attract and retain depositors. Not only must these institutions offer the competitive deposit products consumers want; they must also provide the technological advancements that accompany those offerings. Lacking the time, money, resources, and technical expertise, smaller banks have no choice but to partner with third parties to create (and maintain) the digital banking platforms that make it easy for consumers to open accounts, conduct their daily banking activities, and manage their individual and family finances.

Smaller institutions simply cannot compete if they cannot partner with external resources and third parties cannot provide their services and capabilities without receiving commensurate compensation.

Expanding the brokered deposit definition to capture any fees received by any third party who assists any industry depository institution in any way in gathering or maintaining deposits when the third party does not receive any depositor funds; has no legal authority to close an account or move a depositor’s funds; is not involved in negotiating or setting rates, fees, terms or conditions of an individual’s account; is not proposing or determining an allocation of an individual’s funds; and whose platform does not serve as the institution’s system of record for the IDI’s deposits, will hold the entire community banking industry hostage.

We do not believe it is the FDIC’s intent to limit an IDI’s use of third parties solely because the third party, in the process of helping the institution establish direct, individual depositor relationships, that the IDI solely owns and controls, receives compensation for the support services it provides.

We urge the FDIC withdraw or, at minimum, provide more clarity on the proposed new Compensation Prong. The current language is ambiguous and could be interpreted to mean that any third party who receives any compensation from any source, for providing any assistance to any IDI during their deposit gathering or retention processes, will be considered a deposit broker and all associated deposits will be treated as brokered.

We respectfully ask the agency to clearly identify what constitutes a “relationship or arrangement”; what activities are specifically “related to the placement of deposits” and what third party tasks will be categorized as “administrative services” and thus, ensnared by the proposed “Compensation Prong”.

The Agency's Guidance on Listing Services Is Misguided:

Unfortunately, the agency's focus on third party "compensation" and "administrative services" also seeps into the Proposal's guidance on listing services.

Within the Supplemental Information, the FDIC goes to great length to articulate its support of "passive listing services." The agency states internet sites that advertise information regarding deposit accounts but do not receive or deposit third party funds at one or more IDI; do not have the legal authority to close a deposit account or move a third party's funds to another IDI; are not involved in negotiating or setting rates, fees, terms or conditions of a deposit account; do not propose, allocate, facilitate, or determine deposit allocations; and whose fees are related to (i) the gathering and display of account information (e.g. interest rates) and (ii) an IDI's participation on the site and (f) whose platform does not directly or indirectly aid the depositor in placing funds with an IDI would <u>not</u> meet the definition of a deposit broker. [13]

The FDIC's position on passive listing services relies on two (2) simple concepts – a site is not a deposit broker if it merely informs the decision of a consumer as to whether and with whom to open a deposit account and the service receives flat fees in exchange for the gathering and posting of deposit account information. [14]

By extension, the FDIC's position that "proactive" listing services (those that provide more information than just a list of participating IDIs and interest rates) will be treated as deposit brokers will inexcusably restrict consumers from researching potential providers and identifying the valuable financial products and services that are available to them.

"Proactive" listing services serve a genuine need in the market as informed decisions about financial services are based on more than just "rate" or an "alphabetic listing" of participating institutions.

Consumers have the right to research financial products, services and providers based on whatever criteria they choose. Robust online comparison sites enable consumers to evaluate potential providers based on detailed information regarding their products, rates, terms, conditions, fees, reviews, financial status, industry reputation, rewards, bonuses, locations, digital capabilities, special offers and community involvement, among other things. Informative sites help consumers identify financial institutions whose products, services and values align with their financial needs, geographic requirements, personal values and community involvement.

Additionally, many proactive listing services make it easy for consumers to establish a relationship with their chosen IDI directly from the site. By removing operational obstacles (while maintaining regulatory consumer protections) during the application, approval and funding stages of establishing a new depositor relationship, these platforms provide an efficient and increasingly frictionless way for IDIs, especially community banks, to acquire singularly sourced, independent, direct depositor relationships that the IDI solely owns and controls, at an affordable price.

We believe internet sites that advertise deposit offerings and do not have the legal authority to close a deposit account or move a third party's funds from one IDI to another IDI; are not involved in negotiating or setting rates, fees, terms or conditions of any deposit account offered by any participating IDI; do not propose, allocate, or determine deposit distributions among participating IDIs, whose platform allows consumers to compare institutions and offerings based on criteria specifically selected and/or entered by the consumer; and whose platform enables consumers to connect with an institution of their own choosing and apply for and fund their deposit account directly with that institution should <u>not</u> meet the definition of a deposit broker.

We also feel the FDIC's prohibition of listing services receiving any compensation other than subscription fees in exchange for gathering and posting deposit information is punitive to our industry's smaller participants. Bank of America and Wells Fargo have a market area vastly larger than a single community bank. As such, if each institution is charged a flat fee for its participation on the listing service the community bank will, by default, be at an economic disadvantage because there is no way it will receive the same volume of new accounts as either of the larger national institutions. The only fair pricing is a "per account" fee.

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[13] Proposal, Page 34 & 35.
[14] See generally FDIC Advisory Opinions Number 02-04 (November 13, 2002) and 04-04 (July 28, 2004)

We see no justification for the restriction on other forms of compensation. There is no reason online comparison websites and/or mobile apps should be limited to flat fee or subscription fee structures. Nor do we think it is within the FDIC's authority to dictate the pricing of third-party services within the banking industry.

Like any other media channel, listing services should be able to charge an insured depository institution a fee commensurate with the service(s) provided – e.g., a higher fee for prominent positioning; variable pricing based on the amount of deposits generated; acquisition fees for each new account opened and funded, etc. The net effect of charging an institution more for a premium placement or for the number of accounts generated is no different than if an institution invested more money on advertising in newspapers, billboards or through social media to raise awareness and reach potential customers. A consumer engaging with a listing service is no different than an individual responding to a bank advertisement in another type of media.

Rather than evaluating the channel by which a new direct depositor relationship is generated or the cost of generating that new direct relationship, we believe the revised rule, if the Proposal is not withdrawn, should focus on the strength and characteristics of the direct relationship established between an individual depositor and the IDI that owns and controls that depositor's relationship. Furthermore, the final rule should consider the stable nature of that individual depositor's funds, rather than on the institution's use of a listing service so long as the listing service has no legal authority to close an account or move the depositor's funds; is not involved in negotiating or setting rates, fees, terms or conditions of the individual's account; and is not proposing or determining an allocation of the individual's funds. Deposits enabled through listing services should be excluded from the definition of "deposit broker" when a depositor purposefully selects a participating institution; establishes a bona fide, independent direct relationship with their chosen institution that the IDI owns and controls; and the depositor maintains exclusive control over her/his funds.

Receiving variable compensation for providing consumers with information about deposit products offered by participating IDIs and efficiently enabling those consumers to evaluate, select, connect and establish an independent, direct depositor relationship with their chosen institution should not result in the online listing service being labelled a deposit broker nor the deposits raised through this channel to be treated as brokered. The form of compensation received by the listing service does not change the fundamental nature of the direct relationship established exclusively between the individual depositor and their selected IDI or the fact that the ultimate control of that depositor relationship is maintained by the IDI.

The FDIC should not restrict listing services to passive activities and should remove all compensation restriction from any final rule.

The FDIC Should Recognize the Stable Nature of Transaction Accounts & Reward-Based Checking Accounts

Within the 2020 Final Rule, the FDIC created a primary purpose exception for entities that placed depositor funds into transactional accounts for the purpose of enabling transactions. The logic behind this exception aligns with (a) the statute's original intent – if a person's primary purpose is something other than the placement of deposits, the person is not a deposit broker, and it recognized the stable nature of deposits residing in actively used transaction accounts.

Regarding the first point, as Vice Chairman Travis Hill stated in his dissenting statements, "a prepaid card network places its customer's funds in a bank, not because it is in the business of helping customers open or put money in bank accounts, but because it needs the banking system to move money from place to place. The prepaid card network's primary purpose is to provide customers with a mechanism to make payments and transactions, not to help customers place their funds at banks."

As to the second point, within the 2020 Final Rule, the FDIC identified the factors it would consider in evaluating transaction accounts, including the number of transactions that occurred on a regular basis within the depositor's account; the amount of interest, fees, or other remuneration provided, and the nature of the marketing materials utilized by the third party. To the extent a third party could establish, via the primary purpose exception application process, that it marketed its deposit placement service for the primary purpose of enabling transactions and that its customers (1) earn a nominal amount of interest, fees, or other remuneration on its deposits, based on the interest rate environment at the time, or (2) on average, make more than six transactions a month, then the FDIC stated the entity met the primary purpose exception and would not be a deposit broker.

We believe the FDIC created this exception because the agency recognized the stable nature of transaction accounts' deposits. Transaction account deposits have been used informally by the industry as a "proxy" for what "core deposits" are intended to connote since they are the result of an ongoing depositor relationship and involve a continual series of deposits and withdrawals to meet the depositor's primary banking needs.

Core deposits are not defined by statute. Rather, core deposits are defined in the Uniform Bank Performance Report (UBPR) as the sum of all transaction accounts, money market deposit accounts (MMDAs), non-transaction savings deposits (excluding MMDAs), and time deposits of $250,000 and below, less fully insured brokered deposits of $250,000 and less. (emphasis added). While useful for analytical and examination purposes, this definition does not establish a brightline understanding of what constitutes a "stable source of funds" which the term is intended to convey.

Per its July 2011 Study on Core Deposits and Brokered Deposits (the "Study") the FDIC states core deposits "are intended to include those deposits that are stable and lower costs and that reprice more slowly than other deposits when interest rates rise. These deposits are typically funds of a local customer that also have a borrowing or other relationship with the bank." [15]

Further within the Study, the FDIC states "Core deposits have historically been categorized as stable, less costly deposits obtained from local customers that maintain a relationship with the institution. [16] "[A]s used within the Study, the word "relationship" implies considerably more than that a person is simply a customer of a bank. At a minimum, it requires that a customer has:

- A single deposit of some kind and also has a loan or uses other services of the bank or a bank affiliate (e.g. wealth management, broker-services); or

- An active checking account and either of the following: (i) uses direct deposit, banks online or uses automatic bill pay; or (ii) has another deposit of some kind." [17]

The 2020 Final Rule's Enabling Transaction Exception emphasized the notion that the deposits residing in transaction accounts used monthly by accountholders to execute regular banking activities serve as a stable source of funding, regardless of any third-party involvement.

Now with the Proposal, majority leadership is asserting that any third-party involvement negates the stability of such deposits and thus, by default, is emphasizing the agency's desire for IDI's to establish and maintain singularly sourced, direct depositor relationships that the IDI owns and controls.

- **Deposits Residing in Individually Acquired Consumer Transaction Accounts Should Be Exempt:**

  We believe deposits residing in individually opened consumer transaction accounts that are entirely covered by deposit insurance; opened by an individual who has a bona fide relationship with the IDI; held in the name of that same individual; used monthly by that same individual to make payments to, and receive funds from, third parties; and with respect to which only that same individual is recognized by the IDI as being authorized to designate withdrawals or payments be made from the account, should be expressly excluded from the brokered deposit definition.

  These are the singularly acquired, low-cost deposits the FDIC wants its supervised institutions to build their businesses upon as they are associated with individual depositor relationships that are directly established between an IDI and a consumer who likely works and/or lives in the community the IDI serves.

[15] FDIC: Study on Core Deposits and Brokered Deposits. (the "Study"), Page 5 (July 8, 2011)
[16] Study, Page 32
[17] Study, Page 50

- **Deposits Residing in Individually Acquired Reward-Based Checking Accounts Should Be Exempt:**

  Similarly, we respectfully recommend the FDIC officially recognize the stable nature of "reward-based checking accounts" and overtly exclude deposits that reside in these accounts from the brokered deposit definition.

  - **How Reward-Based Checking Accounts Work:**

    Reward-based deposit accounts were introduced to the market in 2003. These accounts are free, interest-bearing checking accounts with no minimum balance requirements that enables the accountholder to earn a high rate of interest and nationwide ATM withdrawal fee reimbursements when the accountholder meets certain account conditions ("qualifiers").

    Common qualifiers include engaging in a certain number of debit card transaction monthly (usually 10 to 15); making at least one direct deposit, Automated Clearinghouse (ACH) credit or payment transaction monthly; enrolling in the institution's online banking program and agreeing to receive electronic bank statements. These qualifiers permit banks to profit from interchange fee income, reduce expenses associated with printing and mailing statements, and decrease overhead expenses as consumers shift from engaging in branch location activities to conducting transactions online.

    In addition, to control interest expenses, IDIs establish a "cap" that limits the balances upon which the high interest rate will be paid and pay a separate, lower interest rate on the balances that are above the "cap" threshold when the accountholder meets their account's qualifications.

    Should an accountholder not satisfy her/his account's qualifications during a specific cycle period, the accountholder still earns a rate of interest that is typically comparable to the national rate published by the FDIC and has the opportunity to qualify for their account's higher rewards again during the next cycle period.

    The qualifiers and rewards help community banks create deeply connected, actively engage, loyal, long-lasting relationships with individually acquired depositors who typically live and work within their local market area(s).

    In addition, the non-interest income and operational cost savings generated by the accountholders banking behaviors significantly offset, and often completely offset the expenses associated with the account's attractive rewards thus, making the associated deposits one lowest cost sources of funds within the institution.

  - **Extensive Research Proves Reward-Based Deposits Are "More Core Than Core"**

    Rather than repeat the extensive and detailed information we have previously provided the FDIC, we respectfully refer Staff to the materials we shared with the agency (i) in April 2013 (face-to-face presentation); (ii) on January 9, 2014 (face-to-face presentation); (iii) on March 3, 2014 (information packet); (iv) on May 20, 2014 (conference call); (v) on April 23, 2019 (comment letter); (vi) on April 27,2020 (Zoom call); and (vii) on May 27, 2020 (comment letter).

    That said, we have summarized several salient points from the proprietary research we have conducted on specific accountholder and deposit behaviors. This research reflects twenty (20) years of data across more than nine hundred (900+) individual community financial institutions operating in over six thousand (6,000+) branch offices across all fifty (50) of our United States. The analysis is based on more than a half a billion individual data records associated with more than 3 million individually acquired reward-based checking accountholders relationships our community financial institution clients have established directly with their depositors. Over the past two decades, our clients have distributed over $3 billion dollars in account rewards, to more than 3 million individual depositors.

    - ***Reward-based checking accounts create singularly acquired, direct, local depositor relationships:***
      - 95% of all new reward-based checking accounts are opened in an institution's branch office
      - 49% of all reward-based checking accounts are associated with an IDI's existing depositors

- 87.92% of reward checking accounts are associated with residents who live within 10 miles of one of their primary institution's branch offices.

- ***Reward-based checking accounts create deeply connected & actively engaged depositor relationships:***
  - 75% of all reward-based accountholders have 1+ direct deposit or ACH transactions per month
  - 73% of all reward-based accountholders utilize their online banking service at least once a month
  - 75% of all reward-based accountholders receive monthly electronic statements from their IDI
  - 83% of all reward-based accountholders communicated with their IDI electronically
  - 93% of all reward-based accountholders say they like or love their checking account
  - Reward-based accountholders use their debit card twice as often as "free" checking accountholders
  - Reward-based accountholders are twice as likely to have a loan with their IDI than are "free" accountholder
  - Reward-based accountholders utilize 33% more banking services from their IDI than do "free" checking accountholders

- ***99.88% of all reward-based checking account deposits are fully insured:***
  - Insurance Status of Reward-Based Checking Accounts by Balance Tier

Balance Tier Minimum	Balance Tier Maximum	% of All Accounts
Less than	$2,000	63.03%
$2,001	$5,000	12.68%
$5,001	$10,000	7.61%
$10,001	$15,000	4.69%
$15,001	$20,000	3.18%
$20,001	$25,000	2.07%
$25,001	$30,000	1.70%
$30,001	$35,000	0.94%
$35,001	$50,000	1.58%
$50,001	$100,000	1.69%
$100,001	$150,000	0.44%
$150,001	$200,000	0.17%
$200,001	$250,000	0.09%
$250,001+		0.12%

- ***The reward-based checking account structure results in extremely low-cost deposits***

  - *Qualification Requirements*: Reward-based checking accounts require accountholders to meet certain requirements each cycle period in order to qualify for their rewards. These requirements generate non-interest income (i.e. debit card interchange revenue) and cost savings (e.g. eStatements, online banking) for the bank that offset, and often eliminate the expenses associated with offering the account.

  - *Rate Cap:* IDIs establish rate caps to limit the cost of the rewards associated with their reward-based accounts. Our interest-bearing account features a reverse tier structure that pays a high rate of interest up to a certain threshold ("cap") and a lower rate of interest on any dollars that are above that threshold. Thus, the "blended cost" is substantially lower than the promoted interest rate and thus extremely affordable for the institution to offer and manage.

- *Failure To Qualify*: On average, approximately 35% of all reward-based accountholders fail to qualify during each cycle for their rewards. Consequently, they receive only the base rate associated with the account across the entirety of their account balance. Accountholders, of course, have the opportunity to qualify for their rewards again during the next cycle period.

The True Cost of Deposits
Reward-Based Checking Compared to 1 Year & 3 Year CDs

Account Elements	Reward -Based Checking	1 Year CD	3 Year CD
Total Balances	$7,439,247	$7,439,247	$7,439,247
Promoted Interest Rate	5.00%	4.75%	4.15%
Cost of Funds	2.74%	4.75%	4.15%
Interest Expense, Annualized	($203,494)	($353,364)	($308,729)
Non- Interest Expense	($43,838)	$0	$0
Non-Interest Income	$135,350	$0	$0
Annual Marginal Cost / Expense	($111,982)	($353,364)	($308,729)
Effective Cost of Deposits	1.51%	4.75%	4.15%

  - *Definition*: Cost of deposits serve as a holistic "all in" metric of all revenues and expenses associated with the reward-based checking account.
  - *Formula:* Cost of Deposits = [Non-Interest Income] – [Interest Expense + Non-Interest Expense]

- *Results:* The account's (a) qualifications, (b) rate cap and (c) failure to qualify elements result in a cost of deposits that is significantly lower than the account's promoted interest rate.

  Community banks DO NOT have to invest in risky assets to fund the attractive rewards offered on their reward-based accounts. Since the account is a reverse tier, qualification-based, reward offering, accountholder behavior generates enough non-interest income and operational cost savings for the IDI to significantly offset interest expenses making the account's deposit a consistently lower cost, stable source of funds as compared to alternative funding options.

- *Conclusion:* The deposits held in reward-based accounts by individual accountholders who have established a direct ongoing relationship with their financial institution are "more core than core" by every measurable metric the FDIC uses to evaluate an insured depository institution's deposit portfolio and should be considered and treated as "core" rather than "non-core" funding.

The Proposed Primary Purpose Exception Process Lacks Transparency and Will Put Staff Decisions Back into The Subjective Shadows:

We disagree with the proposed changes to the primary purpose exception. The original Section 29 statute was clear: if a person's primary purpose is something other than placing deposits, the person is not considered to be a deposit broker.

The 2020 Final Rule introduced a new objective standard for applying this exception. Prior to the 2020 Final Rule, the FDIC lacked a consistent standard by which it evaluated third party deposit arrangements and exceptions to the rule were granted or denied based upon Staff's subjective judgment of the third party's primary purpose. There was no bright light criterion upon which the industry could rely.

The Proposal largely shifts back to this "in the shadows" pre-2020 approach. It expands the 2020 Final Rule's application process, adding more subjectivity and changing the criteria the FDIC uses to determine if an entity qualifies for a primary purpose exception.

Currently, the FDIC examines whether the main purpose of an entity's business relationship with an IDI is to place deposits. This is a straightforward analysis consistent with the original statute's plain meaning.

The Proposal, however, examines whether the third party's relationship with a bank has a significant purpose other than the placement of deposit or securing FDIC deposit insurance. It seems to assume that every third party's motivation is to place deposits with IDIs. This new criterion turns the current standard on its head and is more complex, harder to meet, and farther removed from the statute's original wording.

Additionally, the Proposal prohibits third parties from applying for a primary purpose exception. Rather, the Proposal requires every bank that receives deposits through or from a third party to apply for an exception for each third-party arrangement they utilize. Thus, if a third party has a deposit arrangement with ten (10) different banks, each individual bank will have to apply for a primary purpose exemption for that specific third party's deposit arrangement.

Given the potential increase in deposit arrangements affected by the Proposal, the subjective nature of this new standard, and the lack of protection for existing arrangements codified within the 2020 Final Rule, we anticipate a massive influx of primary purpose exception applications that the FDIC will undoubtedly struggle to handle with speed and efficiency.

RECOMMENDATIONS:

As we acknowledged above, managing deposit risk via the Section 29 statute is a difficult task. Kasasa proposes the following revisions to the language in the Proposal to address the above-discussed concerns and to better align the Proposal with the original text and purpose of Section 29:

1. **Create An Express Exclusion for Reward-Based Transaction Accounts:** The FDIC should create an express exclusion from the definition of "brokered deposits" for reward-based account deposits where a bona fide independent relationship is established directly between an individual depositor; and the bank owns and controls that depositor relationship; and the depositor must execute specific banking activities, that the bank establishes, to earn the account's rewards.

2. **Create An Express Exclusion for Consumer Transaction Accounts:** The FDIC should create an express exclusion from the definition of "brokered deposit" for transaction and relationship-based account deposits where a bona fide independent relationship is established directly between an individual depositor and a bank; and the bank owns and controls that depositor relationship.

3. **Create An Express Exclusion for Listing Services:** The FDIC should create an express exclusion from the definition of "deposit broker" listing services that enable community banks to promote consumer transaction, savings, and reward-based deposit accounts and whose platform enable consumers to establish a direct depositor relationship with their chosen institution. Additionally, the FDIC should withdraw its restrictions regarding listing service compensation as the composition of that compensation does not change the fundamental nature of the direct relationship established exclusively between the individual depositor and the IDI or the fact that the ultimate control of the depositor relationship is maintained by the IDI.

4. **Create An Express Exclusion for Specific Third Parties:** The FDIC should create an express exclusion from the definition of "deposit broker" for third-party service providers that enable IDIs to offer consumer transaction; savings; and reward-based deposit accounts where the IDI's core processor serves as the system of record for the institution's deposits.

5. **Create A Primary Purpose Exception for Specific Third Parties**: To the extent that the FDIC does not create an express exclusion for third-party service providers under the definition of a deposit broker, the FDIC should create a bright-line standard, within the rule, under the primary purpose exemption for third parties that enable

banks to enter into direct relationships with individual depositors where the third party has no contractual agreement with an individual depositor to place, manage or control the individual's deposits, banking decisions or financial activities and the IDI's core processor serves as the system of record for the institution's deposits.

6. **Clearly Define Brokered Bank – Fintech Arrangements:** The FDIC, the Federal Reserve and the OCC outline the potential risks related to arrangements between banks and third parties to deliver bank deposit products and services to end users in their July 25, 2024 "Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services. The FDIC should expand the "deposit broker" definition to overtly identfy when such arrangements are engaged in the business of placing or facilitating the placement of deposits at one or more insured depository institutions.

7. **Work With Congress to Replace Section 29 With an Asset Growth Cap**: There are valid reasons to wonder if the brokered deposit rules are the best way to address the issues Section 29 of the FDI Act intended to fix. Working with Congress to revise Section 29 of FDI Act to restrict asset growth at troubled institutions would enhance the FDIC's ability to identify and mitigate unsafe and unsound banking practices by allowing the agency to focus on an institution's entire balance sheet, rather than on the presence of an arbitrary type of deposit. Replacing Section 29 with an asset growth restriction is a legislative solution that has been endorsed by former FDIC Chairman Jelena McWilliams and current Vice Chairman Travis Hill as one that accomplishes the public policy goals Congress intended to address, while creating an easier framework for the FDIC to administer.

These proposed recommendations are discussed in further detail below:

1. Create An Express Exclusion from the Brokered Deposit Definition for Reward-Based Deposit Accounts:

We recommend that the FDIC create a narrow, express exclusion from the definition of "brokered deposit" in the current 12 C.F.R. § 337.6(a)(2) for reward-based transaction account deposits where a *bona fide* independent relationship is established directly between an individual depositor and a bank and that bank owns and controls that depositor relationship, using language similar to the following:

> ***Brokered deposit** means any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.*
>
> *i. Brokered deposit does not include a deposit held in a reward-based deposit account provided by an insured depository institution where the account is:*
>
> 1. *Entirely covered by deposit insurance;*
> 2. *Pursuant to a bona fide independent relationship established directly between the individual depositor and the insured depository institution, for the primary purpose of enabling the individual depositor to regularly make payments, receive funds, conduct other financial transactions, reach savings goals or earn rewards as a function of satisfying specific banking activities established by the depository institution;*
> 3. *Titled and held in the name of the same individual depositor;*
> 4. *Governed by terms established by the insured depository institution; and*
> 5. *Controlled by the depository institution and where only the same individual depositor has the authority to close the account or withdraw funds.*

2. Create an Express Exclusion from the Brokered Deposit Definition for Consumer Transaction Accounts:

We recommend that the FDIC create a narrow, express exclusion from the definition of "brokered deposit" in the current 12 C.F.R. § 337.6(a)(2) for transaction and relationship-based account deposits where a *bona fide* independent relationship is established directly between an individual depositor and a bank and that bank owns and controls that depositor relationship, using language similar to the following:

> ***Brokered deposit*** *means any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.*
>
> *i. Brokered deposit does not include a deposit held in a deposit account provided by an insured depository institution where the account is:*
>
> 1. *Entirely covered by deposit insurance;*
> 2. *Pursuant to a bona fide independent relationship established directly between the individual depositor and the insured depository institution, for the primary purpose of enabling the individual depositor to regularly make payments, receive funds, or conduct other financial transactions or to reach savings goals;*
> 3. *Titled and held in the name of the same individual depositor;*
> 4. *Governed by terms established by the insured depository institution; and*
> 5. *Controlled by the depository institution and where only the same individual depositor has the authority to close the account or withdraw funds.*

These narrow exclusions clearly would not cover deposits placed by third parties that own and control the depositor relationship.

Instead, these narrow exclusions would only cover stable sources of funding. Specifically, any final rule should exclude transaction, savings and reward-based account deposits where a tangible, *bona fide* relationship is clearly in place between the depositor and their bank; that is, the relationship is evidenced by the depositor utilizing multiple financial products and services from their institution (e.g., transaction account, savings account, loan, credit card, online banking, direct deposit, online bill pay, debit card, CDs), provided that such accounts are opened by an individual depositor; held in the name of that same individual depositor; utilized regularly by that same individual depositor, and only that same individual depositor is authorized to close the account or designate withdrawals to be made from the account. Transaction, savings and reward-based account deposits are associated with a singularly acquired tangible, direct depositor relationship established between the individual depositor and the bank do not pose risks to the safety and soundness of an institution, nor do they introduce risk to the Fund. These deposits are "sticky" deposits that serve as a stable source of funds upon which the bank can safely and prudently operate.

3. Create An Express Exclusion from the Deposit Broker Definition for Listing Services

The FDIC should create an express exclusion for listing services who assist IDIs establish independent, individually sourced, direct depositor relationships, where the IDI owns and controls the relationship and the listing service does not have the legal authority to close an account or move a depositor's funds from one IDI to another IDI; is not involved in negotiating or setting rates, fees, terms or conditions of any deposit account offered by any participating IDI; does not propose, allocate, or determine deposit distributions among participating IDIs; whose services allows consumers to compare institutions and offerings based on criteria specifically selected and/or entered by the consumer; and whose platform enables consumers to connect with an institution of their own choosing and apply for and fund their deposit account directly with that institution should not meet the definition of a deposit broker, by adding language similar to the following at the end of the current 12 C.F.R. § 337.6(a)(5)(iii), as redesignated:

> *[The term deposit broker does not include] (L) Any listing service that provides services to an insured depository institution in connection with a deposit account established directly between the insured depository institution and the individual depositor where the insured depository institution*

owns and controls the depositor relationship and the listing services does not have the legal authority to close an account or move a depositor's funds from one IDI to another IDI; is not involved in negotiating or setting rates, fees, terms or conditions of any deposit account offered by any participating IDI; does not propose, allocate, or determine deposit distributions among participating IDIs; whose services allows consumers to compare institutions and offerings based on criteria specifically selected and/or entered by the consumer; and whose platform enables consumers to connect with an institution of their own choosing and apply for and fund their deposit account directly with that institution.

Additionally, the FDIC should withdraw its restrictions regarding listing service compensation. An online website or mobile app, like any other media channel, should be able to charge an IDI a fee that is commensurate with the services it provides.

Receiving variable compensation for providing consumers with information about deposit products offered by participating insured depository institutions and efficiently enabling those consumers to evaluate, select, connect with and establish an independent, direct depositor relationship with their chosen IDI should not result in the online listing service being labelled a deposit broker nor the deposits raised through this channel to be declared brokered. The form of compensation received by the listing service does not change the fundamental nature of the direct relationship established exclusively between the individual depositor and the IDI or the fact that the ultimate control of the depositor relationship is maintained by the IDI.

4. Create An Express Exclusion from the Deposit Broker Definition for Specific Third Parties:

The FDIC should create an express exclusion for third-party service providers who assist IDIs establish independent, individually sourced, direct depositor relationships, where the IDI owns and controls the relationship and the third party does not have the legal authority to close an account or move a depositor's funds among one or more IDIs; is not involved in negotiating or setting rates, fees, terms or conditions of any deposit account offered by any participating IDI; does not propose, allocate, or determine deposit distributions among participating IDIs, and the third party's platform does not serve as the system of record for the IDI's deposits and deposit transactions by adding language similar to the following at the end of the current 12 C.F.R. § 337.6(a)(5)(iii), as redesignated:

[The term deposit broker does not include] (K) Any third party that provides services to an insured depository institution in connection with a deposit account established directly between the insured depository institution and the individual depositor where the insured depository institution owns and controls the depositor relationship and the third party does not have the legal authority to close an account or move a depositor's funds from one IDI to another IDI; is not involved in negotiating or setting rates, fees, terms or conditions of any deposit account offered by any participating IDI; does not propose, allocate, or determine deposit distributions among participating IDIs, and whose platform does not serve as the system of record for the IDIs deposits.

5. Create a Primary Purpose Exception for Specific Third Parties:

To the extent that the FDIC does not create an express exclusion for third-party service providers under the definition of a deposit broker, as discussed in the recommendation above, the FDIC should include language like the following in the current Section 337.6(a)(5)(iii)(I), as redesignated:

[The term deposit broker does not include] (I) An agent or nominee whose primary purpose is not the placement of funds with depository institutions if and to the extent, the FDIC determines that the agent or nominee meets this exception under the application process in 12 CFR 303.243(b)~~; or~~.

a. An agent or nominee shall be determined not to have the primary purpose of the placement of funds with insured depository institutions, and the IDI will need not submit an application under the current 12 CFR 303.243(b), if the agent or nominee:

i. *Enables an insured depository institution to offer to depositors a deposit account provided by the insured depository institution; governed by terms established by that insured depository institution and that is opened directly by an individual depositor and held in the name of that same individual depositor at the same insured depository institution for the primary purpose of enabling the depositor to regularly make payments, receive funds, conduct other financial transactions, reach savings goals or earn rewards as a function of satisfying specific banking activities established by the depository institution through that same deposit account at that same insured depository institution and only the individual depositor has the authority to close the account or withdraw funds from it; or*

ii. *Provides services to an insured depository institution in connection with a deposit account established directly between the insured depository institution and the individual depositor, and the third party has no contractual relationship with the individual depositor to place, manage or control the individual's deposits, banking decisions or financial activities; does not have the legal authority to close an account or move a depositor's funds from one IDI to another IDI; is not involved in negotiating or setting rates, fees, terms, or conditions of any deposit account offered by the insured depository institution; does not propose, allocate, or determine deposit distributions among participating IDIs, and whose platform does not serve as the system of record for the institution's deposits or*

We believe that this language for a primary purpose exception would help to narrow the number and types of arrangements that would require IDIs to submit an application while at the same time ensuring coverage of external entities that control the depositor relationship.

To avoid an expansive, expensive and unduly burdensome application process, the FDIC should require primary purpose exception applications only from IDI's who work with third parties whose activities fall outside of the bright-line standard our recommended language would create. To do otherwise would rest upon a more costly alternative, imposing a lengthy and subjective application process that would cause material economic harm to community banks and their third-party service providers while they await the FDIC's exception decision.

Any eventual final rule should focus on who, in fact, owns the depositor relationship and who controls the terms of the deposit relationship. In the absence of control and provided its platform does not serve as the system of record for the institution's deposits, a third-party service provider should not be determined to be deposit broker.

6. Clearly Define Brokered Bank – Fintech Deposit Arrangements:

Over the past several years, the regulators have reviewed arrangements between banks and fintech companies that provide consumers access to deposit products and services. In many of these arrangements, the fintech company, rather than the IDI markets, distributes and provides access to or facilitates the provision of deposit services directly to the end user.

In these arrangements, the fintech provider also plays a critical role in maintaining the arrangement's deposits and transaction records. The agencies have noted that these transaction records may not be adequately reflected in the bank's core processing system. Instead, the bank's core deposit ledger may only include omnibus accounts, often titled to reflect that they are held for the benefit of (FBO) end users. Lack of sufficient access to the deposit and transaction system of record can impair a bank's ability to determine its deposit obligations and may delay end-users' access to their funds.

These arrangements can also result in misaligned incentives, funding concentration concerns and a bank's inability to properly manage emerging liquidity risks, particularly when an arrangement represents a funding concentration. An arrangement may be terminated, or the flow of deposit may be reduced for any number of reasons, including those over which the bank has little control, and which may result in significant stress on the bank. For example, if the fintech provider (e.g., Chime) or an intermediate platform provider (e.g. Synapse) in a deposit-taking arrangement faces a stress event or suddenly terminates the contractual arrangement, a bank could face a liquidity crisis as the provider transfers all of its end user deposits to another institution. End-users will remain loyal to Chime, for example, as it can move the individual's funds to another institution without disrupting the end-user relationship. This is a central concern the regulators identified in their July 25, 2024 *"Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services."*

To address the deposit volatility concerns the FDIC has with middleware providers like Synapse and non-bank providers like Chime, we recommend the FDIC expand the deposit broker definition by adding language similar to the following at the end of the current 12 C.F.R. § 337.6(a)(5)(iii), as redesignated:

(i) The term deposit broker means:

(D) Any person who markets, distributes, and provides access to or facilitates the provision of deposit services directly to end users where the person or a designated entity of the person, rather than the insured depository institution, maintains the depositor's transaction and deposit records.

7. Work With Congress to Replace Section 29 With an Asset Growth Cap:

Replacing Section 29 with an asset growth restriction is a legislative solution that accomplishes the public policy goals Congress intended to address, while creating an easier framework for the FDIC to administer.

With this objective in mind, we respectfully submit the following language from the Asset Growth Restriction Act (S.3962 in the 2020 116th Congress and (S. 5347 in the 2022 117th Congress) authored by Senator Jerry Moran of Kansas as a model for the replacement of Section 29 of the FDI Act.

117th CONGRESS
2d Session
S. 5347
December 21, 2022

IN THE SENATE OF THE UNITED STATES

Mr. Moran introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To amend the Federal Deposit Insurance Act to remove restrictions on brokered deposits, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SECTION 1. SHORT TITLE

This Act may be cited as the Asset Growth Restriction Act of 2020.

SEC. 2. FINDINGS AND PURPOSE

(a) FINDINGS. - Congress finds that—

(1) restrictions on the acceptance of brokered deposits were enacted in 1989 in order to prevent the abuse of the deposit insurance system by troubled depository institutions

(2) since the enactment of the restrictions described in paragraph (1), technological and demographic developments have changed the way in which depository institutions seek and source deposits, and, as a result, many deposits that are classified as brokered pose little, if any, risk to the deposit insurance system; and

(3) in today's economy, the greatest risk to the deposit insurance system is asset growth by depository institutions that are less than well capitalized.

(b) PURPOSE. - The purpose of this Act is to remove the current restrictions on brokered deposits and to authorize the Federal Deposit Insurance Corporation to issue regulations that restrict asset growth by depository institutions that are less than well capitalized.

SEC. 3. ASSET GROWTH RESTRICTIONS

(a) ASSET GROWTH RESTRICTION. - Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f) is amended—

(1) in the section heading, by striking Brokered deposits and inserting Asset growth restrictions; and

(2) by striking subsections (a) through (i), and inserting the following:

(a) DEFINITIONS. - In this section, the terms average, critically undercapitalized, and well capitalized have the meanings given the terms in section 38(b).

(b) REGULATIONS REQUIRED. Not later than 18 months after enactment of the Asset Growth Restriction Act of 202X, the Corporation, in consultation with the Board of Governors of the Federal Reserve System and the Comptroller of the Currency, shall promulgate regulations imposing a restriction on average total asset growth for insured depository institutions that are less than well capitalized to maintain safety and soundness and minimize risk to the Deposit Insurance Fund.

(c) MAXIMUM LEVELS OF GROWTH. - As part of the regulations described in subsection (b), the Corporation shall—

(1) establish a framework to impose one or more maximum levels of growth in average total assets that an insured depository institution that is less than well capitalized may not exceed, and provide appropriate adjustments for growth resulting from corporate restructuring such as acquisitions or mergers; and

(2) establish a waiver process to enable the Corporation to waive the maximum level established in paragraph (1) upon application by an insured depository institution that is not critically undercapitalized, based on conditions set by the Corporation.

(d) EXEMPTIONS AND ADDITIONAL RESTRICTIONS. - As part of the regulations described in subsection (b), the Corporation may—

(1) exempt specified classes of assets from the asset growth restriction if the Corporation, in its discretion, determines that growth in such assets does not present risks to the safety and soundness of an insured depository institution; and

(2) impose additional restrictions on insured depository institutions to prevent circumvention or evasion of this section by an insured depository institution resulting from actions taken by the insured depository institution by, or through, its affiliates.

(e) ORDERS. - The Corporation may, by order—

(1) establish a less restrictive level of growth restriction for a particular insured depository institution that is less than well capitalized, or a group of insured depository institutions that are less than well capitalized, if the Corporation finds that such a level will not pose an undue risk to the Deposit Insurance Fund; and

(2) establish a more restrictive level of growth restriction for a particular insured depository institution that is less than well capitalized, or a group of insured depository institutions that are less than well capitalized, if the Corporation finds that such a level is necessary to protect the Deposit Insurance Fund.

(f) CONFORMING REGULATIONS - The Corporation shall revise the of the Corporation, as in existence on the date of enactment of the Asset Growth Restriction Act of 202X, to ensure that they conform to the requirement of his section.

(b) RULE OF CONSTRUCTION. - An insured depository institution that is in compliance with the regulations or orders issued pursuant to section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f), as amended by subsection (a) of this section, shall be deemed to be in compliance with the asset growth standard established pursuant to section 39 of that Act (12 U.S.C. 1831p–112 U.S.C. 1831p–112 U.S.C. 1831p–112 U.S.C. 1831p–112 U.S.C. 1831p–1).

(c) TECHNICAL AND CONFORMING AMENDMENT. -

Section 274(5) of the Truth in Savings Act (12 U.S.C. 4313(5)) is amended by inserting “, as that provision was in effect on the day before the date of enactment of the Asset Growth Restriction Act of 202X after “Act”.

THE FDIC HAS CLEAR AUTHORITY TO ADOPT OUR RECOMMENDATIONS

The FDIC has clear authority under the FDI Act to adopt these recommendations, including the express exclusion for third-party service providers and singularly acquired transaction accounts held in the name of the depositor who uses the account on a regular basis to conduct her/his banking activities and has sole control of their funds.[18] Nonetheless, if the FDIC believes the above recommendations may be exploited in some manner, the FDIC could explicitly reserve the right within the rule to find excluded deposits to be brokered deposits by rule or by order under particular circumstances as they arise. This reservation of the right to prevent circumvention or evasion is a common regulatory construct.[19] Such a provision would give the FDIC the ability to address broad-based evasions by rule and address more individual evasions by order, while still operating within the procedural protections of the Administrative Procedure Act.

[18] *See, e.g.*, 12 U.S.C. §§ 1819(a)(Tenth), 1820(g), 1831f(f).

[19] *See, e.g.*, 12 C.F.R. § 325.1(c) (reservation of authority regarding annual stress tests); 12 C.F.R. § 304.14 (reservation of authority regarding implementation of reduced reporting requirements); 12 C.F.R. § 204.2(e)(6) (reserving discretion for the Federal Reserve Board under Regulation D), 12 C.F.R. § 235.6 (prohibition on circumvention or evasion under the Federal Reserve Board’s Regulation II).

The principle-based recommendations outlined above align with the text and purpose of Section 29; the FDIC policy goals underlying the Proposal; and the FDIC's intent to address situations where the deposit relationship is contractually established between the depositor and a third party, rather than a direct deposit relationship that is contractually established between the depositor and an IDI.

Our recommendations also enable community banks to use third-party service providers, for a variety of valuable purposes, without fear of triggering the deposit broker rule, provided the third party has no contractual relationship with an individual depositor to place, manage or control the individual's deposits, banking decisions or financial activities and the third party's platform does not serve as the system of record for the institution's deposits. To reduce administrative burdens, an IDI could verify that the third party has no such agreement with depositors via its vendor due diligence process and FDIC examiners could document that such verifications are in place during their normal supervisory activities.

Moreover, our recommendations would avoid interference with the substantial investments that have been made by community banks and third parties like Kasasa in reliance on the FDIC's specific assurances that specified activities would not make a company a deposit broker. After years of industry reliance on specific interpretations, the FDIC bears a high legal burden to explain the reasons for expanding the scope of activities that make a company a deposit broker. The Proposal also rests upon a more costly alternative, imposing a lengthy and uncertain application process while the FDIC decides who is a deposit broker (within and outside of the "primary purpose" exception), which will cause material economic harm to community banks and their third-party service providers while they wait for the decision.

Vice Chairman Hill has publicly stated that the FDIC is constrained by Section 29 and has urged Congress to replace Section 29 with restrictions on asset growth. We believe that with a reorientation of the Proposal (1) to recognize the fundamental difference between brokered deposits and the establishment of individual direct depositor relationships with banks, and (2) to narrow the scope of deposits, as well as the categories of third-party services to which the proposed rule applies, FDIC's revisions would complement the types of changes suggested by Vice Chairman Hill, if Congress were to choose to review, revise or replace some or all of Section 29.

Specifically, a revised rule that incorporates our recommendations would enable community banks to reach unbanked individuals, serve their communities effectively, and compete with our nation's large financial institutions and fintech providers. As demonstrated by the FDIC's own Quarterly Banking Profiles, community banks do not have the luxury of time as on average, our nation has lost a community bank (defined as less than $1 billion in assets) every business day over the past 20 years.[20] The urgency is amplified in this time of political, economic and global uncertainties. The regulatory uncertainty resulting from the FDIC's Proposal is forcing community banks to reevaluate third party relationships, delay investments and incur costs. These costs and delays ultimately impact individual depositors, in the form of increased fees or delays in the development of new and innovative products and services. We urge the FDIC to adopt our recommendations so community banks, and the market more generally, can clearly understand the rules of the road as they navigate these regulatory nuances.

FINAL THOUGHTS

The FDIC's proposed revisions to the 2020 Final Rule threatens to upend the entire fabric of community banking across the nation. This regulation is not only unnecessary—it is a dangerous overreach that could destabilize the very institutions that hold our local economies together.

Community banks like are the lifeblood of small businesses, homeowners, and the communities they serve. Community banks make it possible for a local entrepreneur to start a business, for a family to buy their first home, and for our small towns to thrive. Without access to third parties that help these institutions attract new deposits, many community banks simply won't have the funding resources to meet the growing needs of their communities. This rule

[20] FDIC Quarterly Banking Profile

threatens to choke off a vital source of funding, crippling banks' ability to provide the loans and financial products that fuel the dreams of their local communities.

By reversing the rules established in 2020, the FDIC is cutting off one of the most important lifelines for small financial institutions. Limiting access to diverse source of funding will force community banks to reduce lending, raise interest rates, and restrict credit—harming the very people these institutions exist to serve. This isn't just bad policy, it's a devastating blow to the families, farmers, and small businesses who rely on community banks every single day.

The proposed rule is a blunt instrument written primarily in reaction to the 2023 bank failures and it is based on insufficient evidence. The current regulations have brought clarity and innovation to the financial system without posing the systemic risk the FDIC claims. Community banks, which thrive on deep relationships and local expertise, use brokered deposits wisely and prudently. To impose blanket restrictions based on "correlated risks" will disproportionately hurt smaller institutions while giving the massive national banks an even bigger competitive edge.

The consequences of this rule would be dire. Community banks already operate under immense regulatory pressure. Additional restrictions will force these institutions to cut back on lending to small businesses, farmers, and homeowners, choking off growth in the very areas where credit is already hardest to come by—our rural and small-town communities. Citizens across our country will face higher borrowing costs, less access to financial products, and a diminished level of personal service that only a community bank can provide.

We implore the FDIC to rethink its proposal. Community banks are the backbone of Main Street, and they rely on innovative third-party services and diverse sources of funding to serve their communities. The damage this regulation would cause far outweighs any perceived benefits. The industry needs a balanced approach that fosters responsible banking without crushing the institutions that are the heartbeat of local economies. Please, don't let this rule be the reason community banks are pushed out of the very communities that need them the most.

WITH APPRECIATION

Thank you for opportunity to comment on the Proposal and thank you for continuing our long-standing dialogue on this subject. We would be pleased to make ourselves available, at your convenience, to discuss the key issues we have raised in this letter. Left unchanged, it is our view that community banks and, as a result, consumers, farmers, small business and communities throughout the country would be devastatingly harmed rather than helped by the Proposal.

Sincerely,

[redacted]

Patrick J. Laughlin
Chief Compliance Officer
Kasasa, Ltd.