MID-SIZE BANK COALITION OF AMERICA

November 18, 2024

Via Email: Comments@fdic.gov

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (RIN 3064-AF99)

Ladies and Gentlemen:

The Mid-size Bank Coalition of America (**MBCA**) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (**FDIC**) proposed rule relating to its brokered deposit restrictions (**Proposal**).[1] The MBCA represents more than 100 mid-size banks across the country, with over 13,000 branches in all 50 states, Washington, D.C., and three U.S. territories. MBCA members hold over $2.6 trillion in deposits and have extended over $2.1 trillion in loans while employing over 300,000 people. Mid-size banks are an integral component of the nation's economy, typically serving as hometown banks with highly personal connections to their clients. We write to share this unique perspective as mid-size banks.

The Proposal is of critical importance due to its potential impact on key deposits that our members depend on as a source of funding. Despite its significance, the Proposal lacks adequate support to justify the major changes and negative consequences for mid-size banks that it would introduce. Moreover, the Proposal does not allow adequate time for thorough public consideration of the important issues it raises. Therefore, the Proposal should be withdrawn until the FDIC conducts additional analysis supporting the purported rationale for the proposed changes.[2]

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[1] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68,244 (Aug. 23, 2024).

[2] Such analysis is necessary given that the significant changes proposed to the current framework, which was adopted just four years ago, heavily relies on the same body of evidence on which the FDIC relied when justifying the current rule. For example, the Proposal does not provide transparent or robust evidence that the deposits it aims to reclassify as brokered deposits carry the same risks that have historically troubled regulators and lawmakers. Without substantially new and updated analysis showing a need for the changes, we share the views expressed by FDIC Vice Chairman Travis Hill that revamping of (….continued)

We strongly urge the FDIC to consider the recommendations included in the letter submitted by the American Bankers Association, the American Fintech Council, the Bank Policy Institute, the Consumer Bankers Association, the Financial Services Forum, the Financial Technology Association, the Independent Community Bankers of America, the Innovative Payments Association, the Institute of International Bankers, the National Association of Industrial Bankers and the Securities Industry and Financial Markets Association (**Joint Trades Letter**) earlier this year.[3] We fully share the views expressed in the Joint Trades Letter and write to offer additional insights from the unique perspectives of mid-size banks. In particular, our members believe that:

- The Proposal lacks evidence to support its rulemaking and should be withdrawn;
- The Proposal is likely to significantly and negatively impact mid-size banks and their customers, and these effects should be more closely examined before any changes are adopted;
- The Proposal should be revised to avoid unintended consequences on business arrangements outside of bank-fintech relationships;
- Recent evidence from the banking industry does not support the extensive changes proposed and the Proposal should not be adopted until it undergoes a comprehensive review backed by updated data;
- The Proposal should be clarified to confirm that wholesale banks are subject to higher brokered deposit limits; and
- The "cooling-off" period for regaining agent institution status in the Proposal is too long and should be shortened.

We elaborate on each of these topics in the sections below.

The Proposal lacks evidence to support its rulemaking and should be withdrawn

We share the view expressed by FDIC Board member Jonathan McKernan that the Proposal does not "offer any evidence that some of the deposits that this proposal would re-classify as brokered deposits actually present the same or similar risks."[4] At the

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the current rule is a "major undertaking" that "is a poor use of [the FDIC's] time and resources." Statement by Travis Hill, Vice Chairman, FDIC, Board of Directors, on the Notice of Proposed Rulemaking on Brokered Deposit Restrictions (Jul. 30, 2024), http://www.fdic.gov/news/speeches/2024/statement-vice-chairman-travis-hill-notice-proposed-rulemaking-brokered-deposit.

[3] Comment Letter by the American Bankers Association, et al., on Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; Request for Extension of Comment Period (Aug. 21, 2024), http://www.fdic.gov/system/files/2024-08/2024-unsafe-unsound-banking-practices-brokered-deposits-restrictions-3064-af99-c-001.pdf.

[4] Statement by Jonathan McKernan, Director, FDIC, Board of Directors, on the Proposed Brokered Deposit Restrictions (Jul. 30, 2024), http://www.fdic.gov/news/speeches/2024/statement-
(….continued)

least, the FDIC should offer justification comparable to its 2011 study, updated in 2019, on which it relied when the FDIC adopted changes to the brokered deposits rule in 2020. Providing such information is important because the Proposal would effectively undo a number of the 2020 revisions.[5] As discussed below, our members rely on the current rule to operate their businesses and serve customers. Reversing the existing rule would strain their business models, making it challenging to maintain the services that they have committed to offering their customers.

The Proposal is likely to negatively impact mid-size banks and their customers

Although the FDIC acknowledges that the Proposal will affect "IDIs, consumers, and nonbank firms," that "fewer entities are likely to be exempt from the definition of deposit broker than is the case currently," and that "the amount of deposits at IDIs considered brokered under the proposed rule is likely to increase,"[6] the agency does not attempt to quantify or analyze the further substantial knock-on effects of these changes, particularly on mid-size banks and their customers. The FDIC states: "To the extent that consumers utilize deposits currently, or in future periods, which are not classified as brokered, but would be as a result of the adoption of the proposed rule, they might experience changes in interest rates on those funds, or costs associated with placing those funds with different entities. The FDIC does not have the information necessary to estimate such changes, and therefore, discusses these effects qualitatively."[7] We strongly believe that the Proposal should not be adopted without a thorough quantitative analysis—in particular, the FDIC should analyze and weigh the impact that the Proposal will have on the depositors and communities served by mid-size banks.

Although an industry-wide analysis is not available at this time, our members believe that the Proposal would significantly and adversely affect their banks and the communities they serve. Specifically, the Proposal would reduce depositors' options to place their funds in mid-sized banks by increasing costs and limiting the deposit arrangements that can be offered. Further, this negative effect would be likely to disproportionately affect small depositors. As former FDIC Chairman McWilliams has pointed out, "The cost to innovate is in many cases prohibitively high for community banks. They often lack the expertise, the information technology, and research and development budgets to independently develop and deploy their own technology. That is why partnering with a fintech that has already developed, tested, and rolled out new

jonathan-mckernan-director-fdic-board-directors-proposed-amendments-0. We also agree with FDIC Board member Jonathan McKernan's statement that "it is important that the FDIC make a case for its rulemakings." *Id*.

[5] For example, the Proposal would eliminate the matchmaking and exclusive placement arrangement exceptions under the current rule, revise the 25 percent test designated exception to a 10 percent test exception (and narrow the scope of firms to which the exception may apply), and eliminate the enabling transactions designated exception.

[6] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. at 68,259.

[7] *Id*. at 68,261.

technology is often a critical mechanism for a community [bank]."[8] This reality has not changed for our members in just four short years. Therefore, we believe it is of utmost importance that the Proposal not be adopted without a thorough, quantitative analysis of these effects. To that end, below we describe aspects of the Proposal that we believe are likely to have a significant adverse effect.

First, our members rely on aspects of the current rule that would be removed, or effectively removed, by the Proposal. For example, the Proposal would eliminate the "25 percent test" and notice procedures adopted in the 2020 rules and replace it with a narrower "Broker-Dealer Sweep Exception." The Broker-Dealer Sweep Exception would have a lower eligibility threshold of 10 percent of "assets under management" (as opposed to 25 percent of "assets under administration" for the relevant business line under the current rule),[9] apply only to relationships with registered broker-dealers or investment advisers, and include more onerous procedures, including an application requirement for any arrangements involving an insured depository institution (**IDI**), broker-dealer, and additional third party.[10] Furthermore, the FDIC would rescind the notices and applications approved under the current rule and eliminate the ability of non-IDIs to file applications or notices.

The FDIC acknowledges in the Proposal that these changes could "result in a significant increase" in applications and that "IDIs may incur costs associated with such submissions, including costs associated with gathering more information from third parties as part of the application process."[11] However, the costs of reworking existing bank-fintech and other arrangements to comply with both the substantive and procedural changes introduced by the Proposal could make these arrangements effectively unviable. Our members believe that the FDIC underestimates the time and resources that banks will have to allocate to the notice and application process under the Proposal.[12] In addition, there will be a heavy burden for both banks and third parties, including broker-dealers and investment advisers, to make changes to their systems, policies, and procedures to comply with the proposed rule.[13] These potential costs should be considered before changes are adopted.

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[8] Keynote Remarks by Jelena McWilliams, former Chairman, FDIC, Board of Directors, on the "The Future of Banking" at The Federal Reserve Bank of St. Louis, St. Louis, Missouri (Oct. 1, 2019), http://www.fdic.gov/news/speeches/2019/spoct0119.html.

[9] We also note that while "assets under management" is an appropriate term for measuring the activity of an investment adviser that actively manages client assets, it is inappropriate for measuring the custody of client assets by broker-dealers that are not dually registered with the SEC as investment advisers. Accordingly, the change could lead to legal uncertainty with respect to broker-dealers.

[10] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. at 68,255-56.

[11] *Id*. at 68,260.

[12] Furthermore, although the Proposal allocates responsibility for the applications and notices to IDIs, many banks will apply with respect to the same depositor, which would give rise to inefficiencies in the process and lead to increased aggregate compliance costs in the industry.

[13] These costs are in part acknowledged by the agency in the statement accompanying the Proposal. *See* Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. at 68,259, 61.

Second, the Proposal is likely to materially increase the number of deposits that would be classified as brokered under the rule across the industry. The FDIC states "at the end of the first quarter during which the 2020 Final Rule was in effect—April through June of 2021—IDIs reported almost $350 billion fewer brokered deposits than in the previous quarter, a reduction in reported brokered deposits of more than 30 percent. Therefore, the FDIC believes a material amount of deposits could be reclassified as brokered."[14] Such regulatory changes are likely to have a sweeping impact on the asset/liability management strategies of mid-size banks, cause adverse reactions from ratings agencies and investors, and trigger higher insurance premiums, all as a result of certain key deposits abruptly no longer being considered core deposits.

Specifically, bank asset/liability management strategies generally incorporate brokered deposit limits of 10% to 20% due to supervisory concerns.[15] Therefore, re-classification of certain deposits as brokered deposits would force our members to seek alternate sources of funding and make offering brokered deposits to customers less attractive, thereby reducing the number of options available to customers. As more banks seek out deposits that are classified as core deposits, competition is likely to drive up prices for these deposits, making them more expensive for our members.

In addition, ratings agencies and investors may view the higher volume of brokered deposits as a negative factor, potentially leading to downgrades and spooking investor confidence. The Proposal also could increase FDIC deposit insurance assessments for some IDIs,[16] all the while counting deposits that produce *none* of the attendant risks associated with brokered deposits.

These outcomes are illogical, particularly given evidence that when used prudently, the deposits that would be classified as brokered under the Proposal serve as an effective liquidity management tool for mid-size banks, providing readily available funding resources as a second form of funding. For example, these types of brokered deposits may help a bank maintain stable deposit levels after a significant withdrawal by other customers, typically do not require a pledge of collateral, and often provide a more readily available solution than other funding sources. By requiring banks to classify more deposits as brokered, the FDIC could be unintentionally undermining the stability of these institutions by increasing the risk of a significant deposit shortfall, particularly during periods of economic stress.

These important knock-on effects are not considered by the FDIC in the Proposal,

[14] *Id*. at 68,259. (footnote omitted).

[15] This is different for wholesale banks. The FDIC has yet to offer clear guidance on what constitutes an acceptable level of brokered deposits for wholesale banks. Call Report data reveals a wide variation in brokered deposit levels across all U.S. banks. By failing to define acceptable limits, imposing higher assessment fees on brokered deposits, and implying that these deposits are inherently less stable, the FDIC has inadvertently stigmatized accepting brokered deposits while refraining to advise, particularly wholesale banks, on related limits.

[16] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. at 68,260.

however, they are critical to evaluating the ultimate costs and benefits of the rulemaking.

The Proposal should be revised to avoid unintended consequences on business arrangements outside of bank-fintech relationships

In no uncertain terms, the Proposal is aimed at addressing risks from emerging bank-fintech relationships. In his statement accompanying the release of the Proposal, FDIC Chairman Martin J. Gruenberg highlighted that "Synapse, sometimes referred to as a fintech 'middleware' company, was a deposit broker that facilitated customer deposits for various fintech companies looking for banking services with insured depository institutions" and that the agency "is also evaluating additional rule-making to address the risks to depositors presented by these types of third party deposit arrangements."[17]

However, the sweeping changes in the Proposal are likely to severely and negatively impact many arrangements that existed well before the modern bank-fintech relationship. For example, the Proposal would remove the current "matchmaking activities" prong and add a proposed prong related to deposit allocation services that would not exclude third parties that provide these services between affiliated entities.[18] This change could affect our members' long-standing business arrangements with non-fintech third parties, including those based on earlier staff guidance about affiliated sweep arrangements issued before the current rules were adopted, which the FDIC had previously acknowledged.[19]

Likewise, as drafted, the new fee-related factor in the proposed deposit broker definition could encompass business relationships in numerous traditional banking business lines, including municipal advisors that place deposits on behalf of municipalities, management firms handling record keeping and finances for homeowners associations, and title escrow businesses.[20] Deposits stemming from these and other similar relationships produce none of the attendant risks commonly associated with brokered deposits, and have proven to be very stable over time. We urge the FDIC to revise the Proposal to take into account these and other unintended consequences before adopting any final rule.

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[17] Statement by Martin J. Gruenberg, Chairman, FDIC, Board of Directors, on the Notice of Proposed Rulemaking on Brokered Deposits (Jul. 30, 2024), http://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corpoation.

[18] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. at 68,252.

[19] Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg. 6,742, n. 23 (Jan. 22, 2021) ("This view aligns with the FDIC's intent not to disrupt business arrangements that have existed for a number of years in reliance on prior staff guidance related to affiliate sweep arrangements, when the resulting adjustments to business operations would be solely for the purpose of complying with regulatory changes.").

[20] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. at 68,252.

Recent evidence from the banking industry does not support the extensive changes proposed

The current evidence is unclear as to whether core funding sources that would be reclassified as brokered under the Proposal are inherently destabilizing for banks.[21] The FDIC should be mindful of data indicating that during the global financial crisis, and more recently the events of March 2023, deposits that would be brokered under the Proposal were, in fact, more stable than other deposits at the banks that failed. Rather than proving to be "less sticky," these deposits were crucial to managing liquidity during the volatile financial market. Absent access to the brokered deposit market, more banks would have experienced funding challenges, likely resulting in additional bank failures.

Therefore, the Proposal is premature insofar as it might reclassify some deposits that have proven to be very dependable. In his public statement, FDIC Vice Chairman Travis Hill expressed that although some adjustments to the 2020 rule might be justified based on the industry's past three-and-a-half years of experience, the current proposal is excessive.[22] We agree with this perspective. In the Proposal, the FDIC cites the recent bank failures as the motivating factor for the rulemaking. The FDIC does not, however, present the necessary information to evaluate whether these failures reflect broader trends or how the proposed changes might have resulted in different outcomes. As previously mentioned, the Proposal is based on the same studies that were used to support the current rule. The FDIC has not conducted a recent, in-depth analysis of brokered deposits and their impact on the financial system—as a result, the data supplementing the Proposal is selective and limited. We believe the Proposal should not be adopted until it undergoes a comprehensive review backed by updated data and more specifically, a comprehensive study of the role brokered deposits played across the industry prior to, during, and following the March 2023 market volatility.

The Proposal should be clarified to confirm that wholesale banks are subject to higher brokered deposit limits

We believe the Proposal should clarify that wholesale banks are permitted to hold more brokered deposits than other banks due to the nature of their business strategy. Specifically, wholesale banks are at a competitive disadvantage relative to other banks in attracting retail/core deposits because wholesale clients tend to deposit funds at IDIs that

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[21] *See* e.g., Mark L. Mitchell, et al., Runs to Banks: The Role of Cash Sweeps During Market Downturns, SSRN (Sept. 9, 2020), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3690525 ("Importantly, our results suggest there are notable differences between the impact of sweep deposits versus non-sweep brokered deposits on the overall volatility of bank deposits as a funding sources. Indeed, despite their high volatility, sweep deposits are not destabilizing, but instead stabilizing for banks as investors reduce risk by converting stock to cash during periods of high stress. Instead, it is only the non-sweep brokered deposits that appear to sometimes increase the volatility of total bank deposits. Moreover, sweep deposits from brokerage firms serve to enhance the hedging of liquidity risk by banks in providing loan commitments and lines of credit to corporations.").

[22] Statement by Travis Hill, Vice Chairman, FDIC, Board of Directors, on the Notice of Proposed Rulemaking on Brokered Deposit Restrictions (Jul. 30, 2024), http://www.fdic.gov/news/speeches/2024/statement-vice-chairman-travis-hill-notice-proposed-rulemaking-brokered-deposit.

are also likely to lend to them. Therefore, wholesale banks act strategically in their lending focus, and, as a practical matter, tend to target industries where primary purpose designated exceptions are available. The proposed dramatic changes to both the substance and the process of the primary purpose exceptions to the brokered deposits rule could force wholesale banks to change their entire strategic focus, a process that is costly, time consuming, and risky.

At the very least, wholesale banks that comply with the Liquidity Coverage Ratio (**LCR**) should be permitted to hold higher levels of brokered deposits. LCR-compliant banks hold ample High Quality Liquid Assets (**HQLA)** to cover for liquidity outflows, notwithstanding the harsh liquidity haircuts on deposits based on customer and deposit type in the rule. Moreover, wholesale banks typically don't issue 30-year mortgage loans or invest in long-term illiquid assets. Banks that already employ such prudent risk management practices would not necessarily become safer by classifying even more deposits as brokered.

The "cooling-off" period for regaining agent institution status in the Proposal is too long and should be shortened

Under the 2018 Reciprocal Deposits Rule, an "agent institution" can exclude a capped amount (the lesser of 20% of the institution's total liabilities or $5 billion) of reciprocal deposits from being classified as brokered deposits.[23] To qualify as an agent institution, the institution is required to: (1) as of its most recent exam, have a composite condition of outstanding or good and be well capitalized; (2) have obtained a waiver from the FDIC; or (3) not receive an amount of reciprocal deposits that causes the total amount of reciprocal deposits held by the agent institution to be greater than the average of the total amount of reciprocal deposits held by the agent institution on the last day of each of the four calendar quarters preceding the calendar quarter in which the agent institution was found not to have a composite condition of outstanding or good or was determined to be not well capitalized (referred to as the "special cap").[24] Thus, if an IDI no longer qualifies under prong (1), the IDI must qualify under prong (2) or (3) to remain an agent institution – that is, either receive a waiver from the FDIC or be subject to the special cap. If an IDI is subject to the special cap and receives deposits in excess of that cap, the IDI would no longer be an agent institution and all of its reciprocal deposits would need to be reported as brokered.

The Proposal would clarify how an IDI that loses agent institution status can regain it. In particular, an IDI that lost its agent institution status would be able to regain such status in the following ways: (1) if the IDI is well capitalized, the date the IDI is notified that its CAMELS composite condition is rated outstanding or good at its most recent examination; (2) if the IDI is well-rated, the date the IDI is notified, or is deemed to have notice, that it is well capitalized under applicable regulations; (3) the date on which the FDIC has granted a waiver; or (4) on the last day of the third consecutive calendar quarter during which the IDI did not at any time receive reciprocal deposits that

[23] 12 CFR 337.6(e)(1).

[24] 12 CFR 337.6(e)(2).

caused its total reciprocal deposits to exceed its special cap. For the same reasons discussed above, the issue of agent institution status is of utmost importance to our members, particularly wholesale banks, which tend to rely more on reciprocal deposits relative to other banks.

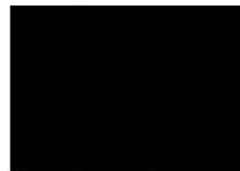
Although we welcome the clarification provided in the Proposal regarding when an IDI can regain its agent institution status after losing it, we strongly believe that, with respect to the fourth scenario noted above, three consecutive quarters is too long and that the proposed cooling-off period should be shortened. Specifically, we believe that an IDI should be able to regain agent institution status after demonstrating two consecutive calendar quarters with lower levels of reciprocal deposits. As noted in the previous sections, these types of deposits, when used prudently, serve as an effective liquidity management tool for mid-size banks and enable banks to access existing sources of funding that are reliable. The lack of access to these deposits could undermine the stability of mid-size banks and increase the risk of a significant deposit shortfall, particularly during periods of economic stress.

Conclusion

We believe that the Proposal should be withdrawn because it lacks sufficient justification for the major changes and negative consequences it would impose on institutions, particularly mid-size banks. Among other things, the Proposal would harm mid-size banks and their customers, negatively affect non-fintech business arrangements, and overlooks recent data showing that deposits that would be brokered under the Proposal were more stable than other deposits during times of economic volatility. These factors should be considered before any changes to the current rules are adopted. In addition, the Proposal should be clarified to confirm that wholesale banks are subject to higher brokered deposit limits and the cooling-off period for regaining agent institution should be shortened.

Should you have any questions or require any additional information, please do not hesitate to contact me at brent.tjarks@midsizebanks.com.

Respectfully submitted,



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