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November 21, 2024

VIA ELECTRONIC MAIL

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/RIN 3064-AF99
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Comments@fdic.gov

Re: Notice of Proposed Rulemaking Comment Letter
Unsafe and Unsound Banking Practices:
Brokered Deposits Restrictions
RIN 3064-AF99

Dear Mr. Sheesley:

NBKC Bank ("NBKC") appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (the "FDIC's") Notice of Proposed Rulemaking ("NPR") entitled "Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions." In that NPR, the FDIC proposes revisions to its regulations relating to the brokered deposits restrictions that apply to less than well-capitalized banks. As described below, this is an issue with which NBKC has experience and significant interest considering its operations, and we hope that the FDIC takes our perspective into account before finalizing its approach to brokered deposits in the modern banking environment.

Background

Competitive Environment. NBKC is a 25-year old bank with approximately $1.2 billion in assets. Like many comparable banks, we continually have been challenged to grow and retain relatively low-cost deposits. With our original focus on obtaining deposits in the local market, this required us to offer increasingly higher interest rates to compete with other banks. Our expansion over the last few years to a nationwide, and more diversified, platform brought to us a different level of competition on a much larger scale.

During that time, NBKC's management recognized that banking was changing rapidly. Not only were banks competing against each other, but financial technology companies ("fintechs") were becoming a legitimate marketplace competitor. Fintechs are disruptive because they generally provide much better customer experience and, through their innovative platforms, can scale their users more rapidly than traditional banks. Consequently, NBKC's management recognized that if we did not take drastic action to compete in this new environment, maintaining our existing funding sources would become even more challenging.

Accordingly, rather than compete with fintechs, NBKC embarked on a strategy to partner with them by offering so-called Banking as a Service ("BaaS"). Through BaaS, NBKC provides fintechs the opportunity to offer depository accounts (checking or savings), issue debit cards, move funds, and deliver other banking services, all while maintaining pass-through FDIC insurance. These BaaS partnerships allow NBKC to increase our outreach and grow our customer base in a manner that would be challenging to accomplish organically.

BaaS Structure. BaaS accounts are structured in two ways: (i) for benefit of ("FBO") accounts; and (ii) individually provisioned accounts.

<u>FBO Accounts.</u> An FBO account is a pooled account through which a fintech itself maintains the relationship with its customers that is governed by the fintech's account agreement, and related terms and conditions. NBKC treats the fintech as its customer and accountholder, including with respect to applicable Bank Secrecy Act/ anti-money laundering Customer Identification Program and due diligence requirements.

Individually Provisioned Accounts. When using individually provisioned accounts, the fintech's customers become direct customers of NBKC, and the relationship is governed by an NBKC account agreement that is essentially similar to the agreement utilized for NBKC's traditional deposit customers.

In the BaaS structure, NBKC does not pay the fintech partners for these deposits, which generate no interest cost to NBKC, and the fintech often offers its solution free of charge to its customers. Each fintech relationship generates revenue opportunities for NBKC that are becoming increasingly more challenging to obtain through the traditional banking model.

Considerations for Brokered Deposit Policy

Generally. The banking industry has changed significantly since our nation's current approach to brokered deposits was established by Congress in Section 29 of the Federal Deposit Insurance Act. We believe that since then, the FDIC increasingly has expanded the original Congressional intent without considering how the banking industry has evolved, particularly over the last few years.

Technology advances, seamless nationwide banking availability, fintech disruption, BaaS relationships, and other financial innovation only have accelerated that (r)evolution, and made the FDIC's brokered deposit policy much more anachronistic. The FDIC's current position appears to place too much emphasis on the involvement of a third party in establishing deposit accounts, without considering what deposit stability means in the current environment.

Deposit Stability. With respect to fintech-related deposits, we submit that there are two significant considerations for the FDIC to evaluate when determining whether deposits should be deemed unstable ("hot money"), relative to traditional deposits: (i) the depositor's ability to move the deposit; and (ii) the fintech's ability to move the banking relationship. As described below, deposits obtained through fintechs maintained by NBKC (under both approaches described above) are generally stable, and as "sticky" as deposits obtained in the traditional manner. Accordingly, we do not believe that either type of deposit should be deemed brokered deposits as the FDIC reevaluates its approach.

With traditional deposits, the depositor has the choice to migrate funds to another financial institution through immediate transfers, such as ACH transactions or wires. Similarly, in the case of deposits made through fintechs, the depositor has the choice to move money to another financial institution (or alternative fintechs) through similar means.

In both cases, depositors retain the ultimate choice and manage their relationships at their direction. Most importantly, the relationship that the depositor maintains with the fintech does not increase the likelihood that the deposit is less stable than a traditional deposit. The customer chooses to "bank" with a fintech for several reasons that are generally unrelated to the interest rate provided, including the approachable customer experience derived from the use of the custom-built technology portal, as well as other special features offered by fintechs that are not offered at traditional banks.

Regarding the relationship between the fintech and NBKC, we submit that these relationships are extremely stable for three reasons:

Fintech Agreements. They are governed by a formal legal agreement between the fintech and NBKC, which are typically for a three-year term. This restricts the ability of a fintech to migrate its deposit relationships to another financial institution, without either breaching the contract or paying an early termination fee, which can be significant. In addition, there are certain regulatory mandates relating to customer notices, balance transfers, etc., all of which make changing financial institutions difficult and cumbersome.

Program Migration. Migrating a BaaS program to another financial institution requires a lengthy process, likely at minimum 180-days, as it is analogous to a financial institution's conversion of its core processing system. This is a significant motivator toward stability, even beyond any of the contractual issues described above.

Customer Debit Cards. The issuance of debit cards to the fintech's customers creates further portability obstacles and migrating from one financial institution to another results in a significant amount of time and expense, while impacting customers significantly.

Adequately Capitalized Status Consequences

Generally. As the FDIC is aware, an "adequately capitalized" bank may not accept, renew, or roll over any brokered deposit unless the bank has received a waiver from the FDIC, which can be challenging to obtain. Even if a bank otherwise exceeds the applicable capital ratio thresholds to be considered "well capitalized" under applicable capital requirements, it is considered no better than "adequately capitalized" if it is subject to a formal enforcement action requiring the bank to maintain a specific capital level.

Previous Experience. NBKC experienced this issue during the last recession, when it was subject to a formal enforcement action with a strict capital requirement, rendering us "adequately capitalized," and therefore subject to the brokered deposit restriction described above. That action, which occurred before we began engaging with fintechs, was triggered because of NBKC's commercial real estate concentration, and the resulting credit losses during the unprecedented economic downturn.

Future Uncertainty. NBKC is concerned that another economic downturn could create similar circumstances that could subject NBKC, and many other comparable banks with fintech relationships, to formal enforcement actions with strict capital requirements. Questions about NBKC's ability to obtain an FDIC wavier would then raise significant doubts about its capacity to work with fintechs, and would create an environment of significant disruption, not just for NBKC and its fintech partners, but also for the fintech customers. Those customers would be required to migrate to other banks, enter into new account agreements with those banks, and be reissued new debit cards. NBKC submits that this outcome would be inconsistent with the original rationale behind the brokered deposit restriction, and likely would affect other similarly situated institutions and create an environment of undue marketplace disruption.

Reversion to Previous Policy

Previous and Current Treatment. Prior to the adoption of the 2020 final rule, NBKC was required by the FDIC to classify all deposits obtained from fintech relationships as brokered deposits. With the adoption of the 2020 final rule, the FDIC addressed the existing outdated regulations by allowing some flexibility in the treatment of certain relationships, in an appropriate manner, such that not all fintech relationship deposits were deemed brokered deposits. As a result of the 2020 final rule, NBKC now categorizes approximately one-third of its fintech deposits as brokered deposits. The exclusive deposit placement arrangement and the primary purpose exceptions in that rule were utilized by NBKC to avoid treating deposits from certain relationships as brokered deposits. The current proposal, which effectively reverts to the regime prior to the 2020 final rule, represents a reversal of the significant progress made by the FDIC in the years leading up to the 2020 final rule that gave these outdated regulations a needed update.

Future Treatment. If the FDIC essentially reverts to policies prior to the 2020 final rule, this will have an immediate and long-standing effect on NBKC. Prior to offering BaaS, NBKC was challenged with acquiring low- and no-cost deposits. NBKC's BaaS offering has been a significant contributor to our deposit growth, and an improvement to our net interest margin. Furthermore, fintech deposits act as a stable and diversified source of liquidity for NBKC. Although still restrictive, because not all NBKC's fintech relationships are deemed non-brokered, the removal of certain exemptions, such as the exclusive deposit placement arrangement and the primary purpose exceptions, is a step backward by the FDIC in addressing opportunities for financial institutions to raise deposits in a manner not contemplated when the regulations originally were established.

NBKC manages concentration and liquidity risk through board-approved limits for: (i) deposit balances per fintech program; (ii) deposit balances for all fintech programs in aggregate; and (iii) brokered deposit balances. A reversion to the previous treatment will result in NBKC's fintech deposits exceeding the current board-approved limit on brokered deposit balances. As a result, NBKC will be required to raise deposits at high rates, thus increasing competition for deposits among other financial institutions, to replace the brokered deposits that NBKC will be required to distribute off-balance sheet to comply with its brokered deposit balances limit. This process will be time-consuming, a strain on existing resources, and financially costly (as NBKC's fintech deposits are non-interest bearing), and will not increase the stability of NBKC's overall deposits.

We are pleased that the FDIC is allocating time and resources to address the topic of brokered deposits. We hope that the FDIC seizes this opportunity to maintain its updated interpretation of the outdated approach to brokered deposits that does not address the deposit relationships possible today, given the advancement in technology that was unforeseen when that approach originally was conceived. We urge the FDIC to specifically consider the concept of fintech-bank deposit relationships, providing NBKC and other comparable banks with the opportunity to transform our business in the modern world and to better serve our customers.

We would be happy to engage with the FDIC further regarding this issue. Please call me directly if we can answer any specific questions and thank you for your consideration of this submission.

Sincerely,

[redacted]

Eric Garretson
Chief Financial Officer