

To: Federal Deposit Insurance Corporation (FDIC)

From: Reese Thompson

Re: *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*  
(FDIC-2024-0072-0001)

Date: October 15, 2024

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## **I. Introduction and Summary of the Argument**

This comment<sup>1</sup> is submitted for the purpose of pleading with the FDIC to withdraw the proposed changes to the 2020 brokered deposits rule and to urge the agency to develop a full and complete understanding of, not only the impact these changes will have on small Insured Deposit Institutions (“IDI”) and the communities which they serve, but also the evidence indicating a need for the proposed changes to the 2020 brokered deposits rule. Currently, the agency has not met the burdens required of it by Executive Order 12866 in which the agency to assess the costs and benefits associated with the proposed rule it seeks to publish, thus exposing the proposed rule to an arbitrary and capricious challenge.<sup>2</sup> The proposed rule looking to change the manner in which brokered deposits are interpreted and broaden the definition of brokered deposits presents an unnecessary and substantial risks to IDIs that are unknown to the agency.

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<sup>1</sup> Disclaimer: This comment is part of a classroom assignment in my Administrative Law Course at Cumberland School of Law. The arguments presented are not necessarily my own views, but instead a comprehensive assessment based on research conducted.

<sup>2</sup> Executive Order 12866, 58 Fed. Reg. 51375 (Oct. 4, 1993).

Additionally, there is not sufficient data to show this problem cannot be solved by the IDIs in their market such that there is a compelling public need for the regulation. In fact, the proposed changes will eliminate the market's ability to solve the problem and may potentially create problematic outcomes for IDI customers engaging in deposit referral programs.<sup>3</sup> With no new data to support these changes, one could argue these changes are purely political and simply being bulldozed through the regulatory process at the tail end of one political party's control over the executive branch in order to eliminate the regulations put in place by the prior party. However, this commentor will leave speculations of that kind to other members of the public. This commentor respectfully asks the FDIC to withdraw the proposed changes to the 2020 rule until such a time that the FDIC can provide current factual and statistical support for the necessity of these changes and properly estimate the impact the proposed changes will have on IDIs the FDIC is tasked with overseeing, the communities which these institutions exist, and the individuals which they serve.

## **II. Background to the Brokered Deposits Rule**

The FDIC is tasked with maintaining stability in the public financial institutions by overseeing IDIs for safety and sound management practices, as well

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<sup>3</sup> See Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68251 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337) (proposing to modify the language in the act to be "one or more," which would eliminate the viable market control mechanism of the exclusive agreement deposit placements; as well as, modifying the deposit broker definition such that everyday citizens may be classified as deposit brokers).

as insuring deposits held by those IDIs.<sup>4</sup> The FDIC has the authority to regulate all deposits insured under the Federal Insurance Act<sup>5</sup> and Financial Institutions Reform, Recovery and Enforcement Act gave the FDIC more specific authority to regulate brokered deposits.<sup>6</sup> The FDIC amended the rule regarding the regulations and reporting requirements for brokered deposits in December of 2020.<sup>7</sup> However, prior to these amendments being finalized the FDIC conducted an extensive and nearly yearlong fact finding and comment period to update previous studies and take in comments from interested parties in the industry.<sup>8</sup> During the comment period the FDIC received 119 comments and did not publish the final rule until months later.<sup>9</sup> The 2020 rule, the FDIC now seeks to change, created more clarity for IDIs as to what constituted a brokered deposit relationship.<sup>10</sup> The 2020 rule also excepted certain transactions from the Brokered Deposit definition and as a result of transactions being reclassified there was a “31.8 percent, decline in brokered deposits between the first and second quarters of 2021 after the 2020 Final Rule

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<sup>4</sup> *About*, FDIC, <https://www.fdic.gov/about> (last visited Oct. 13, 2024).

<sup>5</sup> 12 U.S.C. § 1811(a).

<sup>6</sup> 103 Stat. § 202.

<sup>7</sup> *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*, 89 Fed. Reg. 68244 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337).

<sup>8</sup> FDIC, *Advance Notice of Proposed Rulemaking and Request for Comment, Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions*, 84 Fed. Reg. 2366, 2377-2400 (proposed Feb. 6, 2019) (codified at 12 C.F.R. pt. 337).

<sup>9</sup> *FDIC Federal Register Citations*, FDIC, <https://www.fdic.gov/federal-register-publications/fdic-federal-register-citations-7087> (last visited Oct. 12, 2024).

<sup>10</sup> *Id.*; Ebrima Sanneh, *Bank Allies Say FDIC Brokered Deposit Plan Reflects Outdated Thinking*, AMERICAN BANKER (Aug. 7, 2024), <https://www.americanbanker.com/news/bank-allies-say-fdic-brokered-deposit-plan-reflects-outdated-thinking>.

became effective.”<sup>11</sup> The FDIC now believes the “narrowing is problematic because these deposits continue to present the same risks as before the 2020 Final Rule.”<sup>12</sup>

### **III. The FDIC has not provided sufficient data to support the changes to the Brokered Deposit Rule, such that it is arbitrary and capricious.**

The proposed rule is vulnerable to a challenge on the grounds that it is arbitrary and capricious.<sup>13</sup> Should a court take this rule under review, the court has the authority and, in fact, must “set aside agency action . . . found to be arbitrary [or] capricious.”<sup>14</sup> To withstand a judicial review for an arbitrary and capricious rule the agency must “examine the relevant data and articulate a satisfactory explanation for its action.”<sup>15</sup> An agency’s explanation for the action taken must include a “rational connection between the facts found and the choice made.”<sup>16</sup> The Administrative Procedures Act will not allow a court to accept an agency’s action where there are no findings of fact and no analysis, as the “agency must cogently explain why it has exercised its discretion in a given manner.”<sup>17</sup>

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<sup>11</sup> Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68244 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337).

<sup>12</sup> *Id.*

<sup>13</sup> See *Statement by Jonathan McKernan, Director, FDIC, Board of Directors, on the Proposed Brokered Deposit Restrictions*, FDIC (July 30, 2024), <https://www.fdic.gov/news/speeches/2024/statement-jonathan-mckernan-director-fdic-board-directors-proposed-brokered> (criticizing the agency’s proposed rule for putting forth insufficient data and failing to “make a case for its rulemains.”).

<sup>14</sup> 5 U.S.C. § 706(2)(A).

<sup>15</sup> *F.C.C. v Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009) (quotation marks omitted).

<sup>16</sup> *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quotation marks omitted).

<sup>17</sup> *Id.* at 48.

Here, the FDIC posits the reason for these changes is due to the FDIC’s belief that many IDIs, after FDIC guidance was offered, are misunderstanding or misreporting Brokered Deposits as a result of the language within the 2020 rule.<sup>18</sup> The FDIC reasons these actions could lead to an increased risk to IDIs and the Deposit Insurance Fund (“DIF”).<sup>19</sup> In each of these instances the FDIC fails to identify any statistical information to support these propositions. Instead of referencing the number of questions submitted to the agency concerning the reporting of brokered deposits or identifying specific instances where a brokered deposit was misreported, the FDIC simply cites to the regulation that requires tan IDI to report brokered deposits.<sup>20</sup>

Likewise, the FDIC repeats the mantra that brokered deposits, by their very nature, create a greater risk the IDI will fail, thus putting strain on the FDIC to find a purchaser and draining the DIF, with no current data to support this proposition.<sup>21</sup> However, the recent failure of Silvergate Bank turns the proposition that brokered

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<sup>18</sup> Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68245 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 68245, 68250-51 (stating that FDIC experiences some IDIs misreporting or misapplying the requirements for reporting brokered deposits without providing information to support this claim).

<sup>21</sup> *See, e.g.*, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68244-45 , 68250-52, 68255 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337) (referencing instances where the FDIC “believes” or has “past experiences” that justify the need for these regulations without revealing any cited information to identify these “belie[fs]” and “past experiences.”); *see also*, Patrick Haggerty, *Brokered Deposit Growth at Banks: Is This a Flashing Yellow Light?*, THE FINANCIAL BRAND (Sept. 25, 2023), <https://thefinancialbrand.com/news/banking-trends-strategies/brokered-deposit-growth-at-banks-is-this-a-flashing-yellow-light-169240/> (summarizing the primary argument relied on by the FDIC as “brokered deposits are generally less valuable to would-be acquirers . . . , as a result, banks with meaningful amounts of brokered deposits that find themselves under severe stress are less likely to be acquired and thereby avoid failure [and] . . . once they do fail, the ability of the FDIC to find a purchaser is similarly diminished without a purchase price concession.”).

deposits are less “sticky” on its head, as an analysis showed the brokered CDs were extremely sticky as depositors that had no relationship with the bank kept their money with the IDI because of the penalties for early withdrawal.<sup>22</sup> Instead of relying on data and facts the FDIC seems to rely on a series of hypotheticals and thought exercises in a misguided attempt to justify the need for a complete overhaul of the previous rule.<sup>23</sup> Indeed, the FDIC’s reasoning is just that, a series of hypotheticals with no “rational connection” to any facts or data to support them and no “cogent[] [explanation] why it has exercised its discretion.”<sup>24</sup>

Throughout the proposal, the only clear past experiences referenced by the FDIC are disproportionate outliers cherry picked to justify these broad and sweeping changes.<sup>25</sup> From the period of 2007 to 2017 only 47, roughly 8.8%, of

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<sup>22</sup> FDIC, Remarks by FDIC Vice Chairman Travis Hill at the Cato Institute on “Insights on the FDIC's Agenda” (Sept. 21, 2023), <https://www.fdic.gov/news/speeches/2023/spsept2123.html> (stating that “more than 98% of the bank’s non-brokered deposits had a run off” when the bank announced plans to self-liquidate, but the brokered deposits remained and were “virtually frozen in place.”).

<sup>23</sup> *Statement of Martin J. Gruenberg, Chairman Federal Deposit Insurance Corporation [sic] on the Notice of Proposed Rulemaking on Brokered Deposits*, FDIC (July 30, 2024), <https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corporation> (“For example, under the current rule any third party may immediately invoke a primary purpose exception from being considered a “deposit broker” by submitting a notice indicating that it places less than 25 percent of customer assets under administration, for a particular business line, at more than one bank (“25 percent test”).”).

<sup>24</sup> *See, e.g., Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*, 89 Fed. Reg. 68245 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337) (explaining attempts to make broad sweeping changes, such as changing the “25% exception” to 10% with the simple and flat statement that “FDIC staff is concerned that less than well-capitalized IDIs may seek these exclusive deposit placement arrangements as their condition is deteriorating without being subject to the limitations on brokered deposits, even though the risk is the same.”) *Id.* at 68256 (explaining that a reduction from 25% to 10% is, in the FDIC’s opinion alone, more indicative that third party’s primary purpose is not the placement of deposits); *see Motor Vehicle Mfrs. Ass’n of U.S., Inc. v State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48 (1983) (quotation marks omitted).

<sup>25</sup> *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions*, 89 Fed. Reg. 68246 (proposed Aug. 23, 2024) (to be codified at 12 C.F.R. pts. 303, 337).

the 530 IDIs that failed relied on brokered deposits.<sup>26</sup> While these IDIs did account for roughly 27.3 billion dollars, roughly 38%, of the total losses to the DIF, two IDIs, holding a large amount of brokered deposits when they failed, accounted for roughly 47% of the 27.3 billion dollars lost.<sup>27</sup> These examples plucked out of the weeds are clear sampling errors bordering on sampling bias, as the FDIC makes no further effort to analyze the other 45 IDIs that engaged in the use of brokered deposits, nor does it attempt to address the much larger problem that 483 IDIs failed absent brokered deposits.<sup>28</sup> If anything, these examples should direct the FDIC's attention away from brokered deposits as they did not account for 91% of the bank failures from 2007 to 2017.

Lastly, the FDIC has not properly evaluated the costs and impact these changes will have on the IDIs it oversees, the businesses that rely on these IDIs, or the people that need these IDIs.<sup>29</sup> The FDIC does not provide any data to assess the cost of additional reporting, the number of IDIs that will be re-classified, the potential increase in insurance costs, or negative impact this will have on smaller IDI's ability to provide funding to their communities.<sup>30</sup> This runs afoul of

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<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *See id.*

<sup>29</sup> *See id.* at 68259; see Brian Graham, *The FDIC Should Avoid a Fact-Free Debate on Brokered Deposits*, American Banker (Sept. 10, 2024) <https://www.americanbanker.com/opinion/the-fdic-should-avoid-a-fact-free-debate-on-brokered-deposits> (discussing the rapidly changing environment and varying deposit mechanisms the FDIC seemingly has not investigated or considered in its latest rule proposal).

<sup>30</sup> *See id.* at 68259-65 (repeating the fact that the "FDIC does not possess the data" to adequately evaluate the costs imposed on the institutions the FDIC oversees); Yizhu Wang, *FDIC's Brokered Deposit Proposal Expected to Face Industry Pushback*, S&P Global (Aug. 21, 2024), <https://www.spglobal.com/marketintelligence/en/news->

Executive Order 12866, as the FDIC does not supply the data to properly consider the costs and benefits associated with the proposed rule that is required by Executive Order 12866.<sup>31</sup> If it truly desires to implement these changes and avoid a future judicial challenge, then the FDIC must support its propositions with data reported to it and apply a rational analysis to clearly show the agency engaged in reasonable decision making.

#### **IV. Recommendations**

Should the agency not withdraw the proposed rule, the agency must perform its duties required by the APA and Executive Order 12866. The FDIC should engage in data collection and take the time to properly analyze the information reported to it by the IDIs it oversees to determine if there is a need for these broad sweeping changes and evaluate alternative methods before enacting a new rule. The FDIC can request the IDIs it oversees and that report information to the FDIC to provide the agency with the necessary documents and information so that it can update its study and analyze the trends to determine if the rule is necessary and how it should be implemented. With no data to support its decisions the agency's action cannot be properly evaluated by the public or interested parties within the market.

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insights/latest-news-headlines/fdic-s-brokered-deposit-proposal-expected-to-face-industry-pushback-82943391 (discussing the outdated data and "hastened process").

<sup>31</sup> Executive Order 12866, 58 Fed. Reg. 51375 (Oct. 4, 1993).



Additionally, the agency should provide an exemption for exclusive arrangements. The agency actively seeks to take away the potential market control mechanism of exclusive arrangements without determining whether or not these exclusive arrangements between third party brokerage firms and IDIs are capable of eliminating the past century's concerns about brokered deposits. An exclusive deposit placement arrangement would likely mitigate, if not eliminate, the risks the FDIC believes are propagated by an IDI's use of brokered deposits. Through an exclusive arrangement a deposit broker would be contractually obligated to only place deposits with a specific IDI and would not be able to transfer those deposits elsewhere without violating the contract. Much like the case of Silverbank, an exclusive arrangement would likely render the brokered deposits "virtually frozen in place."<sup>32</sup>

Lastly, the FDIC must clarify the language for fee arrangements or make an private citizens exception. The proposed language would classify a private citizen as a deposit broker if the IDI "pays the person a fee or provides other remuneration in exchange for or related to the placement of deposits." As this is written, it appears any American citizen that receives a referral program bonus, a common practice where IDIs provide current customers with a small cash deposit when the

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<sup>32</sup> FDIC, Remarks by FDIC Vice Chairman Travis Hill at the Cato Institute on "Insights on the FDIC's Agenda" (Sept. 21, 2023), <https://www.fdic.gov/news/speeches/2023/spsept2123.html>.

current customer encourages a friend or family member to open a deposit account with that IDI, would be a deposit broker.<sup>33</sup> Without clarity or a private citizen exception, this would create an incredible reporting burden on the IDI and have a disastrous impact on customers; because, once classified as deposit brokers, these citizens may have to sever ties with their IDI, as the IDI may not be able to legally do business with them as a deposit broker, if it is not well-capitalized.

## **V. Conclusion**

This commentor strongly suggests the FDIC withdraw this proposed rule until the agency has adequate data to fully comply with, not only the requirements set out in the Administrative Procedures Act, but also those required of it by the Executive Office of the United States.<sup>34</sup> Should the FDIC not withdraw the proposed rule the agency must allow for exclusive arrangements to be exempted from the regulation. The agency must also clarify the language in the deposit broker definition to ensure that private citizens engaging in common activities will not be classified as deposit brokers. Thank you, for your consideration of this request.

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<sup>33</sup> See, e.g., *Refer a Friend*, REGIONS BANK, <https://www.regions.com/personal-banking/rewards/refer-a-friend>; *Refer a Friend*, CHASE BANK, <https://accounts.chase.com/raf/landing>; *Refer a Friend*, CB&S BANK, <https://www.cbsbank.com/Refer-A-Friend.aspx>.

<sup>34</sup> See 5 U.S.C. § 706(2)(A); Executive Order 12866, 58 Fed. Reg. 51375 (Oct. 4, 1993).