



Via e-mail

May 2, 2011

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Re: Core and Brokered Deposits Study Mandated by Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Financial Services Roundtable (the “Roundtable”¹) appreciates the opportunity to provide the Federal Deposit Insurance Corporation (the “FDIC”) with comments concerning the Core and Brokered Deposits Study (the “Study”) mandated by Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).² Section 1506 of the Dodd-Frank Act mandates that the FDIC conduct a study to evaluate (i) the definition of “core deposits” for purposes of calculating the insurance premiums of banks, (ii) the potential impact on the Deposit Insurance Fund (“DIF”) of revising the definitions of “brokered deposits” and “core deposits” to better distinguish between them, (iii) the assessment of the differences between core deposits and brokered deposits and their role in the economy and banking sector of the United States, (iv) the potential stimulative effect on local economies of redefining core deposits, and (v) the competitive parity between large and community banks that could result from redefining core deposits.

The Roundtable urges the FDIC to: (i) re-conceptualize how the approach to regulation of brokered deposits in light of the contemporary environment facing insured depository institutions (“IDIs”), (ii) change and upgrade its regulatory treatment of brokered deposits, and (iii) Recognize the stability of deposits arising from long-term relationships between IDIs and affiliated broker-dealers.

At the outset, the Roundtable acknowledges that in certain situations, an IDI may utilize brokered deposits to engage in suboptimal amounts of risk-seeking behavior. In these situations, the FDIC, and the IDIs that pay for the failure of risky IDIs through higher DIF premiums, have a valid basis for seeking regulation of an IDI’s utilization of deposits. As an empirical matter, the Roundtable believes that certain **indicia** are highly correlated with such situations, such as (i) the IDI offering above-market interest rates for brokered deposits, (ii) an IDI relying on “out of network” certificates of deposit to fund itself, and (iii) the IDI being at or near failure. The Roundtable believes that when such **indicia** are present, an IDI’s overreliance on and abuse of brokered deposit funding should indeed be limited under the existing statutory and regulatory framework. The Roundtable requests that when

¹ The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America’s economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

² See <http://www.fdic.gov/regulations/reform/coredeposits.html>.

undertaking the Study, the FDIC seek to distinguish between these situations (situations where an IDI's utilization of "brokered deposits" warrants prudential regulation) and situations where an IDI utilizes deposits in a safe and sound manner and as part of a prudent funding program. In cases where the indicia mentioned above are present, regulation is indeed warranted under the existing brokered deposits framework. It is with respect to situations where such indicia are not present that the Roundtable offers its comments, and believes that a rethinking of the existing framework is warranted.

The Roundtable offers the following additional comments.

I. Brokered Deposits and the Contemporary Environment for Brokered Deposits is Significantly Different

Much of the FDIC's approach to brokered deposit regulation seems to be based on market conditions that existed prior to passage of the Gramm-Leach-Bliley Act (the "GLB Act"). The pre-GLB Act approach to regulation of brokered deposits reflected the concern that brokered deposits were an unstable source of funding for IDIs, meaning that significant amounts of brokered deposits could be removed from an IDI with little or no warning. The Roundtable notes that the events that gave rise to the current statutory and regulatory treatment of brokered deposits occurred with respect to IDIs that had vastly different liability structures than most of today's IDIs.³ This past paradigm seemingly still exercises an influence over the FDIC: as discussed at the March 18th roundtable on brokered deposits, the FDIC seems to assume that IDI excessively relying on brokered deposits necessarily can lead to the institution's failure. The Roundtable believes that although excessive reliance on brokered deposits may be a *symptom* of underlying variables that affect IDI failure rates, such as excessive risk-seeking behavior, there does not seem to be a significant causal relationship between reliance on brokered deposits and IDI failure in the 21st century.⁴

Rather than causing IDI failures, brokered deposits are an essential and often risk-mitigating element of IDI funding strategies. It is clear that the FDIC itself recognizes that the use of brokered deposits is a "legitimate" method of IDI funding.⁵ In the context of its ongoing supervisory relationships with some IDIs, the FDIC in fact seems to recognize that effective use of brokered deposits can help to mitigate the risks associated with normal asset/liability management activities. Indeed, as an empirical matter, the aggregate amount of some categories of brokered deposits actually *increased* during the recent crisis. International regulatory organizations also recognize the legitimacy of brokered deposits as a funding tool. For example, in situations where there is no early withdrawal option, the Basel III Liquidity Coverage Ratio only requires outflows of 10% for term deposits actually maturing within 30 days.

Brokered deposits also have desirable attributes from a safety and soundness perspective. IDIs can and do calibrate brokered deposits to match fund the IDI's asset duration, markedly reducing and for some effectively eliminating the IDI's liquidity risk as well as minimizing interest rate exposure. In certain situations, brokered deposits display safety and soundness-enhancing attributes of callable bonds, such as in cases where a brokered deposit can only be terminated by death or adjudication of incompetence. In all these and other situations, the use of brokered deposits limits, rather than enhances an IDI's risk profile. The Roundtable believes it is appropriate for the FDIC to take into account the risk-reducing function of brokered deposit funding.

³ See, e.g., Christine M. Bradley and Lynn Shibut, *The Liability Structure of FDIC-Insured Institutions: Changes and Implications* (2006).

⁴ See, e.g., Clifford Rossi, *Decomposing the Impact of Brokered Deposits on Bank Failure* (2010).

⁵ See Bradley and Shibut at 5.

The Roundtable also notes that for many IDIs, brokered deposits are quite often used in the context of established, multi-iterative business relationships between the IDI and another entity. As will be discussed in greater detail, certain sources of brokered deposits (such as deposits brokered through an individual customer's relationship with an affiliated broker-dealer, an exclusive insurance agent, or an unaffiliated insurance agent) often come from customers that have established relationships with the broker-dealer or agent that are as stable as retail deposit relationships. The Roundtable submits that the Study should recognize the importance of these relationships, as well as the fact that these relationships often give rise to risk-mitigating, rather than risk-enhancing, sources of deposits.

II. FDIC Should Make Updates and Changes to the Regulatory Treatment of Brokered Deposits

The Roundtable believes that with respect to updated regulatory treatment of brokered deposits, the Study should address five key issues.

First, the Study should recognize the relationship between brokered deposits and the FDIC's DIF assessment system.⁶ In this regard, the Study should consider reductions in assessments for IDIs that utilize brokered deposits as part of an asset/liability management program that enhances their safety and soundness.

Second, the Study should recognize that in certain respects, the FDIC has ample flexibility as to how it can address the issue of brokered deposits. For example, the FDIC retains the flexibility to implement changes to the assessment system's treatment of brokered deposits; similarly, the FDIC retains the flexibility to alter its treatment of brokered deposits in the supervisory context. The Roundtable submits that even without modifications to the existing statutory framework, it is still possible for the FDIC to exercise its discretion in a manner that properly addresses IDI utilization of brokered deposits.

Third, the Study should recognize that brokered deposits may be re-classified based on the duration of the account relationship. After a set period of time, if deposits arising from sweeps or referrals have remained with an IDI, those deposits should no longer be classified as brokered deposits. Similarly, if new funds are added to a deposit account that was originally funded by sweeps or referrals but has remained with the IDI for a set period of time, the new funds should not be treated as brokered.

Fourth, the Study should clarify that non-retail sources of deposit funding that are demonstrably "sticky" should not be treated as brokered deposits. The Roundtable further believes that the "stickiness" of a deposit can be demonstrated by looking to, *inter alia*, (i) the aggregate average duration of the account relationship between the specific IDI and all accounts of the type in question (*e.g.*, the average duration of the broker-dealer sweep or other referral accounts utilized as a source of sweep deposits by the specific IDI), (ii) the duration of the individual account relationship (*e.g.*, after a set period of time, if deposits arising from sweeps or referrals have remained with an IDI, those deposits should no longer be classified as brokered),⁷ and (iii) the amount of time that the funds have been deposited with the IDI (*e.g.*, once a deposit has stayed with an IDI for a year, it should no longer be viewed as brokered).

⁶ See 76 Fed. Reg. 10,672 (Feb. 25, 2011).

⁷ Similarly, if new funds are added to a deposit account that was originally funded by sweeps or referrals but has remained with the IDI for a set period of time, the new funds should not be treated as brokered.

Fifth, the Study should recognize the stability of brokered deposits that arise from established referral relationships. These referral relationships can be one-way or cross-referral relationships. Specific types of referral relationships include, but are not limited to, deposits referred by an IDI's affiliate and deposits referred by an agent of the IDI's affiliate (including insurance agents). Because whether a source of deposits is "referred" often provides little or no information about the risk characteristics of the deposit, the fact that a deposit is referred (whether the referral is compensated or uncompensated) should not determine whether the deposits that result from the referral are treated as brokered.

III. Sweeps and Transfer Transactions from Broker-Dealers Are Not Brokered Deposits

The Roundtable believes that brokered deposits arising from relationships between an IDI and an affiliated broker-dealer deserves in-depth analysis. Brokered deposits arising from an IDI's relationship with an affiliated broker-dealer are currently analyzed under the "primary purpose" exception established under the FDIC's interpretive precedent.⁸ This interpretive precedent has been influenced by the pre-GLB Act paradigm, where IDIs and brokers often existed as part of separate corporate structures, making it less likely that a customer would do business with an IDI that had an affiliated broker-dealer. In the post-GLB Act world, where many large IDIs have a single, interstate IDI and a broker-dealer affiliate, some of the FDIC's existing interpretive precedent seem grounded in market realities of the past.⁹

The Roundtable strongly believes that deposits arising from sweep or transfer transactions between an IDI and its affiliated broker-dealers are not brokered deposits, for the following reasons. First, because employees of an IDI's affiliated broker-dealer have little or no incentive to drive customers of the IDI to open deposit accounts at an IDI other than the affiliate, customers are more likely to be loyal to, and hence more likely to do business with the IDI and its affiliated broker-dealer.

Second, because deposits arising from sweep transactions represent funds from consistent and stable clients of a broker, the deposits are stable, not volatile. In some cases, the average age of deposit accounts arising from an IDI's affiliated broker-dealer is ten years, indicating a stable and non-volatile customer relationship. Indeed, the attrition rate for customers who have a deposit account in the context of an established broker-dealer relationship is often *lower* than the attrition rate with respect to "normal" retail deposit relationships.

Third, sweeps from affiliated broker dealers arise in the context of broad product offerings to the customer. Sweep arrangements are often provided for the convenience of a customer that has an established relationship with the affiliated broker-dealer, IDI and other entities in a company's structure. These established relationships often encompass a variety of product offerings. Because the sweep arrangement arise in the context of multiple product offerings, the customer's loyalty to the institution is often stronger than would otherwise be the case if the customer's relationship with the IDI was restricted to an individual deposit account. Thus, the FDIC's concerns with brokered deposits and deposit volatility are significantly diminished in this context.

Fourth, IDIs do not pay above-market rates with respect to deposits arising from sweep arrangements. This fact mitigates any "hot money" concerns with respect to these types of brokered deposits. Unlike historical situations where IDIs offered interest rates significantly above market in

⁸ See FDIC Interpretive Letter 05-02 (Feb. 3, 2005).

⁹ See, e.g., FDIC Interpretive Letter 92-68 (Oct. 21, 1992).

order to attract deposits, sweep-based accounts offer rates that are generally in line with existing market conditions.

Fifth, large IDIs that utilize sweep arrangements are not dependent on such arrangements as a principal source of funding. During the recent crisis, the FDIC focused on whether risky IDIs were dependent on “non-core” brokered deposits for liquidity as a principal source of funding. Because sweep arrangements do not constitute a significant source of funding for many large IDIs, the Study’s treatment of brokered deposits at large IDIs that arise from sweep arrangements should recognize this fact.

As discussed, the Roundtable does not believe that changes to the existing statutory framework are necessary to treat deposits from sweep and transfer accounts as non-brokered. As a historical matter, the FDIC has interpreted the “primary purpose” exception to avoid classifying non-volatile deposits as brokered.¹⁰ The FDIC should recognize that deposits from an IDI’s affiliated broker-dealer display many of the positive attributes of “stable” deposits (such as high retention rates) and few if any of the negative attributes of “unstable” deposits (such as excessive risk-seeking behavior on the part of the IDI), and the FDIC should align its interpretive guidance with this recognition.

Finally, the Roundtable requests that the Study address the question of fair and consistent enforcement of existing regulation in the broker-dealer context. As noted *supra*, the Roundtable believes that once an account is funded with brokered deposits, deposits arising from the same account *need not* be classified as brokered simply because of initial funding with brokered deposits. Contrary to this sensible approach, the FDIC has suggested that in certain cases an account funded with brokered deposits must *always* be accounted for as a brokered deposit, notwithstanding the inflow and outflow of funds from the account. The Roundtable believes that the FDIC’s approach in these instances may be at odds with its own interpretations,¹¹ and thus the Roundtable requests that the FDIC utilize the Study to clarify that its supervisory approach with respect to brokered deposits will be implemented in a fair and consistent manner.

IV. Conclusion

The Roundtable believes that the Study offers an important opportunity for the FDIC and IDIs that utilize brokered deposits to engage in a dialogue about what statutory, regulatory and supervisory regime is best suited for contemporary economic reality. The markets for IDI funding, and IDIs themselves, have changed significantly since the events that gave rise to the statutory and regulatory framework currently applicable to brokered deposits. The Study should be informed by this new market reality, especially with respect to the established and stable relationships that exist between customers and IDIs that are part of a structure with non-IDI affiliates.

¹⁰ See FDIC Interpretive Letter 92-91 (Dec. 14, 1992) (determining that an automated clearing house is not a deposit broker when it acts as a conduit for customers to move money between accounts); See also FDIC Interpretive Letters 93-30 and 93-31 (noting that certain “affinity groups” are not considered deposit brokers based on analysis of criteria such as (i) the exclusivity of the relationship, (ii) little or no compensation paid by the IDI for a referral, and (iii) high retention rates associated with the relationship).

¹¹ See FDIC Interpretive Letter 92-69 (Oct. 23, 1992) (determining that a troubled IDI’s renewal of certificates of deposit acquired through a broker did not result in brokered deposits because (i) the broker was no longer involved in the transaction, (ii) the customer had to request or acquiesce to the renewal directly and (iii) the certificates of deposit were styled in the name of the customer instead of the broker).

The Roundtable thanks the FDIC for inviting comments on the Study, and welcomes the opportunity to comment. If you have any questions, please do not hesitate to contact Brian Tate at (202) 289-4322.

Sincerely,

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