CENTER FOR CAPITAL MARKETS COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber.com

May 7, 2019

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions – Document Number 2018-28273, RIN 3064–AE94 (FDIC)

Dear Secretary Feldman:

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) appreciates the opportunity to respond to the Federal Deposit Insurance Corporation's ("FDIC") Advanced Notice of Proposed Rulemaking on Unsafe and Unfound Banking Practices: Brokered Deposits and Interest Rate Restrictions (the "ANPR").

The ANPR is an important step for modernizing the regulatory treatment of brokered deposits. The definition of "deposit broker" was adopted when the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") was signed into law. Two years later, the Federal Deposit Insurance Corporation Improvement Act of 1991 was adopted, which amended the threshold for the brokered deposit and interest rate restrictions from a trouble institution to a bank falling below the "well capitalized" Prompt Corrective Action ("PCA") level. The stated objective of the ANPR is to "obtain input from the public as the FDIC comprehensively reviews its brokered deposit and interest rate regulations in light of significant changes in technology, business models, and the economic environments, and products since the regulations were adopted."

The purpose of restrictions on high-rate deposits and brokered deposits is to inhibit banks' rapid growth in risky assets and their ability to fund further such expansion to "grow out" out of their problems. Additionally, these deposits could be

more volatile if customers withdrew funds to achieve higher interest rates at another bank in a manner that creates liquidity issues. However, as the ANPR notes, "historically, most institutions that use brokered and higher-rate deposits have done so in a prudent manner and appropriately measure, monitor, and control risks associated with brokered deposits." Therefore, such restrictions are inappropriate for well capitalized institutions.

The Chamber recommends the FDIC update regulations related to sweep deposit accounts and prepaid cards in ways that take into account the growing role of these products in the financial system.

Growth of Sweep Deposits

Background

Broker-dealers affiliated with insured depository institutions oftentimes provide a "sweep account" service to their customers. The broker-dealer automatically sweeps a certain amount of otherwise idle customer cash into a interest-bearing product such as a money market deposit account at the affiliated insured depository institution. Such services are a convenient way for consumers to help maximize return on their otherwise idle funds and to receive the benefit of FDIC insurance which is not available for free cash held in a brokerage account. The primary purpose of this service is to assist customers with managing cash for the transaction of securities through the broker-dealer.

Deposit account sweep programs offered by brokers to their clients are an important market development since the regulatory regime for brokered deposits was established. Sweep programs provide an important benefit to consumers, and are a demonstrated stable source of funding for insured depository institutions. However, sweep deposits are currently subject to inefficient regulatory uncertainty that could inhibit the availability of this benefit provided to consumers.

The Federal Deposit Insurance Act does not define brokered deposit. However, it does define "deposit broker" to include: 1) Any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties; and, 2) An agent or trustee who establishes a deposit account to facilitate a

business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan. This definition of "deposit broker," and thus "brokered deposits," is subject to nine statutory exceptions and an additional exceptions defined by the FDIC.

Sweep deposits could be treated as "brokered deposits" if not eligible for an exception. A number of institutions that offer sweep deposits currently rely on the "primary purpose" exception which includes "an agent or nominee whose primary purpose is not the placement of funds with depository institutions." This is appropriate given the intent of sweep accounts is to provide a service to customers, not to obtain a primary source of financing for the financial institution.

The FDIC should provide more certainty regarding the treatment of sweep deposits as brokered deposits by:

- Issuing regulations that generally exempt affiliated sweep deposits from the definition of brokered deposits; or,
- By no longer imposing arbitrary conditions on banks and their affiliated broker-dealers applying for the primary purpose exception.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") amended the threshold for the brokered deposit and interest rate restrictions from a troubled institution to a bank falling below the "well capitalized" level in the PCA framework. The FDIC was also authorized to waive the brokered deposit restrictions for a bank that is adequately capitalized upon a finding that the acceptance of such deposits does not constitute an unsafe or unsound practice with respect to the institution.

The Chamber appreciates affirmation of the primary purpose exceptions for sweep deposits swept from affiliated brokerage firms described in the FDIC's 2005 Advisory Opinion ("2005 Advisory Opinion").[1] However, it does not provide sufficient clarity or certainty to market participants. The FDIC takes the position in the 2005 Advisory Opinion, and previous advisory opinions, that "primary purpose" means "primary intent," and therefore "applies to an agent who places funds into a depository institution for a substantial purpose other than to obtain deposit insurance coverage for a customer or to provide the customer with a deposit-placement

[1] Federal Deposit Insurance Corporation. Advisory Opinions, "Are funds held in 'Cash Management Accounts' viewed as brokered deposits by the FDIC?" February 3, 2005. Available at https://www.fdic.gov/regulations/laws/rules/4000-10350.html

service." The 2005 Advisory Opinion recognizes the primary purpose of sweep accounts is to facilitate the customers' purchase and sale of securities but imposes a number of inappropriate restrictions in connection with the use of the "primary purpose" exceptions.

In order to qualify for the primary purpose exception, affiliated broker-dealers must comply with a number of arbitrary conditions, including the requirement that brokerage customers' sweep deposits amount to less than 10 percent of their total account assets. Not only is this condition entirely outside the control of a brokerage firm, it operates to potentially force the firm to shift customer cash from FDIC-insured deposit accounts to less secure investments such as money market funds during declines in the stock market when many investors want to increase the cash portions of their investment portfolios. This 10 percent ratio of permissible sweep deposits appears arbitrary and should be eliminated or substantially increased. A brokerage firm's primary intent in placing customer cash with an affiliated bank is not affected by how much sweep deposits customers choose to hold in their brokerage accounts.

The FDIC should issue regulations to provide more certainty to market participants instead of expecting them to rely on advisory opinions. In general, these regulations should make clear that affiliated sweep deposits do not meet the definition of brokered deposits. The FDIC should define a new exception specifically for affiliated sweep deposits, or make clear that the primary purpose exception, without excessive restrictions, is readily available for brokerage firms sweeping customer cash to affiliated depository institutions. It would not appear there are any statutory prohibitions for the FDIC to make such changes. Moreover, affiliated sweep deposits do not pose risks to financial institutions – there is substantial evidence that such funds are "sticky" and tend to increase when the market is under stressed conditions.

Stability of Financing

The FDIC has not justified imposing restrictions on the use of sweep deposits. Sweep deposits received by insured depository institutions from their affiliated broker dealers are stable and have a history as a source of strength to the balance sheet.

In 2011 the FDIC issued a study ("2011 Study") on Core and Brokered Deposits that found deposits from sweep programs to be relatively stable.[2] The 2011

[2] FDIC. Study on Core Deposits and Brokered Deposits (2011), available at https://www.fdic.gov/regulations/reform/coredeposit-study.pdf

Study found that "growing using these deposits has leveled off after an initial growth spurt, apparently constrained by the amount of funds that a customer keeps un-invested and is willing to have placed in the bank." The 2011 Study also notes there is some reason to believe that deposit sweeps from affiliated broker-dealers do not tend to leave for higher rates or during periods of stress. In fact, during the 2008 financial crisis data shows that banks saw a net *inflow* of sweep deposit brokerage customers seeking to avoid market risk.[3] The FDIC has otherwise already recognized through guidance that sweep deposits are stable and should therefore not be subject to restrictions.

The Liquidity Coverage Ratio also recognizes the stability of sweep deposits. In 2014, the federal banking regulators issued a final Liquidity Coverage Ratio (LCR) rule requiring covered depository institutions to hold enough high-quality liquid assets to withstand a net cash outflows over a 30-day stress period. Thus the LCR reduces the amount of long-term assets that can be funded by short-term liabilities. Notably, the LCR recognizes that sweep deposits are more stable than various other types of deposits at banks by subdividing retail brokered deposits into reciprocal brokered deposits, brokered sweep deposits, and all other brokered deposits. For example, brokered sweep deposits that are entirely covered by deposit insurance, and that are deposited in accordance with a contract between a retail customer or counterparty and a covered company, a covered company's consolidated subsidiary, or a company that is a consolidated subsidiary of the same top-tier company (affiliated brokered sweep deposits), are assigned a 10 percent outflow rate.[4] Therefore, there is strong evidence to demonstrate sweep deposits do not represent the characteristics of risky deposits intended to be captured by the restrictions imposed on brokered deposits.

Prepaid Cards Should Fall under the Primary Purpose Exemption

The Chamber appreciates the ANPR's discussion on the use of prepaid cards and the opportunity to provide input. As the Chamber noted in response to the Consumer Financial Protection Bureau's proposed prepaid rule in 2015, "[u]sage has

[3] See generally, comments from The Charles Schwab Corporation. (2014, January 31). Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring [Letter to Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation], available at https://www.federalreserve.gov/SECRS/2014/February/20140226/R-1466/R-1466_013114_111947_335277918335_1.pdf

surged, permitting unbanked and underbanked Americans access to mainstream financial services and, thereby, full participation in an increasingly digital economy."[5] Prepaid cards are used for a wide variety of purposes and facilitate economic inclusion and smart financial choices. Notably, prepaid cards have provided a new means for economic inclusion for individuals who are not able to access the interbank payment system through the use of a credit card or a debit card linked to a checking account.

Turning to the issue raised in the ANPR, we believe prepaid cards should be eligible for the primary purpose exception. As the ANPR notes, some have argued that the primary purpose of a prepaid card company "is not to provide the cardholders with a deposit-placement service, but to enable the cardholders to make purchases through the interbank payment system." The Chamber agrees with this characterization of the relationship between the prepaid card company and the insured depository institution to facilitate the receipt and making of payments by consumers.

Moreover, much like sweep deposits, prepaid card funds received by insured depository institutions are a source of stability for the institution, given the regulatory requirements that must be satisfied under the Bank Merger Act before such deposits may be moved to a new depository institution, including the need to receive written approval from the primary regulator. Thus, it is not appropriate to view these deposits as being equivalent to the "hot money" that the deposit broker provisions in FIRREA were intended to address.

The ANPR notes that the FDIC generally has not viewed prepaid card companies as meeting the primary purpose exception. However, staff at the FDIC has not distinguished between acting with the purpose of placing deposits for other parties from acting with the purpose of enabling other parties to use deposits to make purchases. Nor has the FDIC meaningfully distinguished between prepaid card funds held on behalf of a program administered by a program manager from prepaid card funds that are held on behalf of a government benefit program or that are held for the depository institution's own program. The Chamber encourages the FDIC to conclude that prepaid cards should be eligible for the primary purpose exception regardless of the program administrator or the purpose of the program because these

[5] Comments from U.S. Chamber of Commerce Center for Capital Markets Competiveness. Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), Docket No. CFPB-2014-0031 [Letter to Consumer Financial Protection Bureau]. (2015, March 23), available at https://centerforcap.wpengine.com/wp-content/uploads/2015/03/2015-3.23-CFPB-Prepaid-Comment-Letter.pdf

instances do not generate the concerns contemplated by the deposit broker provisions.

Closing

We appreciate the FDIC revisiting the regulation of brokered deposits and the attention the ANPR provides to clarifying the treatment of deposit sweep programs and prepaid cards. We believe additional clarification requested in our letter will benefit both consumers and our capital markets.

Sincerely,

Tom Quaadman