REICH & TANG

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June 9, 2020

By Email to comments@fdic.gov
Mr. Robert E. Feldman
Executive Secretary
Attn: Comments
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, DC 20429

Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (RIN 3064-AE94)

Dear Mr. Feldman:

Reich & Tang Deposit Networks appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") Notice of Proposed Rulemaking to revise its brokered deposit regulations ("Proposed Rule"). We commend the FDIC's effort to modernize rules that were developed approximately 30 years ago.

Many thoughtful letters have already been submitted reviewing and commenting on many of the important aspects of the Proposed Rule. We understand that the Proposed Rule is intended to further the goals articulated by Chairman McWilliams to factor in the new technological innovations that did not exist 30 years ago and to minimize risk to the Deposit Insurance Fund. We are focused on the treatment of sweep deposits from broker-dealer sweep programs[1] in light of the proposed "facilitation prong," and the treatment of deposits placed at IDIs by entities that provide services similar to those provided by broker-dealers. We are also focused on the issue of whether deposits that are not brokered must be reclassified as brokered solely because they participate in a bank deposit network.

As further discussed below, we believe that the Proposed Rule (i) will disadvantage community banks, (ii) will perpetuate an un-level playing field for similarly situated market participants, and (iii) will fail to safeguard IDIs by not focusing on the importance of the IDI-customer relationship, but rather on the existence of an administrator.

Several of the letters already submitted have addressed these issues in a very thorough manner and reach conclusions with which we are in general agreement. With respect to the effect of the facilitation prong on the treatment of broker-dealer sweep programs, we are notably in agreement with letters submitted by Total Financial Solutions dba Total Bank Solutions (May 13, 2020), The Securities Industry and Financial Markets Association (April 10, 2002), and Credit Karma (April 14, 2020).

[1] "Sweep program" is defined in 17 C.F.R. § 240.15c3-3(a)(17).

In part as a supplement to these letters, we are writing to share certain information learned from the US rules that implemented the Basel III liquidity coverage ratio ("LCR") and the introduction of the limited exception for reciprocal deposits provided in Section 29 of the Federal Deposit Insurance Act ("FDI Act," 12 U.S.C. § 1831f) and the FDIC implementing regulations (12 C.F.R. § 337.6(e)).

Reich & Tang Deposit Networks

Reich & Tang has been dedicated to administering sweep programs for financial intermediaries and institutional investment entities since 1974, initially using proprietary money market funds. Since 2015, Reich & Tang has been focused solely on administering IDI sweep programs.

Reich & Tang is a leading provider of administration services for sweep programs offered by broker-dealers. Reich & Tang administers these sweep programs in accordance with FINRA guidelines and broker-dealer custody rules, which require, among other things, the creation of separate bank networks for the exclusive benefit of each sponsoring broker-dealer's customers.

Through the Demand Deposit Marketplace℠ ("DDM") program, Reich & Tang makes available a bank deposit network with more than 250 participating financial institutions that place deposits into more than 170 IDIs. Each participating financial institution in DDM places funds into existing agency accounts under the control of the DDM program custodian. Through sweep programs and the DDM program, we are able to provide access to billions of dollars in stable funding for IDIs, from community banks to the largest IDIs.

RECOMMENDATIONS

1. *THE FACILITATION PRONG SHOULD NOT BE USED TO PREVENT COMMUNITY BANKS FROM TREATING DEPOSITS FROM BANK SWEEP PROGRAMS AS NON-BROKERED.*

We appreciate the FDIC's proposal to exempt firms that meet the proposed "less than 25%" test from being considered a deposit broker. We expect that broker-dealers would not be treated as deposit brokers based on this test. However, if a broker-dealer engages an administrator to assist with its implementation or operation of its sweep program, the definition of "facilitation" under the Proposed Rule proposal would require that the sweep funds be considered brokered. Accordingly, the Proposed Rule will fail to assist community banks in their efforts to obtain a source of stable deposits.

Sweep program funds are considered to be a source of stable deposits. In 2014, US regulators finalized the rules implementing the LCR rules. During that rulemaking process, regulators concluded that sweep program deposits should be treated as "relatively stable," with only a 10% to 25% run-off rate presumption.[2] Once the LCR rules were finalized, sweep deposits became sought after by the largest IDIs, which viewed sweep deposits as more attractive funding than wholesale deposits. The largest IDIs acted quickly to replace wholesale deposits, such as broker dealer free credit balances (Rule 15c3-3(e) deposits)—a less stable deposit[3]—with sweep deposits. Since 2014 we have seen a significant change in this marketplace, with the largest IDIs coming to dominate the sweep program deposit space.

[2] 12 C.F.R. §§ 50.32(g)(7) and (g)(8).

[3] Run off rates for free credit balances are 100%. *See* 12 C.F.R. § 50.32(h)(5).

Community banks did not benefit from the recognition of sweep deposits as stable deposits. Instead, as IDIs reduced the amount of broker-dealer free credit balances, community banks absorbed them. The groundwork for this transition had been laid two decades earlier by the 1994 FDIC Interpretive letter that allows IDIs to treat free credit balances as non-brokered.[4] Thus, community banks received less stable funding, while large IDIs received more stable funding. We believe that the Rule Proposal presents an opportunity to remedy this situation and level the playing field.

With their much larger balance sheets and much greater access to alternative funding sources, large IDIs are less sensitive to the classification of deposits as brokered. Large IDIs have plenty of balance sheet runway to capture the vast majority of the sweep deposit marketplace. Conversely, community banks are more sensitive to the classification of deposits as brokered due to their much smaller balance sheets and the perceived risk when brokered deposits exceed 10% (or thereabouts) of total deposits.[5] As a result, even with the recognition of sweep deposits as "relatively stable," community banks were unable to compete with large IDIs.

Unfortunately, in its current form the Proposed Rule likely will not assist community banks. With plenty of demand from larger IDIs, broker-dealers have no incentive to change their operating models to "insource" the work currently being performed by sweep program administrators. If the Proposed Rule is finalized in its current form, community banks will remain on the outside looking in.

The Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act") changed the treatment of certain reciprocal deposits under 12 U.S.C. § 1831f even though Congress recognized that a third-party administrator was involved in the placement of the funds within a bank deposit network. The FDIC should follow Congress' lead in this respect. Like reciprocal deposits, the involvement of a facilitator in the placement of sweep deposits does not change the character of the sweep deposits. We do not believe that the engagement of a third-party administrator by a broker-dealer impacts the stability of sweep deposits.

Accordingly, to strengthen community banks and permit them to acquire more stable deposits, the FDIC should either (i) substantially modify the facilitation prong to assess the stability of a deposit source, rather than the use of a third-party administrator, to determine the status of deposits, or (ii) provide a narrow exception to the facilitation definition to permit broker-dealers to engage an administrator without causing sweep deposits to be classified as brokered.

2. *TRUST COMPANIES AND CUSTODIANS SHOULD BE AFFORDED TREATMENT SIMILAR TO THAT OF BROKER-DEALERS DESPITE DIFFERENT REGULATORY FRAMEWORKS:*

As described above, we believe that broker-dealer sweep deposits should not be treated as brokered regardless of whether an administrator is engaged. Other entities occupy positions similar to

[4] FDIC Advisory Opinion No. 94-39, *Brokered Deposits: Are Funds Deposited in a Special Reserve Bank Account for the Exclusive Benefit of Customers Brokered Deposits Under Sections 29 and 29A of the FDI Act* (Aug, 17,1994).
[5] Due to regulatory concerns, we note that community banks typically establish a limit on the amount of brokered deposits they will accept.

that of broker-dealers and, therefore, should be afforded similar treatment. While they exist within different regulatory frameworks than broker-dealers, trust companies and custodial entities can provide funding for IDIs that is similar in character to that of sweep programs. The nature of the funds held by these entities includes money held in trust for individuals and funds held in retirement accounts. Funds available from these entities are similar or identical to the composition of sweep program funds. However, in most cases these entities would engage an administrator directly or participate in an existing bank network that is administered by a firm, such as Reich & Tang, to assist it in sourcing and placing funds at such IDIs (among other administrative tasks). Assuming that these entities would meet the threshold "less than 25%" test, we believe that the "sweep funds" of customers of these entities also would provide a source of stable funding for IDIs. We do not believe that these deposits should be classified as brokered simply because the trust entity or custodian engages an administrator either directly or through participating in a bank network.[6]

As previously stated, when Congress passed the Economic Growth Act, the treatment of reciprocal deposits changed—within certain parameters. Within these parameters, reciprocal deposits are no longer considered brokered even though placement involves an administrator whose activities on a stand-alone basis under current guidance would be considered a deposit broker. In other words, the involvement of a deposit broker by itself does not demand a wholesale change in the character of these deposits.

Prior to the enactment of the Economic Growth Act, the FDIC recognized that distinctions were appropriate among different forms of brokered deposits. In the final rule release on Assessments in 2009, the FDIC stated that that reciprocal deposits "may be more stable source of funding for healthy banks than other types of brokered deposits and that they may not be as readily used to fund rapid asset growth."[7]

Following Congress's lead, and as it did with reciprocal deposits, the FDIC should take into account the nature of deposits when determining whether to characterize such deposits as brokered. Accordingly, in its consideration of the Proposed Rule, including its potential effects on community banks, we urge the FDIC to avoid a "one-size fits all approach" currently required by the facilitation prong and, instead, consider the nature (and stability) of the funds to be placed at IDIs, whether derived from sweep programs, trust companies or custodians.

3. *RECIPROCAL DEPOSITS HAVE FLOURISHED DUE TO NON-BROKER CLASSIFICATION, ALLOWING COMMUNITY BANKS TO COMPETE EFFECTIVELY WITH THE LARGEST BANKS FOR STABLE, RELATIONSHIP-DRIVEN DEPOSITS. RELATIONSHIP-BASED DEPOSITS PLACED THROUGH A SOURCE*

[6] In connection with trust department and trust company funds, the FDIC should rescind Advisory Opinion 92-51 to the extent it requires treatment of funds as brokered if a trust department or trust company accepts a fee in connection with the sweep. We note that trustees owe a fiduciary duty to the trust.
[7] 74 FR 9525 (Mar. 4, 2009) at 9532.

<u>BANK TO A BANK DEPOSIT NETWORK SHOULD BE ACCORDED TREATMENT SIMILAR TO RECIPROCAL DEPOSITS FOR THE BANKS RECEIVING SUCH DEPOSITS:</u>

Many IDIs that partner with fin-tech companies and other firms have multi-faceted relationships with such entities. The relationships may encompass bill payment services, lending, and placement of deposits. Some aspects of the relationship may be outsourced to other vendors under the direction and oversight of the IDI. For placement of savings, efficiencies can be achieved when a bank deposit network facilitates the allocation of deposits to IDIs that need such deposits.

Frequently, the IDI at which the deposits are made (i.e., the "Source Bank") does not need additional deposits or it prefers to manage its concentration risk by transmitting deposits to another IDI through a bank deposit network. Bank deposit networks, like the one provided by our DDM program, can include hundreds of IDIs that receive deposits based upon a non-discretionary allocation model tied to each IDI's desired level of deposits.[8] The rates available through bank deposit networks generally track the Fed Funds Rate. For IDI customers, the primary benefit of these networks is the maximization of FDIC insurance through the placement of funds with multiple IDIs. The source of funds to an IDI from the DDM program is fully transparent to IDIs that receive deposits, including, if needed in the future, whether the source of funds has been exempted from the definition of deposit broker.

If deposits are not considered brokered at the Source Bank, we do not believe that they should be classified as brokered at the receiving bank because of the depositor's participation in a bank deposit network. The essential nature of the customer relationship remains unchanged and the depositor benefits from maximized FDIC insurance.[9] Again, we note that Congress did not view the use of a third-party administrator of a bank deposit network as "disqualifying" when it permitted non-brokered treatment of reciprocal deposits under the Economic Growth Act.

Accordingly, we recommend that the definition of facilitation be materially modified to permit an IDI network operator that allocates funds based on an objective basis to perform administrative tasks without changing the original character of the deposits.

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[8] A letter from Total Bank Solutions to the FDIC dated May 13, 2020 (p. 8), describes two objective allocation methods ("Distance from Target" and "Waterfall") that are similar to methods used in the DDM program.
[9] We believe that the availability of a bank deposit network increases the stability of deposits placed by large depositors at the Source Bank by permitting the depositor to maximize FDIC insurance.

Conclusion

We sincerely appreciate the FDIC's willingness to modernize the brokered deposit framework, and hope that our recommendations prove useful in moving this project forward. Reich & Tang stands ready and willing to assist the FDIC with respect to any matters in which the FDIC believes perspective of a sweep administrator may prove useful.

Sincerely,

Joseph Jerkovich
EVP and Chief Operating Officer
Reich & Tang Deposit Networks, LLC

Attachment: Appendix A (Additional Information Relating to Reciprocal Deposits)

Appendix A

Additional Information Relating to Reciprocal Deposits

The impact of treating reciprocal deposits as non-brokered has been a significant positive development for community banks across the country. We have heard countless stories about how this change has benefited the stability of deposits at community banks in the DDM program network, and the data bears this out. In 2008, there was a flight to safety from community banks to the large US banks; deposits left the community banks. Reciprocal deposits were at their infancy at that time (2008 and 2009). With these programs now in place, community bank CEOs generally feel that the risk that their large depositors would flee to the "too big to fail banks" during the next crisis has been greatly reduced; and so far through the COVID pandemic this has proven to be the case. Below is a chart that compares the amount of reciprocal deposits at 12/31/2017 to the balance at 3/31/2020 by size of bank as reported on their quarterly call reports:

31-Mar-20

Bank Asset Range	Total Reciprocal Deposits	% of Total	# of Banks	Total Liabilities	% Reciprocal /Liabilities
<$100mm	342,904	0%	70	4,464,845	8%
$100m to $500mm	8,432,285	9%	640	158,247,741	5%
$500mm to $1bn	9,697,666	10%	318	200,397,843	5%
$1bn to $5bn	28,272,362	30%	354	620,333,013	5%
$5bn to $10bn	14,543,772	16%	59	363,040,065	4%
$10bn to $25bn	13,582,512	15%	45	613,485,315	2%
$25bn to $50bn	11,856,414	13%	22	696,488,511	2%
>$50bn	6,063,754	7%	11	3,526,629,425	0%
Total	**92,791,669**	**100%**	**1,519**	**6,183,086,758**	**2%**

31-Dec-17

Bank Asset Range	Total Reciprocal Deposits	% of Total	# of Banks	Total Liabilities	% Reciprocal /Liabilities
<$100mm	241,185	1%	61	3,826,522	6%
$100m to $500mm	5,143,017	12%	462	114,841,482	4%
$500mm to $1bn	6,844,530	16%	223	145,522,251	5%
$1bn to $5bn	14,552,523	35%	226	423,320,317	3%
$5bn to $10bn	6,296,896	15%	40	262,756,821	2%
$10bn to $25bn	6,261,314	15%	25	347,175,478	2%
$25bn to $50bn	2,271,473	5%	12	329,128,005	1%
>$50bn	472,847	1%	6	2,230,582,734	0%
Total	**42,083,785**	**100%**	**1,055**	**3,857,153,610**	**2%**

% Change

Bank Asset Range	Total Reciprocal Deposits	# of Banks
<$100mm	42%	15%
$100m to $500mm	64%	39%
$500mm to $1bn	42%	43%
$1bn to $5bn	94%	57%
$5bn to $10bn	131%	48%
$10bn to $25bn	117%	80%
$25bn to $50bn	422%	83%
>$50bn	1182%	83%
Total	**120%**	**44%**