BankThink Outdated brokered deposit rules need a revamp

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How customers want to interact with their bank and how banks want to serve their customers is worlds apart from nearly 30 years ago when the internet was still in its infancy, mobile phones were a novelty and social media didn't even exist. But some deposit rules have little changed and applying them to today's world is stifling bank innovation and competition to meet evolving customer preferences.

One good example: brokered deposits, a term that the Federal Deposit Insurance Corp. attaches to deposits acquired through the involvement of third parties but that is applied broadly to include a lot of things. Congress created a new law in 1989 designed to limit bank exposure to brokered deposits as they were then used, concerned that deposits that did not originate through a bank's own branches might disappear in times of stress.

However, it was weak institutions that used high-cost funds from money brokers to fuel fast-growing, high-risk loan books that led to Congress and the FDIC's concerns. The solution at the time was to focus on the source of the fuel rather than the loans that went bad. Since then new regulatory guardrails have been installed and updated, helping to manage and mitigate those risks. Yet the rules that were meant to rein in money brokers placing deposits at struggling banks are preventing healthy banks from tapping stable sources of funding that are becoming increasingly more accessible because of new technologies.

While Congress intended for brokered deposit rules to be focused in scope, it casts a much wider net as currently applied to banking in today's world. Banks now rely on affiliates with technological expertise, advertise to customers using social media and compete on different playing fields compared to when the regulations were written. While it seems like commonsense to use these modern channels to accommodate how customers want to bank, they are being swept into the outdated brokered deposit rules and being treated as less stable.

A recent FDIC survey of 35,000 households found that more than 40% of bank customers reported using a mobile device to bank in 2017. That's up from roughly 30% in 2015 and nearly double from when the agency conducted the survey in 2013. To keep pace with the growing demand for mobile access, banks are forming partnerships with technology experts, but those relationships are unnecessarily being stigmatized.

Using social media platforms such as Facebook, Instagram and Twitter to acquire customers is common practice in business, but because a third party is earning a small fee on a finger tap or a mouse click, those platforms may be viewed as deposit brokers, despite those relationships resembling nothing like what was envisioned when the statute was written.

Customers also want to take advantage of a variety of products that banks offer, whether they are money management services, various checking and money transfer tools or a number of other financial conveniences, and they often rely on just one bank for those services. While moving money from one account to another on a bank website is a seamless process for the customer, brokered deposit regulations can identify those relationships very differently.

It's important to note that the tools used for identifying risk have also evolved, more effectively meeting the supervisory purposes for the brokered deposit regulations. Today, banks and regulators alike benefit from more sophisticated programs to identify and manage liquidity and interest rate risk, on top of significantly more robust capital and liquidity supervisory frameworks.

Brokered deposit regulations are also tied to another worsening regulatory problem, the misapplication of the FDIC's national rate cap. American Banker reported last month on the fact that the national rate cap, also decades old, is in need of updating, and how lately it is being applied to healthy banks despite being intended for weaker ones.

Congress and the FDIC should reconsider the relevance of the brokered deposit designation and how it is applied today and make sure that it does not come between customers and how they want to interact with their banks. If not, customers will look somewhere else more accommodating. The alternative providers are already queuing up. While the policy goals that the deposit rules were intended to achieve were appropriate when they were written, they no longer align with modern banking practices that ultimately benefit customers.

It was refreshing to see Congress take a useful step toward updating deposit rules in May when it passed a bipartisan regulatory reform law which recognized that reciprocal deposits are a stable source of funding for community banks and exempted them from the brokered deposit regulations.

Now it’s time for Congress and the FDIC to do more. FDIC Chairman Jelena McWilliams rightly recognized that in September when she announced that the agency would review the overall treatment of brokered deposits. We appreciate McWilliams’ leadership on this issue, and her understanding of the importance of promoting innovation in the banking sector, allowing banks to keep up with how their customers want to be served.

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