May 21, 2009

MEMORANDUM TO: The Board of Directors

FROM: Sandra L. Thompson
Director
Division of Supervision and
Consumer Protection

Michael Bradfield
General Counsel

SUBJECT: Final Rule: Interest Rate Restrictions On Insured Depository Institutions That Are Not Well Capitalized

RECOMMENDATION:

We recommend that the Board of Directors ("Board") adopt a final rule relating to the interest rate restrictions that apply to insured depository institutions that are less than well capitalized. The final rule would amend section 337.6 of the FDIC's regulations (12 C.F.R. § 337.6). The purpose of the final rule would be to provide depository institutions and examiners with a simple method for calculating the interest rate caps. Also, the final rule would more closely align the FDIC's regulation with the statutory intention of preventing institutions that are not well capitalized from paying interest rates on deposits that "significantly exceed" certain market averages.

BACKGROUND:

Under the Federal Deposit Insurance Act, insured depository institutions that are less than well capitalized generally may not pay a rate of interest that significantly exceeds the prevailing rate in the institution's "normal market area" and/or the prevailing rate in the "market area" from which the deposit is accepted. In the case of adequately capitalized institutions with waivers to accept brokered deposits, the institution may not pay a rate of interest on brokered deposits accepted from outside the bank’s “normal market area” that significantly exceeds the “national rate” as defined by the FDIC.

The FDIC has implemented these statutory requirements through section 337.6 of the FDIC’s regulations (12 C.F.R. § 337.6). This section has proved difficult for depository institutions and examiners to apply, and (at present) does not comport with the statutory intention to prevent institutions that are less than well capitalized from paying interest rates on deposits solicited nationally that significantly exceed national averages.

One problem under section 337.6 is that the terms “market area” and “normal market area” could be defined in different ways. For example, these terms could be defined with reference to the locations of a depository institution’s headquarters and branches. In the alternative, these terms could be defined with reference to a depository institution’s marketing practices. At present, the FDIC’s regulations do not define “normal market area.” As a result, bankers and examiners have struggled in determining a bank’s “normal market area.”

Another problem is the definition of the “national rate.” Under the current regulations, the term is defined as follows: “(1) 120 percent of the current yield on similar maturity U.S. Treasury obligations; or (2) In the case of any deposit at least half of which is uninsured, 130 percent of such applicable yield.” 12 C.F.R. § 337.6(b)(2)(ii)(B). Since the adoption of this definition in 1992, the relationship has changed between the yields on Treasury obligations and the interest rates paid by insured depository institutions. As a result, the definition of the “national rate” is outdated.

The final rule would address these problems in two ways. First, the final rule would redefine the “national rate” as “a simple average of rates paid by all insured depository institutions and branches for which data are available.” Decoupling the definition of the “national rate” from the Treasury yield curve would allow the rate cap to be calculated in a way that prevents the payment of rates that significantly exceed prevailing national rates, but would allow depository institutions to pay the prevailing national rates. We note that the FDIC originally chose to couple the definition of the “national rate” to the Treasury yield curve because it was difficult to obtain timely and reliable data on prevailing CD rates. We believe that advances in technology and information availability now make it possible to calculate prevailing national CD rates in a direct and timely manner.

Second, the final rule would create a presumption that the prevailing rate in an institution's local market area is the national rate as defined by the FDIC. This approach recognizes that with the increasing prevalence of Internet deposits and Internet advertising of deposit rates, price competition for deposits has become more national. Moreover, this approach recognizes and avoids the considerable practical difficulties that can exist with trying to ascertain the origin of a deposit and the boundaries of a depository institution's normal market area, and with then calculating the prevailing rates paid within that area.

In implementing the final rule, the FDIC would publish or post the "national rate" on its Web site. In publishing the national rate, the FDIC would publish separate rates for deposits of different amounts and maturities. In addition, the FDIC might publish separate rates for different types of deposit products. For example, the FDIC might publish a rate for NOW accounts and a separate rate for MMDAs.

If a depository institution believes that prevailing deposit rates in its local market area are higher than the national rate published on the FDIC's Web site, the institution will be able to assert that it is operating in a high-rate environment and to provide evidence of such to the appropriate FDIC regional office. In evaluating this evidence, the FDIC may use segmented market rate information (for example, evidence by state, county or "metropolitan statistical area"). Also, the FDIC may consider evidence as to the rates offered by credit unions if the insured depository institution competes directly with credit unions in the particular market. Finally, the FDIC may consider evidence that the rates on certain deposit products (such as NOW accounts) differ from the rates on other products (such as MMDAs).

The final rule is similar to a proposed rule published by the FDIC in February. *See* 74 Fed. Reg. 5904 (February 3, 2009). In response to the proposed rule, the FDIC received 20 comments from insured depository institutions, banking associations and bank service providers. A few of these commenters urged the FDIC to adopt tougher restrictions on insured depository institutions that are not well capitalized. Most of the commenters, however, urged the FDIC to provide insured depository institutions with greater flexibility in offering interest rates.

Under the recommended final rule, as discussed above, an insured depository institution will be given some flexibility in offering rates but the institution will not be allowed to calculate a prevailing rate that is based solely upon the rates offered by a small number of high-rate competitors. Rather, the prevailing rate must represent an average.

The FDIC's authority to restrict interest rates and to restrict the acceptance of brokered deposits by insured depository institutions that are not well capitalized derives from section 29 of the Federal Deposit Insurance Act (12 U.S.C. § 1831f). The legislative history of section 29 indicates that Congress, in enacting the interest rate restrictions, sought to prohibit "the solicitation of deposits by in-house salaried employees through so-called money desk operations." Congress viewed the gathering of high-rate money desk deposits and deposits accepted through brokers (by insured depository institutions that are not well capitalized) as potentially "an unsafe or unsound practice." H.R. Conf. Rep. No. 101-222 at 402-03 (1989), *reprinted in* 1989 U.S.C.C.A.N. 432, 441-42. The final rule is meant to simplify the interest rate restrictions without undermining this Congressional purpose.

The final rule would not become effective until January 1, 2010, somewhat over six months after the date of publication in the Federal Register. The staff believes that such a delayed effective date may be necessary to enable insured depository institutions to adjust to the new rules. In addition, the delayed effective date is consistent with the goals of section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994, which generally requires the Federal banking agencies to make new rules or rule changes that impose additional reporting, disclosure or other requirements effective on the first day of a calendar quarter. Pub. L. No. 103-325.

Notwithstanding this delayed effective date, the staff intends to post national average rates immediately on the FDIC’s Web site. The information on the FDIC’s Web site may assist insured depository institutions in complying with the current rules. Indeed, under the new rules or the current rules, the staff believes that the national average rates may represent the prevailing market rates for many insured depository institutions. For this reason, the Division of Supervision and Consumer Protection would not object to the use of these rates by an insured depository institution that is not well capitalized though such use will not be mandatory during the six-month adjustment period.

CONCLUSION:

For the reasons explained above, the staff recommends that the Board adopt the attached final rule.

Staff members knowledgeable about this case:

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Attachments