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Legal Update

FDIC Finalizes Changes to Brokered Deposits Restrictions

On December 15, 2020, the Federal Deposit Insurance Corporation ("FDIC") finalized revisions to its rules and prior guidance regarding brokered deposits (the "Revisions").[1] The Revisions had been proposed in 2019 (the "Proposal") and were the subject of considerable industry feedback generating over 160 comment letters.[2] The Revisions are intended to modernize the FDIC's framework for regulating brokered deposits, and they alter both the substantive regulations for brokered deposits and the procedures for requesting exceptions and filing reports. They also modify the restrictions on interest rates for certain types of deposits and clarify the application of the brokered deposit requirements to non-maturity deposits (e.g., deposits without a maturity date).

The Revisions generally will become effective on April 1, 2021, but there is an extended compliance period until January 1, 2022, during which institutions and putative deposit brokers may continue to rely on existing public staff advisory opinions and submit notices that are newly required by the Revisions.

In this Legal Update, we discuss the background of the brokered deposit restrictions and describe the key elements of the Revisions.

Background

Following the savings and loan crisis, in 1989, Congress enacted Section 29 of the Federal Deposit Insurance Act to impose restrictions on brokered deposits and notification obligations on deposit brokers.[3] The action was based on the regulators' view that brokered deposits were risky because they potentially drove growth and risk-taking by troubled institutions and were volatile in that they would move based on rates paid by competitor institutions. As a result, several regulatory initiatives were undertaken beginning in the 1980s to address risks associated with brokered deposits.

To address these concerns, the FDIC issued a regulation under Section 29 that restricts the use of brokered deposits and limits rates paid on interest-bearing deposits that are solicited by banks that are less than "well capitalized" under the Prompt Corrective Action framework.[4] If an institution is "adequately capitalized," it must seek a waiver from the FDIC to accept new brokered deposits, and some institutions may be subject to limits on the rate of interest they may pay on brokered deposits. Brokered deposits also are subject to less favorable treatment under the deposit insurance assessment regulation and Liquidity Coverage Ratio requirements.

Section 29 defines a "brokered deposit" as simply a deposit accepted through a "deposit broker." Thus, the meaning of the term "brokered deposits" turns upon the definition of "deposit broker" — if a deposit is accepted through a person who is a "deposit broker," the deposit is a brokered deposit. The FDIC expansively interpreted the scope of the restrictions on brokered deposits by adopting a broad definition of "deposit broker" that was further expanded through subsequent, fact-specific staff interpretations.[5] For example, affiliates and subsidiaries of a depository institution have been considered deposit brokers, as were employees of a depository institution who are not employed exclusively by the institution (e.g., certain individuals dually employed by a financial institution and an affiliate).

Under the FDIC's prior regulation, a deposit broker was defined as:

> 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
>
> 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.[6]

Consistent with Section 29, the FDIC excluded certain persons from the definition of deposit broker. Persons excluded from the definition of deposit broker include those "whose primary purpose is not the placement of funds with depository institutions" (referred to as the "Primary Purpose Exception").[7] While helpful, many of these exceptions proved difficult to interpret or apply because of general changes to the business of banking and the specific changes to the acceptance of deposits.

The FDIC's framework for identifying and regulating brokered deposits had not changed for many years, although the agency recently amended its regulations to implement a provision of the 2018 regulatory reform legislation that excludes a capped amount of certain reciprocal deposits from treatment as brokered deposits.[8] As noted above, this inaction increased the burden from applying the FDIC's framework; for example, as technology has evolved, many banks have innovated away from the branch model that made deposit solicitation analysis simple and straightforward. Also, the FDIC released a study on brokered deposits in 2011 that was required by the Dodd-Frank Act and published an advanced notice of proposed rulemaking on the topic in December 2018 that is the predicate to the Proposal.[9] These developments highlighted the vagueness and effort associated with reviewing contracts and agreements to determine brokered deposit status.

Substantive Changes to Definitions and Exclusions

The Revisions narrow the definition of "deposit broker" by more clearly defining the term and creating more exclusions . The Revisions also change the way in which the limitations on the rates paid on interest-bearing deposits that are solicited by certain banks are calculated and clarify the application of Section 29 to non-maturity deposits.

WHO IS A DEPOSIT BROKER?

First, the Revisions replace the current two-part definition of "deposit broker" with the following four-part definition, which is focused on whether the putative broker has certain types of business relationships with a customer:

(i) Any person engaged in the business of placing deposits of third parties with insured depository institutions;

(ii) Any person engaged in the business of facilitating the placement of deposits of third parties with insured depository institutions;

(iii) Any person engaged in the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties;[10] and

(iv) 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.

Second, the Revisions limit the definitions of "engaged in the business" to situations in which a person acts with respect to more than one depository institution and has a business relationship with the depositor on whose behalf the deposit is being placed. These changes were not in the Proposal, but are intended to respond to industry comments and more closely adhere to the language and intent of Section 29. The primary consequence of these changes is that persons operating exclusive deposit placement arrangements (i.e., a person places deposits at one and only one insured depository institution) will not be deposit brokers, and, therefore, the deposits they place will not be brokered deposits.[11] This may be particularly significant for affiliates and subsidiaries of a depository institution and dual employees, who may place deposits only with the affiliated depository institution.

Third, the Revisions limit the definition of "engaged in the business of placing deposits" to situations in which the person actually receives third-party funds and deposits those funds at more than one depository institution. This change is intended to provide additional clarity on the acts required to be a deposit broker.

Fourth, the Revisions more narrowly define facilitation of deposit placement to limit it to circumstances in which the putative broker takes an active role in opening the account or maintains a level of influence or control over the account after it is open. This reflects the FDIC's intent to tailor the definition of facilitation to circumstances where deposits are less stable as a result of the ability of deposit brokers to control the movement of deposits between depository institutions, as well as the FDIC's view that the non-business activities and purely administrative activities should not cause a person to become a deposit broker.

Under the Revisions, facilitation of deposit placement would occur when the putative broker:

(i) Has legal authority, contractual or otherwise, to close the account or move the third party's funds to another insured depository institution;

(ii) Is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account; or

(iii) Is engaged in matchmaking activities.[12]

This definition is somewhat narrower than was in the Proposal and reflects the FDIC's determination that certain information sharing administrative activities by a person would not influence the movement of deposits between insured depository institutions.[13]

WHO IS EXCLUDED FROM BEING A DEPOSIT BROKER?

Historically, one of the statutory exceptions, the Primary Purpose Exception, was narrowly construed and effectively limited to a handful of specific circumstances that were articulated in FDIC staff interpretations. The Revisions expand the Primary Purpose Exception to explicitly be available to an agent or nominee that is engaged in one or more of 14 designated businesses.[14] This is broader than the Proposal, which would have extended the Primary Purpose Exception to be available to a person who (i) has assets under administration for customers and places less than 25 percent of its total assets under administration for a business line at depository institutions or (ii) places customer funds in transactional accounts at depository institutions to enable transactions or make payments. The 14 designated businesses are listed in Appendix A and largely adopt concepts from prior FDIC staff interpretations. For example, the designated business exclusion for assets under administration effectively codifies the industry-wide relief provided in Advisory Opinion 05-02, although at a more generous ratio than previously provided by staff.[15]

Eligibility for the designated business exclusions will assessed on a business line basis, which means that a person may be able to rely on multiple exclusions for different business lines. The FDIC expects that a person will determine their own appropriate business lines in good faith, bearing in mind that a business line will usually consist of the business relationships with the specific group of customers for whom the person places or facilitates the placement of deposits. The FDIC also expects that depository institutions will have awareness of persons involved in the placement of deposits (i.e., deposit broker or person relying on an exclusion under the Primary Purpose Exception) to properly complete Call Report fields for brokered deposits and will be able to access records related to the Primary Purpose Exception that are maintained by such persons.

The Revisions recognize that other arrangements may qualify for the Primary Purpose Exception, and will allow agents and nominees to apply to use the Primary Purpose Exception on a case-by-case basis. The FDIC also may determine that an approved arrangement should be made generally available to the industry as another arrangement that the FDIC has specifically identified as a designated businesses. However, the preamble to the Revisions explicitly states that the Primary Purpose Exception will not be available if the purpose of the broker's relationship with the customer is to encourage savings, maximize yield, or provide deposit insurance, or has a similar purpose to those examples.

INTEREST RATE LIMITS ON INSTITUTIONS THAT ARE NOT WELL CAPITALIZED

Under Section 29, well capitalized institutions are not subject to any interest rate restrictions. However, the statute imposes interest rate restrictions on insured depository institutions that are less than well capitalized, as defined under the prompt corrective action framework. Specifically, the statutory interest rate restrictions generally limit a less than well capitalized institution from offering rates on deposits that significantly exceed rates in its prevailing market.

The Revisions amend the FDIC's methodology for calculating the national rate, the national rate cap, and the local rate cap for these purposes. The Revisions also provide a new simplified process for institutions that seek to offer a competitive rate when the prevailing rate in an institution's local market area exceeds the national rate cap.

Under the Revisions, the national rate cap will be the higher of: (i) the national rate, as based on weighting by deposits rather than branches (and including credit unions), plus 75 basis points; or (ii) 120 percent of the current yield on similar maturity US Treasury obligations, plus 75 basis points.

The Treasury-based second prong would also provide that, for non-maturity deposits, the prong is the federal funds rate, plus 75 basis points.

Further, the local market rate cap will be 90 percent of the highest offered rate in the institution's local market geographic area. Specifically, a less than well capitalized institution will be permitted to provide evidence that any bank or credit union with a physical presence in its local market area offers a rate on a particular deposit product in excess of the national rate cap. The local market area may include the state, county or metropolitan statistical area in which the insured depository institution accepts or solicits deposits.

The Revisions also eliminate the current two-step process where less than well capitalized institutions request a high rate determination from the FDIC and, if approved, calculate the prevailing rate within local markets. Instead, a less than well capitalized institution may notify the FDIC that it intends to offer a rate that is above the national rate cap and provide evidence that an insured depository institution or credit union with a physical presence in the less than well capitalized institution's normal market area is offering a rate on a particular deposit product in its local market area in excess of the national rate cap.

TREATMENT OF NON-MATURITY DEPOSITS

Section 29 does not explicitly explain how its restrictions apply to deposits that are non-maturity deposits. The Revisions adopt a new interpretation for the solicitation and acceptance of non-maturity deposits that focuses on whether the institution is opening a new account for a customer, accepting deposits in excess of those a customer held at the institution prior to the prompt corrective action downgrade, or increasing the interest rate on the account. Non-maturity deposits would be considered accepted in instances when, after the institution becomes less than well capitalized, a non-maturity brokered deposit account is open; the amount of non-maturity brokered deposit through a particular deposit broker increases the balance above the level existing at the institution at the time of the downgrade; or, for an agent or nominee accounts, when new funds of a new beneficial owner are added to the account.

The preamble to the Revisions notes that the FDIC is considering further modifications to its deposit insurance assessment regulations. Any modifications, however, will be addressed through separate rulemakings at a later date.

Procedural Changes for Primary Purpose Exception

The Revisions add a new process that may be used by any insured depository institution or deposit broker to qualify for the Primary Purpose Exception, thus allowing persons who would otherwise be deposit brokers to avoid this classification.

Persons relying on the designated business exclusions for (i) having assets under administration for customers and placing less than 25 percent of those total assets under administration at depository institutions or (ii) placing customer funds in transactional accounts at depository institutions to enable transactions or make payments must submit a notice to the FDIC or have the institutions at which the deposits are placed submit notice. A person also must notify the FDIC if it previously relied on one of these two designated business exclusions but no longer satisfies the Primary Purpose Exception. The FDIC may request information from filers, but generally expects to make such requests only if there is a reason to believe that the person does not meet or no longer meets the criteria for exclusion.

An institution or person that relies on the 25 percent exclusion will need to provide reports, generally quarterly, on its brokered deposits activity. The reports would need to be submitted to the FDIC. A person or institution that invokes the payments facilitator exclusion will need to provide an annual certification to the FDIC that the person continues to place all customer funds at depository institutions into transaction accounts and that customers do not receive or accrue any interest, fees, or other remuneration.

For 12 other designated business exclusions, no notice is required by the person involved in the placement of deposits or the institution receiving the deposits.

For arrangements not covered by a designated business exclusion, a person or institution would need to submit an application to qualify for the Primary Purpose Exception. Applications would need to include sufficient information to demonstrate that the primary purpose of the person's particular business line is something other than the placement of funds and address the relationship's revenue structure, marketing activities, and fee arrangements.[16] While an application may be submitted by an institution, the FDIC expects that most applications will be submitted by persons involved in the placement of deposits. The FDIC notes that it may impose reporting requirements in connection with approved applications.

Key Takeaways from the Revisions

It is expected that a large portion of existing brokered deposits will no longer be characterized as brokered under the Revisions. These deposits may still be subject to certain reporting requirements, but they would not be subject to the general restrictions on brokered deposits or the less favorable treatment for brokered deposits under the Liquidity Coverage Ratio and deposit insurance assessments.

While the FDIC notes that only 10 institutions (as of June 30, 2020) are subject to the restrictions on brokered deposits (i.e., are not well capitalized), the Revisions are relevant to the more than 1,900 institutions currently reporting brokered deposits. These institutions may be able to reclassify their existing brokered deposits to obtain more favorable treatment for brokered deposits under the Liquidity Coverage Ratio (or the Net Stable Funding Ratio, once effective) or deposit insurance assessments. These institutions also may need to revise their compliance programs to account for the inactivation of all prior public staff advisory letters (as of January 1, 2022) and the creation of new exclusions in the Revisions.

Furthermore, the FDIC estimates that hundreds of persons will be required to make filings to (i) rely on one of the two designated business exclusions that require prior notice or (ii) obtain approval for arrangements that are not covered by any of the exclusions. Putative deposit brokers should consider submitting filings as early as possible, particularly for applications, given that this is a new reporting regime for the FDIC and agency resources may be constrained as the January 2022 deadline approaches.

Overall, the Revisions are a significant step toward rationalizing the FDIC's approach to regulating brokered deposits. They also are consistent with the movement away from relying on staff guidance in place of formal agency action, as all existing public interpretations (listed at the end of the Revisions) will be moved to inactive status. However, some of the remaining problematic elements of the restrictions on brokered deposits are hardcoded into the statute (e.g., limitations on FDIC's waiver authority), and, therefore, action from Congress may be necessary to effect full reform.

Endnotes

[1] Press Release, *FDIC Board Approves Final Rule on Brokered Deposit and Interest Rate Restrictions* (Dec. 15, 2020), https://www.fdic.gov/news/press-releases/2020/pr20136.html.

[2] Press Release, *FDIC Issues Proposed Rule on Brokered Deposit Restrictions* (Dec. 12, 2019), https://www.fdic.gov/news/news/press/2019/pr19121.html; Press Release, *FDIC Issues Proposed Rule on Interest Rate Restrictions Applicable to Less Than Well Capitalized Institutions* (Aug. 20, 2019), https://www.fdic.gov/news/press-releases/2019/pr19072.html. See our article on the Proposal: https://www.mayerbrown.com/en/perspectives-events/publications/2020/01/reverseinquiries.

[3] 12 U.S.C. § 1831f. The requirement for deposit brokers to notify the FDIC was repealed by Congress in 2000.

[4] 12 C.F.R. § 337.6.

[5] FDIC, *Advisory Opinions: Brokerage Activities* (Aug. 30, 2019), https://www.fdic.gov/regulations/laws/rules/4000-100.html#fdicbrok.

[6] 12 C.F.R. § 337.6(a)(5)(i).

[7] 12 C.F.R. § 337.6(a)(5)(ii)(I).

[8] 84 Fed. Reg. 1346 (Feb. 4, 2019).

[9] 84 Fed. Reg. 2366 (Feb. 6, 2019); FDIC, *Study on Core Deposits and Brokered Deposits* (July 8, 2011; updated in 2019 to reflect 2017 data in Appendix 2).

[10] The FDIC has stated that this prong of the definition is intended to "capture" the brokered certificate of deposit ("CD") market and would apply to registered broker-dealers who subdivide bank-issued "master CDs" and then sell the modified CDs to brokerage customers. Such arrangements, however, are within the scope of the existing definition of "deposit broker," and, therefore, should not be viewed as an expansion of the restrictions.

[11] The preamble to the Revisions notes that a person may not create multiple entities to indirectly maintain "exclusive" relationships with multiple insured depository institutions.

[12] Matchmaking is further defined as proposing "deposit allocations at, or between, more than one bank based upon both (a) the particular deposit objectives of a specific depositor or depositor's agent, and (b) the particular deposit objectives of specific banks, except in the case of deposits placed by a depositor's agent with a bank affiliated with the depositor's agent."

[13] The FDIC discusses elsewhere in the preamble to the Revisions that deposit broker status is determined on a person-by-person basis, and, therefore, a third-party intermediary that provides administrative functions to a person placing deposits would need to separately determine if it is a deposit broker.

[14] The Revisions did not expand the exclusion for deposits that an institution places with itself to include subsidiaries of a depository institution on the basis that such entities should be able to rely upon the new exclusion for exclusive arrangements.

[15] *See* FDIC, Adv. Op. 05-02 (Feb. 3, 2005). This option excludes broker-dealers that sweep uninvested cash balances into deposit accounts, so long as those cash balances do not exceed 25 percent of the broker's assets under administration.

[16] The Revisions explicitly exclude brokered CD placement from being part of a business line that is the subject of an application.

Appendix A: Designated Businesses Within the Primary Purpose Exception

Business relationships where, with respect to a particular business line:

(i) less than 25 percent of the total assets that the agent or nominee has under administration for its customers are placed at depository institutions;

(ii) 100 percent of depositors' funds that the agent or nominee places, or assists in placing, at depository institutions are placed into transactional accounts that do not pay any fees, interest, or other remuneration to the depositor;

(iii) a property management firm places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing property management services;

(iv) the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing cross-border clearing services to its customers;

(v) the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing mortgage servicing;

(vi) a title company places, or assists in placing, customer funds into deposit accounts for the primary purpose of facilitating real estate transactions;

(vii) a qualified intermediary places, or assists in placing, customer funds into deposit accounts for the primary purpose of facilitating exchanges of properties under section 1031 of the Internal Revenue Code;

(viii) a broker dealer or futures commission merchant places, or assists in placing, customer funds into deposit accounts in compliance with 17 C.F.R. § 240.15c3-3(e) or 17 C.F.R. § 1.20(a);

(ix) the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of posting collateral for customers to secure credit-card loans;

(x) the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of paying for or reimbursing qualified medical expenses under section 223 of the Internal Revenue Code;

(xi) the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of investing in qualified tuition programs under section 529 of the Internal Revenue Code;

(xii) the agent or nominee places, or assists in placing, customer funds into deposit accounts to enable participation in the following tax-advantaged programs: individual retirement accounts under section 408(a) of the Internal Revenue Code, SIMPLE individual retirement accounts under section 408(p) of the Internal Revenue Code, and Roth individual retirement accounts under section 408A of the Internal Revenue Code;

(xiii) a federal, state, or local agency places, or assists in placing, customer funds into deposit accounts to deliver funds to the beneficiaries of government programs; and

(xiv) the agent or nominee places, or assists in placing, customer funds into deposit accounts pursuant to such other relationships as the FDIC specifically identifies as a designated business relationship that meets the Primary Purpose Exception.

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