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Federal Deposit Insurance Corporation Proposes Significant Revisions to Brokered Deposit Regulations

By Jeffrey D. Haas, Shawn M. Turner, Paul M. Aguggia and Rolland A. Hampton*

In this article, the authors discuss a rule proposed by the Federal Deposit Insurance Corporation that would revise brokered deposit regulations promulgated under Section 29 of the Federal Deposit Insurance Act.

The Federal Deposit Insurance Corporation (FDIC) has announced[1] a proposed rule (the Proposal)[2] that would amend FDIC regulations related to brokered deposits. In a significant departure from existing requirements, the Proposal calls for expanding the definition of a "brokered deposit" to rein in various deposit placement arrangements between insured depository institutions (IDIs) and intermediaries, such as nonbank financial companies. The Proposal would:

(1) Revise the regulatory definition of "deposit broker";

(2) Eliminate the exclusive deposit placement arrangement exception;

(3) Eliminate the "enabling transactions test" exception;

(4) Permit only IDIs, rather than nonbanks, to file notices and applications for a primary purpose exception (PPE);

(5) Change the interpretation of the PPE to consider the third party's intent in placing customer funds at a particular IDI;

(6) Amend the "25% test" designated business exception and allow for a PPE to be available only to broker-dealers and U.S. Securities and Exchange Commission (SEC)-registered investment advisers, and only if less than 10 percent of the total assets that the broker-dealer or investment adviser has under management for its customers is placed at one or more IDIs; and

(7) Clarify how an IDI may regain its agent institution status for the limited exception for reciprocal deposits.

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1 https://www.fdic.gov/news/press-releases/2024/fdic-board-approves-proposed-rule-revise-brokered-deposit-regulations.

2 https://www.fdic.gov/system/files/2024-07/fr-npr-on-brokered-deposit-restrictions_1.pdf.

BACKGROUND

What Are Brokered Deposits?

FDIC regulations define the term "brokered deposit" as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a "deposit broker."[3] Generally speaking, the FDIC views brokered deposits as more volatile than core deposits. Core deposits comprise funds placed at an IDI by individuals in a deposit demand account, such as checking or savings account. The depositor of such funds typically maintains an established relationship with an IDI, and the depositor is viewed as more likely to keep their deposits with an IDI despite interest rate fluctuations. By contrast, brokered deposits comprise funds placed at an IDI through a third-party arrangement. The depositor typically places the funds at an IDI that offers an attractive interest rate, and the depositor is viewed as more likely to withdraw and move funds to a different IDI to obtain a better interest rate at any given time. Though both core deposits and brokered deposits provide an important source of funding to an IDI, Section 29 of the Federal Deposit Insurance Act (FDIA) restricts the use of brokered deposits and additionally limits the rates paid on interest-bearing deposits for IDIs that are less than "well capitalized." If an IDI is "adequately capitalized," it must seek a waiver from the FDIC to accept, renew or roll over new brokered deposits. If an IDI is "undercapitalized," it may not accept, renew or rollover any brokered deposit, and the FDIC is not authorized by statute to grant a waiver.[4]

What Is a Deposit Broker?

Section 29 of the FDIA defines a "deposit broker" as (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.[5]

The definition is very broad. Thus, excluding a statutory exemption, historically, any person or company or organization that engaged in "placing deposits" belonging to others at an IDI or "facilitating the placement of deposits" belonging to others at an IDI was a "deposit broker," and an IDI's acceptance of subject deposits were brokered and, thereby, subject to enhanced regulatory scrutiny.

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[3] 12 U.S.C. § 1831f(g)(1); 12 C.F.R. § 337.6(a)(2).

[4] 12 C.F.R. § 327.

[5] 12 U.S.C. § 1831f(g); 12 C.F.R. § 337.6(a)(5).

What Are the Exceptions to the Definition of a "Deposit Broker?"

Section 29 of the FDIA enumerates several exclusions from the definition of a deposit broker,[6] including that the term "deposit broker" does not include "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."[7] This exclusion is widely recognized as the primary purpose exception (PPE). Historically, the PPE was narrowly interpreted through very fact-specific FDIC staff advisory opinions. Reliance on the exception typically required prior FDIC approval following an industry participant's specific request for a determination. The exception was granted only in instances where the FDIC conclusively determined that the intent of the third party in placing or facilitating the placement of deposits was not to provide a deposit placing service, but instead to promote some other goal.

Such goals were evidenced by a business relationship between an agent or nominee and its customers with respect to a particular business line and included, among others, cross-border clearing deposit services, where a non-bank entity placed customer funds, for a very limited period, at an IDI that acted as an intermediary to clear and settle the transfer of funds into the transaction recipient's bank account;[8] deposits by mortgage servicers who place deposits at IDIs to fulfill their obligations under servicing arrangements;[9] and deposits placed as required collateral for credit card loans[10] or deposits by title companies that place deposits at IDIs to facilitate a real estate transaction.[11]

Historically, the PPE was not applicable when the intent of the third party was to earn fees through the placement of deposits. Without the PPE, or an alternative designated statutory exemption, any intermediary (whether a person, company or organization) that placed or facilitated the placement of a deposit with an IDI, for which they were not the owner, was a deposit broker. Notable examples of intermediaries included, but were not limited to, broker-dealers, independent insurance agents who referred customers to banks,[12] third-party sponsored websites or listing service providers,[13] investment companies that do not place deposits, yet merely refer clients to an

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[6] 12 U.S.C. § 1831f(g)(2).

[7] 12 U.S.C. § 1831f(g)(2)(i).

[8] See FDIC Staff Advisory Opinion 16-01 (May 19, 2016).

[9] See FDIC Staff Advisory Opinion 92-78 (Nov. 10, 1992); see also Advisory Opinion 17-02 (Jun. 19, 2017).

[10] See FDIC Staff Advisory Opinion 94-13 (Mar. 11, 1994).

[11] See FDIC Staff Advisory Opinion 17-02 (Jun. 19, 2017).

[12] See FDIC Staff Advisory Opinion 95-9 (Jun. 29, 1995).

affiliated bank,[14] IDIs or companies that facilitate placement of deposits through a bank network to effectuate pass-through insurance,[15] companies or organizations that provide marketing for an IDI, in exchange for volume-based fees,[16] and even companies that received no fees from the IDI where funds were placed.[17]

THE 2020 RULE

With the emergence of online banking and the substantial growth in IDI deposit-taking capabilities by means of partnerships with intermediaries, particularly nonbank financial service companies, the FDIC in December 2020 overhauled its framework of brokered deposit rules that implement Section 29. The revised brokered deposit rules (the 2020 Rule) established bright-line standards for determining whether an entity meets the statutory definition of "deposit broker" and created exemptions for various deposit placement arrangements that the FDIC previously considered brokered. Under the 2020 Rule, several designated business relationships qualified for the PPE. For those that did not automatically qualify for the PPE, the 2020 Rule established a streamlined application process.

The 2020 Rule notably provided that a person or entity with an exclusive deposit placement arrangement with a single IDI would not be considered a "deposit broker" because the person or entity was not in the "business" of placing deposits or facilitating the placement of deposits. Consequently, intermediaries such as nonbank financial service companies, who contracted an exclusive deposit placing partnership with an IDI, would not meet the "deposit broker" definition.

THE 2024 PROPOSED RULE

The Proposal details numerous concerns from the FDIC, principally that entities misunderstand and inconsistently interpret the 2020 Rule and, therefore, misreport deposits that could pose serious consequences for IDIs and the deposit insurance fund (DIF).

The Proposal, if adopted, would make the following significant revisions:

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[13] See FDIC Staff Advisory Opinion 92-50 (Jul. 24,1992); see also Advisory Opinion No. 04-04 (Jul. 28, 2004).

[14] See FDIC Staff Advisory Opinion 94-15 (Mar. 16, 1994).

[15] See FDIC Staff Advisory Opinion 03-03 (Jul. 29, 2003).

[16] See FDIC Staff Advisory Opinion 93-71 (Oct. 1, 1993); see also Advisory Opinion No. 93-31 (Jun. 17, 1993).

[17] See FDIC Staff Advisory Opinion 94-15 (Mar. 16, 1994).

- *Expanded Definition of "Deposit Broker."* The Proposal would expand the deposit broker definition by:
  (1) Combining the "placing" and "facilitating" activity prongs under the current definition into one provision;
  (2) Removing the term and concept of "matchmaking activities" from the definition and replacing it with a deposit allocation provision; and
  (3) Adding a new factor related to fees.
- *Combining Provisions.* The 2020 Rule separately defined the "placing" and "facilitating" activity prongs of the deposit broker definition. The separation required a discrete analysis for each prong to determine whether any particular deposit was brokered. The FDIC cites that the 2020 Rule definitional structure and requisite analysis has caused confusion among IDIs. As a result, the Proposal would combine the terms into a single prong, a deposit broker would be defined as "[a]ny person engaged in the business of placing or facilitating the placement of deposits of third parties." Under the Proposal, a person is engaged in the business of placing or facilitating the placement of deposits of third parties if that person:
  (1) Receives third-party funds and deposits those funds at one or more IDIs;
  (2) Has legal authority, contractual or otherwise, to close the account or move the third party's funds to another IDI;
  (3) Is involved in negotiating or setting rates, fees, terms or conditions for the deposit account;
  (4) Proposes or determines deposit allocations at one or more IDIs (including through operating or using an algorithm or any other program or technology that is functionally similar), or
  (5) Has a relationship or arrangement with an IDI or customer where the IDI, or the customer, pays the person a fee or provides other remuneration in exchange for or related to the placement of deposits.
- *Deposit Broker Classification Based on Deposit Allocation Provision Among IDIs.* The 2020 Rule defined the term "facilitation" to encompass "matchmaking activities." The Proposal removes the "matchmaking" prong and replaces it with a broader "deposit allocation" provision. Under the proposed deposit allocation provision, an agent or nominee

"that proposes or determines deposit allocations at one or more IDI's (including through operating or using an algorithm, or any other program or technology that is functionally similar)" would be a considered a deposit broker. The Proposal states that the references to "the use of an algorithm or similar technology" is meant to capture situations where the algorithm "proposes or determines deposit allocations among IDI's by directing the flow, or facilitating the flow, of third-party funds to be deposited at a particular IDI." The deposit allocation prong and its reference to "operating or using an algorithm" would appear to implicate third-party service providers that calculate the daily movement of funds needed to administer a deposit sweep program. The Proposal cited that the "matchmaking activities" definition was not well understood by IDIs. According to the FDIC, "IDI's informed the FDIC of the difficulties in obtaining necessary information, such as third-party contracts, to effectively evaluate whether any party in a deposit arrangement, including any additional third party, meets the "matchmaking" definition."

- *Deposit Broker Classification Based on Receipt of Fees.* The Proposal provides that a person would be considered to be "engaged in the business of placing or facilitating the placement of deposits" if they have "a relationship or arrangement with an IDI or customer where the IDI or customer pays the person a fee or provides other remuneration in exchange for deposits being placed at one or more IDI's." This provision is reminiscent of pre-2020 practices. Prior to the 2020 Rule, the FDIC considered fees on a case-by-case basis in determining whether a person, company or organization was a deposit broker. Under the Proposal, the receipt of any compensation in exchange for placing or facilitating deposits would be determinant in a deposit broker analysis.
- *Elimination of Exclusive Deposit Arrangement Exception.* Known as the "exclusive deposit arrangement exception" under the 2020 Rule, any entity that contracts or partners exclusively with one IDI and is not placing or facilitating the placement of deposits at any other IDI is not considered a "deposit broker." As a result, any deposits placed by the entity with the IDI are not brokered deposits. The Proposal would eliminate this exception. The FDIC cited concerns that use of the exception allows an IDI to rely on an entity for 100 percent of its deposits without any of those deposits being considered brokered. While an entity by its exclusive relationship with the IDI could avoid the designation as a deposit broker, an IDI could form multiple

"exclusive" third-party relationships to fund itself without any of those deposits being considered brokered. The FDIC cites that current regulations expose the banking system to the kind of risk the brokered deposit restrictions were intended to address.

- *Curbing the Use of the PPE.* The Proposal would revise the FDIC's analysis for determining when a third party meets the PPE to the deposit broker definition. The exception would apply only when "[a]n agent or nominee whose primary purpose in placing customer deposits at IDI's is for a substantial purpose other than to provide a deposit-placement service or to obtain FDIC deposit insurance with respect to particular business lines between the IDI and the agent or nominee." The Proposal reflects how the FDIC historically interpreted the PPE prior to the 2020 Rule, with a focus on the "intent" of the agent or nominee placing deposits at one or more IDIs, with additional consideration as to whether any fees are paid to an agent or nominee, whether the agent or nominee has discretion to choose the IDI(s) to place customer funds and whether the agent or nominee is mandated by law to place funds into deposit accounts. Under the 2020 Rule, any agent or nominee could apply to the FDIC for the PPE and subsequently report their non-deposit broker status to IDIs. Under the Proposal, only IDIs would be permitted apply for the PPE. The Proposal would also require IDIs to provide copies of contracts relating to the deposit placement arrangement, including all third-party contracts, to supplement the IDI's description of the deposit placement arrangement that is currently required under the 2020 Rule.
- *"25 Percent Test" PPE Redesignated as "Broker-Dealer Sweep Exception."* Under the 2020 Rule, an agent or nominee that sweeps customer funds to IDIs meets the "deposit broker" definition but is eligible for the PPE where less than 25 percent of that agent or nominee's total assets under administration for its customers is placed at IDIs. Under the Proposal, the exception would be available only to a broker-dealer or SEC-registered investment adviser and only if less than 10 percent, rather than 25 percent, of its total assets under management in a particular business line is placed into non-maturity accounts at IDIs. The proposal would allow an IDI to file a designated exception notice for the Broker-Dealer Sweep Exception on behalf of broker-dealers that place deposits at the IDI only if no additional third party (including any affiliate) is involved in the sweep program. Should the Proposal pass, any PPE based on the existing 25 Percent Test would be revoked.
- *Elimination of Enabling Transactions Exception.* The 2020 Rule created

a PPE that exempted a third party that placed 100 percent of customer funds at IDIs into transaction accounts with no fees, interest or other remuneration to the depositor subject to certain notice requirements (the enabling transactions test). Under the Proposal, the enabling transactions test would be eliminated. The FDIC cites that the current enabling transactions test would not satisfy the PPE because placing deposits into accounts with transactional features would not, by itself, prove that the substantial purpose of the deposit placement arrangement is for a purpose other than providing deposit insurance or a deposit-placement service. The FDIC believes that there is no relevant difference between an agent or nominee's purpose in placing deposits to enable transactions and placing deposits to access a deposit account and deposit insurance. Under the Proposal, IDIs that currently rely on the enabling transactions test under the notice or application process could file an application under the general PPE application process.

- *Reciprocal Deposits.* The Proposal would also make certain changes related to reciprocal deposits. Under the FDIC's Reciprocal Deposits Rule, an IDI that qualifies as an "agent institution" may exclude a capped amount of reciprocal deposits – deposits received through a deposit placement network between IDIs – from treatment as brokered deposits. Although the FDIC's Reciprocal Deposits Rule sets forth qualifying provisions to obtain agent institution status, the rule does not address how an IDI that is no longer an agent institution may subsequently requalify as such or may regain that status once lost. Recognizing that neither statute nor regulation provides clarity on the issue, the Proposal would provide guidance for an IDI to regain agent institution status.
- *Designated Business Exceptions.* The Proposal would retain the remaining designated business exceptions listed in the 2020 Rule.

IN SUMMARY

- The Proposal departs from significant changes to the brokered deposit framework implemented by the revised brokered deposit rules adopted by the FDIC in 2020. If passed, certain deposits currently classified as nonbrokered would be reclassified as brokered and, as a result, an insured depository institution's continued custody of the deposits could increase deposit insurance assessments and negatively impact an insured depository institution's supervisory liquidity rating.
- The Proposal would expand the "deposit broker" definition. As a result, institution affiliated parties and intermediaries, such as nonbank

financial companies, would become subject to heightened regulations, with their business model and deposit placing arrangements similarly impacted.

- The Proposal would among other things, allow only banks, rather than their nonbank partners, to file primary purpose exception applications and, notably, eliminate the "exclusive deposit placement arrangement" and "enabling transactions test" exceptions.
- Written comments on this proposed rule had to be submitted on or before November 21, 2024.