

December 20, 2018

Brokered Deposits

FDIC Seeks Public Input as It Comprehensively Reviews Brokered Deposit and Interest Rate Regulations

SUMMARY

On December 18, 2018, the Federal Deposit Insurance Corporation (the “FDIC”) approved an advance notice of proposed rulemaking (the “ANPR”) in connection with a “comprehensive review of the regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized.”¹ The FDIC had previously released guidance regarding brokered deposits in January 2015 (as revised in June 2016) in the form of Frequently Asked Questions (the “FAQs”).² As was discussed in our Memoranda to Clients on [January 14, 2015](#), and [July 5, 2016](#), the FAQs created significant industry concerns regarding the breadth of deposits the FDIC classified as “brokered.”

The ANPR does not propose specific revisions to the brokered deposit regulations (or provide specific answers to interpretive questions), but sets forth the history of the FDIC’s current regulatory framework and summarizes interpretive issues the FDIC has considered. The ANPR provides for a 90-day period during which the FDIC will accept comment on “all aspects of the [FDIC’s] brokered deposits and interest rate regulations,” including with respect to a series of questions that appear designed to provide input to the FDIC on the desirability of possible changes, particularly in light of technological and business innovations that have occurred since the brokered deposit regulations were adopted.

BACKGROUND

Section 29 of the Federal Deposit Insurance Act (“Section 29”), as implemented by the FDIC’s regulations at 12 C.F.R. § 337.6, places restrictions on the acceptance by less than well capitalized insured depository institutions (“IDIs”) of deposits that are obtained through “deposit brokers”³ and therefore are deemed to be “brokered deposits.”⁴ IDIs that are not well capitalized may not solicit, accept, renew or roll

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over brokered deposits. An IDI that is adequately capitalized may request a waiver of this prohibition. However, these waivers cannot be sought in advance, and the waiver process itself can take considerable time. In addition, Section 29 and the FDIC's regulations generally prohibit IDIs that are not well capitalized from paying interest rates on deposits that are more than 75 basis points above published national rates.⁵

As a result of regulatory developments subsequent to the enactment of Section 29, the classification of deposits as brokered can have a significant adverse impact on well capitalized IDIs. First, the amount of an IDI's brokered deposits can affect the following components of its deposit insurance assessment rate:

- for a large or highly complex institution, its core deposits ratio;⁶
- for a small institution (generally under \$10 billion in assets), its brokered deposit ratio;⁷ and
- for certain new small institutions and for all large or highly complex institutions, except large and highly complex institutions that are well capitalized and have a CAMELS composite rating of "1" or "2," an additional brokered deposit adjustment of up to 10 basis points, unless the institution's ratio of brokered deposits to domestic deposits is not greater than 10%.⁸

Second, for a banking organization subject to the federal banking agencies' minimum Liquidity Coverage Ratio ("LCR") requirement,⁹ the assumed outflow rate applied to many brokered deposits is higher than that applied to other deposits.¹⁰ For example, brokered deposits for retail customers or counterparties that are not reciprocal brokered¹¹ or brokered sweep deposits are assigned a 100% outflow rate if they mature within the LCR's 30-day window; reciprocal brokered and brokered sweep deposits are assigned outflow rates of 10%, 25% and 40%; but retail deposits that are not brokered deposits are assigned outflow rates of 3% or 10%. Third, federal banking agency guidance indicates that IDIs that "rely upon" brokered deposits should incorporate PCA-related downgrade triggers into their contingency funding plans; an IDI may not be able to renew or roll over existing brokered deposits upon such a downgrade and, consequently, may need to access other sources of funding.¹² Fourth, because of the regulatory stigma that attaches to deposits classified as brokered, such deposits can harm an IDI's marketplace reputation.

Section 29 generally defines a "deposit broker" as a person "engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with [IDIs]."¹³ In the FAQs, the FDIC construed this term broadly: "The definition of deposit broker applies to third parties engaged in . . . 'facilitating the placement of deposits.' The term 'facilitating the placement of deposits' is interpreted broadly to include actions taken by third parties to connect [IDIs] with potential depositors."¹⁴ There are exceptions from the definition of "deposit broker," including (1) an IDI (with respect to funds placed with that IDI itself); (2) an employee of an IDI, with respect to funds placed with the employing institution; and (3) an agent or nominee whose primary purpose is not the placement of funds with depository institutions.¹⁵

The FDIC has sought to provide more clarity with respect to the definition of "deposit broker" (and the exceptions to that definition) through a number of staff advisory letters issued over the years. In addition,

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in response to a congressional mandate in the Dodd-Frank Wall Street Reform and Consumer Protection Act, the FDIC issued its Study on Core and Brokered Deposit in July 2011 (the “2011 Study”). Although reiterating that “there should be no particular stigma attached to the acceptance by well capitalized banks of brokered deposits per se and that the proper use of such deposits should not be discouraged,” the 2011 Study also expressed concerns about brokered deposits and recommended that Congress neither amend nor repeal the brokered deposit statute.¹⁶ The 2011 Study reviewed the FDIC’s prior brokered deposit guidance and set forth the FDIC’s definitive positions with respect to certain interpretive issues regarding brokered deposits until the FDIC released the FAQs.

On January 5, 2015, the FDIC released the 2015 FAQs, which answered, among other topics, a range of questions regarding classification of deposits as brokered. Taking a broad view of the concept of brokered deposits, the FDIC’s response to nearly every question posed in the FAQs concluded that the deposit at issue was brokered, which, in some cases, represented a departure from industry understanding and/or practice. The 2015 FAQs signaled that the FDIC’s view of brokered deposits extended beyond the high interest rate, “hot money” deposits that had prompted Congress to enact Section 29, and the guidance resulted in widespread industry concern regarding the expansive definition of “brokered deposits.” The FDIC issued revised FAQs on June 30, 2016, which clarified some specific concerns with the 2015 FAQs but retained the FDIC’s expansive view of the types of arrangements that would be classified as brokered.¹⁷

Since the issuance of the 2016 FAQs, the banking industry and others have been significantly focused on the topic of brokered deposits, particularly as a result of technological developments. On July 26, 2018, two members of Congress called for the FDIC to revisit the 2016 FAQs “in light of the rapid technological changes in the banking and payments industry.”¹⁸ Chairman McWilliams has noted that the “banking industry has undergone significant changes since [the brokered deposit] regulations were put into place” and stated that the FDIC would consider “the impact of changes in technology, business models, and products since the brokered deposit requirements were adopted.”¹⁹

DISCUSSION

On December 18, 2018, the FDIC approved the ANPR. The primary theme of the ANPR is the application of the FDIC’s regulatory framework for brokered deposits to modern technology and business practices. Citing inquiries the FDIC has received with respect to technological advances and new business practices and products that IDIs might use to gather deposits, the FDIC noted that the “inherent challenge” in its review of those questions is to “distinguish between third party service providers to the IDI and third parties that are engaged in the business of placing or facilitating the placement of deposits, albeit using updated technology.”²⁰ Specifically, the FDIC reiterated that determining what constitutes a brokered deposit (in other words, determining whether a deposit was placed or facilitated by a person who is “engaged in the business of placing deposits, or facilitating the placement of deposits, of third

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parties with [IDIs]) is a fact-specific analysis that is carried out on a case-by-case basis.²¹ The factors that the ANPR notes the FDIC considers in making this determination include:

- whether the third party receives fees from the IDI that are based, in whole or in part, on the amount of deposits or the number of deposit accounts;
- whether the fees can be justified as compensation for administrative services or other work performed by the third party for the IDI (as opposed to compensation for bringing deposits to the IDI);
- whether the third party's deposit placement activities, if any, are directed at the general public rather than at members (or "affinity groups") or clients;
- whether there is a formal or contractual agreement between the IDI and the third party to place or steer deposits to certain IDIs; and/or
- whether the third party is given access to the depositor's account, or will continue to be involved in the relationship between the depositor and the IDI.²²

The ANPR did not discuss relative weightings of these factors.

The ANPR also summarizes interpretive issues the FDIC has considered with respect to the exceptions from the definition of "deposit broker." These issues include:

- the availability of the IDI exception for wholly owned subsidiaries of an IDI that place deposits under an exclusive relationship with the parent IDI;
- the availability of the employee exception for IDI employees who also have a contractual relationship with an affiliate of the IDI;
- the availability of the "primary purpose" exception, including with respect to affiliate sweeps and general purpose prepaid card accounts;
- whether a listing service that appears to be more than passive (for example, one that charges a bank based on its asset size, as opposed to a flat subscription fee, or that posts rates of "featured" or "preferred" vendors at the top of its rate board) is a deposit broker; and
- whether vendor arrangements between IDIs and providers of software applications that aggregate data to assist IDIs in targeting customers with specific financial products should be viewed as brokered.

With respect to the interest rate restrictions, the ANPR notes that the FDIC has recently seen an increase in deposit products with special promotions or features such as step up interest rates, unusual maturities (for example, 13 or 15 months instead of 12 or 18 months) or one-time cash or award payments to depositors as an incentive to open a deposit account.²³ These features raise questions about how IDIs should calculate and apply interest rate caps.

The ANPR also discusses the FDIC's research on brokered deposits and their impact on the health and resolvability of IDIs. Importantly, Appendix 2 to the ANPR updates the FDIC's analysis in the 2011 Study with data through the end of 2017, and confirms the findings in the 2011 Study, namely that: (1) higher use of brokered deposits is associated with higher probability of bank failure; (2) banks with higher levels of brokered deposits are generally more costly to the Deposit Insurance Fund when they fail; (3) on average, brokered deposits are correlated with higher levels of asset growth and nonperforming loans;

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and (4) brokered deposits that have posed risk to the Deposit Insurance Fund are characterized by rapid growth, volatility and lower value to purchasers of failed banks.²⁴ The ANPR does not, however, engage in a more granular analysis that would correlate failure and loss at failure to types of brokered deposits.

The ANPR's policy objective is to "obtain input from the public as the FDIC comprehensively reviews its brokered deposit and interest rate regulations in light of significant changes in technology, business models, the economic environment, and products since the [brokered deposit] regulations were adopted."²⁵ In furtherance of this objective, the ANPR solicits comment on "all aspects of [the FDIC's] approach to brokered deposits and interest rate restrictions," including with respect to a number of specific questions.²⁶

The questions in the ANPR focus on a variety of areas relating to brokered deposits and interest rate restrictions, including:

- whether there are ways in which the FDIC can improve its implementation of Section 29 while continuing to protect the safety and soundness of the banking system;
- whether there are deposits that are currently considered brokered that should not be (and vice versa);
- whether there are specific technological or other changes in the financial services industry that the FDIC should consider as it undertakes its review of the brokered deposit regulations;
- whether there are ways in which the FDIC can provide additional clarity with respect to identifying brokered deposits and deposit brokers;
- whether there are statutory changes that Congress should consider;
- whether there are alternative solutions to the interest rate restrictions on less than well capitalized institutions;
- whether the methodology used to calculate the interest rate cap, or the amount of the interest rate cap, should be changed; and
- how interest rate restrictions should be applied to Internet-based institutions and deposits with promotional or other special features.

Although the form and scope of any proposed regulations are yet to be determined, the ANPR and the remarks by Chairman McWilliams appear to indicate that the FDIC is committed to updating and modernizing its brokered deposit and interest rate regulations, and the range of questions asked and comments solicited by the ANPR suggest that the FDIC may be willing to propose revised regulations that could meaningfully modify its approach to brokered deposits and interest rate caps.

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ENDNOTES

- ¹ Federal Deposit Insurance Corporation, Draft Advance Notice of Proposed Rulemaking, *Unsafe and Unsound Banking Practices [Brokered Deposits]* (Dec. 18, 2018) at 5, available at <https://www.fdic.gov/news/board/2018/2018-12-18-notice-sum-i-fr.pdf>.
- ² Federal Deposit Insurance Corporation, Financial Institution Letter (FIL-2-2015), available at <https://www.fdic.gov/news/news/inactivefinancial/2015/fil15002.pdf>; Financial Institution Letter (FIL-42-2016), available at <https://www.fdic.gov/news/news/financial/2016/fil16042.pdf>.
- ³ 12 U.S.C. § 1831f; 12 C.F.R. § 337.6.
- ⁴ Certain high-interest rate deposits offered by IDIs that are less than well capitalized are considered “brokered deposits” even without any third-party involvement, as in those situations where the offering IDI itself is considered the “deposit broker” under the statute. See 12 U.S.C. § 1831f(g)(3).
- ⁵ 12 C.F.R. § 337.6(b).
- ⁶ 12 C.F.R. §§ 327.16(b)(1)(A)(3) and (b)(2)(A)(3); 12 C.F.R. Part 327 App. A.VI.
- ⁷ 12 C.F.R. § 327.16(a)(4).
- ⁸ 12 C.F.R. § 327.16(e)(3).
- ⁹ For additional information regarding the application of the LCR following the enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act (“EGRRCPA”), see our Memoranda to Clients, *Financial Services Regulatory Reform Legislation: “Economic Growth, Regulatory Relief, and Consumer Protection Act” is Enacted*, dated May 24, 2018, available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Financial_Services_Regulatory_Reform_Legislation_05_24_18.pdf; and *Regulatory Tailoring for Large U.S. Banking Organizations: Federal Bank Regulators Propose Significant Revisions to the Application of Enhanced Prudential Standards and Capital and Liquidity Requirements for Large U.S. Banking Organizations*, dated November 5, 2018, available at <https://www.sullcrom.com/files/upload/SC-Publication-Regulatory-Tailoring-for-Large-US-Banking-Organizations.pdf>.
- ¹⁰ See Sections 32(a) (retail funding outflow amount), 32(g) (brokered deposit outflow amount for retail customers or counterparties) and 32(h) (unsecured wholesale funding amount) of the federal banking agencies’ respective LCR rules, codified at 12 C.F.R. Part 50 (OCC), 12 C.F.R. Part 249 (Federal Reserve Board) and 12 C.F.R. Part 329 (FDIC); 79 Fed. Reg. 61,440, 61,480-81, 61,490-93, 61,496-97 (Oct. 10, 2014). Generally, the outflow rate applied to a particular deposit depends in part on whether it is considered retail or wholesale and whether that deposit is brokered. In the case of a brokered deposit from a retail customer or counterparty, the outflow rate applied further depends on whether it is a reciprocal brokered deposit, brokered sweep deposit or other type of brokered deposit, such as a term brokered deposit or a non-maturity brokered deposit in a transaction account. The outflow rate applied to a particular brokered deposit also may depend on whether the deposit is fully insured, as well as its maturity.
- ¹¹ Section 202 of the EGRRCPA amended Section 29 to except a capped amount of reciprocal deposits from treatment as brokered deposits for certain IDIs. On September 26, 2018, the FDIC issued a notice of proposed rulemaking and request for comments on proposed regulations to implement this provision of the EGRRCPA. 83 Fed. Reg. 48562 (Sep. 26, 2018). On December 18, 2018, the FDIC approved its final rule to adopt the changes to the reciprocal deposit regulations. FDIC, draft Final Rule, *Limited Exception for a Capped Amount of Reciprocal Deposits from Treatment as Brokered Deposits*, (Dec. 18, 2018), available at <https://www.fdic.gov/news/board/2018/2018-12-18-notice-sum-h-fr.pdf>. The ANPR notes that the EGRRCPA has significantly reduced the percentage of reciprocal deposits that are classified as brokered.
- ¹² See Interagency Policy Statement on Funding and Liquidity Risk Management (March 17, 2010), at 13, available at <http://www.federalreserve.gov/boarddocs/srletters/2010/sr1006a1.pdf>.
- ¹³ 12 U.S.C. § 1831f(g)(1). A “deposit broker” also includes a person engaged in the business of placing deposits with IDIs 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 to use the proceeds of the account to fund a prearranged loan. *Id.*
- ¹⁴ FAQ A5.

ENDNOTES (CONTINUED)

- 15 12 U.S.C. § 1831f(g)(2). The definition of “deposit broker” is subject to nine statutory exceptions:
 - an IDI, with respect to funds placed with that IDI;
 - an employee of an IDI, with respect to funds placed with the employing IDI;
 - a trust department of an IDI, if the trust in question has not been established for the primary purpose of placing funds with IDIs;
 - the trustee of a pension or other employee benefit plan, with respect to funds of the plan;
 - a person acting as a plan administrator or an investment adviser in connection with a pension plan or other employee benefit plan provided that that person is performing managerial functions with respect to the plan;
 - the trustee of a testamentary account;
 - the trustee of an irrevocable trust (other than a trustee who establishes a deposit account to facilitate a business arrangement with an IDI to use the proceeds of the account to fund a prearranged loan), as long as the trust in question has not been established for the primary purpose of placing funds with IDIs;
 - a trustee or custodian of a pension or profit sharing plan qualified under section 401(d) or 430(a) of the Internal Revenue Code of 1986; or
 - an agent or nominee whose primary purpose is not the placement of funds with depository institutions.
- 16 2011 Study at 3.
- 17 For additional information on the FAQs, see our Memoranda to Clients, *Brokered Deposit Guidance: FDIC Issues Frequently Asked Questions on Identifying, Accepting, and Reporting Brokered Deposits*, dated January 14, 2015, available at https://www.sullcrom.com/siteFiles/Publications/S_Publication_Brokered_Deposit_Guidance.pdf; and *Updated Broker Deposit Guidance: FDIC Revises Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits*, dated July 5, 2016, available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Updated_Brokered_Deposit_Guidance.pdf.
- 18 Letter to FDIC Chairman Jelena McWilliams from Representatives Scott Tipton and Blaine Luetkemeyer, dated July 26, 2018, available at <https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2018/08/FDIC-Brokered-Deposits-2018-7-26.pdf>.
- 19 Statement of FDIC Chairman Jelena McWilliams on Implementation of the EGRRCPA, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (October 2, 2018), available at <https://www.banking.senate.gov/imo/media/doc/McWilliams%20Testimony%2010-2-18.pdf>.
- 20 ANPR at 23.
- 21 *Id.*
- 22 *Id.* at 25-26.
- 23 *Id.* at 43.
- 24 *Id.* at 18.
- 25 *Id.* at 6-7.
- 26 *Id.* at 44-46.

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