December 29, 2020

Brokered Deposits

FDIC Adopts Final Rule Updating its Brokered Deposits Regulations

SUMMARY

On December 15, 2020, the FDIC adopted a final rule (the "Final Rule")[1] to revise its regulations on brokered deposits, which are promulgated pursuant to Section 29 of the Federal Deposit Insurance Act.[2] The Final Rule creates "a new framework for analyzing certain provisions of the 'deposit broker' definition, including 'facilitating' and 'primary purpose.'"[3]

The Final Rule retains the basic framework proposed by the FDIC in December 2019 (the "Proposed Rule"),[4] but differs in a number of key respects. In particular, the Final Rule (1) provides that a third party that places, or facilitates the placement of, deposits exclusively with one insured depository institution ("IDI") would not be engaged in the business of placing, or facilitating the placement of, deposits (and therefore would not be a deposit broker); (2) includes 11 business relationships that qualify for the primary purpose exception that were not included in the Proposed Rule; and (3) eliminates the proposed application process with respect to specific business relationships that qualify for the primary purpose exception (but retains an application process for business relationships that do not meet one of these bright-line tests). Our Memorandum to Clients, dated December 16, 2019, discusses the Proposed Rule.

The Final Rule will be effective on April 1, 2021, with full compliance extended to January 1, 2022.

BACKGROUND

Section 29 of the Federal Deposit Insurance Act ("Section 29"), enacted as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and the FDIC's implementing regulations place restrictions on the acceptance by less than well-capitalized IDIs of deposits that are obtained through "deposit brokers"[5] and are therefore deemed to be "brokered deposits."[6] IDIs that are not well capitalized

may not solicit, accept, renew or roll over brokered deposits. An IDI that is adequately capitalized may request a waiver of this prohibition.[7]

Section 29 does not specifically define "brokered deposits," but instead defines "deposit broker" and classifies any deposit obtained by or through a deposit broker as brokered.[8] Section 29 generally defines a "deposit broker" as "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with [IDIs] or the business of placing deposits with [IDIs] for the purpose of selling interests in those deposits to third parties."[9] The Final Rule is intended to modernize the brokered deposits framework, particularly in light of technological developments that provide an increasing number of ways in which consumers transact with their banks. FDIC Chairman Jelena McWilliams has noted that the "banking industry has undergone significant changes since [the brokered deposit] regulations were put into place,"[10] and that "the FDIC's brokered deposits regime has struggled to keep up."[11] Similarly, the preamble to the Final Rule (the "Preamble") observes that "regulations governing brokered deposits are outdated and do not reflect current industry practices and the marketplace."[12]

The Final Rule is the culmination of the FDIC's "comprehensive review of the regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized," which included an advance notice of proposed rulemaking (the "ANPR") that the FDIC approved on December 18, 2018.[13] The ANPR did not propose specific revisions to the brokered deposit regulations, but instead solicited comment on nearly every aspect of the brokered deposits regime. For a discussion of the ANPR, please refer to our Memorandum to Clients, dated December 20, 2018.

Commenters submitted over 130 comment letters in response to the ANPR, and on December 12, 2019, the FDIC approved the Proposed Rule. According to Chairman McWilliams, the Proposed Rule was crafted with four objectives in mind: to (1) develop a framework to encourage innovation within the banking industry; (2) adopt a balanced approach to the interpretation of Section 29; (3) minimize risk to the Deposit Insurance Fund while focusing on the core problem Congress sought to address through the passage of Section 29; and (4) establish an administrative process that focuses on "consistency and efficiency" by establishing easily understandable standards for determining whether a person is a deposit broker.[14]

On December 15, 2020, the FDIC approved the Final Rule.[15] The Final Rule is intended to "take into consideration current industry practice and … allow for continued innovation" and "to ensure that the brokered deposit regulations would continue to promote safe and sound practices while ensuring that the classification of a deposit as brokered appropriately reflects changes in the banking landscape."[16]

KEY CHANGES TO THE BROKERED DEPOSIT REGULATIONS

The Final Rule revises the FDIC's regulations in several respects. Specifically, the Final Rule:

- revises the definition of "deposit broker" by providing that any person that enters into an exclusive deposit placement arrangement with one IDI, and does not place or facilitate the placement of deposits at any other IDI, will not be "engaged in the business" of placing, or facilitating the placement of, deposits;
- revises the definition of "deposit broker" by adding new definitions of "engaged in the business of placing deposits" and "engaged in the business of facilitating the placement of deposits," which further clarify what activities would cause the FDIC to view a third party to be a deposit broker; and
- revises the primary purpose exception to focus on "the business relationship between the agent or nominee and its customers" and to establish bright-line tests for third parties to qualify for the exception, subject to notification requirements for certain relationships, and supplemented by an application process for third parties to qualify for the exception in cases where they do not meet one of the bright-line tests.

In contrast to the Proposed Rule, the Final Rule:

- does not include the "information sharing" prong in the "facilitation" definition, which would have defined a deposit broker to include any third party that, while engaged in business, "directly or indirectly shares any third party information with the [IDI]";
- does not include a general application process to qualify for the primary purpose exception; and
- does not include a requirement for the IDI to monitor third parties' ongoing compliance with the primary purpose exception.

A. REVISIONS TO THE REGULATORY "DEPOSIT BROKER" DEFINITION

Under Section 29, a deposit broker is "any person engaged in the business of placing deposits, or facilitating the placement of deposits …".[17] Historically, the FDIC has interpreted this provision expansively, potentially to include any third party that has any connection to a depositor, with little guidance on whether or how a third party is "engaged in the business of" facilitating the placement of deposits.

The Final Rule includes a four-pronged definition of "deposit broker" that is substantially the same as the Proposed Rule's definition:

- "Any person engaged in the business of placing deposits of third parties with [IDIs];
- "Any person engaged in the business of facilitating the placement of deposits of third parties with [IDIs];
- "Any person engaged in the business of placing deposits with [IDIs] for the purpose of selling those deposits or interests in those deposits to third parties; and
- "An agent or 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."

The Final Rule revises the "deposit broker" definition by defining "engaged in the business of placing deposits" as receiving third-party funds and depositing those funds at more than one IDI.[18] The preamble to the Proposed Rule noted that the FDIC would view a person to be "engaged in the business of placing deposits" if the person "has a business relationship with its customers, and as part of that relationship, places deposits on behalf of the customer."[19] To provide additional clarity on the "deposit broker" definition, the FDIC has codified this view in the Final Rule by including a definition of "engaged in the business" that limits both the first and second prongs of the "deposit broker" definition to persons that meet the above criteria.[20]

With respect to whether a person is engaged in the business of "facilitating" the placement of deposits, and in response to 118 comments on the "facilitation" prong of the "deposit broker" definition, the FDIC substantially revised the Proposed Rule's definition. Under the Proposed Rule, among other things, a person would have been engaged in the business of facilitating the placement of deposits of a third party with an IDI if, while engaged in business, "the person directly or indirectly shares any third party information with the [IDI]."[21]

The Final Rule does not retain the proposed "information sharing" prong. Commenters noted that, contrary to the FDIC's intent to "capture activities that indicate that the third party takes an active role in the opening of an account or maintains a level of influence or control over the deposit account even after the account is opened,"[22] the Proposed Rule would have captured many parties that share information with IDIs, including "essentially every financial technology company,"[23] but that do not take an active role in opening accounts and have little or no ongoing influence or control over an account. Instead, the Preamble states that the Final Rule incorporates certain concepts from the Proposed Rule into a new "matchmaking" prong that is intended "to provide a clear description of the types of activities that were intended to be captured under the facilitation definition."[24]

Under the Final Rule, a person is engaged in the business of facilitating the placement of deposits of a third party with an IDI if, while "engaged in business":

- "The person has legal authority, contractual or otherwise, to close the account or move the third party's funds to another [IDI];
- "The person is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account; or
- "The person engages in matchmaking activities."[25]

Under the Final Rule, "a person is engaged in matchmaking if the person proposes 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," unless the deposits are placed by the depositor's agent at an IDI affiliate of the agent. If a person has access to financial information of a depositor or depositor's agent and a proposed deposit allocation is based on the financial information,

the proposed deposit allocation is deemed to be based on the particular objectives of the depositor or depositor's agent. Similarly, if a person has access to information regarding a bank's deposit balance objectives and a proposed deposit allocation is based on such information, the proposed deposit allocation is deemed to be based on the particular objectives of the bank.[26] The "matchmaking" definition also includes an anti-evasion provision allowing the FDIC to find that a person meets the definition if that person has an "ongoing role in providing any function related to matchmaking," but structures a deposit placement arrangement to evade meeting the definition.[27]

The remaining prongs of the "deposit broker" definition are substantially the same as those in the Proposed Rule and are consistent with the FDIC's past interpretations. In particular, the third prong of the definition is intended to capture brokered certificates of deposit. To reflect changes in the market for brokered certificates of deposit and how such deposits are structured, the Final Rule introduces a definition of "Brokered CDs" that includes a master certificate of deposit arrangement and any arrangement that the FDIC determines has a similar purpose.[28]

B. EXCLUSIVE BUSINESS ARRANGEMENTS

The Final Rule substantially revises the definition of "deposit broker" by limiting the application of the definitions of "engaged in the business of placing deposits" and "engaged in the business of facilitating the placement of deposits" to a person that places, or facilitates the placement of, deposits at "more than one [IDI]."[29] The Preamble explains that a person that enters into an exclusive deposit placement arrangement with one IDI, and does not place or facilitate the placement of deposits at any other IDI, will not be "engaged in the business" of placing, or facilitating the placement of, deposits and therefore will not be a "deposit broker."[30] The Preamble also states that to prevent evasion, the FDIC will view multiple related entities that each place deposits with different IDIs as a single "person" that would meet the deposit broker definition. In addition, the Preamble clarifies the scope of the revised definition by stating that:

> if an agent or nominee places deposits at one IDI as part of one business line, such as part of a sweep program, and places deposits at one or more other IDIs as part of one or more other business lines, such as issuing brokered CDs, that agent or nominee would still qualify as a deposit broker unless it satisfied the primary purpose exception, with respect to a particular business line, or one of the other nine exceptions to the definition of "deposit broker."[31]

C. THE PRIMARY PURPOSE EXCEPTION

Under Section 29 and the FDIC's implementing regulations, there are several exceptions to the definition of "deposit broker."[32] One of these exceptions, the so-called "primary purpose exception," excludes from the definition of deposit broker "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."[33] In determining an agent or nominee's "primary purpose," the FDIC has focused historically on "the reason or intent of the third party" in placing or facilitating the placement of the deposit, and has stated that the agent or nominee's overall business purpose or the amount of revenue that

the deposit placement activity generates are not relevant factors.[34] The result was to severely curtail the availability of the exception.

In a significant departure, the Proposed Rule instead interpreted the primary purpose exception based "on the business relationship between the agent or nominee and its customers."[35] The Proposed Rule identified two types of business relationships that would qualify for the exception, subject to an application and reporting framework through which third parties (or IDIs on behalf of third parties) would apply to the FDIC to qualify for the primary purpose exception.

The Final Rule similarly interprets the primary purpose exception based on business relationships, thereby substantially revising the FDIC's approach to the primary purpose exception. First, the Final Rule identifies several specific business relationships that qualify for the primary purpose exception, with respect to a specific business line ("designated exceptions"). Second, the Final Rule introduces a notice requirement for certain designated exceptions. Third, the Final Rule includes a process for a "third party"[36] (or an IDI on behalf of the third party) that does not meet one of the designated exceptions to apply for a primary purpose exception. Fourth, the Final Rule clarifies the determination of a specific "business line." Fifth, unlike the Proposed Rule, the Final Rule does not require IDIs to monitor third parties' ongoing eligibility for the primary purpose exception.

1. Designated Exceptions

The business relationships identified as designated exceptions in the Final Rule include, with respect to a particular "business line":[37]

- "less than 25 percent of the total assets that the agent or nominee has under administration for its customers [is placed at IDIs];
- "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;
- "a property management firm places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing property management services;
- "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;
- "the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing mortgage servicing;
- "a title company places, or assists in placing, customer funds into deposit accounts for the primary purpose of facilitating real estate transactions;
- "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;
- "a broker dealer or futures commission merchant places, or assists in placing, customer funds into deposit accounts in compliance with 17 CFR 240.15c3-3(e) or 17 CFR 1.20(a);[38]

- "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;
- "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;[39]
- "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;
- "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;
- "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
- "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."[40]

The Final Rule retains the "25 percent" designated exception included in the Proposed Rule with minor changes. The Final Rule uses the term "assets under administration" rather than "assets under management" to clarify that the designated exception does not apply only to assets for which the agent or nominee exercises deposit placement or investment discretion. Although not included in the text of the Final Rule, the Preamble notes that "assets under administration" for a particular business line are calculated as the total market value of all financial assets that the agent or nominee administers on behalf of its customers "that participate in a particular business line."[41] Third parties that meet the Final Rule's criteria are required to file a notice with the FDIC in order to rely on this designated exception, as discussed in greater detail in "Notice and Reporting Process" below.

The Final Rule also retains the "enabling transactions" designated exception included in the Proposed Rule, including the requirement that no fees, interest or other remuneration be provided to the depositor. Third parties seeking to rely on this designated exception are required to file a notice with the FDIC. Third parties that place deposits into accounts through which the customer earns some interest or other remuneration, and therefore do not meet the criteria of the designated exception, can still qualify for the primary purpose exception through the Final Rule's application process, which is discussed further in "Application Process" below. The Preamble states that in evaluating such an application, the FDIC will consider (1) the amount of interest, fees or other remuneration; (2) the average amount of transactions that customers make on a month-to-month basis; (3) whether the agent or nominee's marketing materials indicate that funds placed with IDIs are to enable transactions; and (4) the percentage of customer funds placed into accounts that are not transaction accounts. To provide clarity to potential applicants, the Final Rule provides that the FDIC will approve an application under the "enabling transactions" test if:

> the FDIC finds that the third party's marketing materials indicate that the primary purpose of placing customer deposits at [IDIs] is to enable transactions, and: (1) nominal interest, fees, or other remuneration is being paid on any customer accounts, or (2) the third party's customers make, on average, 6 transactions a month.[42]

A third party that places some portion of deposits into accounts that are not transaction accounts may still qualify for the primary purpose exception based on the criteria noted above, but the FDIC "will more closely scrutinize whether the primary purpose is enabling transactions."[43]

2. Notice and Reporting Process

Although the Final Rule does not require an application in order to qualify for the designated exceptions, if, a third party seeks to rely on the "25 percent" or the "enabling transactions" designated exceptions, the third party (or an IDI that is receiving deposits from the third party), as noted above, must submit a written notice to the FDIC. Notices must include (1) the designated exception on which the third party is relying; (2) a brief description of the business line to which the exception applies; (3) information specific to the designated exception;[44] (4) a brief description of any involvement by an additional third party who qualifies as a deposit broker (or a statement that there is no such involvement); and (5) if the notice is not provided by an IDI, a list of the IDIs that are receiving deposits by or through the particular business line.

The Preamble states that notices will be submitted electronically, and that the third party will be able to rely upon the applicable designated exception for a particular business line upon the FDIC's receipt of the notice.[45] At any time, however, the FDIC may request that the notice filer provide additional information.[46] The Preamble indicates that any such requests will be made only if there is reason to believe the agent or nominee does not meet the criteria for the designated exception, and such requests "generally will be limited to verifying" that the agent or nominee meets the applicable criteria.[47] The third party must also provide the FDIC notice if it no longer meets the criteria for the applicable designated exception.

In addition, an entity that submits a notice under the "25 percent" test must submit quarterly reports to the FDIC that update quantitative information regarding the total amount of customer assets under administration and the total amount of deposits placed on behalf of customers that was provided as part of the original notice submission. Similarly, an entity that submits a notice under the "enabling transactions" test must submit an annual certification that the agent or nominee continues to place 100 percent of customer funds into transaction accounts and that depositors do not receive any interest, fees or other remuneration. Failure to submit accurate information in connection with any notice or report or to submit a required report, or to continue to meet the criteria for a designated exception, can result in the FDIC revoking a third party's primary purpose exception.

3. Application Process

If an agent or nominee does not meet one of the designated exceptions described above, it may still qualify the primary purpose exception by submitting an application to the FDIC.[48] The FDIC will provide a written

determination within 120 days of receiving a complete application, which the FDIC may extend up to an additional 120 days upon notice to the applicant. If the FDIC determines an application is incomplete, it will notify the applicant within 45 days and provide an explanation of the information needed to render the application complete. The FDIC expects to make publicly available redacted summaries of "certain approved applications, as soon as practicable" and states that it retains the authority to publish a list of any additional designated exceptions.[49] IDIs and agents or nominees will be able to rely upon this published list of designated exceptions without an application (but a notice and/or ongoing reporting may be required in connection with any new designated exception). The Final Rule also retains the Proposed Rule's treatment of brokered certificates of deposit, *i.e.*, these activities are considered a "discrete and independent business line from other deposit placement businesses in which [an] agent or nominee may engage," and therefore these deposits would always be considered brokered.[50] Similarly, the Preamble states that the FDIC will not grant the primary purpose exception if the agent or nominee's primary purpose is to place funds into deposit accounts to "encourage savings," "maximize yield" or "provide deposit insurance."[51]

In connection with the approval of any application, the FDIC may require periodic reporting to monitor the ongoing applicability of the primary purpose exception. The FDIC will establish reporting requirements, including the contents and timing of any reports, on a case-by-case basis.

4. Evaluation of Business Lines

The Final Rule applies the primary purpose exception to an agent or nominee's specific business lines. Under the Proposed Rule, the FDIC would have analyzed and determined the business lines of an applicant for the primary purpose exception. In contrast, although the determination of a business line under the Final Rule will be made by the FDIC and depend on the facts and circumstances, the Preamble notes that the FDIC "will generally defer to the descriptions of business lines provided by the applicant or notice-filer," and that "the FDIC expects that in many cases, particularly in the case of agents or nominees who are nonfinancial companies, the identification of a business line will be simple and straightforward."[52] The FDIC, however, "is more likely to scrutinize the identification of a business line if the business relationships to which it refers are materially broader than the business relationships with the specific group of customers for whom the business places, or facilitates the placement of, deposits."[53]

5. Monitoring Requirements

Under the Proposed Rule, an IDI that accepted deposits from a third party that relies on the primary purpose exception would have been required to monitor the third party's ongoing eligibility for the exception. In contrast, the Final Rule does not include this requirement. The Preamble, however, states that the FDIC expects the IDI would be able to access records relating to the third party's eligibility, including copies of any notices or applications. The FDIC also expects that "if an IDI has reason to believe that a third party that qualified for a primary purpose exception no longer qualifies for the primary purpose exception... the IDI would notify the FDIC and its primary financial regulator and report the deposits as brokered."[54]

D. THE IDI EXCEPTION AND DEPOSITS GENERATED THROUGH OPERATING SUBSIDIARIES

Section 29 and the FDIC's regulations exclude from the definition of a deposit broker "an [IDI], with respect to funds placed with that [IDI]."[55] Historically, the exception was only available to the IDI and its divisions or departments, but did not include separately incorporated subsidiaries of the IDI.[56]

The Proposed Rule would have expanded this exception to include a wholly owned subsidiary of the IDI, subject to certain criteria. The Final Rule does not include this provision. The FDIC explained in the Preamble that the proposed expansion of the IDI exception was no longer necessary because it would only have applied to a subsidiary that places deposits exclusively with its parent IDI, and the "deposit broker" definition in the Final Rule "does not include third parties that have an exclusive deposit placement arrangement with one IDI."[57]

ADDITIONAL CHANGES

A. CODIFICATION AND RESCISSION OF ADVISORY OPINIONS

The FDIC discussed in the Proposed Rule its plan to reevaluate existing staff advisory opinions relating to the primary purpose exception, and to codify and make public opinions of "general applicability that continue to be relevant and applicable," while rescinding those that are not.[58] The Proposed Rule solicited comment on which opinions should be codified and why.

As discussed above, the Final Rule codifies several staff advisory opinions by creating designated exceptions for certain business relationships described in those opinions. Prior to the full compliance date of January 1, 2022, IDIs may continue to rely on any existing advisory opinion or other interpretations in determining whether a deposit is brokered. After that date, however, IDIs may not rely on advisory opinions or any other interpretation that was issued prior to the Final Rule. The Final Rule includes an index of publicly available opinions and interpretations, including the FAQs, that the FDIC will move to inactive status on January 1, 2022.[59] Entities that have relied on the FDIC's published interpretations in developing their businesses so as not to meet the deposit broker definition, such as listing services and marketing firms, must determine whether they meet the definition under the Final Rule and make any necessary changes prior to 2022.

B. MODIFICATIONS TO THE FDIC'S ASSESSMENT REGULATIONS

The FDIC noted in the Proposed Rule that it expected the Proposed Rule would result in some deposits no longer being considered brokered deposits and that, as part of a future rulemaking, it would consider modifications to its assessment regulations in light of any changes to the brokered deposit regulations.[60] Because of the economic uncertainty created by the COVID-19 pandemic, the FDIC has postponed its consideration of these changes to deposit insurance assessments.[61]

C. TREATMENT OF NON-MATURITY DEPOSITS

As part of the Proposed Rule, the FDIC was considering an interpretation under which non-maturity brokered deposits would be considered "accepted" for purposes of the brokered deposit restrictions at any time new non-maturity deposits are placed at an IDI by or through a deposit broker.[62]

The Final Rule adopts an interpretation that funds are accepted for purposes of the brokered deposit restrictions whenever (1) a new non-maturity account is opened by or through any deposit broker or (2) in the case of existing non-maturity accounts that were opened by or through a particular deposit broker, when (i) the aggregate amount of funds in all such non-maturity accounts increases above the amount in such accounts at the time the IDI falls to adequately capitalized or (ii) when such deposit broker credits funds for a new underlying depositor to a non-maturity omnibus account.[63]

D. CALL REPORT REQUIREMENTS

The Proposed Rule noted that the FDIC will consider requiring banks to disclose, in their call reports, deposits that are excluded from being reported as brokered because of the primary purpose exception.[64] The purpose the FDIC gave for this change was to "assess the risk factors associated with [such] deposits and determine assessment implications, if any."[65]

The Final Rule does not introduce any requirements relating to call reports, but the Preamble notes that the FDIC, together with the Federal Reserve and the OCC, indicated in their final rule implementing the net stable funding ratio ("NSFR") that they intend to revise call reports to gather data to assist in evaluating the stability of sweep deposits over time. The agencies provided this indication in the context of their explanation of why the final NSFR treats affiliate sweep deposits differently from non-affiliate sweep deposits. The Preamble also notes that any changes to call report requirements would be made in a separate Paperwork Reduction Act notice.[66]

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ENDNOTES

[1] FDIC, Final Rule, Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, *available at* https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf (for purposes of this memorandum, the term "Final Rule" refers to the text of the rule, the term "Preamble" refers to the preamble to the Final Rule and the term "Final Release" refers to the combined Preamble and Final Rule). The Final Release also includes the FDIC's final regulations on interest rate restrictions, including amendments to the methodology for calculating the national rate, national rate cap and the local market rate cap, which are not discussed in this memorandum.

[2] 12 C.F.R. § 337.6.

[3] Final Release at 1.

[4] FDIC, Notice of Proposed Rulemaking: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7,453 (Feb. 10, 2020).

[5] 12 U.S.C. § 1831f; 12 C.F.R. § 337.6.

[6] In situations where IDIs that are less than well capitalized offer certain high interest rate deposits, the offering IDI itself is considered the "deposit broker," and such deposits are therefore "brokered deposits" even without third-party involvement. See 12 U.S.C. § 1831f(g)(3).

[7] Although well-capitalized IDIs can accept brokered deposits without restriction, as a result of regulatory developments since Congress enacted Section 29, the classification of deposits as brokered can have significant negative regulatory and other consequences even for well-capitalized IDIs. For example:

The amount of brokered deposits held by an IDI can increase the IDI's deposit insurance assessment rate. *See* 12 C.F.R. §§ 327.16(b)(1)(A)(3) and (b)(2)(A)(3); 12 C.F.R. Part 327 App. A.VI; 12 C.F.R. §§ 327.16(a)(1) and (e)(3).

For a banking organization subject to the federal banking agencies' minimum Liquidity Coverage Ratio ("LCR") requirement, the assumed outflow rate applied to many brokered deposits is higher than that applied to other deposits. *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 outflow 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).

Because of the regulatory stigma that attaches to deposits classified as brokered, such deposits can harm an IDI's marketplace reputation.

[8] 12 U.S.C. § 1831f(g)(1); 12 U.S.C. § 1831f(a).

[9] 12 U.S.C. § 1831f(g)(1).

[10] 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.

[11] Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation, Keynote Remarks at the Brookings Institution, "Brokered Deposits in the Fintech Age" (Dec. 11, 2019) at 3.

[12] Final Release at 4.

[13] ANPR, 84 Fed. Reg. 2,366 (Feb. 6, 2019).

[14] Chairman McWilliams, *supra* n.11, at 4-5.

ENDNOTES (CONTINUED)

15 Like the Proposed Rule, the Final Rule was approved by a vote of three to one, with Director Gruenberg dissenting.

16 Final Release at 4.

17 12 U.S.C. § 1831f(g)(1)(A).

18 Final Release at 166, to be codified at 12 C.F.R. § 337.6(a)(5)(ii).

19 Proposed Rule, 85 Fed. Reg. at 7,457.

20 Final Release at 168, to be codified at 12 C.F.R. § 337.6(a)(5)(iv).

21 Proposed Rule, 85 Fed. Reg. at 7,472. The additional prongs of the proposed "facilitation definition" included (1) the person has legal authority, contractual or otherwise, to close the account or move the third party's funds to another [IDI]"; (2) "the person provides assistance or is involved in setting rates, fees, terms, or conditions for the deposit account"; and (3) "the person is acting, directly or indirectly, with respect to the placement of deposits, as an intermediary between a third party that is placing deposits on behalf of a depositor and an [IDI], other than in a purely administrative capacity."

22 *See* Final Release at 19.

23 Final Release at 16-17.

24 Final Release at 22.

25 Final Release at 167, to be codified at 12 C.F.R. § 337.6(a)(5)(iii).

26 Final Release at 167, to be codified at 12 C.F.R. § 337.6(a)(5)(iii)(C).

27 Final Release at 168, to be codified at 12 C.F.R. § 337.6(a)(5)(iii)(C)(ii).

28 Final Release at 171, to be codified at 12 C.F.R. § 337.6(a)(5)(v)(I)(4).

29 Final Release at 166-167, to be codified at 12 C.F.R. §§ 337.6(a)(5)(ii)–(iii).

30 Final Release at 14.

31 Final Release at 34.

32 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.

The FDIC's existing regulations include these same exceptions, plus an exception for an IDI that is acting as an intermediary or agent of a U.S. government department or agency for a government-sponsored minority- or women-owned depository institution deposit program. 12 C.F.R. § 337.6(a)(5)(ii).

[33] 12 U.S.C. § 1831f(g)(2)(I).

[34] ANPR, 84 Fed. Reg. at 2,372.

[35] Proposed Rule, 85 Fed. Reg. at 7,459.

[36] In the Final Rule, a "third party" is defined as an agent or nominee that submits a notice that it will rely on a designated exception or applies to be excluded from the "deposit broker" definition under the primary purpose exception. *See* Final Release at 157, to be codified at 12 C.F.R. § 303.243(b)(2)(i).

[37] The Preamble noted that the FDIC included some of these business relationships as designated exceptions in the Final Rule based on a review of its staff advisory opinions, both to "streamline the process for determining whether an agent or nominee meets the primary purpose exception" and to allow entities that have relied on staff opinions to continue do so. Many of these relationships are described in FDIC Advisory Opinions 92-78 (Nov. 10, 1992), 94-13 (Mar. 11, 1994), 94-39 (Aug. 17, 1994), 16-01 (May 19, 2016) and 17-02 (June 19, 2017). The Preamble also notes that some business relationships were included as designated exceptions in response to comments the FDIC received on the Proposed Rule. Final Release at 41.

[38] These provisions require broker-dealers and futures commission merchants to maintain certain funds in segregated "special reserve accounts."

[39] The Preamble states that the FDIC included this designated exception for administrators of health savings accounts ("HSAs") because the FDIC was persuaded that HSA administrators that the primary purpose of the relationship between these administrators and depositors is to facilitate the payment for, or reimbursement of, qualified medical expenses. The Preamble notes, however, that not all individuals use funds in HSAs for qualified medical expenses and that the FDIC will "continue to monitor the evolution and use of HSA accounts over time." If the FDIC determines in the future that the designated exception for HSA administrators is no longer warranted, it will make any changes to the exception through notice and comment rulemaking. Final Release at 49.

[40] Final Release at 168-71, to be codified at 12 C.F.R. § 337.6(a)(5)(v)(I)(1).

[41] Final Release at 38.

[42] Final Release at 163, to be codified at 12 C.F.R. § 303.243(b)(v)(a)(2). Although the text of the Final Rule provides the FDIC will approve an application if, among other things, customers make an average of six transactions a month, the Preamble states that the FDIC will be approve an application if, in addition to the other criteria, the customer on average makes "*more* than six transactions a month." Final Release at 40 (emphasis added).

[43] Final Release at 40.

[44] For the "25 percent" designated exception, the required information is "(1) the total amount of customer assets under administration by the third party for that particular business line; and (2) the total amount of deposits placed by the third party on behalf of its customers, for that particular business line, at all [IDIs], being placed by that third party." For the "enabling transactions" designated exception, the required information is "(1) contractual evidence that there is no interest, fees, or other remuneration being paid to any customer accounts, and (2) a certification that all customer deposits that are placed at [IDIs] are in transaction accounts." Final release at 159, to be codified at 12 C.F.R. §§ 303.243(b)(3)(i)(a)–(b).

ENDNOTES (CONTINUED)

[45] Final Release at 58.

[46] Final Release at 159, to be codified at 12 C.F.R. § 303.243(b)(3)(ii).

[47] Final Release at 58.

[48] Under the Final Rule, an applicant is required to provide, to the extent applicable: (1) a description of the deposit placement arrangements with all entities involved; (2) a description of the particular business line to which the primary purpose exception would apply; (3) a description of the primary purpose of that particular business line; (4) the total amount of customer assets under administration by the third party; (5) the total amount of deposits placed by the third party at all IDIs, including the amounts placed with the applicant, if the applicant is an IDI (including the total amount of term deposits and transactional deposits placed by the third party, exclusive of the amount of brokered certificates of deposit placed by that third party); (6) revenue generated from the third party's activities related to the placement, or facilitating the placement, of deposits; (7) revenue generated from the third party's activities not related to the placement, or facilitating the placement, of deposits; (8) a description of the marketing activities provided by the third party to prospective depositors; (9) the reasons the third party meets the primary purpose exception; (10) any other information the applicant deems relevant; and (11) any other information that the FDIC determines is necessary to complete its review.

[49] Final Rule at 52.

[50] Final Release at 171, 12 C.F.R. § 337.6(a)(5)(v)(I)(3).

[51] Final Release at 54.

[52] Final Release at 55-56.

[53] Final Release at 56.

[54] Final Release at 65.

[55] 12 U.S.C. § 1831f(g)(2)(A).

[56] 85 Fed. Reg. at 7,458; *see also* 84 Fed. Reg. at 2,372 (noting that FDIC staff "has consistently applied the [IDI] exception strictly to the IDI itself and not to separately incorporated legal entities such as subsidiaries or other affiliates").

[57] Final Release at 28.

[58] Proposed Rule, 85 Fed. Reg. at 7,460.

[59] Final Release at 121.

[60] Proposed Rule, 85 Fed. Reg. at 7,463.

[61] Final Release at 74.

[62] Proposed Rule, 85 Fed. Reg. at 7,463.

[63] Final Release at 176-77, to be codified at 12 C.F.R. § 337.6(b)(4).

[64] Proposed Rule, 85 Fed. Reg. at 7,463.

[65] Proposed Rule, 85 Fed. Reg. at 7,463.

[66] Final Release at 75.

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