FDIC Finalizes Changes to Brokered Deposit Regulations

December 21, 2020

On December 15, 2020, the Federal Deposit Insurance Corporation ("FDIC") approved a final rule that establishes a new framework for analyzing whether deposits are classified as brokered deposits (the "Final Rule").[1] The Final Rule also amends the methodology for calculating the interest rate restrictions that apply to less than well capitalized insured depository institutions ("IDIs").[2]

According to FDIC Chair Jelena McWilliams, the Final Rule seeks to "encourage innovation in how banks offer services and products to customers by reducing obstacles to certain types of partnerships" while at the same time "protect the Deposit Insurance Fund." As further discussed below, the Final Rule introduces:

- a bright line test for when a person would be regarded as in the business of placing, or facilitating the placement of deposits, including by clarifying that a third party that partners exclusively with a single IDI would not be regarded as a "deposit broker";
- a new framework and application process for evaluating the applicability of the primary purpose exception ("PPE"); and
- several "designated exceptions" covering a broad range of business relationships that will be deemed to qualify for the PPE without a formal application to the FDIC.

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1 A link to the Final Rule may be founded here: https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf.

2 In particular, the Final Rule amends the FDIC's methodology for calculating the national rate, the national rate cap, and the local rate cap, simplifies the process for IDIs that seek to offer a competitive rate when the prevailing rate in an IDI's local market area rate exceeds the national rate cap and adopts a new interpretation for the solicitation and acceptance of nonmaturity deposits. These changes are not discussed in detail in this update.

We summarize these three categories of changes below and, where applicable, we highlights certain areas in which the Final Rule departs from the FDIC's December 2019 proposal (the "proposed rule").

The Final Rule will be effective on April 1, 2021, with full compliance with the brokered deposit part of the regulation extended to January 1, 2022.[3]

SUMMARY OF THE FINAL RULE

Deposit Broker Definition

Section 29 of the FDI Act provides that a person is a "deposit broker" if, among other things, such person is engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with IDIs, or engaged in the business of placing deposits with IDIs for the purpose of selling interests in those deposits to third parties. The definition of a "deposit broker" also includes any "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." Chair McWilliams had previously described the interpretive framework for the definition as a "fragmented, opaque legal regime that exists outside of the FDIC's public-facing regulations, understood by only a select few." The Final Rule seeks to more clearly define key terms under the statute and thus provide clarity to the FDIC's interpretation of the statutory definition by establishing regulatory tests for these prongs of the deposit broker definition.

1. Engaged in the business with more than one IDI

The first two prongs of the statutory definition of the "deposit broker" provides that a person is a "deposit broker" when it is *engaged in the business* of placing deposits or facilitating the placement of deposits with *insured depository institutions*. The Final Rule clarifies that a person is "engaged in the business" of placing deposits or facilitating the placement of deposits when that person has a business relationship with third parties, and as a part of that relationship, places or facilitate the placement of deposits with more than one IDI on behalf of the third parties.

Accordingly, under the Final Rule, a person that has an exclusive deposit placement arrangement with one IDI, as may be the case with financial technology companies or with a broker-dealer that sweeps deposits to a single, affiliated IDI, would not be deemed to be a deposit broker under this prong of the definition. The FDIC notes, however, that a person that uses multiple entities that each place deposits at different

[3] The Final Rule would be reflected in Call Report Data due June 30, 2021.

IDIs to evade this rule would still be viewed, together with these other entities, as one person for purposes of the Final Rule.

2. Engaged in the business of placing deposits

The statute provides that a person meets the definition of "deposit broker" if the person is "engaged in the business of placing deposits." In a 2016 FAQ and in FDIC Advisory Opinion 94-15, the FDIC previously clarified that a third party "places deposits" when the third party actually delivers funds to an IDI. The Final Rule codifies these interpretations by clarifying that a person is engaged in the business of placing deposits of third parties if that person "receives third party funds and deposits those funds at more than one [IDI]."

3. Engaged in the business of facilitating the placement of deposits

The statute also provides that a person meets the definition of "deposit broker" if the person is "engaged in the business of … facilitating the placement of deposits…" Historically, FDIC staff have interpreted this phrase broadly to include most actions taken by third parties to connect IDIs with potential depositors. The Final Rule provides a three-pronged test for when a person would meet the facilitation prong. In particular, a person would be deemed to be "facilitating the placement of deposits" by engaging in one or more of the following activities:

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 is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account; or

3. The person engages in matchmaking, as defined in the Final Rule

These three prongs are intended to capture activities that demonstrate 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 open. In contrast to the Final Rule's three-pronged approach, the proposed rule had proposed a four prong test. The Final Rule's first two prongs (legal authority and setting rates, terms and conditions) were adopted largely as proposed, but the Final Rule does not adopt the other two prongs as proposed, instead incorporating certain concepts from those prongs into a new third prong. Key elements of this approach are discussed below.

Legal Authority

As under the proposed rule, the Final Rule provides that a person that has legal authority, contractual or otherwise, to close the account or move the third party's funds to another IDI would be deemed to be facilitating the placement of deposits. The FDIC explains that "[h]aving a certain level of influence over account opening, or retaining a level of control over the movement of customer funds after the account is open, indicates that the deposit relationship is between the depositor and the person rather than the depositor and the [IDI]." In such cases, the FDIC views the deposits as tending to be less stable than if the deposits were brought to the IDI through a party does not have influence over the movement of deposits.

Setting Rates, Terms, Conditions

The Final Rule provides that a person that is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account would be deemed to be facilitating the placement of deposits. The Final Rule therefore largely adopts this prong as proposed, except that, in response to commenters, the FDIC clarified that the prong only includes activities where a third party is negotiating or setting rates, terms or conditions rather than simply "providing assistance" in such activities. FDIC staff explained that this prong was not intended to include certain activities such as market research, general consulting or advisory services, or advertising by including a link on a website.

Providing Matchmaking Services

A person would be deemed to be engaged in matchmaking under the Final Rule if the person proposes deposit allocations at, or between, more than one bank[4] 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. A proposed deposit allocation is based on the particular objectives of a depositor (or depositor's agent) when the person has access to specific financial information of the depositor (or depositor's agent) and the proposed deposit allocation is based on such information. Similarly, a proposed deposit allocation is based on the particular objectives of a bank when the person has access to specific information of the deposit-balance objectives of the bank and the proposed deposit allocation is based on such information. Accordingly, the third prong would not capture third parties that provide administrative services as part of a deposit sweep program between a depositor, its broker dealer and unaffiliated banks so long as the third party does not propose deposit allocations.

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[4] The Final Rule uses the term "bank" rather than IDI. Presumably, the Final Rule intends to refer to IDIs generally and not "banks" in the narrow sense of that term..

Notably, this prong would not include would-be matchmakers engaged in such activities if, and to the extent that, these activities are conducted between a bank and an affiliated third party. The FDIC explained that such services by an intermediary are viewed as purely administrative nature due to the pre-existing relationship between the IDI and the affiliate. Importantly however, this third prong does not exclude all deposit relationship between an IDI and its affiliates from the scope of the Final Rule. A third party still could be covered by the first or second prong or deemed to be deemed to be "placing deposits" (as opposed to facilitating the placement of deposits).

Finally, the FDIC acknowledges that it may be possible for an entity that otherwise meets the matchmaking prong to modify its business arrangements in an evasive way. The FDIC has included an anti-evasion provision that would allow the FDIC to make a determination that such arrangements nonetheless meet the matchmaking prong.

4. Other Prongs of Deposit Broker Definition Unchanged

The statute provides that even if a person is not engaged in the business of placing deposits or facilitating the placement of deposits, a person is a deposit broker if the person is engaged in the business of placing deposits with IDIs for the purpose of selling interests in those deposits to third parties or if the person acts as an agent or trustee which 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 does not make any modifications to these prongs of the definition or otherwise provide further interpretation of them. With respect to the former (selling interests in deposits to third parties), the FDIC explained that this prong specifically captures brokered certificates of deposits ("CDs"), noting that brokered CDs have caused "significant losses to the Deposit Insurance Fund."

5. Potential Changes to Regulatory Reporting

As part of the final rule implementing the Net Stable Funding Ratio, the FDIC and other federal banking agencies stated their intent to revise the Call Reports to obtain data that would help evaluate funding stability of sweep deposits over time. In the preamble to the Final Rule, the FDIC stated that it would monitor this information to assess the risk factors associated with sweep deposits and determine implications for deposit insurance assessments, if any. Although the FDIC stated in the preamble to the proposed rule that it would consider requiring reporting of deposits that are excluded from being reported as brokered deposits because of the application of the PPE, no new reporting is being implemented at this time. Instead, the FDIC says that any reporting requirements applicable to the Call Reports would be effectuated in coordination with the Federal Financial Institutions Examination Council in a separate Paperwork Reduction Act notice.

Primary Purpose Exception

Under the statute, the term "deposit broker" excludes "an agent or nominee whose primary purpose is not the placement of funds with depository institutions." As with the prongs of the "deposit broker" definition discussed above, the PPE has been administered by the FDIC through the issuance of guidance and interpretations, rather than through implementing regulations. The Final Rule seeks to provide clarity by establishing a bright line test for determining the PPE's applicability through various "designated exceptions," which are available without an application process (although prior notice is required in two cases described below). In addition, the Final Rule allows agents or nominees that do not meet one of these designated exceptions to formally apply (or for an IDI to apply on behalf of such an agent or nominee) for a PPE based on enumerated criteria. In this regard, the Final Rule represents a significant departure from the proposed rule, pursuant to which firms always would have been required to submit an application to the FDIC to rely on the PPE (although the applications would have been deemed to be approved in certain circumstances).

Designated Exceptions.

Below, we describe the Final Rule's fourteen (14) designated exceptions. Although none of these exceptions will require a formal application to the FDIC, the first two of these will require firms to file a written notice with the FDIC indicating intent to rely on the relevant designated exception.

The applicability of designated exceptions will be done on a business line-by-business line basis. The FDIC explained that this is intended to prevent an agent or nominee engaged in deposit brokerage from evading statutory restrictions by adding or combining its brokerage business with another business such that the deposit broker business is no longer its primary purpose. As explained in the preamble, the term "business line" refers to the business relationships an agent or nominee has with a group of customers for whom the business places, or facilitates the placement of, deposits. The FDIC indicated that although it generally would defer to the descriptions of business lines provided by the applicant (if an application is required) or notice-filer, it would be 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.

Below we first discuss the two business relationships that qualify for a designated exceptions, but that require a notice filing to the FDIC, and then discuss the twelve designated exceptions that do not require any notice filing.

1. Designated Exceptions Requiring Notice Filing

Two of the designated exceptions require the agent or nominee (or IDI) to file a written notice with the FDIC, which would include information regarding:

- the designated exception upon which the entity is relying;
- a brief description of the business line;
- the applicable specific contents for the designated exception;
- a statement that there is no involvement of any additional third party who qualifies as a deposit broker or a brief description of any additional third party that may so-qualify; and
- if the notice is provided by a nonbank entity, a list of the IDIs that receive deposits by or through the particular business line.

An agent, nominee or IDI, as applicable, may rely on such designated exception upon the FDIC's receipt of the notice, which the FDIC intends to provide immediately pursuant to an automated electronic process. The FDIC notes that it may require the notice filer to provide additional information at any time, but that it generally would do so only to verify that the third party meets the criteria for the applicable designated exception and only expects to make such request if it has reason to believe that the agent, nominee or IDI does not meet, or no longer meets, the requirements for the designated exception. Finally, firms that have filed such a notice but no longer meet the requirements for the PPE would need to file a subsequent notice to the FDIC informing the agency of that fact.

The two designated exceptions requiring notice filing are available for persons that meet the below summarized criteria.

- Less than 25 percent of the total assets that the agent or nominee has under administration for its customers are placed at depository institutions (requires the filing of a notice with the FDIC).
    - In the notice filing required by the Final Rule, the agent or nominee (or IDI) also would need to include information regarding the total amount of customers assets under administration by the third party for that particular business line and the total amount of deposits placed by the third party on behalf of its customers, for that particular line, at all IDIs. A person relying

on this exception also would need to provide quarterly reporting to the FDIC regarding these metrics.

- The proposed rule used a formulation based on 25 percent of total assets under management. Acknowledging that the phrase "assets under management" is generally limited to certain broker-dealer and investment advisory businesses, the FDIC revised the exception to refer to assets under administration, which refers to assets for which the agent or nominee provides services beyond asset management.

- The 25 percent test would be assessed by measuring the total market value of all financial assets (including cash balances) that the agent or nominee administers on behalf of its customers that participate in a particular business line.

- 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 (requires the filing of a notice with the FDIC).

  - In the notice filing required by the Final Rule, the agent or nominee (or IDI) would need to provide contractual evidence that there is no interest, fees, or other remuneration being paid to any customer accounts and a certification that all customer deposits are in transaction accounts. Going forward, a person relying on this exception would be required to provide an annual certification that the third party continues to place all customer funds in transaction accounts and that customers do not receive or accrue any interest, fees or other remuneration.

  - Agents or nominees that placed customer deposits at depository institutions in transactional accounts in which the customer does earn some amount of interest, fees, or other remuneration, even if nominal, would not qualify for the designated exception and would continue to be subject to an application process described further below.

    - As a part of any required application, the FDIC would consider : (1) the amount of interest, fees or other remuneration; (2) the amount of transactions that customers make, on average, on a month-to-month basis; (3) the marketing materials provided by the agent or nominee and whether such materials indicate that funds placed into IDIs are to enable transactions for depositors; and (4) whether any funds are placed in deposit accounts that are not transaction

accounts, as well as the percentage of funds placed into such accounts.

- Any required application would be automatically approved if the agent or nominee was able to establish that its customers earn a nominal amount of interest, fees or other remuneration on its deposits (based on the interest rate environment at the time) or, on average, make more than six transactions a month.

2. Designated Exceptions That Do Not Require Notice Filing

The twelve business relationships that qualify for a designated exception, and that do not require a notice filing to the FDIC, available to persons that meet the below summarized criteria.

- A property management firm places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing property management services.
  - This designated exception is available only for property management firms, and may not be available for affiliates of such firms that are not engaged in providing property management services.
  - Companies that assist property management firms or their clients in placing funds at IDIs to maximize yield or deposit insurance may still be deemed to be deposit brokers.
- 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 FDIC acknowledged that IDIs provide a variety of clearing services that may be outside of the scope of this designated exception. The FDIC stated that it would evaluate whether these other clearing services will meet the PPE as a part of the application process.
- 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).

- 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 (i.e., Health Savings Accounts).

- 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 (i.e., 529 plans).

- 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 PPE.

    - From time to time, the FDIC may publish on its website business relationships that it has determined to meet the PPE. Designated exceptions identified in this way may be relied upon without an application.

3. Business Relationships Not Eligible for a PPE

The FDIC also identified certain business relationships that would be ineligible for the PPE. In particular, the FDIC stated that it would continue to consider a person's placement of brokered CDs as deposit brokerage, and that it would not grant a PPE if a third party's primary purpose for its business relationship with its customers is to place (or assist in the placement of) funds into deposit accounts to "encourage savings," "maximize yield," "provide deposit insurance" or any similar purpose.

Application Process for Business Relationships that do not meet a Designated Exception

Agents, nominees or IDIs that meet the "deposit broker" definition, but that do not qualify for a designated exception, may submit an application to the FDIC to rely on the PPE. Applications must include, to the extent applicable:

- a description of the deposit placement arrangements between the third party and insured depository institutions for the particular business line, including the services provided by any relevant third parties;
- a description of the business line for which the applicant is filing an application;
- a description of the primary purpose of the particular business line;
- the total amount of customer assets under management by the third party, with respect to the particular business line;
- the total amount of deposits placed by the third party at all insured depository institutions, including the amounts placed with the applicant, if the applicant is an insured depository institution, with respect to a particular business line. This includes the total amount of term deposits and transactional deposits placed by the third party, but should be exclusive of the amount of brokered CDs being placed by that third party;
- revenue generated from the third party's activities related to the placement, or the facilitating of the placement, of deposits, with respect to the particular business line;
- revenue generated from the third party's activities not related to the placement, or the facilitating of the placement, of deposits, with respect to the particular business line;

- a description of the marketing activities provided by the third party to prospective depositors, with respect to the particular business line;
- the reasons the third party meets the PPE;
- any other information the applicant deems relevant; and
- any other information that the FDIC determines is necessary to complete its review.

Applicants will receive a written determination from the FDIC within 120 days of a complete application, unless extended by the FDIC with notice. The FDIC will notify an applicant within 45 days of submission if an application is not complete and explain what is needed to render the application complete. The FDIC also may extend the 120-day timeframe to complete its review of a complete application for a maximum of 120 additional days. Approved applicants may be subject to periodic reporting requirements, which would be described in any written approval. To the extent that an IDI relies on a third party's PPE but has not itself submitted a notice or application, the IDI would be expected to be able to access the records of the nonbank third party's eligibility, including copies of notices delivered to the FDIC and any accepted applications. At any time after approval of an application, the FDIC may require additional information, require the applicant o reapply for approval, impose additional condition on an approval or withdraw an approval.

The FDIC intends to make publicly available on its website: (1) redacted summaries of certain approved applications; and (2) a list of additional designated exceptions. Redacted summaries available on the FDIC's website are excepted to describe business relationships not discussed in the Final Rule that the FDIC has determined to meet the primary purpose exception and may be cited as support in applications for the PPE in certain circumstances. The FDIC notes further that designed exceptions identified in this way may be relied upon, without an application, by any agent or nominee that meets the published criteria, and that the FDIC would note on its website whether a notice and / or any ongoing reporting will be required with respect to a new designated exception.

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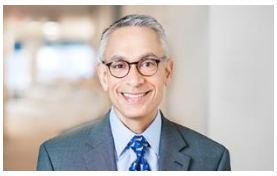

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