

LEGAL UPDATES AND NEWS

FDIC Proposes to Modernize its Brokered Deposit Rules

On December 12, 2019, the Federal Deposit Insurance Corporation (the “FDIC”) issued a notice of proposed rulemaking (the “Proposed Rule”) to modernize certain aspects of its brokered deposit regulatory framework so that the classification of a brokered deposit appropriately reflects technological changes in the banking industry. The FDIC will issue its final rule after reviewing all comments submitted on the Proposed Rule, which is subject to change.

I. Background

Section 29 of the Federal Deposit Insurance Act (the “FDI Act”), as implemented by Part 337 of the FDIC’s regulations, provides that an insured depository institution (“IDI”) that is not well capitalized is prohibited from accepting deposits that are obtained through deposit brokers (i.e., brokered deposits) and from paying interest on deposits that significantly exceed prevailing market rates. An IDI that ceases to be well capitalized while holding brokered deposits may not generally renew, extend or roll over any existing brokered deposits without prior FDIC approval. The FDI Act does not directly define a “brokered deposit,” rather, it defines a “deposit broker” for purposes of these restrictions.

Banks are increasingly utilizing fintech and other third-party entities to engage and interact with customers. This changing technological landscape has caused concern that these entities could be classified as deposit brokers under the FDI Act, even though their activities may only be incidentally associated with a deposit account. In response, the Proposed Rule would create a framework for how the FDIC would analyze certain prongs of the definition of a “deposit broker” and establish an application and reporting process for fintech and other third-party entities to ensure their exemption from being classified as deposit brokers.

II. Summary of Material Provisions of the Proposed Rule

A. Definition of “Deposit Broker”

The FDI Act 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 at IDIs for the purpose of selling interests in those deposits to third parties.” To provide more clarity, the FDIC is proposing to define certain prongs of this definition as follows:

1. “Engaged in the Business of Placing Deposits”

Under the Proposed Rule, the FDIC would consider a person to be “engaged in the business of placing deposits” and a deposit broker if that person has a business relationship with its customers, and as part of that relationship, places deposits on behalf of the customers. The Proposed Rule specifies that any person that places deposits at IDIs on behalf of a depositor as part of its business relationship with that depositor would be “engaged in the business of placing deposits” and be treated as a deposit broker.

2. “Engaged in the Business of Facilitating the Placement of Deposits”

In contrast with the first prong above, this second prong (the “facilitation prong”) of the definition of brokered deposit refers to activities where the person does not directly place deposits on behalf of its customers with an IDI. The Proposed Rule noted that the FDIC has historically interpreted the facilitation prong to include actions taken by third parties to connect IDIs with potential depositors. Critics have argued

that the facilitation prong has been broadly interpreted to include any actions taken by third parties to connect IDIs with potential depositors. In response, the FDIC proposes to more narrowly define the facilitation prong so that a person would be deemed to be engaged in the business of facilitating the placement of deposits if the person either: (1) directly or indirectly shares any third party information with the IDI; (2) has legal authority to close the account or move the third party funds to another IDI; (3) provides assistance or is involved in setting rates, fees, terms or conditions for the deposit account; or (4) acts as an intermediary between a third party that is placing deposits on behalf of its customer and an IDI, other than in a purely administrative capacity. This definition is intended to capture activities that indicate where a third party has a level of control or influence over the deposit account, which demonstrates that the customer/depositor relationship is with the third party rather than the IDI.

3. “Engaged in the Business of Placing Deposits with IDIs for the Purpose of Selling Interests in those Deposits to Third Parties.”

This third prong specifically captures the brokered certificates of deposit (CD) market and would not change the FDIC’s current position. Deposits placed with an IDI by an agent through the brokered CD market will continue to be classified and reported as brokered deposits.

B. Exceptions to the Deposit Broker Definition

The FDI Act and the FDIC regulations provide certain exceptions to the definition of deposit broker, two of which are clarified by the Proposed Rule: (1) the exception for IDIs with respect to funds placed with that IDI (the “IDI exception”); and (2) the exception for a third party whose primary purpose is not the placement of funds with IDIs (the “primary purpose exception”).

1. IDI Exception

Under the IDI exception, an IDI is not considered to be a deposit broker when its full-time employees place funds at their IDI. The FDIC has never interpreted this exception to apply to funds placed at the IDI by its subsidiary. The Proposed Rule, however, recognizes that a subsidiary of an IDI functionally acts as a division and, as such, these deposits would not be brokered deposits if the subsidiary: (1) is wholly-owned by the IDI; (2) places deposits exclusively with its parent IDI; and (3) engages only in activities permissible for its parent IDI.

2. Primary Purpose Exception

The Proposed Rule amends the primary purpose exception to apply when the primary purpose of the third party’s business relationship with its customers is not the placement of deposit funds. The FDIC would determine the applicability of this exception through a formal application and reporting process. Applicants would receive a written determination from the FDIC within 120 days after receiving a complete application. Applicants that meet the primary purpose exception (which would include IDIs that apply on behalf of a third party) would need to provide reports to the FDIC and, if applicable, in the case of IDIs, to its primary federal regulator, which is anticipated to be required on a quarterly basis. The FDIC is also considering requiring banks to report in their Call Reports their deposits that are not brokered deposits due to the primary purpose exception.

The Proposed Rule provides for three separate application processes. Under the first application process, the FDIC would approve an application to qualify for the exception if 25% of the total assets that the third party has under management for its customers for a specific line of business is placed at IDIs. This would permit IDIs to accept deposits (sweeps) from unaffiliated brokers without those deposits being considered brokered deposits, as is the case under the FDIC’s current interpretation of its brokered deposit rules.

Under the second application process, the FDIC would approve an application to qualify for the exception if the third party places 100% of its customer funds into transaction accounts at IDIs and no fees, interest or other remuneration is provided to the depositor. This would be a significant departure from the FDIC's long-standing position that prepaid deposits from debit card program managers were brokered deposits and would be a recognition by the FDIC that the primary purpose of these program managers is to facilitate payments between parties. The Proposed Rule, however, specifies that if the third party or IDI pays any interest, fee or provides any remuneration, then the FDIC would more closely scrutinize the third party's business to determine whether the primary purpose is really to enable the processing of payments.

If neither the first nor second application processes are applicable, a third party would be eligible to apply for the exception under a general application process pursuant to which the FDIC would expect the third party to demonstrate that its primary purpose is something other than the placement of funds at IDIs. The FDIC would consider several factors in evaluating this general application, including: (1) whether the third party receives a majority of its revenue from its deposit placement activity; (2) whether the third party's marketing activities is aimed at opening a deposit account or providing some other service and, if there is some other service, whether the opening of the deposit account is incidental to that service; and (3) the fees and type of fees received by the third party for any deposit placement services offered.

The Proposed Rule clarifies that the primary purpose exception is not available for certain businesses of a third party, including the third party's placement of brokered CDs or placement of funds into deposit accounts for purposes of encouraging savings.

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