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FDIC Approves Final Rule on Brokered Deposits

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On December 15, 2020, the Federal Deposit Insurance Corporation (FDIC) approved a final rule revising its brokered deposit regulations, effective April 1, 2021. Most significantly, the final rule modernizes the regulation of brokered deposits in light of technological and other innovations in the way banks source deposits. The new framework is a welcome development for banks that have been advocating for changes to the outdated brokered deposit rules originally promulgated in 1989.

Under "prompt corrective action" rules that apply to all insured banks, banks that are less than "well capitalized" are subject to limits on acceptance, renewal, or rollover of brokered deposits. Further, regardless of capital level, the prudential agencies generally expect that acceptance of brokered deposits will be a component of a diversified funding strategy and not a tactic to generate funding for rapid expansion or to engage in risky banking activities. The higher the ratio of brokered deposits to non-brokered, the higher the expectations and concerns. High brokered deposits can also result in higher FDIC deposit insurance premiums. While banks that are well capitalized are not limited or restricted in accepting brokered deposits, even healthy banks can be criticized for relying too heavily on perceived "hot money" deposits, and banks are reluctant to rely on funding that would be unavailable if their capital positions change in the future.

A deposit is "brokered" if it is obtained, directly or indirectly, from or through the mediation or assistance of a "deposit broker." The FDIC's existing guidance has broadly interpreted the term deposit broker to include nearly any third party that is involved in gathering deposits, regardless of its role, which has resulted in many types of deposits being deemed brokered. The final rule makes material changes that recognize that these broad standards do not reflect the true riskiness of these deposits and recharacterize a wide swath of deposit marketing arrangements as not brokered.

Similarly, the final rule materially alters application of the "primary purpose exception," a statutory exception providing that an "agent or nominee whose primary purpose is not the placement of funds with depository institutions" is not a deposit broker, and therefore funds placed with banks by such an agent or nominee

are not brokered deposits. Historically, the FDIC has taken a very restrictive view of the primary purpose exception such that it was not often relied upon to avoid brokered deposit treatment, but the final rule sets forth numerous scenarios in which the primary purpose exception may be relied upon to avoid brokered deposit classification.

Significant changes include the following:

- FinTech companies or other third parties are not deposit brokers if they have an exclusive deposit-placing relationship with only one bank. Interestingly, former FDIC Chairman Martin Gruenberg dissented to the final rule largely based on this provision, arguing that this type of exclusive arrangement can still be "moveable" at the whim of the FinTech partner and is thus an unreliable and volatile source of funding for banks.
- The rule significantly narrows the scope of third parties deemed to be in the business of "facilitating the placement of deposits," such that deposits generated through many third parties (including marketing and endorsing arrangements) may now be deemed core deposits unless the third party takes actions that meet one of the following three prongs of the "facilitation" definition in the final rule:
  1) The third party has legal authority, contractual or otherwise, to close accounts or move funds to another insured depository institution.
  2) The third party is involved in negotiating or setting rates, fees, terms, or conditions for deposit accounts.
  3) The third party engages in matchmaking, meaning the third party proposes deposit allocations at, or between, more than one bank based upon both (1) the particular deposit objectives of a specific depositor or depositor's agent; and (2) 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.
- The final rule lists several types of deposit-placement arrangements that automatically meet the primary purpose exception without requiring any application or notice, including when:
  - 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 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 [SEC and CFTC rules];

  - 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;
  - 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; [and]
  - the agent or nominee places, or assists in placing, customer funds into deposit accounts to enable participation in [IRAs or Roth IRAs].

- The final rule sets forth a new application and notice procedure for certain types of deposit-placement arrangements under the primary purpose exemption. For example, only a notice filing is required in situations where (1) less than 25 percent of the total assets that an agent or nominee has under administration for a particular business line of its customers is placed at depository institutions; or (2) 100 percent of the 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. In the latter case, an application is required if the depositor will receive any fees, interest, or other remuneration. The FDIC expects to make publicly available on its website redacted summaries of certain approved applications.

In addition to the changes related to brokered deposits, the final rule updates and clarifies the interest rate restrictions that apply to less-than-well-capitalized banks. Banks that are not well capitalized are prohibited from offering interest rates on their deposits at rates exceeding rates in their prevailing market. The final rule clarifies the method for calculating such rate and provides a new simplified process for banks that seek to offer a competitive rate when their prevailing market rate exceeds the national rate cap.

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