The Payments Report is a complimentary monthly newsletter included in your NEACH membership. It covers legislation and regulatory changes being considered by federal government agencies -- providing analysis of pending actions and inside political intelligence, Congressional priority of legislation, and intent of proposed language. Please share this publication with colleagues in your financial institution or ask them to request a copy by sending an email to info@neach.org.

FDIC Proposes Overhaul of the Brokered Deposit Regime

Overview: On December 12th, the Federal Deposit Insurance Corporation (“FDIC”) issued a Notice of Proposed Rulemaking ("NPR") proposing comprehensive changes to the brokered deposit regulatory framework. The NPR is intended to modernize this framework and reflect the technological changes and innovations that have occurred since brokered deposits were first regulated in 1989. It is informed by public comments the FDIC received in response to its request for input on the brokered deposit regime in December of last year ("ANPR").

Background

Section 29 of the Federal Deposit Insurance Act (the “FDI Act”)\(^1\) was first enacted in 1989—and subsequently amended several times—to combat banking abuses and failures attributed to banks’ previously unrestricted use of brokered deposits. In particular, Congress sought at the time to target brokered certificates of deposit (“CDs”) after troubled institutions’ excessive reliance on these products led to significant losses to the Deposit Insurance Fund. The result was Section 29, which limited the ability of less-than-well-capitalized insured depository institutions (“IDIs”) (i.e., those failing to maintain a minimum level of capital) to fund rapid growth in low-quality, inherently risky assets fueled by brokered deposits.

Today, Section 29 and the FDIC’s implementing regulation subject IDIs that are less-than-well-capitalized to certain constraints on soliciting, accepting, and offering interest rates on brokered deposits. Whether a deposit is subject to these restrictions hinges on the definition of “deposit broker,” a term defined by statute and that the FDIC has historically interpreted broadly. However, the banking landscape has changed significantly since the 1980s (consider, for instance, the emergence of the Internet, smartphones, prepaid cards, and third-party fintech apps), and the FDIC’s effort to clarify which deposit arrangements are considered “brokered”—often through confidential letters and case-by-case staff opinions—has led to a fragmented, opaque, and inconsistent regime ripe for overhaul. The NPR seeks to do just that.

---

\(^1\) See 12 U.S.C. § 1831f; see also 12 C.F.R. 337.6 (implementing regulation).
Summary of the Proposed Rule

The FDI Act defines “deposit broker” as:

- Anyone engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with IDIs;
- Anyone 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 with an IDI to use the proceeds of the account to fund a prearranged loan.

The statute and regulation also contain exceptions to this definition, including one that excludes IDIs, with respect to funds placed with that IDI (the “IDI Exception”) and one that excludes “an agent or nominee whose primary purpose is not the placement of funds with depository institutions” (the “Primary Purpose Exception”).

Both the definition and its exceptions have been the subject of numerous FDIC staff interpretations and agency guidance that, according to commenters responding to last year’s ANPR, have broadened the scope of “deposit broker” to cover nearly every transaction with an IDI involving a third party. Throughout the ANPR responses, commenters consistently appealed to the FDIC for definitional clarity and almost unanimously requested narrowing the scope of the brokered deposit regime. Some focused on specific types of deposits they believed should be outside the definition, such as those underlying prepaid cards—these commenters argued such deposits constitute stable sources of funding offered by companies engaged in the business of offering prepaid payments rather than placing deposits.

The NPR responded to these and other comments with a new framework for analyzing the “deposit broker” definition and its corresponding exclusions, proposing to:

1. Clarify the definition of “deposit broker” by:

   - Interpreting the phrase “engaged in the business of placing deposits” to cover instances where a person places deposits on behalf of its customers as part of its business relationship with them.
   - Interpreting the phrase “facilitating the placement of deposits” to capture activities that show an active role in opening accounts or a level of influence or control over a deposit account, even after it is opened. To do so, the “facilitation” prong would cover specified activities, including where a person:
     - Directly or indirectly shares any third-party information with the IDI;
     - Is involved in setting rates, fees, terms, or conditions for the deposit account;
     - Has legal authority to close the account or move the funds to another IDI; or
     - Acts, directly or indirectly with respect to the placement of deposits, as an intermediary between a third party placing deposits on behalf of a depositor and an IDI, other than in a purely administrative capacity.
   - Continuing to interpret the phrase “placing deposits with [IDIs] for the purpose of selling interest in those deposits to third parties” as capturing the brokered CD market. Most often, the brokered CD market refers to deposit placement arrangements where master CDs are issued by a bank and are
then subdivided by and sold through broker-dealers to customers in amounts that would assure full FDIC insurance coverage.

2. Amend the IDI Exception to also apply to an IDI’s wholly owned subsidiary, as long as: the IDI owns 100% of the subsidiary’s outstanding stock; the subsidiary places deposits of retail customers exclusively with the parent IDI; and the subsidiary engages only in activities permissible for the parent IDI.

3. Amend the Primary Purpose Exception to apply when the primary purpose of an agent’s or nominee’s business relationship with its customers is not the placement of funds with IDIs. The NPR proposes two specific instances where the exception would apply:

   o First, the exception would apply when less than 25% of the total assets an agent or nominee manages for its customers, in a particular business line, is placed at IDIs.

   o Second, the exception would apply where an agent or nominee places depositors’ funds into transactional accounts for the purpose of enabling payments. This covers all situations where 100% of customer funds are placed into IDI transaction accounts and no fees, interest, or other remuneration is provided to the depositor. However, if the agent, nominee, or IDI pays any sort of interest, fee, or remuneration, the FDIC would consider a number of factors (e.g., volume of transactions in customer accounts, the amount of interest or fees, etc.) in determining whether the primary purpose is truly to enable payments and the PPE applies.

   The primary purpose exception specifically would not apply to the placement of brokered CDs or where a third party’s primary purpose for its business relationship with its customers is to place funds into deposit accounts to “encourage savings,” “maximize yield,” or “provide deposit insurance” or similar circumstances.

4. Establish a Primary Purpose Exception Application Process requiring an IDI or nonbank third party to request permission from the FDIC to avail itself of the Primary Purpose Exception. An applicant would need to submit specific information in its request to the FDIC, after which the agency must provide a written determination within 120 days. Approved applicants would need to provide reports to the FDIC (and, in the case of an IDI, to its primary federal regulator), and could be subject to requests from the agency for additional information to ensure approval is still appropriate or to verify the accuracy of submitted information.

   Outlook: The FDIC requests comments on all aspects of its proposed approach, including input on the specific questions and issues the agency raises throughout the NPR. Comments are due within 60 days after the NPR is published in the Federal Register.
OCC and FDIC Propose Long Awaited Reforms to CRA Regulations

**Overview:** On December 12, 2019, the Federal Deposit Insurance Corporation (“FDIC”) and Office of the Comptroller of the Currency (“OCC”) issued a joint Notice of Proposed Rulemaking (“NPR”) recommending significant changes to the regulations implementing the Community Reinvestment Act (“CRA”), which were last updated nearly 25 years ago. Over the past several years, the OCC, FDIC, and Federal Reserve have worked to assess and update the CRA regulatory framework, culminating in the current rulemaking process that kicked off in August 2018 with the OCC’s advanced notice of proposed rulemaking (“ANPR”).

According to the FDIC and OCC, this month’s NPR addresses the public response to the ANPR and other public comments by making the CRA regulatory regime more objective, transparent, consistent, and understandable. More specifically, the NPR aims to address the emergence of widespread digital banking and to further encourage lending in underserved communities, including rural areas and tribal lands.

The NPR has faced criticism from community groups who are concerned that it will substantially weaken the CRA regime. Significantly, dissent also came from the FDIC itself when board member Martin Gruenberg voted against the NPR and concurrently issued a statement of opposition. Chief among the proposals receiving opposition appears to be the new method for measuring CRA performance, discussed further below.

**Summary of the Proposed Rule**

The CRA was originally enacted in 1977 with the goal of combating redlining and ensuring fairness and access to housing and credit, particularly for low- and moderate-income (“LMI”) communities. To do so, the statute imposes an affirmative obligation on banks to invest in and serve their local communities, including LMI neighborhoods. Banks are periodically evaluated on whether and to what extent they have met this obligation, and ultimately receive a public written report and CRA rating. Low ratings can subject banks to supervisory consequences.

The NPR states that it is designed to achieve a list of “positive outcomes” related to the CRA, such as creating incentives for banks to do more, reducing CRA deserts, reducing uncertainty, increasing small business and small farm lending, and encouraging long-term commitment to community reinvestment. The proposed changes to the CRA regulatory framework are organized within four key areas, described below.

1. **Activities Qualifying for CRA Credit**

Currently, two main categories of activities qualify for CRA credit: (1) retail banking activities, which generally cover retail loans (e.g., home mortgages, consumer loans, small business loans) and retail banking services (e.g., deposit services, credit services, branch distributions); and (2) community development (“CD”) activities (e.g., supporting affordable housing, small business or small farm financing, and community services for LMI individuals).

According to the NPR, banks are often uncertain about what activities qualify for CRA credit until their supervisory agencies conduct evaluations, which often occur years after an activity takes place. In addition, determinations of what activities count as qualifying are often inconsistent between evaluations, agencies, and years.

The NPR proposes to clarify the activities that qualify for CRA credit by defining “qualifying activity” and establishing specific criteria that identify the types of activities that would count for CRA credit. The proposed criteria generally include activities that already qualify for CRA credit as well as additional activities that meet the needs of economically disadvantaged individuals and areas, but are not currently covered by the CRA.
framework. The proposal would also require agencies to publish illustrative examples of qualifying activities and create a procedure for banks to request confirmation that a particular activity qualifies for CRA credit.

2. CRA Assessment Areas

Today, a bank’s CRA performance is evaluated within delineated assessment areas that must include the areas where its main office, branches, and deposit-taking ATMs are located, as well as the surrounding area where it conducts a significant amount of its lending activity. The FDIC and OCC believe this “facility-based” approach, which mostly depends upon the physical presence of brick and mortar locations, is out-of-date in light of the evolution of modern banking and the rise of online and digital services.

The NPR would preserve the existing facility-based assessment areas, but then expand them to include additional “deposit-based” areas where banks have significant concentrations of retail domestic deposits. Specifically, banks receiving at least 50% of their retail domestic deposits from outside their facility-based assessment areas would have to delineate deposit-assessment areas where they receive at least 5% of their total retail domestic deposits. In addition, the proposal allows for banks to receive CRA credit for qualifying activities conducted outside of their assessment areas in certain situations. This change is intended to incentivize banks to reduce banking deserts and provide investment and lending services to all communities in need.

3. Methods for Measuring CRA Performance

The current framework for evaluating CRA performance describes broadly how agencies should weigh and score a bank’s qualifying activities, but, generally, many banks believe the scores and assessments are subjective and at times opaque, complex, and inconsistent.

The NPR proposes to establish new general performance standards for evaluating banks with more than $500 million in assets in each of the four previous quarters (though small banks could opt into these standards, if they wish). The new standards would assess two fundamental components of CRA performance against benchmarks established before an evaluation period begins:

(a) The appropriate distribution, or number, of a bank’s qualifying retail loans to LMI individuals, small farms, small businesses, and LMI geographies in a community; and

(b) The impact, or quantified value, of the bank’s qualifying activities, as measured by comparing the value of the qualifying activities relative to its retail domestic deposits.

The proposal establishes a method for a bank to receive a presumptive rating of “satisfactory” or “outstanding” by meeting certain minimum performance thresholds on its retail lending distribution tests, certain empirical benchmarks on the average of its annual CRA evaluation measures, and minimum CD lending and investment requirements.

Critics have expressed concern that the new approach uses a single metric (i.e., adding up the dollar value of activities such as lending and CD investments or services) that does not consider the quality of a bank’s activities or whether they are responsive to local needs. And according to Mr. Gruenberg in his statement of opposition, the proposal “would allow a bank to achieve a less than satisfactory rating in nearly half of its assessment areas and still receive a satisfactory or even outstanding rating.” Finally, critics claim the new method is arbitrary, pointing to the NPR itself to show the proposal is based upon inadequate and incomplete data.
Still, banks could instead choose to be evaluated under strategic plans they develop themselves; this option could address, for instance, the unique needs of banks without retail domestic deposits or that do not originate retail loans.

4. **CRA-Related Data Collection, Recordkeeping, and Reporting**

The current CRA framework does not impose data collection and reporting requirements on all banks—for instance, small banks are generally exempt from such requirements and data is not collected on all CRA activity (e.g., CD investments and services).

The NPR would require small banks to collect and maintain (although still not report) data on their retail domestic deposits. In addition, banks that will be evaluated under the new general performance standards would have to collect, maintain, and report certain data involving their qualifying and specified non-qualifying activities, retail domestic deposits, and assessment areas. The agencies would provide further guidance on what data must be collected and maintained.

**Outlook:** Interestingly, while the FDIC, OCC, and Federal Reserve Board are each charged with implementing the CRA (and have issued identical regulations regarding the same), only the OCC (which acted on its own with respect to the ANPR) and the FDIC published the NPR. The Federal Reserve Board’s absence from the NPR suggests that there remains disagreement among federal regulators regarding the proper way to modernize the CRA framework.

The FDIC and OCC request comments on all aspects of the proposed changes, including input on the specific questions and issues raised throughout the NPR. Comments are due within 60 days after the NPR is published in the *Federal Register*. In the meantime, Congress will be scrutinizing the NPR via at least two hearings in January in the House Financial Services Committee, and perhaps others. As such, this major effort to reform standards seeking to ensure that banks pursue financial inclusion will be receiving significant public attention over the coming weeks.

---

Craig Saperstein, a member of NACHA’s Government Relations Advisory Group, is a partner in the Public Policy practice of Pillsbury Winthrop Shaw Pittman LLP in Washington, D.C. In this capacity, he provides legal analysis for clients on legislative and regulatory developments and lobbies congressional and Executive Branch officials on behalf of companies in the payments industry. Deborah Thoren-Peden is a partner and member of the Financial Institutions Team at Pillsbury Winthrop Shaw Pittman LLP. She provides advice to financial institutions, bank and non-bank, and financial services companies. Daniel Wood is a Senior Associate and member of the Financial Services Regulatory Team. He provides analysis for financial institutions, technology companies, and clients that offer consumer financial products. The information contained in this update does not constitute legal advice and no attorney-client relationship is formed based upon the provision thereof.