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FDIC Issues Advanced Notice of Proposed Rulemaking on Brokered Deposit Framework

Overview: In mid-December, the Federal Deposit Insurance Corporation (“FDIC”) released an Advanced Notice of Proposed Rulemaking (“ANPR”) outlining its comprehensive review of brokered deposits and interest rate caps. The ANPR signals the FDIC’s first step toward updating the legal framework for brokered deposits in light of significant changes—particularly in technology, business models, the economic environment, and financial products—since brokered deposits were first regulated in 1989.

Rather than proposing specific regulatory changes, the ANPR instead first provides background on brokered deposits—including an overview of the regulatory history, related FDIC research, and current regulatory landscape—followed by a review of interpretive issues the FDIC has encountered. The ANPR concludes with a general request for comment as well as a list of fourteen specific questions from the FDIC.

Background on Brokered Deposit Regulation

Historical framework. According to the ANPR, concerns about the danger of banks’ unrestricted use of brokered deposits began as early as the 1970s, but the breaking point came in 1982, when a bank failure “resulted in the largest bank payout of insured deposits in the history of the FDIC up until that time.” Critically, the failing bank had used brokered deposits to grow its assets from $30 million to $436 million in a span of just five years. Investigations into the bank and other institutions showed that brokered deposits were being used to pursue rapid growth in risky lending without adequate controls. By 1989, Congress had added Section 29 to the Federal Deposit Insurance Act—which governs brokered deposits—in an attempt to stem banking abuses and failures that were attributed to brokered deposits.

Current legal framework. Today, Section 29 and the FDIC’s implementing regulations impose certain restrictions on the acceptance or solicitation of “brokered deposits” by insured depository institutions (“IDIs”). The restrictions vary based on whether an IDI is meeting its minimal capital requirements: generally, only well-capitalized IDIs (as opposed to those that are adequately- or under-capitalized) may freely solicit, accept, and offer interest rates on brokered deposits without restriction.

Whether a certain type of deposit is considered “brokered” determines whether restrictions are triggered, and is therefore a major recurring topic for industry and the FDIC. Undefined by Section 29, the term “brokered deposit” hinges on the definition of “deposit broker,” which requires a case-by-case analysis to determine whether a particular arrangement is covered. Generally, a deposit broker is a third party (other than the deposit owner) who is “engaged in the business of placing deposits, or facilitating the placement of deposits” with an IDI.

Importantly, there are several exceptions to the deposit broker definition, including, among
others, the bank itself, the bank’s employee or trust department, trustees of testamentary accounts or irrevocable trusts. The “primary purpose exception” covers a third party who acts as a depositor’s agent and “whose primary purpose is not the placement of funds with depository institutions.”

Most brokered deposits are one of the following three types of deposits: (1) Master CDs; (2) sweep deposits viewed as brokered; and (3) reciprocal deposits. In 2018, Congress passed the Economic Growth, Regulatory Reform, and Consumer Protection Act, which permits well-capitalized and well-rated IDIs to except a certain amount of reciprocal deposits from being characterized as brokered deposits—the exception amount may be up to the lesser of 20% of an IDI’s total liabilities, or $5 billion. Typically, the ubiquitous listing service deposits are not considered brokered.

**Interpretive Issues**

The second half of the ANPR lists a series of interpretative issues related to brokered deposits that the FDIC and industry have grappled with over the years.

**Deposit broker definition.** First among the issues is the recurring “deposit broker” definitional question on what triggers Section 29 restrictions. Due to the extensive volume and variety of arrangements between third parties and IDIs, FDIC staff have published numerous Advisory Opinions assessing on a case-by-case basis the application of the definition to specific facts and circumstances. The ANPR lists the following factors staff considers in these evaluations:

- Whether the third party receives fees from the IDI that are based (in whole or in part) on the amount of deposits or the number of deposit accounts.
- Whether the fees can be justified as compensation for administrative services (such as recordkeeping) or other work performed by the third party for the IDI (as opposed to compensation for bringing deposits to the institution).
- Whether the third party’s deposit placement activities, if any, are directed at the general public as opposed to being directed at members (or “affinity groups”) or clients.
- Whether there is a formal or contractual agreement between the IDI and the third party (e.g., referring or marketing entity) to place or steer deposits to certain IDIs.
- Whether the third party is given access to the depositor’s account, or will continue to be involved in the relationship between the depositor and the IDI.

According to the ANPR, the “inherent challenge” is often in distinguishing between third party service providers to an IDI and third parties that facilitate the placement of deposits, “albeit using updated technology.”

**Primary purpose exception.** The primary purpose exception, with its potentially broad reach, has been the subject of extensive interpretation by FDIC staff. Generally, an arrangement falls within the exception when a third-party agent’s “deposit-placement activity is incidental to some other purpose.” To make this determination, FDIC staff reviews the third party’s intent, the structure of the fee arrangement, and any programmatic relationship between the third party and IDI.

**Prepaid cards.** To date, the FDIC’s position has been that a prepaid card company or program manager likely qualifies as a “deposit broker,” and does not qualify for the primary purpose exception. Some prepaid card industry stakeholders have argued that the primary purpose exception applies since the “primary purpose” of such third parties is to enable cardholders to make purchases, rather than to provide them with a deposit-placement service. According to the ANPR, however, FDIC staff has not made this distinction. The ANPR says the following:

When funds are placed into demand deposit accounts (as in the case of custodial accounts used by prepaid card companies), the deposits will be available for withdrawals or transfers or spending. Thus, prepaid card companies have not been viewed as meeting the “primary purpose” exception.

**Other issues.** The ANPR also discusses brokered deposit regulations in the context of certain software applications for personal use, deposit listing services, IDI-affiliated sweeps by broker dealers, and accounting or related software products, among others.
**Outlook:** Through the ANPR, the FDIC has requested comment on “all aspects of its regulatory approach to brokered deposits and interest rate restrictions,” with particular emphasis on a list of fourteen specific questions, including:

- Are there ways the FDIC can improve its implementation of Section 29 of the FDIA while continuing to protect the safety and soundness of the banking system? If so, how?
- Are there types of deposits that currently are/are not considered brokered that should/should not be considered brokered? If so, please explain why.
- Are there specific changes that have occurred in the financial services industry since the brokered deposits regulation was adopted that the FDIC should be cognizant of as it reviews the regulation? If so, please explain.
- Do institutions currently have sufficient clarity regarding who is or is not a deposit broker and what is or is not a brokered deposit? Are there ways the FDIC can provide additional clarity through updates to the brokered deposits regulation, consistent with the statute and the policy considerations described above?
- Are there areas where changes might be warranted but could not be effectuated under the current statute? Are there any statutory changes that warrant consideration from Congress?

Comments are due within 90 days after the ANPR is published in the Federal Register.

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