

# The Banking Law Journal

Established 1889

An A.S. Pratt™ Publication

MAY 2019

**EDITOR'S NOTE: LOOKING BACK, AND AHEAD**

Steven A. Meyerowitz

**THE BROOKE AMENDMENT AND SECTION 8 HOUSING: REVISITED**

Timothy D. Naegele

**SIMPLIFYING CAPITAL FOR COMMUNITY BANKS**

Carleton Goss

**FDIC COMMENCES RULEMAKING PROCESS TO REVIEW APPROACH TO BROKERED DEPOSIT REGULATION**

Michael Nonaka, Stuart Stock, Karen Solomon, Dwight Smith, Randy Benjenk, and Jenny Konko

**MINDING THE GAAP: WHAT YOU NEED TO KNOW ABOUT THE CURRENT EXPECTED CREDIT LOSSES METHODOLOGY**

Robert C. Azarow, Helen Mayer Clark, and Amber A. Hay

**SQUARE'S PENDING APPLICATIONS TO CHARTER A UTAH INDUSTRIAL BANK AND FOR FDIC DEPOSIT INSURANCE**

Christine A. Edwards and Julius L. Loeser



LexisNexis

# THE BANKING LAW JOURNAL

---

---

VOLUME 136

NUMBER 5

May 2019

---

**Editor's Note: Looking Back, and Ahead**

Steven A. Meyerowitz

243

**The Brooke Amendment and Section 8 Housing: Revisited**

Timothy D. Naegele

245

**Simplifying Capital for Community Banks**

Carleton Goss

272

**FDIC Commences Rulemaking Process to Review Approach to  
Brokered Deposit Regulation**

Michael Nonaka, Stuart Stock, Karen Solomon, Dwight Smith,  
Randy Benjenk, and Jenny Konko

279

**Minding the GAAP: What You Need to Know About the  
Current Expected Credit Losses Methodology**

Robert C. Azarow, Helen Mayer Clark, and Amber A. Hay

288

**Square's Pending Applications to Charter a Utah Industrial  
Bank and for FDIC Deposit Insurance**

Christine A. Edwards and Julius L. Loeser

295



LexisNexis®

**QUESTIONS ABOUT THIS PUBLICATION?**

---

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Matthew T. Burke at ..... (800) 252-9257

Email: ..... matthew.t.burke@lexisnexis.com

Outside the United States and Canada, please call ..... (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at ..... (800) 833-9844

Outside the United States and Canada, please call ..... (518) 487-3385

Fax Number ..... (800) 828-8341

Customer Service Website ..... <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or ..... (800) 223-1940

Outside the United States and Canada, please call ..... (937) 247-0293

---

ISBN: 978-0-7698-7878-2 (print)

ISSN: 0005-5506 (Print)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

---

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc.

Editorial Office  
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862  
[www.lexisnexis.com](http://www.lexisnexis.com)

MATTHEW  BENDER

# *Editor-in-Chief, Editor & Board of Editors*

---

**EDITOR-IN-CHIEF**

**STEVEN A. MEYEROWITZ**

*President, Meyerowitz Communications Inc.*

**EDITOR**

**VICTORIA PRUSSEN SPEARS**

*Senior Vice President, Meyerowitz Communications Inc.*

**BOARD OF EDITORS**

**JAMES F. BAUERLE**

*Keevican Weiss Bauerle & Hirsch LLC*

**BARKLEY CLARK**

*Partner, Stinson Leonard Street LLP*

**MICHAEL J. HELLER**

*Partner, Rivkin Radler LLP*

**SATISH M. KINI**

*Partner, Debevoise & Plimpton LLP*

**DOUGLAS LANDY**

*Partner, Milbank, Tweed, Hadley & McCloy LLP*

**PAUL L. LEE**

*Of Counsel, Debevoise & Plimpton LLP*

**GIVONNA ST. CLAIR LONG**

*Partner, Kelley Drye & Warren LLP*

**STEPHEN J. NEWMAN**

*Partner, Stroock & Stroock & Lavan LLP*

**DAVID RICHARDSON**

*Partner, Dorsey & Whitney*

**STEPHEN T. SCHREINER**

*Partner, Goodwin Procter LLP*

**ELIZABETH C. YEN**

*Partner, Hudson Cook, LLP*

THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. Copyright 2019 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail [Customer.Support@lexisnexis.com](mailto:Customer.Support@lexisnexis.com). Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, [smeyerowitz@meyerowitzcommunications.com](mailto:smeyerowitz@meyerowitzcommunications.com), 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

# FDIC Commences Rulemaking Process to Review Approach to Brokered Deposit Regulation

*Michael Nonaka, Stuart Stock, Karen Solomon, Dwight Smith, Randy Benjenk, and Jenny Konko\**

*The authors of this article discuss the Federal Deposit Insurance Corporation's Advance Notice of Proposed Rulemaking seeking comment on the regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized.*

The Federal Deposit Insurance Corporation (“FDIC”) issued an Advance Notice of Proposed Rulemaking (“ANPR”) seeking comment on the regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized.<sup>1</sup> The FDIC for some time has been exploring the extent to which the current regulatory approach for brokered deposits requires reform. The ANPR’s indication that the agency is “undertaking a comprehensive review” of the approach signals the start of an extensive rulemaking process that should result in significant changes to the way brokered deposits are identified and regulated.

## BACKGROUND

Brokered deposits, as simply defined in FDIC regulations, are deposits that are “obtained, directly or indirectly, from or through the mediation or assistance of” a “deposit broker.” The term “deposit broker” means, subject to certain important exceptions, (1) “any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions, or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties; and (2) an agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan.”

The FDIC and other federal and state banking agencies historically have viewed brokered deposits as presenting greater risk than non-brokered (i.e.,

---

\* Michael Nonaka, Stuart Stock, Karen Solomon, Dwight Smith, Randy Benjenk, and Jenny Konko are attorneys at Covington & Burling LLP.

<sup>1</sup> FDIC, Advance Notice of Proposed Rulemaking Relating to Brokered Deposits, 12 C.F.R. Part 337, RIN 3064-AE94, available at <https://www.fdic.gov/news/board/2018/2018-12-18-notice-sum-i-fr.pdf>.

core) deposits because brokered deposits may (1) be used to facilitate a bank's rapid growth and expansion into riskier asset classes, (2) be associated with increased volatility due to the tendency of deposit brokers (and customers of such brokers) to "chase" the highest rates by withdrawing and moving funds to deposit products at different banks offering the higher rate at the time, and (3) have less franchise value (i.e., value to prospective purchasers of a failed bank) than core deposits.<sup>2</sup>

Under Section 29 of the Federal Deposit Insurance Act ("FDI Act") and the FDIC's regulations, a bank that is less than well capitalized under regulatory capital standards is either prohibited from accepting, renewing, or rolling over a brokered deposit or restricted from doing so if the bank has not applied for and received a waiver from the FDIC. Such a bank also is prohibited from paying rates on deposits that significantly exceed rates paid in their normal market area or the national rate established by the FDIC by regulation.

### PRIOR REGULATORY AND LEGISLATIVE ACTION

Although the ANPR represents the first opportunity for comprehensive reform of the regulatory approach to brokered deposits, certain aspects of the approach have been the subject of limited regulatory and legislative action over the past decade, including the following key actions:

- Economic Growth, Regulatory Relief, and Consumer Protection Act<sup>3</sup>—Section 202 of the Act excludes "reciprocal deposits"—which are deposits received by a bank through a deposit placement network with the same maturity and in the same amount as deposits placed by the bank with other banks in the network—from the brokered deposit restrictions in the FDI Act up to \$5 billion or 20 percent of the bank's total liabilities, whichever is less.<sup>4</sup> The FDIC issued a final rule implementing Section 202 concurrently with issuance of the ANPR.<sup>5</sup>
- FDIC Identifying, Accepting, and Reporting Brokered Deposits: Fre-

---

<sup>2</sup> The ANPR acknowledges that "most institutions that use brokered and higher-rate deposits have done so in a prudent manner and appropriately measure, monitor, and control risks associated with brokered deposits."

<sup>3</sup> Pub. L. No. 115-174 (May 24, 2018).

<sup>4</sup> According to the ANPR, reciprocal deposits that are reported as brokered deposits fell from \$48.5 billion as of March 30, 2018, the last reporting quarter before the act took effect, to \$17.1 billion as of June 30, 2018, the first reporting quarter after the Act took effect.

<sup>5</sup> FDIC, Limited Exception for a Capped Amount of Reciprocal Deposits from Treatment as Brokered Deposits, 12 C.F.R. Parts 327 and 337, RIN 3064-AE89, *available at* <https://www.fdic.gov/news/board/2018/2018-12-18-notice-sum-h-fr.pdf>.

quently Asked Questions<sup>6</sup>—The FAQs collect and restate a number of existing FDIC advisory opinions regarding brokered deposits and also provide new guidance in certain areas of the regulatory approach. The FDIC initially issued the FAQs in January 2015 without public notice and comment and re-issued the FAQs after receiving considerable informal input from the banking industry.

- Dodd-Frank Act Study on Core Deposits and Brokered Deposits<sup>7</sup>—The study was submitted to Congress pursuant to Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and shows that higher brokered deposit use is associated with higher probability of bank failure and higher deposit insurance fund loss rates. The study also serves as a helpful resource in restating and analyzing prior FDIC advisory opinions regarding the applicability of the brokered deposit regulations to products such as sweep deposits and prepaid products.
- FDIC Deposit Insurance Assessment Rules<sup>8</sup>—The FDIC deposit insurance assessment rules generally increase the applicable deposit insurance assessments paid by a bank if the bank's levels of brokered deposits exceed a certain threshold, provided that the bank's supervisory ratings and capital ratios do not meet certain criteria.

## IDENTIFYING BROKERED DEPOSITS

Overall, identifying brokered deposits can be challenging because the definitions in the FDIC regulation<sup>9</sup> are open-ended. The FDIC's advisory opinions and FAQs provide clarity with respect to certain specific products, but insufficient clarity for determining definitively the applicability of the rules to new products or other products not covered in the opinions or FAQs.

Evaluating whether a deposit is a brokered deposit first entails an analysis of whether the deposit was originated by an entity that is a deposit broker, and this analysis requires consideration of a number of different factors, including remuneration paid to the relevant entity and marketing conducted by the entity. If the entity is determined to be a deposit broker, the further analysis is whether the entity is excluded from the definition of deposit broker under the FDIC regulations. This analysis likewise may require consideration of a number

---

<sup>6</sup> Rev. July 14, 2016.

<sup>7</sup> July 8, 2011, updated to reflect 2017 data in Appendix 2 in the ANPR.

<sup>8</sup> Feb. 25, 2011, May 20, 2016.

<sup>9</sup> 12 C.F.R. § 337.6.



of different factors, some of which may overlap with the factors analyzed in the first step of the analysis, particularly if the “primary purpose” exception is analyzed.<sup>10</sup> One of the byproducts of this multi-factor approach is to introduce a level of subjectivity and, at times, inconsistency in the identification of brokered deposits. This can have the effect of making it difficult to design deposit products, including innovative and technology-driven deposit products that involve a third-party fintech company, because the applicable regulatory regime may not be known with certainty by the parties until after the product has been launched and examined by the bank’s regulators. The rulemaking process initiated by the ANPR has the potential to address these challenges.

### THE ADVANCE NOTICE OF PROPOSED RULEMAKING

The FDIC’s ANPR broadly requests comment on a number of specific questions that are intended to cover every aspect of the regulatory approach to brokered deposits. In addition to these questions and other information about the historical use of and regulatory approach for brokered deposits, the ANPR includes the following observations that may be of interest to institutions:

- *Sweep Accounts*—As of September 30, 2018, 28 insured depository institutions have indicated to the FDIC that they receive funds swept from an affiliate broker-dealer under conditions that qualify the affiliate for the primary purpose exception to the definition of broker-dealer. The average amount of funds swept from the affiliated broker-dealers in September 2018 was \$724 billion.
- *Advancements in Technology*—Questions to the FDIC about whether an entity is a deposit broker have been related recently to “advancements in technology, and new business practices and products that [insured depository institutions] might utilize to offer services to customers and also to gather deposits.” The ANPR notes that “the inherent challenge often is to distinguish between third party service providers to the [insured depository institution] and third parties that are engaged in the business of placing or facilitating the placement of deposits, albeit using updated technology.”
- *Factors Relevant to Definition of Deposit Broker*—The FDIC staff reviews deposit arrangements on a case-by-case basis to determine whether an entity is a deposit broker, including the following factors: (1) whether

---

<sup>10</sup> Under this exception, an entity is not a deposit broker if the entity is “an agent or nominee whose primary purpose is not the placement of funds with depository institutions.” 12 C.F.R. § 337.6(a)(5)(i)(I).

the entity receives fees from the bank that are based (in whole or in part) on the amount of deposits or the number of deposit accounts, (2) whether any such fees can be justified as compensation for administrative services or other work performed by the entity for the bank, (3) whether the entity's activities are directed at the general public versus customers or members of an affinity group, (4) whether there is a formal or contractual agreement between the bank and the entity, and (5) whether the entity is given access to the depositor's account or will continue to be involved in the depositor's relationship with the bank.

- *Insured Depository Institution Exception*—The FDI Act provides an exception to the definition of deposit broker for a bank itself with respect to funds placed with that bank, but this exception traditionally has not been applied to bank subsidiaries or other affiliates.
- *Employee Exception*—The FDI Act similarly provides an exception to the definition of deposit broker for an employee of the bank, with the term “employee” being defined narrowly and not always covering employees who may have some form of contractual relationship with an affiliate or non-affiliate.
- *Pension or Other Employee Benefit Plans*—The FDI Act provides an exception from the definition of deposit broker for trustees of pension and other employee benefit plans with respect to funds in the plan, and administrators or investment advisors provided that the person is performing managerial functions with respect to the plan. Individual Retirement Accounts (IRAs), 529 savings plans, and Health Savings Accounts (HSAs) are not expressly covered by this exception but may be covered by the exception for trust departments if a bank's trust department serves as trustee or custodian for such a plan and the trust has not been established for the primary purpose of placing funds with banks.
- *Primary Purpose Exception*—This exception has received the most attention from banks and the FDIC staff because of its potentially broad reach. In analyzing the applicability of the exception, the FDIC staff generally has considered whether placing or facilitating the placement of deposits is for a substantial purpose other than deposit insurance or a deposit-placement service—in other words, whether placing or facilitating the placement of deposits is incidental to some other purpose. In making this determination, the staff reviews the intent of the entity when acting as agent or nominee vis-à-vis the deposits and other factors that indicate the entity is incentivized to place or facilitate the placement of deposits with the bank. Factors

include the existence and structure of fee arrangements and any programmatic relationship between the bank and the entity (note, these factors also are relevant to whether the entity is a deposit broker, see above). This review involves an analysis of the underlying agreements between the bank and entity and, in our experience, related marketing materials and other customer communications. The staff does not rely exclusively on the entity's business purpose and has not considered the size of the entity or amount or percentage of revenue generated by the deposit placement activity.<sup>11</sup>

- *Deposit Listing Services*—The ANPR restates the criteria analyzed to determine whether a service that lists available bank deposit products (including terms and rates) is a deposit broker. In general, a listing service will not be a deposit broker if (1) the person or entity providing the listing service is compensated solely by means of subscription fees and/or listing fees, (2) the fees paid by banks to list products with the service are flat fees, (3) the listing service performs no services in exchange for these fees except the gathering and transmission of information concerning the availability of deposits and/or the transmission of messages between depositors and banks, and (4) the listing service is not involved in placing deposits but rather all funds are remitted directly by the depositor to the bank. The listing service may not, in publishing or displaying information or transmitting messages to depositors, attempt to steer depositors or their funds to particular banks. The FDIC staff has learned of listing services that offer other services, including offering advice to banks on liability and funds management and regulatory compliance screening, sending customer information directly to the banks listing deposits with the service, charging a fee to banks based on asset-size, and displaying the deposit products for “featured” or “preferred” banks at the top of the listing. The ANPR questions whether these other services may amount to steering that would be inconsistent with the criteria.
- *Accounting and Related Software Products*—The FDIC staff has evaluated whether companies that place deposits at one bank or a group of banks through accounting or related software are deposit brokers and concluded that these companies are deposit brokers (and not eligible for the primary purpose exception) because (1) the offering of this software

---

<sup>11</sup> The ANPR also references FDIC Advisory Opinion 05-02 (Feb. 3, 2005), which analyzes the primary purpose exception in the context of sweep programs and establishes criteria for the exception to apply to such programs.

is not a sufficiently distinct purpose from providing access to a deposit account with core banking functions (e.g., daily cash management) and (2) these arrangements often have involved a volume-based fee being paid by the bank(s) to the company. The fee is (in the staff's view) an incentive for the company to place deposits at preferred banks.

- *Prepaid Cards*—Likewise, the FDIC staff has declined to apply the primary purpose exception to prepaid card companies that sell prepaid cards to the public and deposit the sale proceeds into a custodial deposit account with the bank. While the payment functionality of the prepaid card technically is different from the functionality of the deposit account, the staff has not viewed this difference as being sufficient for the primary purpose exception—that is, making payment services available through the prepaid card is not sufficiently distinct from providing access to a deposit account since a deposit account typically provides such features.
- *Software Applications for Personal Use*—Certain software applications enable customers to link their bank accounts in order to assist with personal finance planning, bill payment, and opening new accounts. The application may aggregate information across customers, analyze this information, and make the aggregated information available to banks to target customers with deposit products. The application may assist banks with targeting advertisements to these customers and facilitate the customers' opening accounts with the banks. In certain circumstances, the application provider may receive compensation based on the referral. The ANPR does not express a view of whether these providers are deposit brokers but implies that they would be under the current regulatory approach.<sup>12</sup>

In terms of requests for comments, the FDIC's ANPR seeks comment on “all aspects of its regulatory approach to brokered deposits and interest rate restrictions, and in particular the following [questions]:”

- 1) Are there ways the FDIC can improve its implementation of Section 29 of the FDI Act while continuing to protect the safety and soundness of the banking system? If so, how?

**Brokered Deposits:**

- 2) Are there types of deposits that are currently considered brokered that should not be considered brokered? If so, please explain why.

---

<sup>12</sup> The ANPR also offers observations on the maximum interest rate restrictions that are not summarized in this article.

- 3) Are there types of deposits that are currently not considered brokered that should be considered brokered? If so, please explain why.
- 4) 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.
- 5) 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?
- 6) 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?
- 7) Should the FDIC make changes to the Call Report instructions so that the agency can gather more granular information about types of brokered deposits?
- 8) In general, the FDIC welcomes any additional data or market information related to brokered deposits, particularly related to those types of brokered deposits that are not specifically reported by institutions in their Call Reports (e.g., Master Certificates of Deposits held in the name of DTC and deposits placed through unaffiliated sweep programs).

**Interest Rate Restrictions:**

- 9) Are there alternatives that the FDIC should consider in addressing Section 29's interest rate restrictions for less than well capitalized institutions?
- 10) Should the methodology used to calculate the "national rate" be changed? If so, how?
- 11) Should there remain a presumption that the prevailing rate in any "market area" is the national rate? If not, how should the FDIC define the "normal market area"?
- 12) Should the amount of the rate cap, currently 75 basis points over either the national rate or the prevailing market rate, be revised? If so, how?
- 13) How should deposits with promotional or special features be treated with respect to the national rate or the prevailing market rate?

- 14) How should the rates offered by internet-based or electronic commerce-based institutions be calculated?