The Federal Deposit Insurance Corporation's Proposed Brokered Deposits Rule: **Eight Things To Know**

On December 12, 2019, the Federal Deposit Insurance Corporation ("FDIC") proposed significant changes to its regulatory framework for brokered deposits for insured depository institutions ("IDIs"). The Notice of Proposed Rulemaking (the "NPR"), which follows the FDIC's December 2018 Advanced Notice of Proposed Rulemaking, would modernize key aspects of the brokered deposit framework to reflect technological and industry changes that have occurred since the brokered deposit framework was introduced by statute in 1989. Comments must be submitted to the FDIC within 60 days after the NPR is published in the Federal Register.

1 The NPR would, with targeted revisions to a handful of key provisions, modernize and bring clarity to a brokered deposit framework that has not been revisited or updated in many years.

By doing so, the NPR would provide useful guidance regarding how the framework applies to bank collaborations with fintech companies and other third parties and new technologies that banks use to engage and interact with consumers, and in some cases, would create new avenues to ensure related deposits are not deemed brokered. The NPR emphasizes the need to analyze the third party's business and specific business lines to understand whether the third party is a deposit broker.

2 The cornerstone of the NPR is a new framework by which IDIs or third parties could apply for a written determination from the FDIC that specific deposit relationships qualify for the primary purpose exception, which by statute exempts an agent or nominee whose primary purpose is not the placement of funds with IDIs.

This new framework for application of the primary purpose exception would bring greater clarity to an area that traditionally has been the source of some uncertainty and ambiguity, particularly with respect to broker-dealer sweep arrangements and the placement of customer funds for the purpose of enabling payments. (Details below.)

3 Subject to an application process, the NPR would make the primary purpose exception available to a wide range of broker-dealer sweep arrangements, including where deposit payments are not the primary purpose the third party's business.

The NPR would expressly apply the primary purpose exception to the placement of customer assets under management ("AUM") by third parties so long as less than 25% of that third party's total AUM for a particular business line were placed at IDIs. An application would be required for arrangements meeting that standard, but would be eligible for expedited processing. Similar arrangements that don't meet the 25% test would also be eligible to apply, but would be reviewed on a case-by-case basis.

4 Similarly, and again subject to application, the NPR would make the primary purpose exception available to certain arrangements where a third party places customer funds with an IDI for the purpose of enabling payments, depending on the fee structure.

The NPR would expressly apply the primary purpose exception to the placement of customer funds by a third party into transactional accounts where the purpose of the arrangement was to enable transactions or make payments. Where a third party places all of such customer funds into transaction accounts and no interest, fee, or other remuneration is paid on any customer account, the arrangement would be subject to expedited application processing; if any interest, fee, or other remuneration is paid, the primary purpose exception would still be available, but the FDIC would more closely scrutinize the third party's business to determine whether its primary purpose is truly to enable payments. (There is potential ambiguity in the NPR as to which payments are relevant, as the proposed rule text references payments "on any customer accounts *by the third party*," but the preamble refers more broadly to payments both by the third party or the depository institution.) This aspect of the NPR should be of keen interest to prepaid card managers and payments-focused fintech partners, though underlying fee and marketing structures seem likely to drive the FDIC's ultimate analysis on this point.

5 Other third party deposit placement arrangements may also meet the primary purpose exception, but applicants would need to demonstrate to the FDIC that the primary purpose of the third party is something other than the placement of funds at IDIs.

For such applications, the FDIC notes that key aspects of its review would include the third party's revenue structure, how they market their services to customers, and the other services the third party offers. This is likely to be of interest to a wide range of other market participants, such as HSA administrators or custodians. The NPR also expressly states that the placement of brokered certificates of deposit ("CDs") and deposit placements for the purpose of encouraging savings, maximizing yield, providing deposit insurance, or any similar purpose would *not* be eligible for the primary purpose exception.

6 The NPR lays out a process by which either banks or third parties could seek the primary purpose exception, but would also impose ongoing reporting obligations on those that receive one.

The NPR makes clear that third parties may apply directly for the primary purpose exception, or that IDIs may apply on their behalf. It also specifies what information the application would require, and states that the FDIC will act on completed applications within 120 days unless this timeframe is extended by the FDIC. However, recipients of the primary purpose exception would become subject to ongoing reporting obligations; these would not be standardized, but rather described individually in each written approval, though the NPR anticipates that reporting would be required on a quarterly basis.

7 The NPR would also revise and clarify the core definition of "deposit broker."

In particular, it would provide clear and objective regulatory criteria by which a person would be considered engaged in the business of facilitating the placement of deposits (one prong of the deposit broker definition), such as whether the person shares third-party information with the IDI or has the authority to close the account or move third parties' funds elsewhere.

8 If finalized, the NPR may also impact other regulatory requirements that reference brokered deposits, including deposit insurance assessments and the liquidity coverage ratio ("LCR").

The FDIC specifically notes that, if it moves forward with the proposed changes, it would also consider any modifications to the deposit insurance assessment framework in a future rulemaking. In a speech the day prior to the release of the NPR, FDIC Chairman Jelena McWilliams noted that such changes could include taking into account unaffiliated sweeps that would qualify for the primary purpose exception under the NPR and certain listing service deposits, which, in many cases, are not considered brokered today. The NPR also notes – but does not elaborate upon – the NPR's potential implications for the LCR, which applies more stringent outflow assumptions to brokered deposits.

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