The Banking Law Journal

Established 1889

An A.S. Pratt™ PUBLICATION APRIL 2020

LexisNexis

THE BANKING LAW JOURNAL

VOLUME 137 **NUMBER 4** **April 2020**

LexisNexis®

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ISBN: 978-0-7698-7878-2 (print)
ISSN: 0005-5506 (Print)

Cite this publication as:

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

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MATTHEW BENDER

(2020–Pub.4815)

Editor-in-Chief, Editor & Board of Editors

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. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail 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, 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 Revamps Brokered Deposit Rules

Jeremy Newell and Cody Gaffney*

Intending to modernize the regulatory framework applicable to brokered deposits, the Federal Deposit Insurance Corporation has issued a notice of proposed rulemaking. The authors of this article explain the proposal.

The Federal Deposit Insurance Corporation (the "FDIC") has issued a notice of proposed rulemaking[1] intended to modernize the regulatory framework applicable to brokered deposits. Since the FDIC promulgated its original brokered deposit regulations in 1989, there have been significant technological changes and innovations across the banking industry that affect the way banks source deposits. The proposal is intended to address those developments and provide greater certainty regarding what constitutes a brokered deposit by clarifying certain elements of the definition of "deposit broker" and key exceptions thereto, adopting several bright-line tests, and establishing an application process by which banks or third parties could obtain a written determination from the FDIC that an arrangement satisfies the "primary purpose" exception.

CURRENT REGULATORY FRAMEWORK

Under the current regulatory framework, insured depository institutions ("IDIs") that are not well capitalized are generally prohibited from accepting funds for deposit obtained, directly or indirectly, by any deposit broker. Additionally, brokered deposits can increase an IDI's deposit insurance assessment rate.

Under the Federal Deposit Insurance Act, the term "deposit broker" is defined expansively to mean:

- Any person engaged in the business of placing deposits of third parties with IDIs;
- Any person engaged in the business of facilitating the placement of deposits of third parties with IDIs;
- Any person engaged in the business of placing deposits with IDIs for

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[1] https://www.fdic.gov/news/board/2019/2019-12-12-notice-dis-b-fr.pdf.

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 "deposit broker" definition is subject to nine statutory exceptions. For example, an IDI is deemed not to be a deposit broker with respect to funds placed with itself (the "IDI exception"). Most significantly, "deposit broker" also does not include an agent or nominee whose primary purpose is not the placement of funds with depository institutions (the "'primary purpose' exception").

The proposed rule would both clarify various prongs of the "deposit broker" definition and revise the application of certain of these exceptions.

REVISIONS TO THE "DEPOSIT BROKER" DEFINITION

With respect to the "deposit broker" definition itself, the proposed rule would define the first prong—"engaged in the business of placing deposits"—to capture a person that has business relationships with its customers, and as part of such relationships, places deposits on behalf of the customers.

With respect to the second prong—"facilitating the placement of deposits"—the proposed rule would provide four specific facilitation activities that, were a person to engage in them, would result in that person being deemed a deposit broker:

- The person directly or indirectly shares any third party information with the IDI;
- The person has legal authority to close the account or move the third party's funds to another IDI;
- The person provides assistance with or is involved in setting rates, fees, terms, or conditions for the deposit account; or
- The person is acting, directly or indirectly, with respect to the placement of deposits, as an intermediary between a third party that is placing deposits on behalf of a depositor and an IDI, other than in purely administrative capacity.

REVISIONS TO CERTAIN EXCEPTIONS TO THE "DEPOSIT BROKER" DEFINITION

The proposed rule would modify the application of both the IDI exception and the primary purpose exception.

With respect to the IDI exception, the proposed rule would clarify that the exception applies to a wholly-owned operating subsidiary of an IDI that places deposits of retail customers exclusively with the parent IDI, provided that the subsidiary engages only in activities permissible for the parent IDI.

With respect to the "primary purpose" exception, the proposed rule would both (i) establish a process by which a third party (or an IDI on behalf of a third party) could apply to the FDIC for a written determination that the "primary purpose" exception applies to a particular arrangement, and (ii) provide substantially greater guidance and clarity as to when the "primary purpose" exception applies.

In particular, the proposal lays out three different bases upon which an IDI or third party could apply for a written determination that the "primary purpose" exception applies. The contents of the application would differ depending on which of the three bases is being claimed.

First, the "primary purpose" exception would apply where less than 25 percent of the total assets (based on the total market value of all financial assets, including cash) that the agent or nominee has under management for its customers in a particular business line is placed at depository institutions.

Second, the "primary purpose" exception would apply to an agent or nominee that places depositors' funds into transaction accounts (rather than time deposits) for the purpose of enabling payments. In that case, the "primary purpose" exception would be presumed to apply where no interest, fees, or other remuneration is paid on any customer accounts by the third party. If such remuneration is being paid, the applicant must demonstrate that the primary purpose of the particular business line under which customers' accounts are offered is to enable customers to make transactions.

Third, the "primary purpose" exception could apply to other arrangements not covered under either of the preceding bases, subject to case-by-case review by the FDIC. The preamble to the proposed rule enumerates some of the factors that the FDIC would consider in such case-by-case review, including (i) the revenue structure for the agent or nominee, (ii) the agent or nominee's marketing activities, and (iii) the fees and types of fees received by an agent or nominee.

Written determinations would generally be provided within 120 days of a complete application. However, the preamble to the proposed rule indicates that FDIC expects that expedited processing would be available for applications that are simple and straightforward, likely including applications made under the first and second bases described above. The proposal also indicates that the FDIC expects to impose ongoing reporting requirements on those obtaining a "primary purpose" exception, which would be specified in the written determination.

TREATMENT OF EXISTING GUIDANCE

The preamble to the proposed rule indicates that the FDIC intends to revisit existing staff advisory opinions to identify those that are no longer relevant or applicable based on any revisions made to the brokered deposit regulations.