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Locke Lord QuickStudy: Brokered Deposits: FDIC Adds an ?Additional Business Relationship to the Primary Purpose ??Exception

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Effective January 10, 2022, the Federal Deposit Insurance Corporation (“FDIC”) issued a final rule ??(the “Primary Purpose Rule”) that adds a specific business relationship that qualifies under the ?Primary Purpose Exception which in turn excludes deposits thereunder from the classification as ??“brokered deposits,” as set forth in Section 29 of the Federal Deposit Insurance Act (“FDI Act”). ?

As noted in our previous QuickStudy, the FDI Act does not define a “brokered deposit.” Instead, ?Section 29 deems all deposits facilitated by “deposit brokers” to be subject to the FDI Act. A “deposit ?broker” is defined as any person (i) engaged in the business of placing deposits, or facilitating the ?placement of deposits, of third parties with an insured depository institution (“IDI”) or in the business ?of placing deposits with IDIs for the purpose of selling interests in those deposits to third parties and ??(ii) 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. With very limited exceptions, ?deposits garnered through a third-party agent or nominee will remain brokered deposits. For ?example, Section 29 of the FDI Act provides an exception from the definition of deposit broker where ?a non-discretionary custodian provides only ministerial functions to facilitate deposit sweeps (such ?as managing individual customer deposits to remain within FDIC insurance limits) and the custodian ?does not receive compensation in the form of a percentage of the interest earned on the account. ?Section 29 also provides a mechanism where IDIs and custodians can apply to the FDIC for an ?exception based on specific facts and circumstances. This new Primary Purpose Rule stems from ?applications for exception that the FDIC believes would benefit the industry as a whole.?

As a reminder, the primary purpose exception excludes from the definition of a deposit broker any ??“agent or nominee whose primary purpose is not the placement of funds with depository ?institutions.” In Section 29 of the FDI Act, the FDIC identified a number of business relationships (or ??“designated exceptions”) that meet the “primary purpose” exception thereby eliminating the need for ?the parties to apply to the FDIC for a specific exception. For instance, the “25 percent test,” a broker ?dealer (BD) that enters into a deposit sweep agreement directly with an IDI to deposit the BD’s ?customers’ excess cash into a deposit account at the IDI likely would meet the primary purpose ?exception so long as less than 25 percent of the BD’s total assets under administration for its ?customers, in a particular business line, is placed at IDIs.?

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In the new Primary Purpose Rule, the FDIC added the following additional business arrangement ?that meet the primary purpose exception without requiring an application. The FDIC plans to make ?conforming changes to the Call Report instructions to document data collection for these new ?exceptions. ?

New Designated “Primary Purpose” Exception: ?

- An agent or nominee that is “engaged in the business of placing” customer funds at IDIs in a ?custodial capacity will not be deemed to be a deposit broker if the agent or nominee activities ?are limited to following instructions received from a depositor or depositor’s agent specific to ?each IDI and deposit account, and the agent or nominee neither plays any role in determining ?at which IDI(s) to place any customers’ funds, nor negotiates or set rates, terms, fees, or ?conditions, for the deposit account. The FDIC clarified that if the agent or nominee decides ?which IDIs are to receive depositor funds, then the agent or nominee likely meets the ??“engaged in the business of placing” part of the deposit broker definition and such deposits ?would be brokered deposits. Moreover, if the agent or nominee provides technology such as ?an algorithm that is used to determine or recommend at which IDI(s) to place customer funds ?are placed, that agent or nominee would be deemed a deposit broker and therefore the ?deposits so placed would not eligible for the primary purpose exception.?

The full text of the Rule can be found here.?

Conclusion

This QuickStudy is intended as a guide only and is not a substitute for specific legal or tax advice. ?Please reach out to the authors for any specific questions. We expect to continue to monitor the ?topics addressed in this QuickStudy and provide future client updates when useful.?

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