

Locke Lord QuickStudy: FDIC Issues Final Rule to Modernize Brokered Deposit Regulation and Refines the Primary Purpose Exception

Locke Lord LLP

WRITTEN BY

Douglas Faucette

On December 15, 2020, the Federal Deposit Insurance Corporation (“FDIC”) issued a final rule (the “Rule”) to modernize its regulations that implement Section 29 of the Federal Deposit Insurance Act (“FDI Act”). The FDIC said that it took a fresh, holistic look at Section 29 regulation to establish a new regulatory framework intended to be adaptable to current and future banking technology and other factors affecting brokered deposits in the banking industry. The Rule will be effective as of April 1, 2021, with an extended compliance date of January 1, 2022 to allow industry participants to conform existing brokered deposit activities that were exempted under prior FDIC guidance. The FDIC’s continued focus with the new Rule is to develop regulations that segregate stable from less stable deposits by tagging them as non-brokered or brokered, respectively.

The FDIC Board approved the brokered deposit Advanced Notice of Proposed Rulemaking (ANPR) on December 18, 2018 and published the ANPR in the Federal Register on February 6, 2019. The FDIC then filed its notice of proposed rulemaking (“Brokered Deposits NPR”) on February 10, 2020, which included certain regulatory changes based on industry comments to the ANPR.

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.

Breaking down the definition of a deposit broker. A person is a deposit broker if it:

- Is “engaged in the business of placing deposits” received from third parties and deposits those funds at more than one insured depository institution;
- “engaged in the business of facilitating the placement of deposits” if the person places deposits of third parties at more than one insured depository institution, and
 - has legal authority to close the account or move the third party’s funds to another insured depository institution;
 - is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account; or
 - engages in matchmaking activities. Matchmaking activities include;

- proposing deposit allocations at, or between, more than one bank based upon both (a) the particular deposit objectives of a specific depositor or depositor's agent, and (b) the particular deposit objectives of specific banks.

Key Exceptions

- The IDI Exception. An IDI (or a division thereof) is not a deposit broker when it or its employees place funds at the parent IDI. The Rule does not, however, extend to incorporated subsidiaries or affiliates of the IDI. Subsidiaries and affiliates of an IDI can be excluded from the definition of deposit broker, assuming meeting the other criteria, if the subsidiary or affiliate maintains exclusive deposit placement arrangement with the parent/IDI.
- Section 29 allows for a "primary purpose exception" when the agent's primary business is not placing funds with IDIs. The FDIC has designated two primary purpose exceptions, the "25 percent test" and the "enabling transactions" exceptions as self-effecting, subject to a notice filing and periodic reporting.
 - Primary purpose "designated" "25 percent test" exception. A person will not be deemed to be a deposit broker if less than 25 percent of the total assets that the agent or nominee has under administration for its customers, in a particular business line, is placed at IDIs. If more than 25 percent of the total customer assets under administration is placed at IDIs, the agent may still apply for a primary purpose exception.
 - To determine the amount of customer assets under administration for a particular business line, the agent must measure the total market value of all the financial assets (including cash balances) that the agent or nominee administers on behalf of its customers that participate in a particular business line. Assets under administration includes both customer assets managed by the agent and those customer assets for which the agent provides other services but may not exercise deposit placement or investment discretion.
 - Primary purpose designated "enabling transactions" exception. A person will not be deemed to be a deposit broker if the agent places customer funds with an IDI for the primary purpose of enabling transactions. Under the Rule, if the agent places 100 percent of its customer funds into transaction accounts, and no fees, interest, or other remuneration is provided to the depositor, the agent will meet the designated exception of enabling transactions. If the customer earns some amount of interest, fees, or other remuneration, the agent may still apply for the primary purpose exception via the application process, subject to the FDIC's review of the following factors:
 - The amount of interest, fees, or other remuneration;
 - The number of transactions that customers make, on average, on a month-to-month basis;
 - The marketing materials provided by the agent or nominee indicate that funds placed into insured depository institutions are to enable transactions for depositors; and
 - If any customer funds are placed in deposit accounts that are not transaction accounts, the percentage of customer funds placed in deposit accounts that are not transaction accounts.

If the amount of interest, fees and other remuneration is nominal and the number of transactions per customer averages 6 or more per month, the FDIC likely will find that the agent meets the primary purpose exception.

Activities that remain Brokered Deposits

- Deposit Placements of Brokered CDs. If an agent places brokered CD's, all of the agent business line's placement of deposits at IDIs will be deemed brokered deposits. Deposits related to brokered CDs will not be included for purposes of determining whether a person's other business lines meet the primary purpose or other exceptions.
- Deposit Placements for Purposes of Encouraging Savings. The Rule would continue to classify "sweep arrangements" as brokered deposits, subject to the exceptions for college savings (529) plans and the 25 percent test. Specifically, brokerage account sweep programs administered by a third party likely will remain classified as brokered deposits with two possible exceptions. First, if the third party serves as an administrator only, then the third party may not be a deposit broker. Second, if the brokerage firm manages the sweep program directly and otherwise meets the criteria for the 25 percent test primary purpose, it may be excepted from being a deposit broker.

The full text of the Rule can be found [here](#).

Conclusion

The new Rule creates opportunities to review deposit programs and potentially recategorize deposits as non-brokered. It also presents opportunities for deposit brokers to create new "administrative" business lines that will make deposits more attractive to IDIs. This paper is intended as a guide only and is not a substitute for specific legal or tax advice. Please reach out to the author for any specific questions. We expect to continue to monitor the topics addressed in this paper and provide future client updates when useful.

—

1. 12 CFR Part 337.6

RELATED INDUSTRIES + PRACTICES

- [Banking + Financial Services Regulation](#)
- [Investment Funds + Investment Management Services](#)