

Banking and Finance Law Daily Wrap Up, BANKING OPERATIONS— FDIC publishes notice of proposed rulemaking on brokered deposit restrictions, (Jul. 31, 2024)

Banking and Finance Law Daily Wrap Up

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The proposed rule would simplify the definition of “deposit broker,” eliminate the “exclusive deposit placement arrangement” exception, and revise the interpretation of the primary purpose exception to consider the third party’s intent in placing customer funds at a particular IDI.

The Federal Deposit Insurance Corporation has [published](#) a [notice of proposed rulemaking](#) on “Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions,” which would revise 12 C.F.R. Parts 303 and 337. The FDIC Board of Directors approved the NPR as [recommended](#) by staff in an effort to strengthen the safety and soundness of the banking system by revising its regulations on brokered deposits. Comments are due 60 days after publication of the NPR in the *Federal Register*.

In a Financial Institutions Letter, the FDIC indicated that the proposed changes were in line with FDIC’s experience since the adoption of the 2020 final rule and the large bank failures in 2023 ([FIL-47-2024](#)). The FDIC indicated that the proposed revisions “seek to strengthen the safety and soundness of the banking system, help ensure uniform and consistent reporting of brokered deposits, and reduce operational challenges and reporting burdens on insured depository institutions (IDIs).”

Proposal. The proposed rule would revise the definition of “deposit broker” and would amend the analysis of the “primary purpose” exception to the “deposit broker” definition. The proposed rule would also amend the primary purpose exception (PPE) for two of the designated business relationships under the primary purpose exception, as well as make changes to the notice and application process for the primary purpose exception. In addition, the proposed rule would clarify when an IDI can regain status as an “agent institution” under the limited exception for a capped amount of reciprocal deposits.

More specifically, the proposed rule would:

- Simplify the definition of “deposit broker,” including by removing the “matchmaking activities” definition and replacing it with a broader definition related to deposit allocation services and add a new factor related to fees;
- Eliminate the “exclusive deposit placement arrangement” exception from the definition of “deposit broker” and clarify that even if a person has an exclusive deposit placement arrangement with one IDI, if it is placing or facilitating the placement of deposits at one or more IDIs, that person is included within the “deposit broker” definition;
- Revise the interpretation of the primary purpose exception (PPE) to consider the third party’s intent in placing customer funds at a particular IDI;
- Allow only IDIs, and not third parties, to file notices or applications for PPEs;
- Revise the “25 percent test” designated business exception to be available only to broker-dealers and investment advisers registered with the United States Securities and Exchange Commission and only if less than 10 percent of the total assets that the broker-dealer or investment adviser has under management for its customers is placed at one or more IDIs;
- Eliminate the enabling transactions designated business exception; and,
- Clarify when an IDI, which has lost its agent institution status, can regain that status for purposes of the limited exception for reciprocal deposits.

Policymaker statements. In a [statement](#), FDIC Chairman Martin J. Gruenberg highlighted how several recent bank failures confirmed the FDIC's view that the 2020 Final Rule had too narrow a definition of "deposit broker." Explained Gruenberg, "the concern here is that less than well-capitalized banks may seek these exclusive deposit placement arrangements as their condition is deteriorating without being subject to the limitations on brokered deposits, even though the risk is the same." He offered the example of the crypto company Voyager, which was not considered a "deposit broker" -- and therefore deposits it placed in its partner bank were not considered brokered -- merely because it had an exclusive deposit placement arrangement with one bank and highlighted from the fallout of Voyager's failure. Gruenberg also discussed the collapse of Synapse Financial. "The changes to the brokered deposit rule contained in this proposal address the fundamental relationship between a bank, a depositor, and a third party intermediary, and the risks the relationship may pose as illustrated by the recent failure of the nonbank deposit broker Synapse Financial," said Gruenberg. "The changes would also help strengthen the important prudential protections of the brokered deposit rule required by statutory restrictions and reduce the very serious risks that brokered deposits pose to less than well-capitalized IDIs and the Deposit Insurance Fund."

Acting Comptroller of the Currency Michael J. Hsu also supported the proposal. "Not all deposits are created equal," Hsu said in a [statement](#). "From a bank liquidity risk perspective, some are riskier than others. Our regulations need to better differentiate between them."

FDIC Vice Chairman Travis Hill expressed concerns and indicated that he voted "no" on the proposal. "Revamping this rule is a major undertaking that, in my opinion, is a poor use of our time and resources," [said](#) Hill. He continued, "While I think certain refinements of the 2020 rule might be warranted based on our experience over the past three-and-a-half years, the proposal goes too far." He disagreed with the revised approach to the primary purpose exception and with eliminating the "enabling transactions" designated exception.

Director Johnathan McKernan also issued a [statement](#) indicating a lack of support for the proposal. Said McKernan, "I am unable to support this proposal without a more compelling case for some of its more significant changes." He continued, "The underlying concern, I suspect, relates to skepticism of banks' partnerships with fintech, but those risks would be better regulated through rules that are more fit for that purpose."

Industry comments. Trade groups representing consumer and banking interests offered comments on the proposed regulatory action. Shayna Olesiuk, Director of Banking Policy of consumer focused group Better Markets [praised](#) the action. "We applaud the FDIC's actions today to better protect Main Street Americans and businesses from destabilizing 'hot money' brokered deposits, the inappropriate mixing of commerce and banking, the failure to have effective resolution plans, the questionable outside control of banks, and the well-known risks from uninsured deposits." She continued, "The 2020 brokered deposits rule created a giant loophole that has been exploited by fintech and crypto firms at the expense of the safety and soundness of the banking system. The loophole was unjustified, dangerous, and increased the likelihood of liquidity crises, bank failures, and taxpayer bailouts including what we saw in spring 2023. Today, the FDIC Board decided that it would reconsider the definition of brokered deposits, which skyrocketed after the 2023 banking crisis and reached an all-time record high of \$1.3 trillion in fourth quarter 2023. We support making the definition of brokered deposits more inclusive of all types of risky 'hot money' that could amplify or aggravate a crisis, and impose supervisory penalties on banks that overly rely on brokered deposits."

Rob Nichols, the President and CEO of the American Bankers Association, also released a [statement](#), expressing disapproval of the FDIC's proposal. "We're disappointed that the FDIC's brokered deposits proposal would reverse important reforms put in place in 2020. This sweeping measure would restrict access to sources of liquidity while penalizing banks for pursuing funding sources that enable them to meet the needs of their communities. Additionally, we are skeptical about the FDIC's plan to use the brokered deposits framework to regulate bank partnerships with crypto and fintech companies." The ABA also questioned the timing of the proposed notice, "given the pending change in FDIC leadership."

Companies: American Bankers Association; Better Markets

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