THE FDIC CONSIDERS MODERNIZING ITS BROKERED DEPOSIT RULES

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Brokered deposits is a hot topic once again. On December 19, 2018, the Federal Deposit Insurance Corporation (the "FDIC") published an advance notice of proposed rulemaking and request for comment on possible updates to its brokered deposit rules (the "FDIC Proposal").[1] The FDIC Proposal comes after FDIC Chairman Jelena McWilliams released a statement in September 2018 indicating that the FDIC would review whether its existing brokered deposit rules may be outdated and inconsistent with the ways in which banks now use technology to support their deposit-gathering activities. The stated objective of the FDIC Proposal is to obtain input from the public as the FDIC reviews its brokered deposit rules "in light of significant changes in technology, business models, the economic environment, and products since the regulations were adopted." The FDIC Proposal reports that as of September 30, 2018, approximately 40% of all U.S. banks held brokered deposits.[2]

The FDIC's existing brokered deposit rules, which implement Section 29 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831f, generally prohibit banks that are not considered "well capitalized" for regulatory purposes from accepting brokered deposits and from paying a rate of interest on any deposits (whether or not brokered) that is significantly in excess of prevailing market rates.[3] A bank that ceases to be well capitalized at a time when it holds brokered deposits may not accept any new brokered deposits or renew or roll over any of its existing brokered deposits.[4]

Under existing FDIC regulations, a brokered deposit is a deposit that a bank obtains, directly or indirectly, from or through a "deposit broker." A deposit broker generally includes any person "engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions."[5] The FDIC has historically interpreted this definition broadly and viewed many types of third-party arrangements as covered by its brokered deposit rules. The FDIC's point of view is that brokered deposits can be a volatile funding source and, in some cases, have resulted in the depository bank rapidly growing its balance sheet with risky assets.[6] Each of these possibilities poses fundamental concerns for the safety and soundness of the depository bank and for the FDIC as its deposit insurer.

In July 2016, the FDIC issued a Financial Institution Letter in the form of frequently asked questions on identifying, accepting, and reporting brokered deposits (the "FAQs").[7] While the FAQs clarified some of the FDIC's policy positions on brokered deposits, a fair amount of ambiguity remains, particularly for the many forms of bank and fintech company partnerships now in the marketplace. For example, it seems clear from the FAQs that deposits received by a bank through an arrangement where the bank compensates a fintech company based on the volume of deposits that the bank receives are likely to be viewed as brokered deposits. Less clear, however, is what types of compensation arrangements the FDIC would view as not indicative of a deposit broker relationship.[8]

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The FAQs also suggest that the involvement of a third-party program manager in a bank's prepaid card program can cause the deposits underlying the prepaid accounts to be considered brokered deposits. The FDIC's rationale appears to be that the placement of deposits is not incidental to some objective other than the placement of deposits, and therefore, there is no other "primary purpose" for the activity that should result in an exception. Given the range of functions provided by prepaid cards (from expense management to payment of payroll to distribution of student funds), this view of prepaid card deposits has come under criticism. The growth of prepaid cards and the use by banks of program managers for such products and similar deposit offerings would seem to be the exact kind of changes in technology, business models, and products that now justify a review of the FDIC's brokered deposit rules.

Section 29 of the Federal Deposit Insurance Act was enacted in 1989, at a time when most banks gathered deposits primarily or exclusively through brick-and-mortar branches. Today, most banks are interested in leveraging digital tools to gather deposits and enhance their customers' banking experience. These tools are generally developed by third parties, sometimes by a fintech company in partnership with a bank. Under the FDIC's existing brokered deposit rules, there is uncertainty as to whether the FDIC views deposits gathered through relationships such as these as brokered deposits. We expect that banks, fintech companies, and fintech investors will carefully monitor the FDIC Proposal in the hope that the FDIC provides clearer guideposts around brokered deposits, especially in the area of bank and fintech partnerships. Ideally, the FDIC Proposal will lead to regulations that make it easier for banks and fintech companies to work together in offering safe and innovative products and services.

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[1] *See* FDIC FIL-87-2018, Reciprocal Deposit Rulemaking and Request for Comments on Brokered Deposit and Interest Rate Restriction Issues, https://www.fdic.gov/news/news/financial/2018/fil18087.html.
[2] *See* id. at 14.
[3] *See* 12 C.F.R. § 337.6(b).
[4] *See infra* note 7 at 14.
[5] 12 C.F.R. § 337.6(a)(5)(i).
[6] *See, e.g., supra* note 1 at 7.
[7] *See* FDIC FIL-42-2016, Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits, https://www.fdic.gov/news/news/financial/2016/fil16042.html.
[8] The FDIC Proposal states that a relevant consideration in determining whether a deposit is brokered (specifically, whether the "primary purpose exception" to the definition of "brokered deposits" at 12 C.F.R. § 337.6(a)(5)(ii)(I) applies to the deposit) is "[w]hether the fees [paid by the bank to the third party] can be justified as compensation for recordkeeping or other work performed by the third party for the [bank] (as opposed to compensation for bringing deposits to the [bank])." *See supra* note 1 at 31. Banks should expect that the FDIC will make this determination based on its assessment of the facts and circumstances of the particular fee arrangement.

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