MEMO

TO: The Board of Directors

FROM: Doreen Eberley
Director, Division of Risk Management Supervision

DATE: July 30, 2024

RE: Notice of Proposed Rulemaking on Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

RECOMMENDATION

Staff recommend that the FDIC's Board of Directors (Board) adopt and authorize publication of the attached notice of proposed rulemaking (NPR or proposal) with a 60-day comment period. The proposed rule would:

- Amend the "deposit broker" definition to (1) remove the "matchmaking activities" definition and replace it with a broader definition related to deposit allocation services, and (2) add a new factor related to fees;
- Eliminate the exclusive placement arrangement carve-out and clarify that "deposit broker" under section 29 of the Federal Deposit Insurance Act (FDI Act) includes engaging in the business of placing deposits at *one or more* insured depository institutions (IDIs);
- Revise the interpretation of the primary purpose exception (PPE) and replace it with the historical FDIC staff interpretation that includes consideration of the third party's intent in placing customer funds at a particular IDI;
- No longer allow third parties to apply for a PPE and instead only allow IDIs to apply;
- Revise the "25 percent test" designated business exception to a modified 10 percent test (the proposed "Broker-Dealer Sweep Exception");
- Eliminate the enabling transactions designated exception; and
- Clarify when an IDI that has lost its agent institution status can regain status for purposes of the limited exception for reciprocal deposits.

Concur:

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Harrel M. Pettway
General Counsel

BACKGROUND

Legal Authority and Policy Objectives

Section 29 of the FDI Act[1] prohibits less than well capitalized[2] IDIS[3] from accepting brokered deposits. The FDIC has found significant reliance on brokered deposits increases an institution's risk profile, particularly as its financial condition weakens. The FDIC's statistical analyses and other studies have found that an IDI's use of brokered deposits in general is correlated with a higher probability of failure and higher losses to the Deposit Insurance Fund (DIF) upon failure.[4]

On December 15, 2020, the FDIC Board adopted a final rule that established a new framework for analyzing whether certain deposit arrangements qualify as brokered deposits (the 2020 Final Rule).[5] After the 2020 Final Rule took effect, the FDIC initially observed a significant decline in reported brokered deposits. IDIs reported a nearly $350 billion, or 31.8 percent, decline in brokered deposits between the first and second quarters of 2021 after the 2020 Final Rule became effective, which is the largest quarterly decline since brokered deposit reporting began in 1983. This significant decline can be interpreted as IDIs reclassifying a considerable amount of deposits from brokered to not brokered, as a result of the 2020 Final Rule.

This is because, in large part, the changes made by the 2020 Final Rule have narrowed the types of deposit-related activities that are considered brokered. In the FDIC's view, this narrowing is problematic because these deposits continue to present the same risks as before the 2020 Final Rule. The 2020 Final Rule also expanded the types of business relationships that are eligible to be excepted from the "deposit broker" definition. For instance, the 2020 Final Rule excluded certain factors, such as the payment of fees, from the "deposit broker" definition that had historically been viewed as relevant to whether a deposit is brokered. The 2020 rule also expanded the scope of the primary purpose exception to the deposit broker definition, which has allowed for a significant number of business lines to be excluded from the deposit broker definition.[6] As a result, this has led to certain deposit arrangements that would have been

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[1] 12 U.S.C. 1831f.

[2] For purposes of section 29 of the FDI Act and section 337.6 of the FDIC's Rules and Regulations, 12 CFR 337.6, the terms "well capitalized," "adequately capitalized," and "undercapitalized" have the same meaning as to each IDI as provided under the regulations implementing section 38 of the FDI Act issued by the appropriate federal banking agency for that institution. *See* 12 CFR 337.6(a)(3)(i).

[3] Insured depository institutions include banks and savings associations insured by the FDIC. *See* 12 U.S.C. 1813(c)(2).

[4] *See* FDIC, Study on Core Deposits and Brokered Deposits, (July 8, 2011), available at https://www.fdic.gov/regulations/reform/coredeposit-study.pdf. *See also* 84 FR 2366, 2369 (Feb. 6, 2019). The FDIC updated its analysis in the 2011 Study on Core Deposits and Brokered Deposits with data through the end of 2017. *See id.* at 2384-2400 (Appendix 2).

[5] *See* FDIC, Press Release: FDIC Board Approves Final rule on Brokered Deposit and Interest Rate Restrictions (Dec. 15, 2020) available at https://www.fdic.gov/news/press-releases/2020/pr20136.html. The 2020 Final rule was published in the Federal Register on January 22, 2021. *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions Final Rule, 86 FR 6742 (January 22, 2021).

[6] *See e.g.*, FDIC, Public Report of Entities Submitting Notices for a Primary Purpose Exception (PPE) As of 03/15/2024, available at https://www.fdic.gov/resources/bankers/brokered-deposits/public-report-ppes-notices.pdf.

as brokered prior to the 2020 Final Rule as no longer being classified as brokered, even though such deposits present the same or similar risks as brokered deposits.

Based on the FDIC's experience, the decline in reported brokered deposits is also due, in part, to some IDIs misunderstanding and misreporting deposits under the 2020 Final Rule. Despite the FDIC's efforts in conducting industry outreach and providing clarifying information,[7] the FDIC has observed a number of challenges with entities understanding certain provisions of the 2020 Final Rule, which has resulted in some level of inaccurate and inconsistent application of the rule. In turn, this has resulted in some deposits that meet the "brokered deposit" definition under the 2020 Final Rule not being correctly reported as brokered on IDIs' Consolidated Reports of Condition and Income (Call Reports).[8] Many of these challenges arise from section 337.6(a)(5)(v)(I)(1)(i) in the rule allowing third parties to provide a notice regarding the 25 percent test primary purpose exception. FDIC staff have observed some IDIs relying on this primary purpose exception notice, without conducting analyses, or without having access to the appropriate documentation to conduct analyses, to determine whether an additional third party involved in the arrangement is a "deposit broker," thereby rendering the arrangement brokered.[9]

If left unchanged, this underreporting of brokered deposits could have serious consequences for IDIs and the DIF, which is used to protect depositors of insured banks and to resolve failed banks, as such underreporting impedes the ability to evaluate the extent of reliance on brokered deposits and the effects on an IDI's risk profile for supervisory and deposit insurance pricing purposes. Moreover, the FDIC is concerned that these issues expose IDIs individually and the banking system more broadly to the type of risk the brokered deposit restrictions are intended to address—namely that a less than well capitalized institution could rely on less stable third party deposits for rapid growth that may weaken the safety and soundness of IDIs and the banking system and expose the FDIC to increased losses.

Additionally, experiences since the 2020 Final Rule have shown that some of the underlying reasons to narrow the coverage of the rule have proved to be problematic. For example, First Republic Bank,[10] which failed in May 2023 after contagion effects from the failure of Silicon Valley Bank, experienced a significant run on affiliated sweep deposits, and in

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[7] For example, the FDIC maintains a dedicated brokered deposits webpage that includes "Questions and Answers Related to Brokered Deposits Rule" and a "Statement of the [FDIC] Regarding Reporting of Sweep Deposits on Call Reports," among other resources. *See* FDIC, Banker Resource Center Brokered Deposits, available at https://www.fdic.gov/resources/bankers/brokered-deposits/.

[8] "Call Reports" consist of the Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices (FFIEC 031), the Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only (FFIEC 041), and the Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less than $5 Billion (FFIEC 051).

[9] *See e.g.*, FDIC, Decision of the Supervision Appeals Review Committee, In the Matter of * * *, Case No. 2022-02 (Apr. 26, 2023), available at https://www.fdic.gov/resources/regulations/appeals-of-material-supervisory-determination/appeals/sarc202202.pdf.

[10] *See* Off. of Inspector Gen., FDIC, Material Loss Review of First Republic Bank, Report No. EVAL-24-03 (Nov. 28, 2023) available at https://www.fdicoig.gov/sites/default/files/reports/2023-12/EVAL-24-03.pdf.

particular uninsured affiliated sweep .[11] This suggests that in the case of First Republic, affiliated sweeps were no more "sticky" than unaffiliated sweeps, contrary to the exemption in section 337.6(a)(5)(iii)(C)(1) for affiliated entities. Moreover, in the case of the failure of crypto company Voyager,[12] it was not considered a "deposit broker" – and Voyager deposits were not considered brokered – because it had an exclusive deposit placement arrangement with one IDI. Under the 2020 Final Rule, exclusive deposit placement arrangements are excluded from the definition of a "deposit broker" even though Voyager's activities were the same as a "deposit broker," and the failure of Voyager created the same legal, operational, and liquidity risks for its partner IDI as if it had, say two partner banks, and had been classified as a deposit broker. FDIC staff is concerned that less than well-capitalized IDIs 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.

To address these concerns and challenges, the FDIC is proposing amendments that would (1) simplify certain definitions of the 2020 Final Rule to reduce operational challenges and reporting burdens on IDIs; (2) help ensure uniform and consistent reporting of brokered deposits by IDIs; and (3) strengthen the safety and soundness of the banking system by ensuring that less than well capitalized institutions are restricted from relying on brokered deposits to support risky, rapid growth.

A History of Concerns and Related Research

An IDI's use of brokered deposits often raises its risk profile, which has long been a concern among bank regulators and Congress.[13] This concern arose because: (1) such deposits could facilitate a bank's rapid growth in risky assets without adequate controls; (2) once problems arose, a problem bank could use such deposits to fund additional risky assets to attempt to "grow out" of its problems, a strategy that ultimately increased the losses to the DIF when the institution failed; and (3) brokered and high-rate deposits were sometimes considered less stable because deposit brokers (on behalf of customers), or the customers themselves, were often drawn

[11] During the quarter leading up to failure, First Republic Bank reported a sharp decline in affiliate sweep deposits that were not fully insured, from $8.3 billion to $1.1 billion from December 31, 2022 to March 31, 2023; they also experienced a decline from $1.9 billion to $1.4 billion in insured affiliated sweep deposits. Over the same period, First Republic Bank reported an increase in fully insured non-affiliate sweep deposits, from $7.3 billion to $8.7 billion.

[12] *See In re* Voyager Digital Holdings, Inc. et al., No. 22-10943, (Bankr. S.D.N.Y July 6, 2022).

[13] Congressional hearings regarding brokered deposits were held between 1984 and 1988, and in 1989, as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). *See* 84 FR at 2368. *See also* "Problems of the Federal Savings and Loan Insurance Corporation: Hearings Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate," (part II) 101st Cong., 1st Sess. 230–231 (1989). *See also e.g.*, Congressional testimony of Senators Graham and Sarbanes on Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, Proceedings and Debates of the 102nd Congress, First Session, November 21, 1991, 137 Cong. Rec. S17322-01, 1991 WL 243977 ("One of the lessons from the thrift crisis is their ability to gather deposits through brokered deposits and increase the size of the institution and the funds they had available very rapidly without additional capital and, quite frankly, without additional management. Then, to take these funds out and invest them in what turned out to be very risky matters, is certainly a lesson America has to learn and look at.") (referring to testimony of the President of the Independent Bankers Association provided in April 1990).

Historically, brokered deposits have been a key cause of bank failures. For example, in 1982, brokered deposits were found to have been a key cause of the largest payout of insured deposits to date with the failure of Penn Square Bank.[14] Between 2007 and 2017, 530 IDIs failed and were placed in FDIC receivership with estimated loss to the DIF for these institutions of $71.9 billion. 47 of these institutions that failed relied heavily on brokered deposits and each caused an estimated loss to the DIF of over $100 million. These 47 institutions held total assets representing 20.9 percent of the $396.9 billion in aggregate total assets of the 530 failed institutions, but accounted for $27.3 billion in estimated losses to the DIF, representing 38 percent of the $71.9 billion in all DIF estimated losses for that same period.[15]

In the aftermath of the financial crisis of 2008 and 2009, section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act directed the FDIC to conduct a study of core and brokered deposits, which the FDIC completed in 2011. In the FDIC's Study on Core Deposits and Brokered Deposits,[16] the FDIC found that higher brokered deposit use was associated with higher probability of bank failure and higher DIF losses, and that, on average, brokered deposits were correlated with higher levels of asset growth, higher levels of nonperforming loans, and a lower proportion of core deposit funding.

In December 2017, the FDIC published Crisis and Response: An FDIC History, 2008–2013, which showed that failures and CAMELS rating downgrades were more concentrated among IDIs that made relatively greater use of wholesale funding sources, which includes brokered deposits. Moreover, the Inspectors General of the federal banking agencies have prepared reports detailing how brokered deposits were sometimes used by failed banks between 2007 and 2017.[17]

In 2019, the FDIC updated its analysis in the 2011 Study on Core Deposits and Brokered Deposits with data through the end of 2017.[18] As part of that update, statistical analysis found that brokered deposit use is associated with higher probability of an IDI's failure and higher DIF loss rates.

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[14] 84 FR 2366, 2367 (Feb. 6, 2019); FDIC, History of the Eighties—Lessons for the Future, Chapters 2 and 9, *passim* (Dec. 1997), available at https://www.fdic.gov/bank/historical/history/; Phillip L. Zwieg, Belly Up: The Collapse of the Penn Square Bank, Chapter 9 (1985).

[15] The estimated loss data is as of March 31, 2024, available at: https://banks.data.fdic.gov/bankfind-suite/failures.

[16] *See* FDIC, Study on Core Deposits and Brokered Deposits, (July 8, 2011), available at https://www.fdic.gov/regulations/reform/coredeposit-study.pdf.

[17] *See* 84 FR 2366, 2369-70 (Feb. 6, 2019) (citing Safety and Soundness: Analysis of Bank Failures Reviewed by the Department of the Treasury Office of Inspector General, OIG–16–052, August 15, 2016; Follow Up Audit of FDIC Supervision Program Enhancements, FDIC Office of Inspector General, Report No. MLR–11–010, December 2011 Summary Analysis of Failed Bank Reviews, Board of Governors of the Federal Reserve System, Office of Inspector General, September 2011).

[18] *See* 84 FR at 2384-2400 (Appendix 2).

Current Statutory and Regulatory Framework

Section 29 of the FDI Act, imposes restrictions on a less than well-capitalized IDI from accepting funds obtained, directly or indirectly, by or through any deposit broker for deposit into one or more deposit accounts (referred to as brokered deposits).[19] Section 29 does not directly define the term "brokered deposit." Section 337.6 of the FDIC's Rules and Regulations implements section 29[20] and defines the term "brokered deposit" as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker."[21] Thus, the meaning of the term "brokered deposit" turns upon the definition of "deposit broker."

Under section 29, a "deposit broker" is defined, in part, as "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties."[22] An agent or trustee also meets the "deposit broker" definition when establishing a deposit account to facilitate a business arrangement with an IDI to use the proceeds of the account to fund a prearranged loan.[23]

The deposit broker definition is subject to nine statutory exceptions.[24] Section 337.6 includes the statutory exceptions to the "deposit broker" definition plus the following tenth exception: "An insured depository institution acting as an intermediary or agent of a U.S. government department or agency for a government sponsored minority or women-owned depository institution program."[25]

Deposit Broker Definition in the 2020 Final Rule

In the 2020 Final Rule, the FDIC amended the brokered deposit regulation to further define circumstances under which a third party is a "deposit broker." More specifically, the 2020 Final rule provides "[a] person is engaged in the business of placing deposits of third parties if that person receives third party funds and deposits those funds at more than one insured depository institution."[26] It also provides that "a person is engaged in the business of facilitating the placement of deposits of third parties" if that person is engaging in any of the following activities with respect to deposits placed at more than one IDI:

- The person has legal authority, contractual or otherwise, to close the account or move the third party's funds to another insured depository institution;

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[19] 12 U.S.C. 1831f(a). An "undercapitalized" depository institution is prohibited from accepting deposits from a deposit broker. An "adequately capitalized" insured depository institution may accept deposits from a deposit broker only if it has received a waiver from the FDIC. *See* 12 U.S.C. 1831f(c).
[20] Section 337.7 of the FDIC's Rules and Regulations, 12 CFR 337.7, implements section 29's interest rate restrictions. The proposed rule would not amend these provisions.
[21] 12 CFR 337.6(a)(2).
[22] 12 U.S.C. 1831f(g)(1)(A).
[23] 12 U.S.C. 1831f(g)(1)(B).
[24] 12 U.S.C. 1831f(g)(2).
[25] 12 CFR 337.6(a)(5)(v)(J).
[26] 12 CFR 337.6(a)(5)(ii).

- The person is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account; or
- The person engages in matchmaking activities.[27]

A person is engaged in "matchmaking activities" if the person proposes deposit allocations at, or between, more than one IDI based upon both the particular deposit objectives of a specific depositor or depositor's agent, and the particular deposit objectives of specific IDIs.[28] The "matchmaking activities" definition further provides that a proposed deposit allocation is based on the particular objectives of:

- A depositor or depositor's agent when the person has access to specific financial information of the depositor or depositor's agent and the proposed deposit allocation is based upon such information; and
- A bank when the person has access to the target deposit-balance objectives of specific banks and the proposed deposit allocation is based upon such information.[29]

The "matchmaking activities" definition, however, excludes deposits placed by a depositor's agent with an IDI affiliated with the depositor's agent.[30]

Exclusive Deposit Placement Arrangements in the 2020 Final Rule

The 2020 Final Rule provides that a person is engaged in the business of placing deposits or facilitating the placement of deposits of third parties if that person receives third party funds and deposits those funds at more than one IDI or if that person is engaged in certain activities with respect to deposits placed at more than one IDI.[31] The preamble to the 2020 Final Rule specified that any person that has an exclusive deposit placement arrangement with one IDI and is not placing or facilitating the placement of deposits at any other IDI, will not be "engaged in the business" of placing, or facilitating the placement of, deposits at IDIs and therefore will not meet the "deposit broker" definition.[32]

The Primary Purpose Exception in the 2020 Final Rule

The 2020 Final Rule provides that the primary purpose exception applies when, with respect to a particular business line, the primary purpose of the agent's or nominee's business relationship with its customers is not the placement of funds with depository institutions.[33] Moreover, the 2020 Final Rule identifies fourteen designated business exceptions with respect to a particular business line as meeting the primary purpose exception. [34]

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[27] 12 CFR 337.6(a)(5)(iii)
[28] 12 CFR 337.6(a)(5)(iii)(C)(1).
[29] *Id*.
[30] *Id*.
[31] 12 CFR 337.6(a)(5)(ii)-(iii).
[32] *See* 86 FR 6742, 6745 (January 22, 2021).
[33] *See* 12 CFR 337.6(a)(5)(v)(I).
[34] 12 CFR 337.6(a)(5)(v)(I)(1).

The 2020 Final Rule allows the FDIC to identify additional relationships as designated business exceptions to the primary purpose exception.[35] On January 10, 2022, the FDIC published an additional designated exception for certain non-discretionary custodians engaging in specific arrangements related to the placement of deposits.[36]

For the 25 percent and enabling transactions test exceptions, a third party or an IDI on behalf of a third party must file a notice with the FDIC for a particular business line.[37] Under the current process, the FDIC provides immediate email acknowledgement of receipt of the notice filing and the third party that is the subject of the notice may rely upon the applicable designated exception for the particular business line. Notice filers under the 25 percent test must also satisfy quarterly reporting requirements, while notice filers under the enabling transactions test must provide an annual certification.[38] For the other designated exceptions, no notice, application, or reporting is required.

For agents or nominees that do not meet one of the designated business exceptions, such third parties, or an IDI on behalf of a third party, may apply for a primary purpose exception in accordance with the requirements contained in §303.243(b).[39] Moreover, the 2020 Final Rule provides a specific application process for a primary purpose exception to enable transactions with fees, interest, or other remuneration provided to the depositor.[40]

The Reciprocal Deposits Limited Exception

In 2018, section 29 of the FDI Act was amended as part of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"), to allow "agent institutions" to except a capped amount of "reciprocal deposits" from treatment as brokered deposits.[41] Section 29 generally provides that reciprocal deposits are excepted when the total amount of reciprocal deposits held by an agent institution does not exceed the lesser of $5 billion or 20 percent of the total liabilities of the agent institution. [42]

On December 18, 2018, the FDIC adopted a final rule (the 2018 Reciprocal Deposits Rule), to amend its regulations that implement brokered deposits and interest rate restrictions to conform with the changes to section 29 by EGRRCPA.[43] Consistent with section 29, the 2018 Reciprocal Deposits Rule defines "agent institution" to mean an IDI that places a covered deposit

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[35] 12 CFR 337.6(a)(5)(v)(I)(1)(xiv).
[36] *See* 87 Fed. Reg. 1065 (January 10, 2022).
[37] *See* 12 CFR 303.243(b). Where customer funds placed at depository institutions are placed into transaction accounts, and fees, interest, or other remuneration are provided to the depositor, an applicant can apply for a primary purpose exception, with respect to the particular business line, according to the requirements listed in 12 CFR 303.243(b)(4)(i).
[38] 12 CFR 303.243(b)(3(v).
[39] 12 CFR 337.6(a)(5)(v)(I)(2).
[40] 12 CFR 303.243(b)(4)(i).
[41] 12 U.S.C. 1831f(i)(2)(E).
[42] 12 U.S.C. 1831f(i)(1).
[43] *See* 84 FR 1346 (Feb. 4, 2019). The Reciprocal Deposits Rule was effective March 6, 2019. Section 337.6(e) of the FDIC's Rules and Regulations, 12 CFR 337.6(e), implements section 29's limited exception for reciprocal deposits.

through a deposit placement network at other IDIs in amounts that are less than or equal to the standard maximum deposit insurance amount, specifying the interest rate to be paid for such amounts, if the IDI:

- As of its most recent annual examination under 12 U.S.C. §1820(d), was found to have a composite condition of outstanding or good and is well-capitalized;
- Has obtained a brokered deposit waiver from the FDIC;[44] or
- Does not receive an amount of reciprocal deposits that causes the total amount of reciprocal deposits held by the agent institution to be greater than the average of the total amount of reciprocal deposits held by the agent institution on the last day of each of the four calendar quarters preceding the calendar quarter in which the agent institution was found not to have a composite condition of outstanding or good or was determined to be not well capitalized.[45]

Under the 2018 Reciprocal Deposits Rule, an "agent institution" can except reciprocal deposits from being classified as brokered deposits up to its applicable statutory caps—the "general cap" or "special cap." Under the "general cap," an agent institution may except reciprocal deposits up to the lesser of the following amounts from being classified as brokered deposits: $5 billion or an amount equal to 20 percent of the agent institution's total liabilities. Reciprocal deposits in excess of the general cap, as well as those deposits that do not meet the definition of a "reciprocal deposit," may not take advantage of the limited exception and are to be reported as brokered deposits.

The "special cap" applies if the IDI either was found to not have a composite condition of outstanding or good when most recently examined under section 10(d) of the FDI Act or is not well capitalized and has not received a waiver from the brokered deposit restrictions under section 29(c). In this case, the IDI may still meet the "agent institution" definition and be subject to the "special cap", if, after becoming subject to the "special cap", the IDI does not receive reciprocal deposits that result in its total reciprocal deposits to be in excess of the "special cap." The "special cap" is the average amount of reciprocal deposits held at the IDI on the last day of each of the four calendar quarters preceding the calendar quarter in which the agent institution was found not to have a composite condition of outstanding or good or was determined to be not well capitalized. If an IDI receives reciprocal deposits in excess of its special cap, it is no longer an agent institution. If an IDI is not an agent institution, it is not eligible to use the limited exception and all of its reciprocal deposits should be reported as brokered deposits.

As such, the amount of reciprocal deposits excepted from being considered brokered turns on whether the IDI qualifies as an agent institution and if so, whether the IDI is subject to the special cap.

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[44] The FDIC can only grant brokered deposit waivers for institutions that are classified as adequately capitalized; IDIs that are well-capitalized but not well rated or are undercapitalized are not eligible. *See* 12 U.S.C. 1831f; 12 CFR 337.6(c).

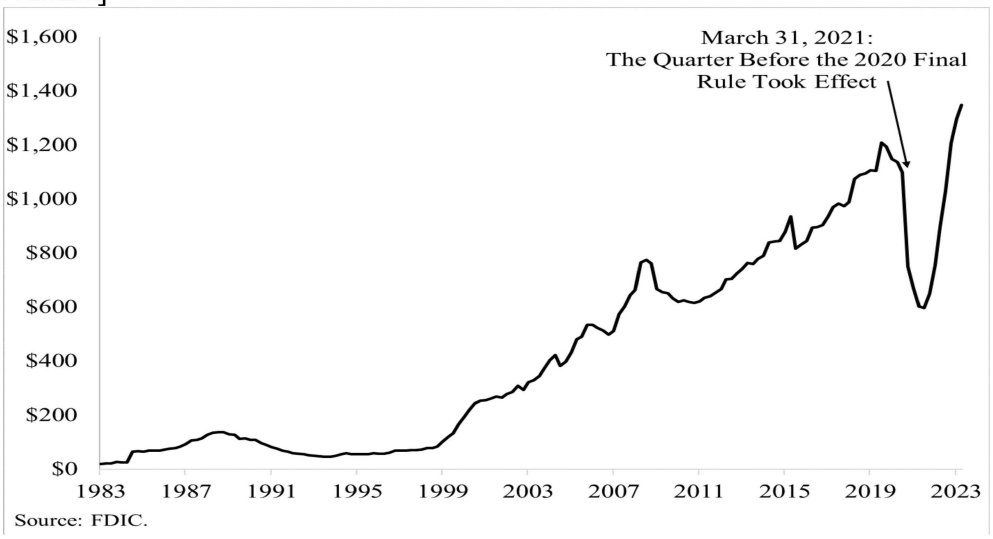
[45] 12 CFR. 337.6(e)(2)(i).

Developments Post-2020 Final Rule

Call report brokered deposits data

Following the April 1, 2021 effective date of the 2020 Final Rule, IDIs reported a significant decrease in brokered deposits in their Call Report filings. As illustrated in [Chart 1], from March 31, 2021 to June 30, 2021, brokered deposits declined by nearly $350 billion, or 31.8 percent, the largest decline since brokered deposit reporting began in 1983. Brokered deposit balances continued to decline through March 31, 2022, following the extended compliance date of January 1, 2022. The FDIC notes, however, that as of the fourth quarter of 2023, brokered deposits at all IDIs are 22.5 percent higher than the quarter before the 2020 Final Rule took effect (first quarter 2021), despite the considerable amount of deposits that are no longer considered brokered based on the 2020 Final Rule changes. This increase in reported brokered deposits is due to increases in insured brokered deposit balances, including brokered reciprocal deposits. These increases may be driven in part by higher interest rates, which have exacerbated competition for deposit funding, and depositors seeking additional deposit insurance coverage, particularly following the failures that occurred in the first half of 2023.

Chart 1 – Brokered deposits reported by all IDIs from Q3 1983 through Q4 2023 [Billions of Dollars]



Expansion of certain third-party arrangements that deliver deposits to IDIs

Since the April 1, 2021 effective date of the 2020 Final Rule, the FDIC has observed the continued expansion of IDI arrangements with third parties to deliver deposit products (particularly those with transactional features) for a variety of IDI objectives, including to expand geographic reach, offer innovative products, and raise deposits. In these arrangements, an IDI typically makes deposit products or services available through an arrangement in which a third party, rather than the IDI, markets, distributes, or otherwise provides access to or assists in the placement of customer deposits at particular IDIs. Depending on the services provided by the third party, and the availability of regulatory exceptions to the "deposit broker" definition (e.g., the "enabling transactions" test under the primary purpose exception or the exclusive placement arrangement exception), the deposits may or may not be considered brokered.

Recent events, however, underscore the precarious nature of these funding arrangements as they can be highly unstable, with either the third party or the underlying customers moving funds based on market conditions or other factors. These arrangements can also be prone to other forms of disruption such as the potential or actual insolvency of the third party, as recently demonstrated by the bankruptcy of Synapse Financial Technologies, Inc. (Synapse).[46] Synapse, sometimes referred to as a fintech "middleware" company, was a deposit broker that facilitated customer deposits for various fintech companies looking for banking services with IDIs. Moreover, the rapid growth with such deposits without corresponding growth in risk management practices can expose IDIs to operational, liquidity, and legal risks. In certain circumstances, these arrangements are excluded from the brokered deposit definition pursuant to changes implemented by the 2020 Final Rule, even though the arrangements exhibit the same risks as brokered deposits.

An example is the failure of Voyager, which was exempted from the brokered deposit definition by virtue of the exclusive deposit placement arrangement exception. Where less than well-capitalized institutions may be able to continue to grow with such deposits, because they are not currently treated as brokered deposits, the FDIC believes that these arrangements have the potential to undermine the safety and soundness of such institutions individually, and financial stability more broadly.

DISCUSSION OF THE PROPOSAL

Overview

Staff recommend that the Board adopt and authorize for publication this proposal and request for comment that would strengthen the brokered deposit regulations by revising certain provisions to further support the statutory language and purpose of the brokered deposit restrictions, as well as simplifying certain provisions that pose operational challenges.

Deposit Broker Definition

The proposed rule would amend the "deposit broker" definition by revising the "engaged in the business of placing deposits" ("placing") and "engaged in the business of facilitating the placement of deposits" ("facilitating") prongs. The revised "deposit broker" definition would (1) combine the "placing" and "facilitating" prongs, (2) remove the term "matchmaking activities" and replace it with a deposit allocation provision, and (3) add a new factor related to fees. Specifically the proposed rule would provide that a person is engaged in the business of placing or facilitating the placement of deposits of third parties if that person engages in one or more of the following activities:

- The person receives third party funds and deposits those funds at one or more IDIs;
- The person has legal authority, contractual or otherwise, to close the account or move the third party's funds to another IDI;
- The person is involved in negotiating or setting rates, fees, terms, or conditions for the deposit account;
- The person proposes or determines deposit allocations at one or more IDIs (including through operating or using an algorithm, or any other program or technology that is

[46] *See In re* Synapse Fin. Tech., Inc., No. 1:24-bk-10646-MB (Bankr. C.D. Cal. R. Apr. 22, 2024).

functionally similar) ; or

- The person has a relationship or arrangement with an IDI or customer where the IDI, or the customer, pays the person a fee or provides other remuneration in exchange for, or related to, the placement of deposits.

Exclusive Placement Arrangement

The 2020 Final Rule amended the FDIC's regulations so that the brokered deposit restrictions do not apply where a third party that otherwise meets the definition of deposit broker has an exclusive deposit placement arrangement at only one IDI. Under this change, an IDI can rely for one hundred percent of its deposits on an unaffiliated third party without any of those deposits considered brokered. The IDI can fall below well capitalized and still rely on those third party placed deposits for one hundred percent of its funding without any of those deposits being considered brokered, which provides an avenue for less than well capitalized IDIs to obtain and retain brokered deposits that appears to conflict with intent of the statutory prohibition. An IDI can form multiple "exclusive" third party relationships to fund itself without any of those deposits considered brokered. Thus, the current regulation exposes the banking system to the kind of risk the brokered deposit restrictions were intended to address.

For these reasons, and to mitigate any unintended effects of the interpretation as related to the statute's purpose, the FDIC is proposing to revise the brokered deposit regulations to restore their applicability to any third party that meets the definition of deposit broker, including those involved in placing deposits at only one IDI.[47]

Primary Purpose Exception Analysis

The proposed rule would revise the analysis for determining when an agent or nominee meets the primary purpose exception to the "deposit broker" definition. The statutory definition of the "primary purpose exception" excludes "an agent or nominee whose primary purpose is not the placement of funds with depository institutions" from being considered a "deposit broker.

The current regulation focuses the primary purpose exception analysis on the third party's business relationship with its customers. While that is an important part of analyzing the exception, the FDIC believes that the relationship between the IDI and third party is also important in determining the purpose motivating the placement of third-party deposits and if the primary purpose is or is not the placement of funds with IDIs.

Accordingly, the proposal provides that the primary purpose exception to the "deposit broker" definition would apply when an agent or nominee whose primary purpose in placing customer deposits at IDIs is for a substantial purpose other than to provide a deposit-placement service or FDIC deposit insurance with respect to particular business lines.[48] As detailed below,

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[47] This proposal would be consistent with the general statutory interpretation rule that "[i]n determining the meaning of any Act of Congress, words importing the plural include the singular, unless the context indicates otherwise." *See* 1 U.S.C. 1.

[48] The FDIC would view a third party placing funds for the primary purpose of providing FDIC deposit insurance to third parties as not meeting the statutory exception, as the purpose of providing FDIC insurance coverage is indistinguishable from the placement of deposits.

the proposal would provide additional factors to consider, including fees or other remuneration provided to the third party, in determining whether the intent of the third party in placing deposits at an IDI is for a substantial purpose other than to provide a deposit-placement service or FDIC deposit insurance.

Eligible applicants for the primary purpose exception process

The proposed rule would also update the primary purpose application process under §303.243(b). The 2020 Final Rule allows a third party or an IDI on behalf of a third party to submit a primary purpose exception application. From the FDIC's experience, some third parties have provided insufficient information for the FDIC to process an application, such as failing to provide required information on all parties within a deposit arrangement, including the receiving IDIs. Moreover, the FDIC has observed some IDIs misunderstand the primary purpose exception application approvals provided to third party applicants, as the IDI was not the applicant and the approval does not apply to its particular deposit placement activity with the third party.

For these reasons, the FDIC proposes to no longer allow third parties to apply for a primary purpose exception. As proposed, each IDI wishing to rely on a primary purpose exception would be required to submit an application for the specific deposit placement arrangement that it has with the third party involved. This would provide the FDIC the opportunity to review the specific facts and circumstances surrounding the deposit placement activity between the individual IDI applicant and the third party in determining whether a primary purpose exception should be approved.

Proposed additional factors for primary purpose exception application

Under the 2020 Final Rule, applicants that seek a primary purpose exception must include certain information when submitting an application to the FDIC.[49] The proposed rule would add new factors to be considered as part of the primary purpose exception application. Specifically, the proposed rule would amend §303.243(b)(4)(ii) to include consideration of whether:

- The IDI, or customer, pays fees or other remuneration to the agent or nominee for deposits placed with the IDI and the amount of such fees or other remuneration, including how the amount of fees or other remuneration is calculated
- The agent or nominee has discretion to choose the IDI(s) at which customer deposits are or will be placed; and
- The agent or nominee is mandated by law to disburse funds to customer deposit accounts.

These new factors would supplement the factors that were provided under the 2020 Final Rule. The FDIC believes consideration of these factors, in conjunction with the existing factors, is necessary to fully consider the purpose of the placement of third party deposits at an IDI and whether the third party is eligible for a primary purpose exception. Approval of a primary purpose exception application would be based on the consideration of all applicable factors and

[49] *See* 12 CFR 303.243(b)(4)(ii).

any additional information provided by the applicant

25 Percent Test Designated Exception

The proposed rule would revise the current "25 percent test" designated exception and its notice process to (1) align with the proposed analysis of the primary purpose exception; and (2) ensure that the FDIC and the IDI can properly determine whether any additional third parties meet the "deposit broker" definition before the exception can be invoked. In order to more clearly describe the business arrangements intended to qualify for this primary purpose exception, the proposed rule would revise the "25 percent test" and rename it as the "Broker-Dealer Sweep Exception."

Reporting Issues with the 25 Percent Test

Since implementation of the 2020 Final Rule, the FDIC has encountered a number of challenges with notice filings submitted under the 25 percent test and reporting associated with sweep deposits. The challenges became more apparent since the new reporting items related to sweep deposits were added to the Call Report shortly after the 2020 Final Rule became effective. The FDIC anticipated that most unaffiliated sweep deposits would be classified as brokered deposits because of the understanding that most broker-dealers, even those with valid primary purpose exceptions, outsourced their deposit allocation functions to an intervening third party providing matchmaking activities and these additional third parties would thus meet the "deposit broker" definition.[50] Approximately 27 percent of all IDIs reported a non-zero amount for total sweep deposits that are not brokered deposits as of December 31, 2023.

The FDIC has observed several reasons for this misreporting. An IDI must conduct a detailed analysis to accurately determine the status of all third parties involved in a sweep deposit program. The analysis may include a review of the agreements between the broker-dealer and any additional third party within the deposit placement arrangement, including third parties with which an IDI may not have a direct contractual relationship.[51] Additionally, the FDIC has observed a number of IDIs and other stakeholders misunderstanding the current "matchmaking activities" definition. This lack of understanding has likely contributed to IDIs overreporting sweep deposits as not brokered when these deposits should be considered brokered.

Proposed Broker-Dealer Sweep Primary Purpose Exception

As proposed, subject to the additional conditions below, the Broker-Dealer Sweep Exception would be available only to a broker-dealer or investment adviser registered with the Securities and Exchange Commission and only if less than 10 percent of the total assets that the broker-dealer or investment adviser, as agent or nominee, has under management for its customers, in a particular business line, is placed into non-maturity accounts at one or more IDIs, without regard to whether the broker-dealer or investment adviser and depository institutions are

[50] The FDIC has identified a few IDIs that retain these functions in house and are properly reporting unaffiliated sweep deposits as not brokered

[51] *See* FDIC, Statement of the [FDIC] Regarding Reporting of Sweep Deposits on Call Reports, (July 15, 2022) available at https://www.fdic.gov/resources/bankers/brokered-deposits/statement-sweep-deposits.pdf.

affiliated.

In addition, the proposal would amend one of the key measures used as part of this designated exception from "customer assets under administration" to "customer assets under management." From the FDIC's experience with the 2020 Final Rule, "customer assets under administration" is a more appropriate measure when including a broader group of business relationships and business lines, whereas "assets under management" would be appropriate under the proposed rule to accurately reflect the scope of the types of services provided by broker dealers and investment advisers. The proposed rule would define "assets under management" to mean securities portfolios and cash balances with respect to which an investment adviser or broker-dealer provides continuous and regular supervisory or management services.

Prior Notice Requirement (no additional third parties)

In order to ensure accurate and uniform reporting by depository institutions receiving sweep deposits from broker-dealers, the proposed rule would allow an IDI to file a designated exception notice for the Broker-Dealer Sweep Exception on behalf of broker-dealers that place deposits at the IDI only if *no additional third party* (including any affiliate) is involved in the sweep program. IDIs would be able to rely on the Broker-Dealer Sweep Exception if the FDIC has not provided a written disapproval within 90 days from submission.

Application Requirement (additional third parties)

In an effort to ensure that the FDIC has the ability to properly scrutinize the role of additional third parties as part of sweep programs, the proposal would create an application process for IDIs that wish to invoke the Broker-Dealer Sweep Exception when additional third parties are involved in the arrangement. The application process would review whether the broker-dealer or investment adviser meets the criteria under the Broker-Dealer Sweep Exception and it would review whether any additional third party involved in the deposit placement arrangement meets the "deposit broker" definition. If the additional third party meets the "deposit broker" definition, then the FDIC would deny the application and the deposits being placed through the sweep program would be brokered notwithstanding the broker-dealer itself qualifying for a primary purpose exception. The proposed rule would require an application regardless of whether the sweep arrangement involves IDI-affiliated parties. The FDIC believes treating affiliated and unaffiliated relationships the same when an additional third party is involved would help ensure consistent and equitable treatment of sweep deposits across the industry.

Enabling Transactions Designated Exception

The 2020 Final Rule distinguished between acting with the purpose of placing deposits and acting with the purpose of placing deposits to enable transactions and created the enabling transactions primary purpose exception. A third party qualifies for the current enabling transactions primary purpose exception by either submitting an application or submitting a notice.

The current enabling transactions test would not satisfy the proposed primary purpose exception, because placing deposits into accounts with transactional features would not, by itself,

prove that the substantial purpose of the deposit placement arrangement is for a purpose other than providing deposit insurance or a deposit-placement service. The FDIC believes that there is no relevant difference between an agent or nominee's purpose in placing deposits to enable transactions and placing deposits to access a deposit account and deposit insurance.

For these reasons, the FDIC is proposing to eliminate the enabling transactions test and the corresponding notice process. As proposed, IDIs that currently rely on a primary purpose of enabling transactions under the notice process could file an application under the general primary purpose exception application process under current § 303.243(b)(4)(ii) (subject to the amendments under the proposed rule), if they believe that the primary purpose in placing customer deposits at IDIs is for a substantial purpose other than to provide a deposit-placement service or FDIC deposit insurance with respect to the particular business line. The proposed rule would also eliminate the application process for the enabling transactions exception where interest, fees, or other remuneration is provided to depositors under § 303.243(b)(4)(i). Applications previously approved under this provision would be rescinded.

Other Designated Business Exceptions

Under the 2020 Final Rule, the FDIC identified other designated business exceptions that meet the primary purpose exception in addition to the 25 percent and enabling transactions tests discussed above. The proposed rule would retain the remaining designated business exceptions listed in the 2020 Final Rule , as well as the additional designated exception for non-discretionary custodians engaged in the placement of deposits.

Agent Institution Status for Reciprocal Deposits

In response to questions raised as to when an IDI might regain agent institution status after losing such status, and in recognition that the current statute and regulation do not provide clarity on this issue, the FDIC proposes to add a new section 337.6(e)(3) to provide a path for an IDI to regain agent institution status. Under the proposal, an IDI that lost its agent institution status would be eligible to regain its agent institution status as follows:

- If the IDI is well capitalized, the date the IDI is notified that its CAMELS composite condition is rated outstanding or good at its most recent examination under 12 U.S.C. §1820(d);
- If the IDI is well-rated, as of the date the IDI is notified, or is deemed to have notice, that it is well capitalized under regulations implementing section 38 of the FDI Act issued by the appropriate federal banking agency for that institution;
- The date the FDIC grants a brokered deposit waiver; or
- On the last day of the third consecutive calendar quarter during which the IDI did not at any time receive reciprocal deposits that caused its total reciprocal deposits to exceed its special cap.

REQUEST FOR COMMENTS

Staff recommend issuing this proposal with a 60-day comment period. The FDIC would seek comment on all aspects of the rule and in response to a series of specific questions.

CONCLUSION

The proposed rule is intended to address challenges related to certain provisions of the broker deposit regulations and to help strengthen the safety and soundness of IDIs and the banking system as a whole. FDIC staff recommend that the Board approve the NPR for publication in the *Federal Register*.

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