Brokered-Deposit Liberalization

Cite

FDIC, Final Rule; Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions

Recommended Distribution

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Website

https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf

Impact Assessment

- IDIs now have more flexibility finding funding sources across a spectrum of providers and products in ways that may reduce costs but increase run-risk.
- Fintech and even bigtech funding partnerships are less restrictive, increasing innovation as well as potential risk both to IDIs and some customers.
- LCR/NSFR compliance is facilitated.
- An array of sweep-account, collateral-secured, and other funding vehicles are exempted, increasing the ability of banks to offer new products and cross-market them.
- NIM may be slightly increased if new deposit options are less costly than core products.
- DIF premiums will drop for many IDIs.
- Deposit pricing under stress scenarios could shift to non-rate features (e.g., reward programs, loan discounts).

Overview

Easing restrictions from a proposal already intended to facilitate additional funding from products then considered brokered deposits,[1] the FDIC has finalized new rules creating a new brokered-deposit framework in which funding relationships long considered brokered deposits instead may be gathered without impediments even by under-capitalized insured depository institutions (IDIs). For example, the new rule now excludes from brokered deposits those placed by a third party with an exclusive arrangement with only one IDI. IDIs may, however, depend on more than one such entity as long as the deposit-facilitator deals with no other IDI, allowing an

[1] See **DEPOSITINSURANCE109**, *Financial Services Management*, January 6, 2020.

array of fintech and even bigtech partnerships that critics fear will accelerate the "rent-a-bank" constructs also empowered by recent, controversial OCC actions. The FDIC believes its new approach will facilitate innovation, inclusion, and macroeconomic growth, acknowledging that heightened run-risk is also possible but noting its inability to measure it with regard to an array of now-exempted products and business relationships. The final rule also alters the interest-rate caps governing third-party deposits taken by IDIs that are less than well-capitalized, revising thresholds to reflect Internet-funding channels and persistent low rates without necessarily giving weaker IDIs greater capacity to gather high-rate funds without triggering prohibitions designed to prevent *de facto* funding via runnable third-party channels.

Impact

Repeated crises going back at least to the 1980s have long led the FDIC to take a cautious stand on the use of brokered deposits, with an earlier advance notice of proposed rulemaking laying out the FDIC's research on how the continuing ability of under-capitalized IDIs to attract funds from outside their traditional deposit base leads to higher FDIC resolution costs and broader moral hazard.[2] While acknowledging potential risk, the FDIC has now taken a considerably more forgiving stand on brokered deposits. This, it says, reflects the significant technology advances in recent years that have broadly changed the way funds are now routinely gathered without regard to traditional branch networks.

As Acting Comptroller Brooks pointed out when he supported the final rule, the FDIC's new policy combines with recent OCC chartering decisions[3] and preemption rulings [4] to make collaborations between IDIs and fintechs or even bigtech-platform companies a powerful new market option. This may indeed accelerate the innovation and even the inclusion cited by the FDIC, but it also raises many challenges to legacy IDIs some believe result principally from regulatory arbitrage, not added consumer value. The wide swath of exempted deposit products and relationships that are no longer considered brokered may also allow weaker institutions to bid up direct rates or associated features (e.g., reward programs) for certain products that then puts direct or indirect net-interest margin (NIM) pressure on sound entities, much as occurred prior to 2008. As noted, the FDIC generally declined or was unable to calculate the run risk resulting from potential realignment of funding products and prices.

According to the FDIC, about forty percent of IDIs now take deposits previously considered brokered, with these institutions accounting for 92 percent of IDI assets. The agency says it cannot measure how many deposits will still be considered brokered, but it seems likely that many large banking organizations will gain considerable relief in terms of product offerings, DIF assessments, and funding flexibility should capital levels falter.

Instead of measuring the extent to which accepting deposits once considered brokered increases the potential for bank failures and higher-cost resolutions, the FDIC focuses instead on the benefits to IDIs of the reduced stigma associated with

[2] See **DEPOSITINSURANCE108**, *Financial Services Management*, January 2, 2019.

[3] See *Client Report* **CHARTER28**, December 8, 2020.

[4] See **PREEMPT35**, *Financial Services Management*, November 2, 2020.

fewer deposits considered to have been brokered and the more lending and thus greater economic growth likely as banks gain new funding sources. However, banks are currently flush with deposits, making it likely that, at least in the near term, newly-gained flexibility will affect liability configuration more than total deposit amounts at healthy banks.

Current liquidity regulation may contribute to this reconfiguration. Core deposits enjoy preferred liquidity treatment under the liquidity coverage ratio (LCR)[5] and net stable funding ratio (NSFR),[6] but brokered deposits are deemed to have more run-risk and thus are given less generous treatment. Deposits now excluded from the brokered definition due to this new rule become favored core deposits for liquidity-regulatory purposes, creating an incentive for IDIs to create new sweep accounts and open other new funding windows once deemed brokered where market conditions make this attractive. FDIC Director Martin Gruenberg voted against the final rule on grounds that the combined impact of the new brokered-deposit definition and unchanged LCR/NSFRs creates significant funding risk for banking organizations because many newly-eligible deposits are less "sticky" than true core deposits.

The final rule also addresses the rates adequately- and under-capitalized IDIs may charge on permissible deposits. Banks that fall below well-capitalized thresholds are subject to statutory brokered-deposit restrictions. These permit adequately-capitalized IDIs to gather brokered funds and reciprocal deposits not otherwise considered brokered only after receiving a waiver from the FDIC. Still less well-capitalized IDIs may not take any brokered deposits, with rate caps applicable to ensure that rollovers or other continuing deposits do not grow due to unduly high rates. The final rule revises the national and local interest-rate caps, altering the methodology to address Internet deposit-taking and ultra-low rates and declining to add special features (e.g., reward points) in the calculation; instead, these features will be assessed over time and, if needed, a revised methodology will be proposed. These rate caps have little near-term impact because the vast majority of IDIs now are well-capitalized.

The FDIC is at pains in the liberalizing rule to emphasize that nothing in it undermines its ability on a supervisory basis to deem a deposit to be brokered or to address other risks (e.g., funding concentrations). However, FDIC examiners do not supervise state member or national banks, meaning that the agency's ability to restrict risky funding is limited only to the relatively small number of large small-state nonmember banks it directly supervises. The OCC and FRB along with state banking agencies will insist on express compliance with the new deposit-taking standards but may not address practices the FDIC might wish to constrain to ensure DIF protection and least-cost resolution.

[5] See **LIQUIDITY17**, *Financial Services Management*, October 1, 2014.

[6] See **LIQUIDITY32**, *Financial Services Management*, October 27, 2020.

What's Next

This rule was finalized on December 15 by a 3-1 vote, with Mr. Gruenberg dissenting as discussed above. It is effective on April 1, 2021 with an extended compliance deadline of January 1, 2022, when existing FDIC opinions and other interpretations no longer apply. Entities that must file notices (see below) to ensure that they are not considered deposit brokers should do so as quickly as possible. Entities that wish to apply for a primary-purpose exception should also do so no later than September 3 of 2021. Written applications received by that date will be addressed by the January 1, 2022 compliance deadline unless extended.

The FDIC also plans when COVID stress diminishes to reconsider the manner in which brokered deposits are considered for DIF assessments.[7] The data discussed below on deposits now not considered brokered will determine how current rules may change. In the interim, the reduction of the number of relationships considered brokered may reduce premium assessments. The net stable funding rule also indicates that the banking agencies will monitor how sweep-account balances change and resulting stability implications.[8] The FDIC also intends to monitor these data to analyze impact of this brokered-deposit rule. Disclosures changes through the call reports will be implemented under separate public-notice procedures.

Chair McWilliams and many industry commenters supported the final rule but want the current approach altered to focus on asset growth as a sanction trigger for troubled banks instead of a funding cap. It remains to be seen if the next Congress will take this up.

Analysis

The analysis below only references the rule's notice and application procedures. Entities covered by them should refer to the final rule for applicable detail. The final rule also revokes some prior FDIC staff advisories and codifies others in revised form; entities concerned by these changes should refer to the final rule's detailed review of prior and continuing standards. The FDIC has not grandfathered prior opinions if not codified in this rule nor is a transition provided beyond the compliance deadlines noted above.

A. Deposit Broker

Because the law has no definition of brokered deposit, the brokered-deposit regulation relies instead on defining the business of being a deposit broker to reach the funds that may prove problematic if placed with troubled IDIs. Some activities that may be exempt based on the activities described below may nonetheless require prior notice to the FDIC to ensure an exemption from deposit-broker treatment. Key features in the final rule provide that:

- entities with an exclusive relationship to one IDI are not deposit brokers. This addresses situations in which a fintech places deposits with only one

[7] See **DEPOSITINSURANCE110**, *Financial Services Management*, April 1, 2020.
[8] See **LIQUIDITY32**, *Financial Services Management*, October 27, 2020.

IDI allowing these to continue without restraint even if the IDI ceases to be well-capitalized;
- entities that have a business relationship with a third party whose deposits are placed at an IDI are deposit brokers; and
- the activities that constitute facilitating deposit-placement that create a deposit broker are rolled back. Facilitation now applies to arranging deposit placement at more than one IDI through activities that take an "active role" opening accounts (e.g., negotiating, rate-setting) or has a level of legal control over the account after opening. These terms are extensively defined in the final rule.

Information-sharing activities that in the NPR would have been considered facilitation no longer apply, but "match-making" through unaffiliated sweep-account placement or similar services does. An anti-evasion prong has been added to the final match-making definition.

The following arrangements also constitute the business of deposit brokerage:

- placement of brokered CDs, which is considered a discrete and separate business line regardless of other business purposes that may qualify for a primary-purpose exception (see below);
- deposit placements for the purpose of encouraging savings by, for example, offering to maximize yield or ensure FDIC coverage; and
- cases where, while the agent or nominee is exempt under law, its third-party intermediaries are not and act as deposit brokers.

B. Exceptions

The final rule reinterprets the primary-purpose exception that has long governed situations in which deposits are placed but the entity that places them is not doing so as its primary business. Instead of establishing the proposed, general application process for determining permissible deposit placements, the final rule establishes numerous cases in which the exception would be deemed to apply. These include:

- instances in which an entity only places deposits with one IDI, in which case the overall exception to the definition of deposit broker applies;
- where less than 25 percent of assets of the agent or nominee under administration are placed with IDIs;
- if 100 percent of deposits placed are in noninterest-bearing transaction accounts which may also not otherwise reimburse the depositor. An application process for less clear situations is also established, although the FDIC cautions that exceptions will generally be made only when it is clear that funds are used in transaction or payment activities;
- property-management accounts;
- funds used for cross-border clearing purposes;
- when the agent or nominee is a mortgage servicer;
- real-estate transaction accounts placed by title companies;
- certain tax-related intermediation accounts;
- segregated broker-dealer and futures-commission merchant accounts that

protect customers;

- deposits representing secured credit-card collateral;
- health savings accounts, qualified tuition accounts, and numerous other tax-preferred accounts (e.g., IRAs);
- government-benefit accounts as long as these are not commingled with other account purposes. The language here would appear to make state and even federal agencies potential brokers if benefit funds are deposited into ordinary transaction accounts unless IDIs segregate customer accounts so that benefits go into special-purpose accounts and any other funds a customer may receive (e.g., income) are in separate accounts; and
- accounts in FDIC-designated business relationships not deemed to be deposit brokerage. An application process for new or unclear cases is established; the rule details the factors the FDIC will consider in reviewing such applications.

C. Interest-Rate Caps

National rates are now calculated on bank and credit-union marketshare, not physical branches, better describing the current marketplace and the role of Internet-only deposit-takers. Rates remain calculated on actual rates without incorporating the many reward programs or other deposit incentives that have become common in the current, ultra low-rate environment due to data challenges. The national rate cap is the higher of: (1) the national rate based on weighting by deposits rather than branches (including credit unions) plus 75 basis points; or (2) 120 percent of the current yield on similar-maturity U.S. Treasury obligations plus 75 basis points. The Treasury-based second prong also provides that, for nonmaturity deposits, the prong would be the federal funds rate plus 75 basis points. The second prong of the national rate cap for nonmaturity deposits is the federal funds rate plus 75 basis points.

The final rule's local market rate cap is 90 percent of the highest offered rate in an IDI's local market geographic area. Nonmaturity deposits are considered brokered if new accounts are opened after the IDI ceases to be well-capitalized or if funds are added to an existing account at a higher rate.

The final rule also simplifies the process through which less than well-capitalized institutions may request a waiver from these rate caps on grounds that they operate in a high-rate area.