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FDIC Finalizes Brokered Deposits Rule Promoting Bank-Fintech Partnerships

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The Federal Deposit Insurance Corporation (the "FDIC") finalized its brokered deposits rule to revise and modernize its regulations relating to brokered deposits, clarifying an outdated regime as to what deposits should be considered to be brokered. The final rule is to be effective April 1, 2021, although insured depository institutions (each, an "IDI") will be granted an extended compliance date until January 1, 2022. The final rule represents another important step forward for bank-fintech partnerships by providing clearer guideposts around what constitutes a brokered deposit.

Background

Brokered deposits historically have been viewed as "hot money," imposing higher risk on receiving IDIs because they are placed with an IDI by a third party and not the specific retail customer. Therefore, such funds can be withdrawn with little to no prior notice, creating liquidity concerns. As a result, Section 29 of the Federal Deposit Insurance Act (12 U.S.C. § 1831f) (the "FDIA"), as implemented by Section 337.6 of the FDIC's regulations, was enacted to limit IDIs from accepting any deposit obtained, directly or indirectly, by or through any "deposit broker," unless the IDI is well capitalized or, in the case of an adequately capitalized IDI, if it has received a waiver from the FDIC.

The FDIA and the FDIC's implementing regulations, however, do not define "brokered deposit" and only define a "deposit broker" as:

> (A) any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with IDIs or the business of placing deposits with IDIs for the purpose of selling interests in those deposits to third parties; and
>
> (B) 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.

Although the FDIA and FDIC's regulations contain certain exceptions as to who is not a deposit broker, these exceptions have traditionally been narrowly interpreted. Specifically, although Section 29 of the FDIA requires that the FDIC review the "primary purpose" of the entity placing deposits at an IDI, FDIC interpretations of the statutory exception essentially negated the exception. Accordingly, the changes addressed in the final rule clarify that not all deposits placed at an IDI by a third party raise such concerns, and effectively reverse long-standing FDIC guidance.

The Final Rule

In sum, the final rule makes three significant changes to the existing brokered deposits framework:

1. *Exclusive Deposit Placement Arrangements*. Any entity that contracts or partners exclusively with one IDI, and is not placing or facilitating the placement of deposits at any other IDI, is not considered a "deposit broker" under the final rule and, therefore, any deposits placed by the entity with the IDI will not be brokered deposits.

2. *Expanded Primary Purpose Exception*. Any entity whose primary purpose is not the placement of deposits or who accepts deposits as part of a suite of financial products and services will not be considered a deposit broker under the final rule's expanded "primary purpose" exception.

3. *No Actual Receipt of Customer Funds*. Any entity that facilitates customer deposits into an IDI without actually receiving customer funds before placing deposits will no longer be deemed a deposit broker assuming it meets other conditions in the final rule.

Each of these changes, which are discussed in greater detail below, reverses years of FDIC guidance and regulatory burdens that have imposed significant limits upon bank-fintech relationships.

Exclusive Deposit Placement Arrangements

Most significantly, the final rule provides that:

> where an entity ***partners with one IDI to establish exclusive deposit placement arrangements***, and is not placing or facilitating the placement of deposits at any other IDI, such entity will not be "engaged in the business" of placing, or facilitating the placement of, deposits and, therefore, ***will not meet the "deposit broker" definition***.

This revision recognizes that some IDIs establish exclusive business arrangements with third parties, sometimes for deposit placement services or as part of a larger offering of financial products and services. Under the final rule, when one party places deposits exclusively with one IDI, such party would not be a deposit broker and, therefore, such deposits would not be brokered deposits.[1]

There is no indication in the final rule that any service contracts or program agreements between an entity, on the one hand, and its single, exclusive IDI partner, on the other hand, must contain express exclusivity provisions. Instead, the better view is that the entity collaborating with the IDI can only work with one single IDI through which it places deposits in order to rely on the exclusion. On the other hand, an IDI could form multiple exclusive third-party relationships without deposits raised in such relationships deemed to be brokered deposits.

The FDIC notes that, if an agent or nominee places deposits at one IDI as part of one business line (e.g., a deposit sweep program), and places deposits at one or more other IDIs as part of one or more other business lines (e.g., issuing brokered CDs), that agent or nominee would qualify as a deposit broker, unless it satisfied the primary purpose exception with respect to a particular business line or qualified for one of the statutory exceptions to the definition of "deposit broker." The FDIC also notes that, where an entity creates or utilizes multiple entities that each place deposits at different IDIs, those entities will collectively be viewed as a single entity and, therefore, qualify as a deposit broker.

Expanded Primary Purpose Exception/Designated Exceptions

Although, historically, the primary purpose exception has been marginalized through restrictive interpretations, the final rule dramatically expands the scope of the primary purpose exception and reduces the number of instances where an application, notice, or other reporting requirement to the FDIC would be required.

Enabling Transactions Test

The final rule generally adopts the "enabling transactions test" for the primary purpose exception as proposed, with a few modifications. Under the final rule, if an agent or nominee places 100% of its customer funds that have been placed at IDIs into transaction accounts, and no fees, interest, or other remuneration is provided to the depositor, the agent or nominee will meet the enabling transactions test for the primary purpose exception.

Entities that seek to rely on the designated exception for "enabling transactions" will not be subject to an application process, as outlined in the proposed rule, and will instead be required to file a notice with the FDIC. Those submitting a notice under the enabling transactions test must thereafter provide annual certifications to the FDIC of their reliance on this exception.

Under the final rule, agents or nominees that place customer deposits at IDIs in transactional accounts in which the customer earns some amount of interest, fees, or other remuneration will be subject to the FDIC's application process. According to the FDIC, the following criteria will be considered as part of that application:

- the amount of interest, fees, or other remuneration paid to depositors;
- the average amount of transactions that depositors make on a month-to-month basis;
- the marketing materials provided by the agent or nominee indicate that funds placed into IDIs are to enable transactions for depositors; and
- the percentage of funds placed in deposit accounts that are not transaction accounts, if any.

The FDIC will deem the entity as satisfying the primary purpose exception if the entity that places all customer deposits at IDIs in transactional accounts can establish in its application that it markets and offers its deposit placement service for the primary purpose of enabling transactions and that its customers:

- earn a nominal amount of interest, fees or other remuneration on its deposits, based on the interest rate environment at the time; or
- average more than six transactions a month.

This exception likely will be of most utility to prepaid card providers that have relationships with more than one IDI but can establish that their customers earn nominal interest or make more than an average of six transactions per month. As noted above, if a prepaid card provider has a relationship with only one IDI, the prepaid card provider will not meet the definition of a deposit broker under the final rule and, therefore, funds placed at the IDI would not be deemed to be brokered deposits.

Deposit Placements of Less than 25% of Customer Assets under Administration.

The final rule also adopts an exception if less than 25% of the total assets that the entity has under administration for its customers, in a particular business line, is placed at IDIs. The FDIC expects entities to make a good faith determination as to what constitutes a "business line." This exception requires a notice to the FDIC, and an entity relying on this exception will be required to provide reporting on a quarterly basis to the FDIC to update any figures provided in the original notice.

Of course, if an entity has a relationship with only one IDI, it will not meet the definition of a deposit broker under the exclusivity provisions of the final rule.

Additional Designated Exceptions

In the final rule, the FDIC also identifies several specific business relationships as meeting the primary purpose exception, which are described as "designated exceptions." These designated exceptions are set forth in Appendix A. Business relationships that qualify for these designated exceptions will not be required to go through the application or notice process. (Relationships that qualify for the enabling transaction or 25% tests will be required to provide notice.)

Application to Obtain a Primary Purpose Exception

Entities that do not meet the designated exceptions can still apply to the FDIC for a primary purpose exception. As part of its review, the FDIC will consider:

- the revenue structure for the applicant;
- whether the applicant's marketing activities to prospective depositors is aimed at opening a deposit account or to provide some other service (e.g., lending);
- if there is another service, whether the establishment of the deposit account is incidental to that other service; and
- the fees, and types of fees, received by the applicant for any deposit placement service offered.

The FDIC anticipates making redacted summaries of certain approved applications and a list of additional designated exceptions publicly available, to the extent applicable, which should provide additional guidance to the types of activities the agency believes qualify for the primary purpose exception.

Engaged in the Business of Facilitating the Placement of Deposits

Under the final rule, an entity is deemed to be engaged in the business of facilitating the placement of deposits if that entity is engaged in certain activities with respect to deposits placed at more than one IDI. The final rule provides that, if an entity engages in any one of the following activities, the entity will be a deposit broker and, therefore, such deposits placed at IDIs will be brokered deposits:

- the entity has legal authority, contractual or otherwise, to close the account or move the customer's funds to another IDI;
- the entity is involved in negotiating or setting rates, fees, terms or conditions for the deposit account; or
- the entity engages in "matchmaking."

- Under the final rule, an entity is engaged in "matchmaking" if the entity 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, except in the case of deposits placed by a depositor's agent with an IDI affiliated with the depositor's agent.

The "matchmaking" prong will pick up entities that engage in matchmaking as part of an unaffiliated deposit sweep program between a depositor, its broker-dealer, and various unaffiliated IDIs.

The final rule highlights that traditional listing services, entities that provide marketing services, and entities that design their own deposit products—such as deposit accounts that produce interest or rewards based on account activity—will need to evaluate the new criteria set forth in the final rule to determine whether their current arrangements meet the deposit broker definition. The FDIC expects that many will not, assuming they do not assume an active role in the opening of an account or maintain a level of influence or control over the deposit account after it is opened, and otherwise do not meet any of the three facilitation prongs.

As noted above, if an entity has a single, exclusive relationship with only one IDI, it would not be a deposit broker under the final rule.

Engaged in the Business of Placing Deposits

An entity also meets the definition of "deposit broker" if the entity is "engaged in the business of placing deposits" on behalf of a third party (i.e., a depositor) at IDIs. The final rule amends the definition of "deposit broker" by:

- requiring that the entity has a business relationship with its customers in order to be "engaged in business;" and
- providing that the entity must receive customer funds and deposit those funds at more than one IDI to satisfy the "engaged in the business of placing deposits" prong of the deposit broker definition.

With the addition of the requirement that an entity must receive customer funds and deposit those funds with an IDI, apps, marketing services, or other entities that conveniently facilitate the placement of deposits would not be deposit brokers engaged in the business of placing deposits if the deposits are being placed directly by customers and those entities do not take possession of customer funds and deposit such funds on behalf of the customer. However, that entity also must not be engaged in the business of facilitating the placement of deposits described above.

Of course, as discussed above, if an entity has a single, exclusive relationship with only one IDI, it would not be a deposit broker.

Compliance

The final rule will become effective on April 1, 2021 with an extended compliance date of January 1, 2022. As of April 1, 2021, an entity that intends to rely upon a designated exception for the primary purpose exception that requires a notice submission must file a notice with the FDIC and comply with any applicable reporting requirements. However, entities can continue to rely upon existing FDIC

opinions or other interpretations that predated the final rule in determining whether deposits placed by or through an agent or nominee are brokered deposits until the final rule's full compliance date of January 1, 2022. After January 1, 2022, such entities may no longer rely on FDIC opinions or other interpretations that predated the final rule, and, to the extent such entities instead opt to rely on a designated exception for which a notice is required, a notice must be filed. After January 1, 2022, the opinions and other publicly available interpretations appended to the final rule will be moved to inactive status.

Similarly, starting April 1, 2021, entities that wish to apply for a primary purpose exception may submit an application starting on that date. The FDIC will begin its application review no later than September 3, 2021. Written determinations for applications submitted on or before September 3, 2021 will be provided by January 1, 2022, unless extended. After January 1, 2022, entities that rely on the primary purpose exception will no longer be permitted to rely on existing FDIC opinions or other interpretations that predated the final rule and must file an application with the FDIC, if necessary.

Relevant Documents:

- Final Rule
- Fact Sheet on Brokered Deposits
- Fact Sheet on Interest Rate Restrictions
- Chairman's Statement
- FDIC Board Member Gruenberg's Dissent
- Acting Comptroller of the Currency's Statement
- News Release

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Paul Hastings is actively counseling bank and fintech clients dealing with the FDIC's brokered deposits rule. Please contact us if you would like to discuss any of these issues in detail.

If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings lawyers:

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Appendix A

Designated Business Exceptions that Meet the Primary Purpose Exception

The following business relationships are designated as meeting the primary purpose exception, subject to 12 C.F.R. § 303.243(b)(3): Business relationships where, with respect to a particular business line:

1. less than 25% of the total assets that the agent or nominee has under administration for its customers;

2. 100% of depositors' funds that the agent or nominee places, or assists in placing, at depository institutions are placed into transactional accounts that do not pay any fees, interest, or other remuneration to the depositor;

3. a property management firm places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing property management services;

4. the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing cross-border clearing services to its customers;

5. the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of providing mortgage servicing;

6. a title company places, or assists in placing, customer funds into deposit accounts for the primary purpose of facilitating real estate transactions;

7. a qualified intermediary places, or assists in placing, customer funds into deposit accounts for the primary purpose of facilitating exchanges of properties under Section 1031 of the Internal Revenue Code;

8. a broker dealer or futures commission merchant places, or assists in placing, customer funds into deposit accounts in compliance with 17 C.F.R. § 240.15c3-3(e) or 17 C.F.R. § 1.20(a);

9. the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of posting collateral for customers to secure credit-card loans;

10. the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of paying for or reimbursing qualified medical expenses under Section 223 of the Internal Revenue Code;

11. the agent or nominee places, or assists in placing, customer funds into deposit accounts for the primary purpose of investing in qualified tuition programs under Section 529 of the Internal Revenue Code;

12. the agent or nominee places, or assists in placing, customer funds into deposit accounts to enable participation in the following tax-advantaged programs: individual retirement accounts under Section 408(a) of the Internal Revenue Code, Simple individual retirement accounts under Section 408(p) of the Internal Revenue Code, and Roth individual retirement accounts under Section 408A of the Internal Revenue Code;

13. a Federal, State, or local agency places, or assists in placing, customer funds into deposit accounts to deliver funds to the beneficiaries of government programs; and

14. the agent or nominee places, or assists in placing, customer funds into deposit accounts pursuant to such other relationships as the FDIC specifically identifies as a designated business relationship that meets the primary purpose exception.

[1] The FDIC determined that, under an exclusive business arrangement between a third party and a single IDI, the entity is less likely to move its customer funds to other IDIs in a way that would make the deposits less stable. However, aside from contractual provisions requiring exclusivity and/or restricting termination for convenience, there is no requirement that an entity must stay with an IDI with whom it partners.