November 21, 2024

Via Electronic Mail

James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Comments – RIN 3064-AF99

Re: Notice of Proposed Rulemaking – Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (RIN 3064-AF99)

Ladies and Gentlemen:

The Bank Policy Institute[1] submits this comment in response to the Federal Deposit Insurance Corporation's notice of proposed rulemaking[2] relating to the FDIC's regulatory framework for brokered deposits (the "NPR"). BPI has engaged extensively with the FDIC on the brokered deposits framework over many years.[3]

We believe that the proposed revisions to the FDIC's brokered deposits regulation are inappropriate and ill-advised, even more so in light of the FDIC's recent acknowledgement that it

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

2 FDIC, Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68244 (Aug. 23, 2024), *available at* https://www.govinfo.gov/content/pkg/FR-2024-08-23/pdf/2024-18214.pdf.

3 *See* Letter to FDIC, from the Bank Policy Institute re: Comments to the FDIC's Brokered Deposits NPR (Jun. 5, 2020) (the "2020 NPR Comment Letter"); Letter to FDIC, from the Bank Policy Institute re: Comments to the FDIC's Brokered Deposits ANPR (May 6, 2019) (the "2019 ANPR Comment Letter"); Letter to FDIC, from The Clearing House Association L.L.C. (one of BPI's predecessor organizations), the American Bankers Association, the Financial Services Roundtable (one of BPI's predecessor organizations), the Independent Community Bankers of America, and the Institute of International Bankers re: Financial Institutions Letter FIL (51-2015): Request for Comment on Frequently Asked Questions Regarding Identifying, Accepting, and Reporting Brokered Deposits (Dec. 28, 2015); Letter to Charles Yi, General Counsel, FDIC, from The Clearing House Association L.L.C., the American Bankers Association, and the Institute of International Bankers re: Comments to January 5, 2015 Financial Institutions Letter (FIL-2-2015) (Aug. 11, 2015). BPI's 2019 ANPR Comment Letter and 2020 NPR Comment Letter are attached hereto as Appendix A and Appendix B, respectively.

does not have the data necessary to understand how certain types of deposits behave and whether certain deposits are riskier than others.[4]

The proposed rule would undo many of the most important changes to the FDIC's brokered deposits regulation that were adopted in 2021 (the "2021 Rule")[5] to address major advances in technology, business practices and products that have occurred since the FDIC's initial brokered deposits regulation was issued in 1990.[6] The proposed rule ignores the FDIC's rationale for the 2021 Rule, despite the robust notice-and-comment process the FDIC undertook over a period of two years before issuing it, and, as a result, would cause many deposits that Section 29 of the Federal Deposit Insurance Act ("Section 29") was not intended to address to be reclassified as brokered. Moreover, the NPR does not even refer to the substantial issues that would be created for banks that have implemented funding programs in reliance on the 2021 Rule.

We believe that the FDIC has not justified such sweeping changes and indeed, based on statements in the Deposits RFI issued concurrently with the NPR[7] and as demonstrated by the FDIC's statements in the NPR,[8] does not possess the data to justify them. The FDIC makes

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4 *See, e.g.*, FDIC, Request for Information and Comment, Request for Information on Deposits, 89 Fed. Reg. 63946 at 63948 (Aug. 6, 2024), *available at* https://www.govinfo.gov/content/pkg/FR-2024-08-06/pdf/2024-17298.pdf (the "Deposits RFI") ("[T]he FDIC recognizes that different types of uninsured deposits may not necessarily behave the same way . . . [T]he FDIC does not have historical data on banking industry trends for these types of deposits, including how depositors for these different types of deposits would behave under conditions of economic or liquidity stress . . . [T]he FDIC is seeking information on deposits, including how banks measure or evaluate the stability of different types of deposits and whether and how banks monitor collateralized or secured deposits, or intercompany deposits, such as deposits with affiliates and subsidiaries.").

5 FDIC, Final Rule, Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg. 6742 (Jan. 22, 2021), *available at* https://fdic.gov/sites/default/fil§es/2024-03/2020-12-15-notice-dis-a-fr.pdf.

6 FDIC, Final Rule, Unsafe and Unsound Banking Practices, 55 Fed. Reg. 39135 (Sept. 25, 1990), *available at* https://archives.federalregister.gov/issue_slice/1990/9/25/39132-39140.pdf#page=4.

7 *See, e.g.*, 89 Fed. Reg. at 63946 ("The Federal Deposit Insurance Corporation (FDIC) is soliciting comments . . . on deposit data that is not currently reported in the Federal Financial Institutions Examination Council's (FFIEC) Consolidated Reports of Condition and Income (Call Report) or other regulatory reports . . . "), 63947 ("Through this request for information, the FDIC is seeking to further evaluate whether and to what extent certain types of deposits may behave differently from each other, particularly during periods of economic or financial stress.").

8 *See, e.g.,* 89 Fed. Reg. 68259 ("The FDIC does not have the data necessary to estimate the amount of deposits that would be reclassified as brokered under the proposed rule."); *id.* at 68259–60 ("The FDIC does not have the data to estimate the amount of deposits that would be reclassified as brokered by the proposed rule at particular IDIs, nor how many IDIs, if any, might make changes to the structure of their liabilities."); *id.* at 68260 ("The FDIC does not have the data to estimate the amount of deposits that would be reclassified as brokered by the proposed rule at individual IDIs, and thus cannot estimate how many IDIs, if any, may incur costs associated with maintaining compliance with, or maintaining management buffers relative to, these regulatory ratios because of the proposed rule."); *id.* ("It is possible that some IDIs may choose to make changes to the organizational structure of their institutions if the proposed rule is adopted. . . . The FDIC does not have the information to estimate any such changes or attendant costs."); *id.* ("The FDIC believes that if the proposed rule was adopted, IDIs affected may incur some costs associated with making changes to their internal systems, policies, and procedures

only vague reference to recent isolated incidents,[9] none of which were related to brokered deposits, as support for some of the most important proposed changes, while also ignoring all conclusions the FDIC reached less than four years ago during the 2021 Rule rulemaking process. In fact, as described further below, recent empirical research by BPI utilizing publicly reported data on non-brokered sweep deposits shows that the FDIC's assertions regarding at least one type of affected deposits is not supported by the data. Moreover, while the NPR repeatedly states the FDIC does not have the data necessary to estimate the amount of deposits that would be reclassified as brokered under the proposal, a BPI survey of affected members indicates the effect is likely to be significant: among a group of ten affected BPI member banks, there is estimated to be a nearly 110 percent increase in deposits held by the member banks that could be classified as brokered under the proposal. Accordingly, the FDIC should withdraw the proposed rule and consider revisions to the brokered deposits regulation only after obtaining a more complete understanding of current deposits, their characteristics and risks, and all of the costs and benefits of the proposed changes.

If, nonetheless, the FDIC determines to promulgate a final rule, substantial change is necessary in several critical areas. Our recommendations are intended to maintain stability of current business arrangements and maintain the clarity established under the 2021 Rule with respect to the brokered deposits framework, and to do so in a manner that promotes banks' safety and soundness, protects the Deposit Insurance Fund, allows banks to serve their customers and to support the U.S. economy and is consistent with Congress's intent in regulating brokered deposits.

I. Executive Summary

Our comments discuss the key proposed changes in turn. Across these comments, we have several overarching points of concern.

Lack of support and rationale. The proposed rule is arbitrary and capricious and should be withdrawn. The FDIC's rationale for the proposed rule is not supported by the available data, and the FDIC does not articulate a rational justification for the proposed

associated with deposit brokering activities and arrangements (especially those involving third parties). The FDIC does not have the data to be able to reliably estimate the costs associated with these changes, but expects that they are likely to be modest."); *id.* ("The FDIC does not have the information necessary to estimate the proposed rule's expected effects on deposit insurance assessments because it does not possess the data necessary to estimate the amount of deposits that would be reclassified as brokered at particular IDIs under the proposed rule."); *id.* at 68264 (same); *id.* at 68261 ("The proposed rule may affect consumers that utilize brokered deposits, deposit placement services or arrangements. . . . The FDIC does not have the information necessary to estimate such changes, and therefore, discusses these effects qualitatively."); *id.* ("The FDIC does not have the information necessary to quantify the potential changes in filings that are likely to occur if the proposed rule was adopted."); *id.* at 68264 ("The FDIC does not have data to be able to reliably estimate the amount of deposits that would be re-classified as brokered under the proposed rule."); *id.* at 68265 ("The FDIC does not have information on the number or size of potentially affected third parties.").

[9] The specific examples cited by the FDIC are bank failures in the spring of 2023 and the failure of two crypto-related companies. *See* 89 Fed. Reg. at 68245, 68261 (citing failure of First Republic); *id.* at 68250 (citing failure of Synapse); *id.* at 68245, 68250 (citing failure of Voyager). The FDIC provides no evidence in the NPR that any of these failures was caused, or expedited, by brokered deposits.

comprehensive changes to its brokered deposits regulation. Further, the FDIC has not properly considered the costs and benefits of the proposed rule.

Inconsistent with law. The proposed rule is inconsistent with Section 29 in several respects. The proposal takes an overly expansive view of the deposit broker definition and an unduly restrictive view of the primary purpose exception. As a result, the proposal would scope in many activities and third parties that were not Congress's intended target for the brokered deposits framework.

Impact on broker-dealer and investment adviser sweep programs. Several of the proposed changes would operate to classify more broker-dealer and investment adviser deposit activities as brokered. Changes to the definition of deposit broker and to the designated exceptions, including the current 25 percent test, likely would result in classifying a significant number of deposits as brokered, at least until an application could be granted. Yet, these proposed changes are not supported by any evidence and are inconsistent with Section 29. Recent empirical research by BPI demonstrates non-brokered sweep deposits as currently reported exhibit no statistically significant correlation with bank risk (using stock returns as a proxy for market implied bank riskiness) after accounting for bank-specific characteristics, indicating fundamentally different risk characteristics from traditional brokered deposits. This research is discussed further in Section IV.B.a., and the complete analysis is attached hereto as Appendix C. Overall, we are concerned that the FDIC has not considered how the proposed rule, taken as a whole, could make the receipt of deposits from ordinary broker-dealer sweep programs much more challenging for IDIs and raise indirect costs for customers.

Undue weight on fees. The proposal would give undue weight to the payment of fees in classifying deposits as brokered. Revisions to the definition of deposit broker would treat the payment of a fee of *any* amount or kind to a third party as sufficient to characterize the deposit as brokered. Additionally, revisions to the primary purpose exception would also treat the payment of fees as disqualifying for the exception. As a result, deposits would be considered brokered if any third party receives a fee connected to placing the deposits, including administrative, recordkeeping, marketing and referral fees, irrespective of what that person's primary purpose actually is. This would limit IDIs' ability to utilize third parties for a range of administrative and technological services that facilitate and enhance the IDI's relationship with its customers and that may be prohibitively expensive, time-consuming or inefficient for the IDI to develop for itself.

If the FDIC decides to promulgate a final rule, there are a number of critical changes that the FDIC should adopt. In particular, a final rule should reflect the following changes from the proposed rule:

- The definition of "deposit broker" should be revised.
    - The proposed rule's definition of "engaged in the business of placing or facilitating the placement of deposits" should not include a prong related to the payment of fees.
    - The final rule should retain the 2021 Rule's exclusion for exclusive deposit arrangements.
    - The final rule should eliminate, or at a minimum clarify the application of, the "deposit allocation" prong.

- The final rule should retain an exclusion for affiliates in the "deposit allocation" prong.

- The primary purpose exception should be revised.
  - The proposed rule ignores the plain reading of Section 29 and would read the primary purpose exception out of the statute.
  - The introduction of fees as a factor under the primary purpose exception would significantly narrow the primary purpose exception.
  - The proposed rule would reduce the clarity and transparency introduced by the 2021 Rule in analyzing the primary purpose exception.
  - The final rule should retain the 2021 Rule's designated business exceptions for the "25 percent test" and "enabling transactions".
    - The proposed rule's broker-dealer sweep exception is overly narrow, and the proposed changes to the 2021 Rule's 25 percent test should not be adopted. If the FDIC determines to revise the 25 percent test, the following changes are necessary:
      - The threshold to qualify for the exception should not be reduced from 25 percent to 10 percent.
      - The definition of "assets under management" should be updated to "assets under management or administration".
      - The final rule should clarify that the broker-dealer sweep exception applies to all deposits placed at IDIs by a broker-dealer on behalf of its clients, and not only to deposits placed through a formal sweep program.
      - The definitions of "broker-dealer" and "investment adviser" should be revised to include certain entities that are not required to register with the SEC.
      - The broker-dealer sweep exception, and the corresponding ability to rely on the notice process, should be available regardless of whether an additional third party is involved in the arrangement.
    - The FDIC should not adopt the alternatives discussed in the proposal that would (1) rescind the 25 percent test entirely or (2) limit the broker-dealer sweep exception to apply only to deposits swept to an affiliated IDI.

            - The final rule should retain the enabling transactions exception.

- The notice and application processes should be revised.

    - The proposed rule's primary purpose exception notice and application processes are administratively unfeasible and may have unintended adverse consequences on consumers.

        - Providing that only IDIs may submit notices and applications for the primary purpose exception will pose serious challenges, risks and costs for IDIs, which may also have adverse consequences on consumers.

        - The proposed rule significantly lengthens the maximum period of review of both notices and applications by the FDIC, which would cause disruptions for IDIs, third parties and customers.

        - The final rule should include procedural protections for notice filers or applicants in the event the FDIC decides to revoke the exception in its sole discretion.

- There should be grandfathering and a conformance period.

    - Existing deposit relationships should be grandfathered.

    - The final rule should not take effect for at least two years after it is adopted.

- The final rule should include additional changes that would clarify important areas of the brokered deposits framework.

    - The FDIC should exclude third parties from the "deposit broker" definition with respect to deposits placed by the third party with an affiliated IDI.

    - The FDIC should include designated business exceptions for activities that satisfy applicable statutory or regulatory requirements.

    - The final rule should clarify the treatment of FDIC guidance introduced prior to the 2021 Rule.

II. Background

Congress enacted Section 29 in response to the so-called "hot money" that exacerbated the savings and loan crisis of the 1980s, when troubled institutions with deteriorating loan portfolios and "regulators . . . breathing down [their] throat[s]" would buy funds through third-

party brokers as their "only chance for survival".[10] Congress's principal concern was troubled institutions' reliance on "hot money" deposit brokers, *i.e.*, those brokers who, for the primary purpose of pecuniary gain based on the volume of deposits placed, actively placed short-term deposits at banks offering higher-than-market interest rates. In other words, these brokers were engaged in the business of (1) placing funds or (2) facilitating the placement of funds, and the customer's relationship was with the deposit broker, who was seeking to place the funds at whichever insured depository institution ("IDI") was then offering high interest rates.

When Section 29 was enacted in 1989, Congress intended to reduce the potential dangers of "hot money" by limiting the ability of less than well capitalized IDIs to accept these deposits and limiting the interest rate such IDIs could pay on deposits. In contrast, under the proposed rule and the broader regulatory framework that has evolved since 1989, banks that accept deposits under a wide variety of programs would be seriously penalized *even if* the bank is well capitalized and otherwise in sound financial condition and *even if* the rates on those deposits are market rates (or no interest is paid on those deposits at all). These penalties include (1) higher deposit insurance assessment rates; (2) requirements to maintain additional liquid assets to offset the higher outflow rates assigned to brokered deposits under the liquidity coverage ratio (brokered deposits also are generally assigned lower Available Stable Funding factors under the net stable funding ratio); (3) for G-SIBs, higher G-SIB surcharges that require G-SIBs to hold higher levels of total loss absorbing capacity; (4) for Category III and Category IV institutions, potentially higher liquidity coverage ratio and net stable funding ratio requirements than would otherwise apply; (5) expending additional time and resources on liquidity planning (*e.g.*, incorporating PCA-related downgrade triggers into contingency funding plans); and (6) reduced ability to compete with non-bank competitors that are not required to factor liquidity costs into product offerings that would result in brokered deposits for a bank (*e.g.*, money market mutual funds). Higher levels of brokered deposits may also result in additional scrutiny through the supervisory process, as bank examiners may make negative assumptions about the characteristics of deposits classified as brokered. Similarly, because a bank's level of brokered deposits is reported publicly, the classification of a deposit as "brokered" may lead analysts, investors, rating agencies and depositors to draw negative conclusions, which could in turn adversely affect an IDI's (or its parent company's) stock price, ratings and, in certain cases, even the stability of the IDI's deposits. Banks will also have to expend significant time and resources to navigate the uncertainties the proposed rule introduces, particularly with respect to effects on capital and liquidity requirements, as brokered deposit balances may change significantly between reporting periods as notices and applications work their way through the FDIC's proposed process for reliance on the primary purpose exception. The NPR fails to acknowledge, and therefore presumably did not take into account, any of these consequences resulting from an expansive definition of "deposit broker".

In December 2018, the FDIC began a long and thorough process of evaluating its brokered deposits regulation by issuing an advanced notice of proposed rulemaking (the "2018 ANPR"). The FDIC received over 130 comment letters in connection with the 2018 ANPR. The FDIC then issued a notice of proposed rulemaking in 2020 and received over 160 comment letters. The FDIC adopted its current brokered deposits regulation in December 2020 only after this extensive process of gathering data and analyzing comments over a two-year period.

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[10] Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (Apr. 19, 1989). Please refer to the 2019 ANPR Comment Letter (attached hereto as Appendix A) at 3–4 for a more detailed discussion of the legislative history of Section 29.

The FDIC now seeks to eliminate or substantially revise many aspects of the 2021 Rule without conducting a similarly robust process and without providing sufficient data or justification for these changes. On August 21, 2024, BPI and a coalition of trade associations submitted a letter to the FDIC noting the serious deficiencies in data and analysis in the NPR and requesting an extension of the comment period for the proposed rule.[11] As BPI noted in that letter, the public does not have access to industry-wide data related to the deposits that the proposed rule would classify as brokered, and any attempt by industry participants to collect and analyze this information on a collective basis would be a highly sensitive undertaking that would be complicated by confidentiality considerations and that would require substantially more time than the proposed rule's comment period. Although the FDIC granted a 30-day extension of the comment period, the FDIC did not publish industry data and permit the public at least 60 days to examine the data before commenting on the proposed rule. This is made all the more troubling in light of the FDIC's failure to consider appropriately the many costs and other negative effects of the proposed rule.

Accordingly, although we have set forth numerous examples from our member banks in this letter, our ability to assemble and analyze comprehensive data to demonstrate the expected actual impact of the proposed rule is severely limited. The information we have been able to collect in the time provided shows that the magnitude of the proposal's costs could be significant: a survey of ten affected BPI member banks showed a nearly 110 percent increase in deposits held by the member banks that could be classified as brokered under the proposed rule, and among these institutions, $409 billion in deposits are estimated to be affected by the proposed changes. The survey also found that BPI's member banks, when weighted by their estimated value of affected deposits, expect to spend an average of 82 hours of labor to complete each notice and application, far more than the three hours of labor per each notice, and the ten hours of labor per each application, that the FDIC estimated institutions would spend under the proposal.

More broadly, the proposed rule fits into a trend of agency actions that seek to prescribe or restrict banks' funding sources, and we are concerned that it is not coordinated with several other initiatives that also relate to bank deposits, funding and liquidity issues. For instance, the banking agencies' pending long-term debt proposal for regional banks broadly states that increased reliance on uninsured deposit funding has given rise to vulnerabilities at banking organizations, without acknowledging the distinctions among types of uninsured deposits.[12] We

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[11] Letter to FDIC, from Bank Policy Institute *et al.*, Regarding Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; Request for Extension of Comment Period (Aug. 21, 2024), *available at* https://bpi.com/wp-content/uploads/2024/08/BPI-and-a-Coalition-of-Trades-Ask-FDIC-to-Withdraw-Brokered-Deposit-Proposal.pdf.

[12] *See* OCC, FRB, FDIC, Notice of Proposed Rulemaking, Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, 88 Fed. Reg. 64524, 64525 (Sept. 19, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-09-19/pdf/2023-19265.pdf ("In recent years, certain banking organizations that are not [GSIBs] have grown in size and complexity, and new vulnerabilities have emerged, such as increased reliance on uninsured deposits."). Similarly, recent comments by FDIC Chairman Gruenberg suggest that reducing uninsured deposits is among the benefits of the LTD proposal. *See* 2023 European Systemic Risk Board Annual Conference – Panel Discussion: Banking Sector Turbulences (Nov. 16, 2023), *available at* https://www.youtube.com/watch?v=M5naHjaV2Fw ("On the relationship between [LTD] and uninsured deposits . . . we don't want more uninsured deposits, we want less

are concerned the FDIC has not considered the collective impact of these initiatives and how, taken together, they could raise the costs of banks' available funding sources, or reduce the availability of these sources. Furthermore, the impact on the U.S. economy is nowhere considered in the NPR.

Additionally, we are concerned that the FDIC is using the brokered deposits framework to address a variety of policy goals that should be addressed by other regulations. For instance, aspects of this proposal appear motivated by a concern with third-party "fintech" arrangements and the risks of third-party fintech companies failing.[13] We share Director McKernan's concerns that the brokered deposit definition is poorly suited to address any policy concerns with bank-fintech arrangements generally.[14] Similarly, the brokered deposits framework, which was enacted solely to address problems of rapid growth at less than well capitalized banks,[15] is not suited to address other concerns, including liquidity management and deposit concentration. Concerns that are not directly related to Section 29's purpose should be addressed through applicable existing regulations[16] or through new regulations adopted through appropriate rulemaking processes specific to those concerns, and not through regulation of brokered deposits. Using the brokered deposits framework—which Congress developed to address a specific concern—like Maslow's hammer to attempt to solve unrelated policy concerns is inapposite.

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uninsured deposits, quite frankly, in terms of concentrations . . . And also the expectation is, assuming we move forward with the [LTD] rule, [LTD] will take the place of some of the uninsured deposits on the balance sheet of some of these institutions, which would have multiple, multiple benefits.").

13 *See, e.g.*, 89 Fed. Reg. at 68245 (discussing the failure of Voyager, a crypto company), 68250 (discussing the failure of Synapse, a fintech company).

14 *See* Statement by Jonathan McKernan, Director, FDIC, Board of Directors, on the Proposed Brokered Deposit Restrictions (Jul. 30, 2024), *available at* https://www.fdic.gov/news/speeches/2024/statement-jonathan-mckernan-director-fdic-board-directors-proposed-brokered ("The underlying concern, I suspect, relates to skepticism of banks' partnerships with fintech, but those risks would be better regulated through rules that are more fit for that purpose.").

15 *See, e.g.*, Insured Brokered Deposits and Federal Depository Institutions, Hearings before the Subcommittee on General Oversight and Government Investigations of the House Committee on Banking, Housing, and Urban Affairs at 8, Cmte. Print 101-28, 101st Cong., 1st Sess. (May 17, 1989) (remarks of Sen. Murkowski) at 10 (noting that Section 29 is meant to be a "*narrowly drawn* provision that specifically targets the *most flagrant abusers*") (emphasis added).

16 In particular, we note that comprehensive regulation has been enacted to manage liquidity risk at large banks. For example, the Federal Reserve's Regulation YY requires a number of items that significantly enhance the liquidity risk management capabilities of banks, including (1) liquidity stress testing frameworks, which would capture the risk profile of deposits, as well as corresponding liquidity buffers; (2) a contingency funding plan; (3) cash flow projections processes; (4) liquidity risk limits, which would capture deposit funding concentration risks; (5) a process to review new product lines and businesses; and (6) appropriate governance and senior management oversight of liquidity and related policies and procedures. *See* 12 C.F.R. § 252.34. In addition, IDIs and their holding companies are subject to regulatory and internal capital and liquidity stress testing, as well as regulatory liquidity requirements under the liquidity coverage ratio and net stable funding ratio. *See* 12 C.F.R. Part 46; 12 C.F.R. Part 50; 12 C.F.R. Part 249; 12 C.F.R. Part 252; 12 C.F.R. Part 325; 12 C.F.R. Part 329. IDIs are also subject to heighted standards for risk management, including liquidity risk. *See, e.g.*, 12 C.F.R. Part 30, App. D.

Further, we are concerned that the proposed rule would make sweeping changes to the brokered deposits framework without any meaningful consideration of a range of more appropriate alternatives. We have identified below numerous instances in the proposed rule where the FDIC could have considered more targeted alternatives but has instead resorted to a complete removal or replacement of existing provisions. Any action by the FDIC to revise the brokered deposits framework should thoughtfully and credibly consider viable and obvious alternatives to overhauling the existing framework.

III. The proposed rule is arbitrary and capricious and should be withdrawn

Under case law interpreting the Administrative Procedure Act (the "APA"), agencies are required to consider all pertinent aspects of a problem and not to rely on improper factors,[17] and must "examine the relevant" and available evidence.[18] Agencies may not make unexplained assertions that are unsupported by the available evidence, but rather must "articulate a rational connection between the data in the record and its determination".[19] In addition, consideration of a regulation's economic impacts and "costs and benefits" is a necessary part of reasoned decision making.[20] The proposed rule falls well short of each of these standards, for the reasons explained below.[21] As such, the proposal should be withdrawn and, if reissued, should address these fundamental deficiencies.

A. The proposed rule is arbitrary and capricious because the FDIC's rationale for the proposed rule is not supported by the available data and the FDIC does not articulate a rational justification for the proposed comprehensive changes to its brokered deposits regulation

Concurrently with the NPR, the FDIC issued its Deposits RFI. In connection with the Deposits RFI, the FDIC Chairman acknowledged that "the FDIC does not have historical data on banking industry trends for different types of insured and uninsured deposits, *including how depositors would behave in times of stress*", and that the Deposits RFI's purpose is to "seek[ ]

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17 *See, e.g.*, *Bos. Redevelopment Auth.* v. *Nat'l Park Sev.*, 838 F.3d 42, 47 (1st Cir. 2016) ("An agency action is arbitrary and capricious when the agency relied on improper factors, failed to consider pertinent aspects of the problem, offered a rationale contradicting the evidence before it, or reached a conclusion so implausible that it cannot be attributed to a difference of opinion or the application of agency expertise.") (quoting *Assoc'd Fisheries of Maine, Inc.* v. *Daley*, 127 F.3d 104 (1st Cir. 1997) (internal quotation marks omitted).

18 *Motor Vehicle Mfrs. Ass'n of U.S., Inc.* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); cf. *Ariz. Public Serv. Co.* v. *EPA*, 562 F.3d 1116, 1124 (10th Cir. 2009) ("Because the EPA failed to address the area's air problems and did not examine the relevant data or articulate a rational basis for its decision, the federal plan is arbitrary and capricious.").

19 *Nat'l Parks Conservation Ass'n* v. *U.S. EPA*, 788 F.3d 1134, 1143 (9th Cir. 2015); *Greater Yellowstone Coal., Inc.* v. *Servheen*, 665 F.3d 1015, 1020 (9th Cir. 2011); see *State Farm*, 463 U.S. at 43.

20 *See Mexican Gulf Fishing Co.* v. *U.S. Dep't of Commerce*, 60 F.4th 956, 973 (5th Cir. 2023) (citing *Michigan* v. *EPA*, 576 U.S. 743, 751 (2015)).

21 In addition to this letter, BPI is submitting a companion letter that explains in more detail the legal deficiencies of the proposed rule.

information on the characteristics that could affect the stability and franchise value of different types of deposits".[22]

The absence of such data is evident in the NPR. For example, the NPR is not informed by any understanding of the behavior of different types of deposits that the proposed rule would classify as brokered and whether such deposits demonstrate the characteristics of "hot money" or otherwise exhibit risks similar to the types of deposits Section 29 was intended to capture.[23]

The only data-driven analysis of brokered deposits the FDIC cites in the NPR is the FDIC's 2011 Study on Core and Brokered Deposits (the "2011 Study")[24], which the FDIC updated in 2019 based on 2017 data.[25] However, reliance on the 2011 Study as support for the proposed rule is deeply flawed for a number of reasons. First, the 2011 Study does not conclude that higher levels of brokered deposits are *a cause* of bank failures or increased losses to the Deposit Insurance Fund. The 2011 Study finds only that higher levels of brokered deposits at an IDI, in addition to many other factors, are "correlated" with higher probability of the IDI's failure and higher losses to the Deposit Insurance Fund.[26] Second, the 2011 Study notes that due to "the absence of sufficient data", the FDIC "could not reach firm conclusions" regarding the types of "brokered deposits" that may pose a higher (or lower) risk.[27] Third, the 2011 Study does not discuss the types of deposits that the FDIC is proposing to reclassify as brokered in the proposed rule. In fact, as a result of technological developments and changes in how customers access banking services, many of the types of activities and services that would be reclassified as brokered by the current proposal did not exist at the time of the 2011 Study. As stated by Director McKernan, "[t]he proposal does a good job of marshaling evidence of the risks posed by brokered deposits. The proposal does not, however, offer any evidence that some of the deposits that this proposal would re-classify as brokered deposits actually present the same or similar risks".[28]

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22 Statement of Martin J. Gruenberg, Chairman Federal Deposit Insurance Corporation Request for Information on Deposits (Jul. 30, 2024), *available at* https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corporation-2 (emphasis added).

23 We believe the FDIC's rulemaking process for the 2021 Rule allowed the FDIC to understand better the types of deposit products currently offered by banks and related relationships with third parties. However, as discussed below, the proposed rule does not acknowledge this process and seemingly disregards any analysis conducted by the FDIC in connection with the 2021 Rule.

24 FDIC, 2011 Study on Core Deposits and Brokered Deposits (Jul. 8, 2011), *available at* https://www.fdic.gov/sites/default/files/2024-03/coredeposit-study.pdf.

25 FDIC, Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 at 2384–2400 (appendix 2) (Feb. 6, 2019).

26 *See* 2011 Study at 3, 59. Indeed, the NPR acknowledges that the 2011 Study only finds a correlation and not a causative effect. *See* 89 Fed. Reg. at 68260 ("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 DIF upon failure") (citing the 2011 Study) (emphasis added).

27 2011 Study at 4.

28 Statement by Jonathan McKernan, Director, FDIC, Board of Directors, on the Proposed Brokered Deposit Restrictions (Jul. 30, 2024), *available at* https://www.fdic.gov/news/speeches/2024/statement-jonathan-mckernan-director-fdic-board-directors-proposed-brokered.

Apart from the 2011 Study, the FDIC only marshals anecdotes of incidents that have occurred since the 2021 Rule went into effect to attempt to justify the sweeping changes the proposed rule would impose. For example, the FDIC discusses concerns regarding the failure of First Republic Bank in 2023 as justification for the removal of an exclusion from the "matchmaking" definition for affiliate sweep deposits.[29] However, the FDIC provides no data showing that brokered deposits played any role in First Republic's failure. The FDIC OIG's Material Loss Review of First Republic Bank cites numerous causes for the failure but does not have a single mention of brokered deposits.[30] Nor does the FDIC's own report on the supervision of First Republic Bank list brokered deposits among the causes of failure.[31] Similarly, the Material Loss Review of neither Silicon Valley Bank nor Signature Bank mentions brokered deposits as a cause of those bank failures.[32]

In other instances, the FDIC relies on opaque assertions of "supervisory experience". For example, the FDIC notes "based on the FDIC's experience, these exceptions are overly broad and cover a variety of business lines rather than a narrow set of business lines intended by the FDIC's bright-line designated exceptions" as its rationale for both restricting the "25 percent test" designated business exception and removing the "enabling transactions" designated business exception.[33] The FDIC does not substantiate this experience, nor does it provide any analysis as to why the scope of business lines covered by the existing designated

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29 *See* 89 Fed. Reg. at 68245 ("For example, First Republic Bank, 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 particular uninsured affiliated sweep deposits. This suggests that in the case of First Republic, affiliated sweeps were no more 'sticky' than unaffiliated sweeps, contrary to the exemption in § 337.6(a)(5)(iii)(C)(1) for affiliated entities.").

30 *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.

31 *See* FDIC, FDIC's Supervision of First Republic Bank (Sept. 8, 2023), *available at* https://www.fdic.gov/news/press-releases/2023/pr23073a.pdf.

32 *See* Off. of Inspector Gen., FDIC, Material Loss Review of Signature Bank, Report No. EVAL – 24–02 (Oct. 23, 2023), *available at* https://www.fdicoig.gov/sites/default/files/reports/2023-12/EVAL-24-02.pdf; Off. of Inspector Gen., Board of Governors of the Federal Reserve System, Material Loss Review of Silicon Valley Bank, Evaluation Report 2023-SR-B-013 (Sept. 25, 2023), *available at* https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf. Although the recent Material Loss Review of Republic First Bank (an approximately $6 billion Pennsylvania bank that failed in April 2024) discusses brokered deposits, it does not cite brokered deposits as a cause of the bank's failure. To the contrary, the report indicates that the bank's ability to accept reciprocal deposits and thereby obtain deposit insurance for large deposits that exceeded FDIC deposit insurance thresholds allowed the bank to maintain uninsured deposit relationships that may have otherwise left the bank. Nor does the Material Loss Review cite any concerns about the scope of the deposits classified as brokered or recommend any changes to the existing definition. Rather, the report recommends that the FDIC "[d]evelop detailed guidance that clarifies what information should be considered when assessing whether it is appropriate to approve a brokered deposit waiver for 'Adequately Capitalized' IDIs." Off. of Inspector Gen., FDIC, Material Loss Review of Republic First Bank, Report No. EVAL–25–01 at 35 (Nov. 12, 2024), *available at* https://www.fdicoig.gov/sites/default/files/reports/2024-11/EVAL-2025-01%20Material%20Loss%20Review%20of%20Republic%20First%20Bank.pdf. Unlike the proposed sweeping revisions to the existing framework, the OIG's recommendation is a much more targeted proposal aimed at managing the type of risks that Section 29 was intended to address.

33 89 Fed. Reg. at 68255.

business exceptions is too broad. An agency can "rel[y] on its own experience as factual support for its decision to promulgate a rule" only if the agency "adequately record[s] and explain[s] that experience on the record".[34] This example and other instances in the NPR that rely on bare assertions of supervisory experience are plainly inconsistent with the FDIC's obligation under the APA to identify and make available the studies, data, assumptions and methodology and critical factual material on which the proposed rule is based.[35]

More importantly, the FDIC disregards entirely data and evidence gathered over the two years before the 2021 Rule was enacted and provides no new data or rationale to justify its complete abandonment of many of the conclusions the FDIC reached in connection with the 2021 Rule. As one example, the NPR asserts in a conclusory manner that the 2021 Rule's treatment of certain types of deposit-related activities "is problematic because these deposits continue to present the same risks as before the [2021 Rule]".[36] These statements necessarily rely on the FDIC's pre-2021 views, which, for the reasons noted above, are outdated and not supported by the available data. In addition, the FDIC's statements disregard entirely the two years of effort by the FDIC staff to gather information on current deposit relationships and to make reasoned judgments regarding the types of deposits that should be classified as brokered.

The FDIC therefore proposes a rule that is unexplained and unsupported by any of the data on which the FDIC relies in the NPR. As a result, the proposed rule is arbitrary and capricious.

B. The proposed rule is arbitrary and capricious because the FDIC has not properly considered the costs and benefits of the proposed rule

If adopted in its current form, the proposed rule would result in significant costs for IDIs and their customers. However, the FDIC does not appear to have considered these costs at all in the NPR.

As noted above, there are several immediate regulatory consequences for banks that would need to reclassify certain of their deposits as brokered, such as increased deposit insurance assessments and requirements to maintain additional liquid assets due to brokered deposits being assigned higher outflow weights and lower Available Stable Funding factors under applicable liquidity rules (without any risk assessment of the underlying deposit). The FDIC, based on the FDIC's own statements that it lacks the data to do so,[37] is unable to

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34 *Nat'l Tour Brokers Ass'n* v. *ICC*, 671 F.2d 528, 533 (D.C. Cir. 1982).

35 *See Owner-Operator Independent Drivers Ass'n* v. *FMCSA*, 494 F.3d 188, 199 (D.C. Cir. 2007) (noting that agencies have the "duty to identify and make available technical studies and data that [they] ha[ve] employed in reaching the decisions to propose particular rules") (quotation marks and citation omitted) (applying 5 U.S.C. 553(b)(3), (c)); *Small Refiner Lead Phase-Down Task Force* v. *EPA*, 705 F.2d 506, 535 (D.C. Cir. 1983) (noting that agencies "must explain the assumptions and methodology" underlying a proposed rule).

36 89 Fed. Reg. at 68244. The proposed rule includes similar statements at 68245 ("[The 2021 Rule] has led to certain deposit arrangements that would have been brokered prior to the [2021 Rule] as no longer being classified as brokered, even though such deposits present the same or similar risks as brokered deposits.") and at 68250 ("[T]hese arrangements are excluded from the brokered deposit definition pursuant to changes implemented by the [2021 Rule], even though the arrangements exhibit the same risks as brokered deposits.").

37 *See, e.g.,* 89 Fed. Reg. at 68260 ("The FDIC does not have the data to estimate the amount of deposits that would be reclassified as brokered by the proposed rule at individual IDIs, and thus

consider these important costs. There are numerous other costs on IDIs and customers that would result from the proposed rule. Significantly, banks have expended considerable time and resources to enter into many third-party arrangements, and did so in reliance on the 2021 Rule. Under the proposed rule, many, if not nearly all, of these relationships would be subject to sudden disruption and uncertainty. The proposed rule may result in IDIs becoming less willing or able to offer diverse and innovative deposit products due to the potential classification of the resulting deposits as brokered, or willing to do so only at an increased price, resulting in harm to depositors. The NPR's failure to acknowledge these consequences of the proposed rule, in addition to the FDIC's own admission that it does not possess sufficient data to understand even the most basic impact of the proposed rule on customers, IDIs or other entities,[38] demonstrate that the FDIC fundamentally does not understand the costs of the proposed rule, much less that the FDIC actually considered the costs and benefits of the proposed rule.

For the foregoing reasons, BPI submits that the proposed rule is arbitrary and capricious and must be withdrawn. BPI strongly urges the FDIC to undertake additional study of the different types of deposit products offered by IDIs, with particular focus on the types of deposits that the proposed rule would re-classify as brokered, as well as the costs to consumers, IDIs and other entities that would result from changes to the brokered deposits regulation. Only then could the FDIC re-issue a notice of proposed rulemaking that would meet the procedural and

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cannot estimate how many IDIs, if any, may incur costs associated with maintaining compliance with, or maintaining management buffers relative to, these regulatory ratios because of the proposed rule."); *id.* ("The FDIC does not have the information necessary to estimate the proposed rule's expected effects on deposit insurance assessments because it does not possess the data necessary to estimate the amount of deposits that would be reclassified as brokered at particular IDIs under the proposed rule.").

38 *See, e.g.,* 89 Fed. Reg. 68259 ("The FDIC does not have the data necessary to estimate the amount of deposits that would be reclassified as brokered under the proposed rule."); *id.* at 68259–60 ("The FDIC does not have the data to estimate the amount of deposits that would be reclassified as brokered by the proposed rule at particular IDIs, nor how many IDIs, if any, might make changes to the structure of their liabilities."); *id.* at 68260 ("The FDIC does not have the data to estimate the amount of deposits that would be reclassified as brokered by the proposed rule at individual IDIs, and thus cannot estimate how many IDIs, if any, may incur costs associated with maintaining compliance with, or maintaining management buffers relative to, these regulatory ratios because of the proposed rule."); *id.* ("It is possible that some IDIs may choose to make changes to the organizational structure of their institutions if the proposed rule is adopted. . . . The FDIC does not have the information to estimate any such changes or attendant costs."); *id.* ("The FDIC believes that if the proposed rule was adopted, IDIs affected may incur some costs associated with making changes to their internal systems, policies, and procedures associated with deposit brokering activities and arrangements (especially those involving third parties). The FDIC does not have the data to be able to reliably estimate the costs associated with these changes, but expects that they are likely to be modest."); *id.* ("The FDIC does not have the information necessary to estimate the proposed rule's expected effects on deposit insurance assessments because it does not possess the data necessary to estimate the amount of deposits that would be reclassified as brokered at particular IDIs under the proposed rule."); *id.* at 68264 (same); *id.* at 68261 ("The proposed rule may affect consumers that utilize brokered deposits, deposit placement services or arrangements. . . . The FDIC does not have the information necessary to estimate such changes, and therefore, discusses these effects qualitatively."); *id.* ("The FDIC does not have the information necessary to quantify the potential changes in filings that are likely to occur if the proposed rule was adopted."); *id.* at 68264 ("The FDIC does not have data to be able to reliably estimate the amount of deposits that would be re-classified as brokered under the proposed rule."); *id.* at 68265 ("The FDIC does not have information on the number or size of potentially affected third parties.").

substantive requirements applicable to all federal agency rulemaking. If, however, the FDIC determines to disregard these basic flaws in its proposed rule and move forward in the rulemaking process, BPI believes the critical changes outlined in the following sections should be made to the final rule.

IV. Comments on the proposed rule

A. The Definition of "Deposit Broker"

1. The proposed rule's definition of "engaged in the business of placing or facilitating the placement of deposits" should not include a prong related to the payment of fees

The proposed rule would continue to define a "deposit broker" as, among other things, any person "engaged in the business of placing or facilitating the placement of deposits of third parties with [IDIs]".[39] The proposed rule would, however, include a new definition of "engaged in the business of placing or facilitating the placement of deposits". This definition would provide that a person that "has a relationship or arrangement with an [IDI] or customer where the [IDI] or customer pays the person a fee or provides other remuneration in exchange for deposits being placed at one or more [IDIs]" is engaged in the business of placing or facilitating the placement of deposits of third parties with IDIs.[40] In the NPR, the FDIC noted that this prong of the definition would include "fees for administrative services provided in connection with a deposit placement arrangement".[41] The FDIC's rationale for including a fee prong is that "a less than well-capitalized IDI could accept third-party deposits that share characteristics with deposits the FDIC has historically observed as constituting a brokered deposit. For example, such third-party deposits may be more likely to leave the IDI if another IDI were to offer more favorable terms or pay a higher fee".[42] Put simply, the FDIC seemingly is of the view that the payment of a fee of *any* amount or kind to a third party is sufficient to characterize the deposit as brokered.

The FDIC's proposed fee-based approach to analyzing arrangements between third parties and IDIs ignores the basic statutory requirement that a deposit broker be "*engaged in the business* of placing or facilitating the placement of deposits", and focuses entirely on compensation rather than the characteristics of the third party's actual business and the resulting deposits, the relationships between the IDI and depositor and the role of the third party after the initial placement of deposits. As a result, the proposed definition is overly broad and potentially would result in third parties that are not actually engaged in the business of placing or facilitating the placement of deposits being classified as deposit brokers.

As an example, IDIs may engage in referral arrangements or other marketing activities with third parties, or use third-party platforms, for which the IDI may pay an ongoing subscription or maintenance fee, to interact directly with clients. These third parties, particularly due to technological advances such as smartphone applications, may be uniquely positioned to provide marketing and referral services that would be difficult for IDIs—especially smaller IDIs—to develop themselves. Such third parties are not engaged in the business of placing or facilitating the placement of deposits, but rather are engaged in marketing or similar activities.

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[39] Proposed 12 C.F.R. § 337.6(a)(5)(i)(A).

[40] Proposed 12 C.F.R. § 337.6(a)(5)(ii)(E).

[41] 89 Fed. Reg. at 68252.

[42] *Id.*

In addition, in many of these cases, the third party merely connects the depositor to the IDI. The customer opens the deposit account directly with the IDI and has an ongoing relationship only with the IDI and not with the third party. As another example, a school or company may have an existing relationship with an IDI. The school or company may refer depositors, *e.g.*, new students or the company's employees or customers, to the IDI, and may receive a nominal referral fee for doing so. However, these arrangements are driven by the broader relationship between the school or company and the IDI and are not a result of the school or company being engaged in the business of facilitating the placement of deposits. In addition, as with many referral arrangements, after the relationship between the IDI and the depositor is established, the depositor's ongoing banking relationship is with the IDI, and the school or company is not involved. In each of these marketing and referral relationships, the deposits and the relationship between the depositor and the IDI exhibit none of the characteristics with which the FDIC expressed concern in the NPR, *i.e.*, the third party has no ability to move the deposits to another IDI, and the depositor would have no incentive to move deposits to another IDI based on fees paid to the third party by the IDI. However, the proposed rule would equate the receipt of a marketing, referral or other administrative fee by the third party with being engaged in the business of placing or facilitating the placement of deposits and classify the third party as a deposit broker.

As another example, a broker-dealer may engage a third-party intermediary to assist in administering a sweep arrangement between the broker-dealer and one or more IDIs.[43] Under these programs, the third-party intermediary allocates deposits to IDIs based on the broker-dealer's predetermined list of IDIs. To manage its deposit levels, each participating IDI communicates to the broker-dealer and the third-party intermediary the amount of sweep deposits it is willing to accept. The third-party intermediary then uses an algorithm, based on the list of predetermined IDIs and the deposit levels each IDI is willing to accept, to provide the broker-dealer with proposed instructions for placing its sweep deposits. The broker-dealer reviews these instructions and issues instructions to its settlement agent to sweep free cash balances in brokerage accounts to the participating IDIs based on the broker-dealer's instructions. The third-party intermediary has no contractual right or other ability to move deposits to another IDI (based on the payment of higher fees or otherwise) and no ability to negotiate the rates or terms of a deposit. By any objective metric, the broker-dealer or IDI does not pay the third-party intermediary for deposit placement but rather for technological and administrative services that are necessary for the broker-dealer to allocate deposits among IDIs that participate in the program. As a result, fees paid to the third-party intermediary do not indicate that the third-party intermediary is engaged in the business of placing or facilitating the placement of deposits. The same analysis applies to fees received by third parties in exchange for ancillary services after the placement of deposits, such as recordkeeping and other administrative services. However, because the FDIC would consider the payment of any fee (including administrative fees) to a third party "in exchange for *or related to* the placement of deposits",[44] whether by the IDI or the third party's customer, the NPR appears to treat even the most tenuous connection between a potential depositor and a third party as causing the third party to be a deposit broker.

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[43] We recognize that under the proposed rule, the broker-dealer itself may also be a deposit broker under these arrangements unless the deposit broker qualifies for an exception. However, for the reasons described above, an intermediary that performs only administrative functions should not be considered a deposit broker and these arrangements should not result in brokered deposits as long as the broker-dealer is not a deposit broker.

[44] 89 Fed. Reg. at 68251 (emphasis added).

Put simply, by using fees as a proxy for being engaged in the business of placing or facilitating the placement of deposits, the proposed rule would collapse the analysis of whether a third party is performing an actual deposit broker function into a question of whether the third party is engaged in any business at all related to deposits. As a result, much like the FDIC did prior to the 2021 Rule, the proposed rule would conflate very different concepts of marketing, administrative services and potentially any other business, with deposit brokerage based solely on the payment of fees, while ignoring and severely limiting the opportunity for banks to attract non-brokered deposits by establishing long-term, stable relationships with depositors through marketing, referral and other arrangements.

The FDIC maintained in the NPR that a third party with discretion to choose the IDIs at which to place customer deposits "may be more likely to move customer funds to other IDIs in a way that makes the deposits less stable."[45] However, the inverse is indisputably true: a third party with no discretion is unable to move deposits to IDIs in a way that makes those deposits less stable. The final rule should eliminate the fee prong and, like the 2021 Rule, focus on whether the third party is involved in negotiation or setting rates or other terms of the deposit account or has contractual or other authority to close the deposit account or move deposits to another IDI. A third party's receipt of fees alone, unlike the ability to negotiate the terms of the account or having legal authority to close the account, does not implicate the FDIC's concern that deposits could easily be moved to other IDIs, even if another IDI is offering a higher fee.

If, notwithstanding these flaws, the FDIC retains a fee prong in the definition of "engaged in the business of placing or facilitating the placement of deposits" in the final rule, it should be narrowed so as not to capture every conceivable service provided by a third party. In particular, the final rule should expressly exclude from the fee prong (1) administrative, recordkeeping and other similar fees (including fees in exchange for technological and administrative services where the third party has no right or discretion to close the deposit account or move the deposits or to negotiate the rates or terms of a deposit), (2) fees in exchange for ancillary services provided after the placement of deposits with a given IDI, and (3) marketing and referral fees, whether paid by an IDI or a customer of the third party.

2. The final rule should retain the 2021 Rule's exclusion for exclusive deposit arrangements

Under the 2021 Rule, the definitions of "engaged in the business of placing deposits" and "engaged in the business of facilitating the placement of deposits" excluded persons that place or facilitate the placement of deposits at only one IDI.[46] In excluding third parties that establish exclusive relationships with IDIs, the FDIC noted that these third parties are "less likely to move [their] customer funds to other IDIs in a way that makes the deposits less stable".[47] The proposed rule would eliminate this exclusion. As its rationale, the FDIC asserts a concern that the exclusion could be used by a deteriorating IDI "to expose[ ] the banking system to the kind of risk the brokered deposits restrictions were intended to address" by, for example, forming multiple exclusive third-party relationships to pursue rapid and risky growth without any of the resulting deposits being classified as brokered.[48]

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[45] *Id.* at 68254.

[46] 12 C.F.R. §§ 337.6(a)(5)(ii) and (iii).

[47] 86 Fed. Reg. at 6745.

[48] 89 Fed. Reg. at 68253.

This hypothetical is fundamentally inconsistent with the nature of exclusive business relationships. The FDIC does not point to a single example of an exclusive business arrangement fueling rapid growth and leading to an institution's failure. Exclusive business relationships, including segregated and sponsored accounts, are not formed quickly. These relationships require significant commitments of both parties and are established only after substantial due diligence, vetting and arm's-length negotiation. As a result, it is highly unlikely that a depositor would transition to another IDI over marginal changes in pricing or that an IDI could form exclusive business relationships in a way that would allow it to use the relationships to support unusually rapid growth. In addition, the governing agreements often permit termination or cancellation only after a lengthy notice period to allow the parties significant time to transition to alternative arrangements. Moreover, the fact that a third party has entered into an exclusive deposit relationship with only one IDI demonstrates that such third party is not engaged in "the business of" placing or facilitating the placement of deposits with IDIs. By definition, such a third party is working with a single IDI only to serve the third party's own specific business and administrative needs and is not in the general business of placing or facilitating the placement of deposits. Such a third party, therefore, should not be treated as a "deposit broker".

The FDIC's rationale also overlooks the nature of the parties to exclusive business relationships. Many exclusive deposit arrangements are made between an IDI and other types of traditional financial institutions that do not themselves offer deposit products, such as insurance companies, as a service to those institutions' customers to provide deposit referral and similar arrangements. These exclusive partnerships have been designed to meet holistically the financial services needs of those institutions' customers and are not used by an IDI as a source of deposits to support rapid growth. A blanket removal of the exclusion for exclusive deposit arrangements without any consideration for the type of third party involved would disrupt many exclusive arrangements in which IDIs have invested significant time and effort and that result in long-term, stable relationships between IDIs and depositors.

The FDIC makes two additional claims with respect to exclusive relationships. First, the FDIC asserts that an IDI could rely on a third party for 100 percent of its deposits without any of those deposits being classified as brokered, "which provides an avenue for less than well-capitalized IDIs to obtain and retain brokered deposits that appears to conflict with the intent of the statutory prohibition".[49] Although it is true that an IDI's reliance on a third party for 100 percent of its deposits would be problematic, that would be true in any case where the IDI relies on a single party for its entire deposit base, whether the deposits are brokered or not. The FDIC ignores the fact that such risk already is addressed—appropriately—as part of existing rules and supervisory oversight related to levels of concentration in an IDI's deposit base.[50] If the FDIC is concerned with funding concentrations, there are more targeted approaches available than entirely removing the exclusion for exclusive business relationships.

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49 *Id.*

50 *See, e.g.,* 12 C.F.R. § 252.34(g) (requiring certain bank holding companies to establish limits that address, among other things, "[c]oncentrations in sources of funding by instrument type, single counterparty, counterparty type, secured and unsecured funding, and as applicable, other forms of liquidity risk."); Board of Governors of the Federal Reserve System, Commercial Bank Examination Manual, Section 3200.1, at 20 (providing that any examination should include an assessment of "inherent liquidity risk" that "may raise if an institution has concentrations in specific business activities, products, and sectors, or if it has balance-sheet risks, such as unstable liabilities, risky assets, or planned asset growth without an adequate plan for funding the

Second, the FDIC states that it is removing the exclusion "to mitigate any unintended effects of the interpretation as related to the statute's purposes and its application to brokered CDs", because, based on discussions with a single, unidentified "market participant", the FDIC is concerned that the 2021 Rule would permit an IDI to establish exclusive relationships for the issuance of brokered CDs.[51] This concern is entirely unfounded. The preamble to the 2021 Rule expressly clarifies that brokered CDs "*without exception*" must be categorized as brokered.[52] The FDIC puts forward no evidence that any IDI has interpreted the 2021 Rule in a manner that would permit classifying a brokered CD as non-brokered or that an IDI has attempted to establish such relationships. Removing the exclusive relationships exclusion because of an unsubstantiated and very narrow concern is unsound and unjustified. If the FDIC has a concern about abuse related to brokered CDs, the FDIC should include in the final rule a provision to clarify that "brokered CDs", as defined in the 2021 Rule, are brokered deposits even if they are placed at an IDI through an exclusive relationship, not throw the proverbial baby out with the bathwater. For these reasons, the exclusion for exclusive business relationships should be retained in the final rule but could be tailored to address the FDIC's concerns without upsetting well-established business relationships negotiated at great time and effort in reliance on the 2021 Rule.

3. The final rule should eliminate, or at a minimum clarify the application of, the "deposit allocation" prong

The proposed rule would replace the "matchmaking" prong of the definition of "engaged in the business of facilitating the placement of deposits" under the 2021 Rule with a new "deposit allocation" prong that would include in the definition of "engaged in the business of placing or facilitating the placement of deposits" a person that "proposes or determines deposit allocations at one or more [IDIs] (including through operating or using any algorithm, or any other program or technology that is functionally similar)".[53] The proposed rule does not define or describe when a third party would be deemed to propose or determine deposit allocations. Troublingly, the FDIC indicated in the NPR that "[t]he FDIC views this conduct as objectively within the 'deposit broker' definition if the algorithm or functionally similar program or technology proposes or determines deposit allocations among IDIs by directing the flow, *or facilitating the flow*, of third-party funds to be deposited at a particular IDI".[54] This formulation is extremely broad and, because the FDIC does not define or otherwise describe with any detail when a third party would be deemed to be "facilitating the flow of funds", the proposed rule seemingly could classify as a deposit broker any third party that provides any service to an IDI in connection with the IDI's deposit products, through the use of any technology that is involved in any manner in the flow of funds at any stage, including even core banking systems. The breadth and vagueness of this aspect of the proposed rule is particularly ironic in light of the FDIC's

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asset growth."); Joint Agency Advisory on Brokered and Rate-Sensitive Deposit (May 11, 2001) (directing bank management to adopt risk management systems that include "[r]easonable control structures to limit funding concentrations . . . designed to control excessive reliance on any significant source(s) or type of funding . . . includ[ing] brokered funds.").

[51] 89 Fed. Reg. at 68253.

[52] 86 Fed. Reg. at 6748 ("Nevertheless, under the final rule, *without exception*, and as further explained below in the section discussing the primary purpose exception, brokered CDs continue to be classified as brokered.") (emphasis added).

[53] Proposed 12 C.F.R. § 337.6(a)(5)(ii)(D).

[54] 89 Fed. Reg. at 68252 (emphasis added).

purported concern that IDIs have misconstrued the matchmaking prong,[55] which includes criteria that are far clearer than those in the proposed deposit allocation prong.

If applied broadly, the proposed deposit allocation prong would capture many third parties that by any rational measure are not engaged in the business of deposit brokerage activities—and thereby define as brokered large amounts of deposits that are not the product of the bank's use of a deposit broker. In particular, technological developments, evolving business practices and innovative products result in relationships between IDIs and third parties that facilitate and enhance the IDI's relationship with its customers. In myriad cases, the third party does not have any discretion in allocating deposits and essentially provides only back-office and other administrative functions for the IDI through the use of software or other technology that may be prohibitively expensive, time-consuming or inefficient for the IDI to develop for itself. For instance, in the sweep programs discussed in Section IV.A.1 above, the third party allocates deposits using an algorithm to IDIs based on the broker-dealer's predetermined list of IDIs and the amount of sweep deposits each participating IDI is willing to accept. The third party has no contractual or other right to move deposits to another IDI and no ability to negotiate the rates or terms of a deposit, but under the FDIC's apparent reading of the proposed rule, the third party could be captured by the "deposit allocation" prong. The proposed definition could lead to the perverse result of weakening an IDI's ability to attract and retain customers.

Accordingly, the "deposit allocation" prong should not be adopted. If the FDIC nonetheless determines to retain a "deposit allocation" prong, it should be revised to exclude clearly third parties that do not have discretion to select the banks that participate in a sweep or similar program and that do not otherwise have the authority to move deposits from one IDI to another. We suggest this be done in any final rule by defining "proposing or determining deposit allocations" to exclude business relationships where the third party (1) does not select the IDIs that participate in the business relationship and (2) does not possess the authority or discretion to approve or execute deposit allocation instructions, even if the third party uses an algorithm, software or other technology to automate the instructions (including formula-based instructions) for another party such as an IDI or broker-dealer.[56]

4. The final rule should retain an exclusion for affiliates in the "deposit allocation" prong

Under the 2021 Rule's "matchmaking prong", a third party engaged in matchmaking activities is not a deposit broker with respect to "deposits placed by a depositor's agent with a bank affiliated with the depositor's agent".[57] The proposed rule would not include a similar exclusion for affiliates under the "deposit allocation" prong because "recent experience has demonstrated that third parties do propose or determine deposit allocations at both unaffiliated and affiliated IDIs and these deposits, when uninsured, do not seem to act in a more 'sticky' manner just because there is an affiliation between a broker and an IDI".[58] The "recent

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[55] *See id.* at 68251.

[56] As discussed above, if the final rule retains a fee prong, these third parties should also be excluded from the "fee prong" of the "engaged in the business of placing or facilitating the placement of deposits" definition because they are not engaged in the business of facilitating the placement of deposits, but rather are engaged in the business of providing administrative services.

[57] 12 C.F.R. §§ 337.6(a)(5)(iii)(C)(1).

[58] 89 Fed. Reg. at 68252.

experience" the FDIC cites is a single bank failure; namely, First Republic Bank's failure in 2023.[59]

The FDIC's analysis of the First Republic failure is problematic in a number of respects. First, as discussed in Section III.A above, the FDIC provides no evidence that brokered deposits (or deposits that would be classified as brokered under the proposed rule) played any role in First Republic's failure (or in Silicon Valley Bank or Signature Bank's failures, for that matter). Second, as the FDIC itself acknowledges, to the extent affiliate sweep deposits behave similarly to unaffiliated sweep deposits (an assertion that is contrary to the FDIC's own past analysis[60]), that is only the case when the affiliated sweep deposits *are uninsured*.[61] Third, the FDIC's claim that affiliate deposits are no more "sticky" than unaffiliated deposits is counter to the FDIC's earlier, more thorough analysis. For example, in 2021, the FDIC, along with the OCC and the Federal Reserve Board, confirmed in the final rule for the Net Stable Funding Ratio that affiliate sweep deposits are more likely to "exhibit a stability profile associated with deposits directly from retail customers".[62]

In cases where there is a sweep deposit or similar relationship between an IDI and its affiliate (for instance, an IDI and its affiliated broker-dealer), the presence of an additional third party in the flow of deposits does not fundamentally change the nature of the relationship, particularly because the additional third party acts solely in an operational and non-discretionary capacity, and the resulting deposits continue to be more stable than unaffiliated deposits. Accordingly, the final rule, similar to the 2021 Rule, should exclude from the "deposit allocation" prong any person that facilitates the placement of deposits by a depositor's agent with a bank that is affiliated with the depositor's agent.

B. The Primary Purpose Exception

1. The proposed rule ignores the plain reading of Section 29 and would read the primary purpose exception out of the statute

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[59] *See id.* at 68245.

[60] *See* OCC, FRB, FDIC, Final Rule, Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 86 Fed. Reg. 9120, 9145 (Feb. 11, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-02-11/pdf/2020-26546.pdf ("A sweep deposit arrangement places deposits at one or more banking organizations, with each banking organization receiving the maximum amount that is covered by deposit insurance, according to a priority 'waterfall.' Within the waterfall structure, affiliates tend to be the first to receive deposits and the last from which deposits are withdrawn. Because of this priority relationship with an affiliate, a covered company is more likely to receive and maintain a steady stream of sweep deposits provided by a retail customer or counterparty across a range of market conditions. The priority relationship with an affiliate results in a deposit relationship that is reflective of an overall relationship with the underlying retail customer or counterparty where these deposits generally exhibit a stability profile associated with deposits directly from retail customers."). Moreover, the 2011 Study notes that the data suggest "deposits swept from affiliated broker-dealers . . . appeared likely to pose fewer problems than other brokered deposits". 2011 Study at 4.

[61] *See* 89 Fed. Reg. at 68245 (noting that the decline in uninsured affiliate sweep deposits at First Republic from December 31, 2022 to March 31, 2023 was from \$8.3 billion to \$1.1 billion, whereas the decline in insured affiliated sweep deposits was far less pronounced (from \$1.9 billion to \$1.4 billion)).

[62] 86 Fed. Reg. at 9147.

Under Section 29 and the FDIC's existing regulations, a person that would otherwise be a deposit broker is excepted from the "deposit broker" definition if the person's "primary purpose is not the placement of funds with depository institutions".[63] Congress was clear that Section 29 was intended to be a "*narrowly drawn* provision that specifically targets the *most flagrant abusers*".[64] The primary purpose exception is critical to fulfilling this purpose and ensuring that Section 29 does not apply more broadly than Congress intended, and the plain language of the statute clearly evinces that intent. The FDIC's proposed interpretation of the primary purpose exception, which focuses on the third party's "primary purpose *in placing customer deposits at IDIs*"[65] rather than the third party's primary purpose, is inconsistent with the face of the statute and its intent.

First, the FDIC's proposal ignores the presence of the word "primary" in the statute. There is substantial precedent for interpretation of "primary" as "first" or "foremost".[66] A plain reading of the statute therefore acknowledges that there may be multiple purposes for any given deposit arrangement. Even an explicit purpose of placing deposits at an IDI is not sufficient to classify the deposits as brokered if there is another, primary purpose. In fact, an explicit purpose of any third party in connection with the specific act of "placing customer deposits at IDIs" is always going to be the placement of the deposits at the IDI. The clear language of the statute therefore requires an assessment of whether the third party has purposes other than the explicit purpose of placing deposits at an IDI, and whether *any* of those other purposes is the third party's primary purpose in the overall deposit arrangement.

Although the FDIC seemingly acknowledges this meaning of "primary" by noting in the NPR that "the focus of the exception is on the role of the agent or nominee (or third party) and whether that third party places customer deposits at an IDI *as a secondary purpose in furtherance of some other 'primary purpose'*",[67] the proposed rule would in effect ignore the presence of the word "primary" by requiring an analysis of the third party's intent behind the specific act of "placing customer deposits at IDIs", *i.e.*, at the specific moment the deposit is placed. For instance, in applying the proposed rule's primary purpose analysis, the FDIC states in the NPR, "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

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63 12 U.S.C. § 1831f(g)(2)(I); 12 C.F.R. § 337.6(a)(5)(v)(I).

64 Insured Brokered Deposits and Federal Depository Institutions, Hearings before the Subcommittee on General Oversight and Government Investigations of the House Committee on Banking, Housing, and Urban Affairs at 8, Cmte. Print 101-28, 101st Cong., 1st Sess. (May 17, 1989) (remarks of Sen. Murkowski) at 10 (emphasis added).

65 89 Fed. Reg. at 68253.

66 *See, e.g.*, *Malat* v. *Riddell*, 383 U.S. 569, 572 (1966) ("We hold that, as used in § 1221(1) [of the Internal Revenue Code of 1954], 'primarily' means 'of first importance' or 'principal.'"); *Open Soc'y Inst.* v. *U.S. Citizenship & Immigr. Servs.*, 573 F. Supp. 3d 294, 312 (D.D.C. 2021) ("interpretation of 'primarily' as meaning 'principally,' as distinct from 'incidentally or secondarily,' comports with the dictionary definition of the term . . . Indeed, construing the word 'primarily' to mean 'principally' borders on the tautological."); *Thomas* v. *United States*, 758 F. Supp. 529, 540 (E.D. Mo., 1991) ("Primary is defined as meaning of first importance or principally . . . ."); *Marshall* v. *Burger King Corp.*, 504 F. Supp. 404, 409 (E.D.N.Y., 1980) ("[P]rimary is much more plausibly interpreted in its usual sense as meaning chief, principal, or first of several functions."); *Koehring Co.* v. *Adams*, 452 F. Supp. 635, 638 (E.D. Wis., 1978) ("The plain and ordinary meaning of the word 'primarily' is 'first' or 'foremost.'").

67 89 Fed. Reg. at 68253 (emphasis added).

insurance".[68] Such an analysis examines solely the third party's purpose behind the specific act of placing deposits at the isolated moment the deposit is placed, resulting in a circular and predetermined conclusion that the third party's purpose in placing the deposits is the placement of deposits. The FDIC's proposed analysis is not based on any consideration of the third party's other purposes or the context of its overall business or relationship with depositors. This interpretation would appear to read the primary purpose exception out of the statute.

Similarly, although the FDIC states in the NPR that "in understanding why the third party is placing deposits on behalf of customers at particular IDIs, consideration should be given to *both* the customer-third party relationship *and* the third party-IDI relationship",[69] the NPR makes clear that the FDIC intends to analyze these relationships *separately* and determine that the primary purpose exception is unavailable if the FDIC determines that *either* relationship does not have a "substantial purpose" other than providing deposit insurance or a deposit-placement service. The FDIC notes that "[t]his is because the primary purpose of a customer's business relationship with a third party may be distinct from the intention of the third party in placing those customer funds at particular IDIs".[70]

This interpretation of the primary purpose exception attempts to distinguish between the primary purpose of the business relationship between a third party and its customers and a third party's intent in placing deposits at an IDI, while ignoring the *plain reading of the statute* that a third party qualifies for the primary purpose exception even if one of its purposes is to place funds with IDIs, so long as such purpose is not the third party's *primary* (*i.e.*, "first" or "foremost") purpose. The FDIC's proposed analysis again ignores the fact that third parties whose primary purpose in their relationship with a client is not to provide a deposit-placement service or obtain FDIC deposit insurance for the client, often have relationships with IDIs only if the third parties are placing deposits at IDIs. Under the FDIC's proposed analysis, the FDIC would always examine the relationship between the third party and the IDI separately from the relationship between the third party and the depositor, and the third party will in almost all cases have the primary purpose of placing deposits at the IDI when examining only the relationship between the third party and the IDI. As a result, the FDIC would in almost all cases disregard entirely the relationship between the third party and the depositor. It is difficult to imagine under the FDIC's proposed approach a scenario where a third party would be able to rely on the primary purpose exception, even where the placement of deposits is clearly ancillary to the third party's overall business purpose and relationship with its customers (*i.e.*, the third party's primary purpose). Again, the FDIC effectively would engage in improper nullification by applying the primary exception in such a narrow manner as to render it virtually unavailable.[71]

The FDIC states that this proposed interpretation is "similar to how the FDIC historically interpreted the [primary purpose] exception before [the 2021 Rule]."[72] The fact that the FDIC applied an erroneous interpretation prior to 2021 does not support the proposed change. As we

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68 *Id.* at 68257.

69 *Id.* at 68253 (emphasis added).

70 *Id.*

71 *See In re McDaniel*, 973 F.3d 1083, 1101 (10th Cir. 2020) (citing *In re Crocker*, 941 F.3d 206, 220 (5th Cir. 2019), as revised (Oct. 22, 2019) (explaining that the interpretation of a statutory exception cannot be so narrow as to introduce doubt whether the exception continues to "serve[] much purpose").

72 89 Fed. Reg. at 68253.

described in our 2019 ANPR Comment Letter, the FDIC's pre-2021 analysis was contrary to congressional intent and a plain reading of the statute.[73]

For the foregoing reasons, BPI believes that the proposed rule's approach for analyzing whether a third party should qualify for the primary purpose exception should not be adopted in the final rule.

2. The introduction of fees as a factor under the primary purpose exception would significantly narrow the primary purpose exception

The FDIC should not introduce fees as a disqualifying factor in its analysis of a third party's primary purpose. The proposed rule defines anyone who receives fees related to the placement of deposits as a deposit broker.[74] Then, in describing the types of relationships that could qualify for the primary purpose exception, the proposed rule identifies the payment of fees as disqualifying, because any payment of fees, in the FDIC's view, demonstrates that the primary purpose of a person in placing or facilitating the placement of deposits for a fee is the placement of deposits, and therefore the person cannot have a primary purpose other than the placement of deposits. The circularity of this construct demonstrates the absurdity of the proposal's design—it creates a definition, the exception to which contains an element of the definition as disqualifying. The effect of this design is to render the primary purpose exception unavailable to anyone who receives a fee connected to the placement of deposits, including administrative, recordkeeping, marketing and referral fees, irrespective of what that person's primary purpose actually is. This outcome cannot be what Congress intended.

By finding that the presence of fees both causes a third party to be a deposit broker and renders the main exception unavailable, the FDIC dramatically narrows an important exception in Section 29 without explaining how it serves the statutory purpose. Had Congress intended to make the primary purpose exception unavailable to entities that receive fees in connection with the placement of deposits, it could have done so explicitly. In the absence of any direction or authority from Congress directing the FDIC to treat the payment of fees as disqualifying under the primary purpose exception, the proposed fee factor should not be adopted.

3. The proposed rule would reduce the clarity and transparency introduced by the 2021 Rule in analyzing the primary purpose exception

Not only is the FDIC's proposed interpretation of the primary purpose exception clearly inconsistent with the statutory language and congressional intent, the FDIC's shift from an examination of the third party's overall business and its relationship with its customers under the 2021 Rule[75] to a specific analysis of the third party's intent when it is placing deposits at the IDI reduces the clarity and transparency introduced by the 2021 Rule. An assessment of a third party's purpose behind the specific act of placing a deposit is inherently difficult for an applicant to demonstrate. In fact, an analysis that would focus only on whether the intent of the third party in placing deposits is for a substantial purpose other than to provide a deposit-placement service or FDIC insurance intrinsically has a chilling effect for two reasons. First, an IDI would

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[73] *See* 2019 ANPR Comment Letter at 9–10 (attached hereto as Appendix A).

[74] *See* Proposed 12 C.F.R. § 337.6(a)(5)(ii)(E).

[75] *See* 86 Fed. Reg. 6749 ("[T]he primary purpose exception would apply when *the primary purpose of the agent's or nominee's business relationship with its customers* is not the placement of funds with depository institutions.") (emphasis added).

not want to expend resources developing programs with third parties that the FDIC may later determine fail to qualify for the primary purpose exception. Second, an IDI would not want to be subject to "second guessing" by the FDIC and the reputational damage, and even potential monetary penalties, if forced to reclassify and restate the categorization of its deposits.

On the contrary, standards set forth in the 2021 Rule that are based on the agent's overall business purpose provide much-needed clarity to IDIs and help IDIs assess with a greater degree of certainty whether deposits would be brokered. Such predictability reduces unnecessary costs for IDIs and their customers. As such, the FDIC should not adopt the proposed changes to the 2021 Rule's approach to analyzing whether a third party should qualify for the primary purpose exception.

4. The final rule should retain the 2021 Rule's designated business exceptions for the "25 percent test" and "enabling transactions"

Under the 2021 Rule, the FDIC adopted several "designated business exceptions" that meet the primary purpose exception. The proposed rule would significantly narrow one of the most important exceptions (the "25 percent test" exception) and eliminate another important exception (the "enabling transactions" exception) entirely. For the reasons described below, the proposed changes to the 2021 Rule's designated business exceptions for agents or nominees should not be adopted.

a. The proposed rule's broker-dealer sweep exception is overly narrow, and the proposed changes to the 2021 Rule's 25 percent test should not be adopted

Under the 2021 Rule, an agent or nominee qualifies for the 25 percent test designated business exception if less than 25 percent of the total assets that the agent or nominee has under administration, for a particular business line, for its customers is placed at depository institutions.[76] In adopting the 25 percent test, the FDIC concluded "that the primary purpose of a third party's business relationship with its customers is not the placement of funds with [IDIs] if the third party places less than 25 percent of customer assets under [administration] for its customers, for a particular business line, at IDIs."[77] The proposed broker-dealer sweep exception would significantly revise nearly every aspect of the existing exception for agents and nominees. In particular, the proposed rule would make five significant changes: first, the threshold would be reduced from 25 percent to 10 percent; second, the threshold would apply to "assets under management" rather than "assets under administration"; third, the exception apparently would apply only to deposit sweep programs and not to other deposits placed by the agent or nominee; fourth, the exception would be available only to broker-dealers or investment advisers registered with the SEC; and fifth, the exception (and therefore IDIs' ability to rely on

[76] 12 U.S.C. § 337.6(a)(5)(v)(I)(1)(i).

[77] FDIC, Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453, 7459 (Feb. 10, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-02-10/pdf/2019-28275.pdf. As just one example, the FDIC noted that "a broker dealer that sweeps uninvested cash balances into deposit accounts at [IDIs] would meet the primary purpose exception if the amount of customer funds it places [in] deposit accounts represents less than a quarter of the total amount of customer assets it manages for its broker dealer business." *Id.*

the related notice process rather than a more burdensome application process) would not be available if any additional third party is involved in the deposit placement arrangement.

Each of these proposed revisions to the 2021 Rule would be made without compelling justification. Indeed, the FDIC's only justifications for the proposed broker-dealer sweep exception are vague assertions, with no supporting evidence, that (1) a 10 percent threshold "*may* reduce potential risks to safety and soundness and to the DIF"[78] and (2) placing 10 percent of customer funds at IDIs is "more indicative" of the broker dealer's or investment adviser's primary purpose.[79]

With respect to the first rationale, BPI's empirical research indicates that, when controlling for relevant bank characteristics (*e.g.*, bank size), there is no statistically significant relationship between sweep deposit concentrations and bank risk.[80] This research examined the relationship between banks' reliance on brokered deposits and sweep deposits and their stock returns (as a proxy for bank risk) during the significant stress event of the March 2023 mid-sized bank crisis. The research utilized the information on sweep deposits that has been reported on the Call Report since soon after the 2021 Rule was finalized. While the research found smaller banks with higher concentrations of brokered deposits in March 2023 experienced significant negative excess returns during stress periods, sweep deposits not classified as brokered deposits showed virtually no correlation with bank stock performance during the March 2023 stress period for banks in any size category. Therefore, the proposed changes cannot be justified on the basis of safety and soundness.

With respect to the FDIC's second rationale, the FDIC asserts this is the case because it views "the 10 percent threshold as evidence that a de-minimis amount of customer funds are placed into deposit accounts for the primary purpose of re-investment rather than to provide a deposit placement service or deposit insurance."[81] The FDIC's focus on whether one threshold is "more indicative" of a party's primary purpose than a higher threshold does not justify a lower threshold than one the FDIC previously determined meets the primary purpose exception. Moreover, the FDIC's statement indicates that the primary purpose exception would apply only where an agent or nominee places a *de minimis* amount of customer funds (as a percentage of total customer funds under management) with IDIs. This is inconsistent with any reasonable interpretation of the word "primary."[82] Because the FDIC has not provided any rationale that

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78 89 Fed. Reg. at 68256 (emphasis added). It is unclear why the FDIC believes that a third party may have a fiduciary duty to transfer *insured* deposits, which are protected regardless of the IDI's financial condition, to another IDI when an IDI is perceived to be weak, and how that concern is actually relevant to, or mitigated by, the lowering of the threshold.

79 *Id.*

80 *See* BPI, *The FDIC's Proposed Brokered Deposit Reclassification: An Empirical Evaluation* (Nov. 21, 2024) (attached hereto as Appendix C).

81 89 Fed. Reg. at 68256.

82 *See, e.g.,* FDIC, Advisory Opinion No. 92-75 (Nov. 3, 1992, repealed on Apr. 1, 2021 by the 2021 Rule) (providing that "more than 50%" of an employee's compensation will need to consist of salary in order for the employee's compensation to be "primarily" in the form of a salary); *In re Kelly*, 841 F.2d 908, 913 (9th Cir. 1988) ("The ultimate question we must decide under section 707(b) is, of course, whether debtors have '*primarily* consumer debts.' 'Primarily' means 'for the most part.' *Webster's Ninth New Collegiate Dictionary* 934 (1984). Thus, when 'the most part'—i.e., *more than half*—of the dollar amount owed is consumer debt, the statutory threshold is passed.") (emphasis added); *Hall* v. *Bassett & Assocs., Inc.*, No. 20-CV-01067-NRN, 2021 WL

would justify the proposed changes to the 25 percent test, those changes should not be adopted.

If the FDIC determines to revise the 25 percent test, the following changes are necessary.

i. The threshold to qualify for the exception should not be reduced from 25 percent to 10 percent

Considering first the reduction in the limit as it relates to broker-dealer sweep programs, we have several concerns. In reducing the asset threshold to qualify for the exception from 25 percent to 10 percent, the FDIC asserts that the lower threshold is "more indicative that the primary purpose for broker-dealers and investment advisers in placing customer funds at IDIs is to temporarily safe-keep customer free cash balances . . . that are awaiting reinvestment."[83] As noted above, the FDIC seemingly bases this conclusion on the fact that 10 percent was the threshold the FDIC had permitted prior to the 2021 Rule, but without persuasive justification and without any analysis to refute the 2021 Rule's conclusion that the 25 percent threshold is adequate to demonstrate that the primary purpose of the third party is not the placement of funds with IDIs.[84]

The plain statutory language makes the primary purpose exception available to a party whose primary purpose is not the placement of funds at IDIs. The primary purpose exception therefore represents a congressional determination that only a third party whose *primary purpose* is the placement of funds with IDIs should be classified as a deposit broker. In particular, common sense dictates, for example, that registered broker-dealers and investment advisers—which are highly regulated and operate primarily for the purpose of facilitating securities transactions and advising customers regarding such transactions—do not have the "primary purpose" of placing deposits with IDIs.

The proposed rule also fails to recognize that there must be a buffer below the defined percentage threshold to account for market fluctuations. The value of securities in a customer's brokerage account fluctuates depending on market circumstances, even during relatively stable times. From our members' experience, broker-dealers and investment advisers generally use a buffer to ensure their continued eligibility for the current primary purpose exception, such that deposits placed with IDIs do not exceed 15 percent to 20 percent of total assets under administration to account for these fluctuations. In other words, a 10 percent threshold would result in a far lower threshold in practice. Our members estimate that this could result in an

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1978743, at 5 (D. Colo. May 17, 2021) ("The regulations define 'primary duty' as 'the principal, main, major or most important duty that the employee performs.' 29 C.F.R. § 541.700(a). This is a holistic evaluation guided in part by the amount of time spent performing exempt work. While not the 'sole test,' employees 'who spend *more than 50 percent* of their time performing exempt work will generally satisfy the primary duty requirement.' 29 C.F.R. § 541.700(b).") (emphasis added).

83 89 Fed. Reg. at 68256.

84 *See* Statement by Travis Hill, Vice Chairman, FDIC, on the Notice of Proposed Rulemaking on Brokered Deposits Restrictions (Jul. 30, 2024), *available at* https://www.fdic.gov/news/speeches/2024/statement-vice-chairman-travis-hill-notice-proposed-rulemaking-brokered-deposit ("I do not think it is accurate to conclude that the primary purpose of a company that collects funds from customers and, for example, places 12 percent of those funds at banks is the placement of deposits, given that 88 percent of those funds are placed elsewhere.").

actual threshold of 5 to 7.5 percent, or potentially even less, which is too restrictive for the exception to be meaningfully available to broker-dealers and investment advisers.

The reduction of the threshold to 10 percent may also have unintended procyclical effects during times of stress that would exacerbate strains on the banking system. During periods of general economic stress, the amount of cash that a broker-dealer or investment adviser holds as a percentage of total assets under management tends to increase due to customers selling securities.[85] In addition, total assets under management may decrease in times of stress, which may further increase the level of cash held as a percentage of total assets under management. As a result, the 10 percent threshold is more likely to become a binding constraint on third parties' ability to place deposits with IDIs even though the primary purpose of the third party in placing deposits (*i.e.*, to facilitate the purchase and sale of securities) has not changed. In such circumstances, IDIs would be required to treat many sweep deposits as brokered and, as a result, may be unwilling to continue accepting sweep deposits, thereby potentially exacerbating strains on IDIs and other parties during periods of economic stress.

Under the 2021 Rule, the 25 percent test designated business exception has been the most important and readily available exception for IDIs that accept sweep deposits from broker-dealers. Given the severe reduction in the threshold in the proposed rule, in conjunction with the general narrowing of the primary purpose exception, we are concerned that the FDIC has not considered how the proposed rule, taken as a whole, could make the receipt of deposits from ordinary broker-dealer sweep programs much more challenging for IDIs and raise indirect costs for customers.

For these reasons, the FDIC should not reduce the asset threshold to 10 percent.

ii. The definition of "assets under management" should be updated to "assets under management or administration"

The proposed rule would limit the applicability of the broker-dealer sweep exception to registered broker-dealers and investment advisers that place less than 10 percent of "assets under management" at IDIs.[86] The proposed rule would define "assets under management" as "securities portfolios and cash balances with respect to which an investment adviser or broker-dealer provides continuous and regular supervisory or management services".[87] By limiting the definition to assets for which the broker-dealer or investment adviser provides *continuous and regular supervisory or management services*, the proposed rule apparently would permit the exception only if deposits placed at IDIs are less than 10 percent of assets held in actively managed accounts. This would limit the scope of the exception in ways that are inconsistent with the FDIC's practice even prior to the 2021 Rule, which did not limit the exception to

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[85] *See* James R. Barth, *et al.*, *Runs to Bank: The Role of Sweep Banking Deposits During Market Downturns*, Fama-Miller Working Paper Series, at 3 (Forthcoming), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3809322 ("Our empirical results indicate a robust and negative relation between stock market returns and sweep deposits to banks by brokerage. . . . This finding indicates an asymmetric relationship between sweep deposits growth and stock returns. We view this result as consistent with the "run to the bank" thesis; as stock markets drop, brokerage customers reduce exposure to risky assets and thereby raise cash, which is swept to banks.").

[86] Proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(1)(i).

[87] Proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(11).

deposits swept from actively managed accounts.[88] Many broker-dealers offer sweep features in connection with self-directed brokerage or investment accounts in which the individual investor retains all investment discretion. The depositing of free cash balances in these accounts by a broker-dealer or investment adviser, similar to the depositing of free cash balances in accounts that are actively managed, is incidental to the broker-dealer or investment adviser's ultimate purpose of managing or administering funds that are held for investment. Whether or not the account is actively managed is irrelevant to the question of whether the broker-dealer has a primary purpose of placing funds with an IDI. The proposal does not provide any compelling rationale for this distinction. For these reasons, the final rule should retain the "assets under administration" definition from the 2021 Rule, or should revise the proposed "assets under management" definition to include customer assets held in both managed accounts and accounts for which an investment adviser or broker-dealer does not exercise investment discretion.

iii. The final rule should clarify that the broker-dealer sweep exception applies to all deposits placed at IDIs by a broker-dealer on behalf of its clients, and not only to deposits placed through a formal sweep program

Broker-dealers and investment advisers, which operate primarily for the purpose of facilitating securities transactions and advising customers regarding such transactions, offer a variety of cash management services to their clients that involve depositing at IDIs cash balances held in investment accounts with the broker-dealer. The primary purpose of the broker-dealer in depositing these cash balances is to facilitate investment by providing a secure solution for investors to manage and hold cash balances. The FDIC recognized in the 2021 Rule the various ways in which broker-dealers may provide cash management services and clarified that the exception would apply "if less than 25 percent of the total assets that the agent or nominee has under management for its customers, in a particular business line, is placed at [IDIs]".[89] This is consistent with the plain meaning of the primary purpose exception, as the exception should apply based on whether the agent or nominee's foremost purpose is the placement of deposits with IDIs, and not based on the manner by which the deposits are placed. As noted above, a broker-dealer or investment adviser's primary purpose is to facilitate and provide advice regarding securities transactions, and the placement of deposits is incidental to that purpose. This is the case whether the deposits are placed through an automatic sweep program, through another cash management program or at the instruction of the broker-dealer's client.

However, the FDIC apparently would apply the proposed broker-dealer sweep exception only to automatic sweep programs. In particular, the FDIC notes that "[i]n 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

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[88] *See* FDIC, Advisory Opinion No. 05-02 (Feb. 3, 2005, repealed on Apr. 1, 2021 by the 2021 Rule).

[89] 86 Fed. Reg. at 6751. The FDIC had previously provided in the notice of proposed rulemaking for the 2021 Rule an example of the exception as applied to sweep deposits: "a broker dealer that sweeps uninvested cash balances into deposit accounts at [IDIs] would meet the primary purpose exception if the amount of customer funds it places [in] deposit accounts represents less than a quarter of the total amount of customer assets it manages for its broker dealer business." 85 Fed. Reg. at 7459.

Exception.'"[90] Limiting the exception to automatic sweep programs would substantially narrow the applicability of the current 25 percent test. However, the FDIC does not directly acknowledge this significant change, nor does it provide any specific explanation for the change.

For these reasons, the final rule should clarify that the exception applies to deposits placed by broker-dealers and investment advisers on behalf of their clients, without regard to the manner or mechanism for placing the deposits, as long as the deposits do not exceed the applicable asset threshold.[91] We also propose that the FDIC rename the revised designated business exception to the "broker-dealer and investment adviser exception" to be consistent with our proposed changes.

iv. The definitions of "broker-dealer" and "investment adviser" should be revised to include certain entities that are not required to register with the SEC

The proposed rule would apply the broker-dealer sweep exception only to "broker-dealers" and "investment advisers", which the proposed rule would define as broker-dealers or investment advisers registered with the SEC.[92] However, banks, bank holding companies and trust companies provide advisory and other services in a similar manner to registered broker-dealers or investment advisers, but may rely on specified exclusions from SEC registration requirements because the regulatory frameworks that govern their activities provide a comparable (or greater) level of oversight to those imposed on SEC-registered broker-dealers and investment advisers. For these reasons, the final rule should apply the exception to entities that perform the same functions as registered broker-dealers or investment advisers but Congress has determined are not required to register with the SEC.

v. The broker-dealer sweep exception, and the corresponding ability to rely on the notice process, should be available regardless of whether an additional third party is involved in the arrangement

As noted above, the proposed rule would make the broker-dealer sweep exception, and therefore the ability to rely on the notice process, available only if no additional third party is involved in the deposit placement arrangement.[93] Even prior to the 2021 Rule, the FDIC's guidance on sweep programs did not require that the IDI not use third parties.[94] This makes sense because the primary purpose of the broker-dealer or investment adviser that provides the sweep feature to customers is not to provide a deposit-placement service but rather to facilitate the purchase and sale of securities. In this context, third parties tend to perform mainly

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[90] 89 Fed. Reg. at 68255.

[91] We note that this exception would exclude brokered CDs, as both the 2021 Rule and the proposed rule provide that brokered CDs constitute a separate business line that is not eligible for the primary purpose exception. 12 C.F.R. § 337.6(a)(5)(v)(I)(3); proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(3).

[92] Proposed 12 C.F.R. §§ 337.6(a)(5)(iv)(I)(1)(i), 337.6(a)(5)(iv)(I)(9)–(10).

[93] Proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(1)(i).

[94] *See* FDIC, Advisory Opinion No. 05-02 (Feb. 3, 2005, repealed on Apr. 1, 2021 by the 2021 Rule).

administrative functions for sweep deposits based on a pre-determined list of IDIs provided by the broker-dealer.

In excluding the participation of any third party, the FDIC cites only its determination that unaffiliated sweep deposits were misreported as non-brokered after the 2021 Rule went into effect because IDIs purportedly misunderstood the application of the "matchmaking prong".[95] However, after the 2021 Rule went into effect, the FDIC issued guidance to clarify the application of the matchmaking prong to sweep programs in which an additional third party is involved.[96] The FDIC does not discuss in the NPR the effectiveness of this guidance or why it could not be codified in the final rule. Eliminating the exception for relationships in which *any* additional third party is involved is an overly broad remedy to a narrow concern, and one that lacks any compelling justification. In addition, as discussed in Section IV.A.3 above, these third parties frequently provide only back-office and other administrative functions for the IDI or broker-dealer through the use of software or other technology that may be prohibitively expensive or time-consuming for the IDI or broker-dealer to develop for itself, and do not have discretion to identify at which banks to place the deposits, to execute the allocation of deposits or otherwise to move deposits to other IDIs.

For these reasons, the final rule should make the broker-dealer sweep exception available regardless of whether an additional third party is involved. At a minimum, the final rule should clarify that the exception is available where the additional third party is not a deposit broker (including because the third party's involvement is purely limited to the performance of administrative functions ancillary to the overall deposit arrangement) for the reasons discussed in Sections IV.A.1 and IV.A.3 above.

b. The FDIC should not adopt the alternatives discussed in the proposal that would (1) rescind the 25 percent test entirely or (2) limit the broker-dealer sweep exception to apply only to deposits swept to an affiliated IDI

In the NPR, the FDIC specifically invited comment on (i) whether the 2021 Rule's 25 percent test should be rescinded entirely or (ii) whether the proposed rule's broker-dealer sweep exception should be limited to deposits placed at an IDI that is affiliated with the broker-dealer or investment adviser. For the reasons discussed in Section IV.B.4.a above, BPI

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95 *See* 89 Fed. Reg. at 68255 ("Since the implementation of the [2021 Rule], the FDIC has encountered a number of challenges with notice filings submitted under the 25 percent test and with reporting associated with sweep deposits . . . 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. This has resulted in a large number of unaffiliated sweep deposits being misreported as nonbrokered.").

96 *See* FDIC, Questions and Answers Related to Brokered Deposits Rule (Jul. 15, 2022), *available at* https://www.fdic.gov/sites/default/files/2024-03/brokered-deposits-qa.pdf ("If, as part of a broker dealer sweep program, a person identifies at which banks to place the funds of individual customers of the broker dealer, the person is, for purposes of the 'matchmaking' definition, 'proposing deposit allocations'" and that if such person "also satisfies the other criteria in the 'matchmaking' definition, the person would meet the 'facilitation' part of the 'deposit broker' definition.").

strongly opposes both alternatives, as well as any other alternative that would further limit the application of the 2021 Rule's 25 percent test.

c. The final rule should retain the enabling transactions exception

The proposed elimination of the enabling transactions exception is based on an incorrect interpretation of Section 29, would classify many deposits that Section 29 was not intended to address as brokered, and potentially would harm underbanked consumers that rely on these relationships to gain access to a transactional account.

To qualify for the enabling transactions designated business exception in the 2021 Rule, deposits must be placed into "transactional accounts that do not pay any fees, interest, or other remuneration to the depositor".[97] These deposits are placed in connection with arrangements that are intended to provide consumers, who may be underbanked, access to transactional accounts so that they are able to transact in a safe and reliable manner without needing to hold cash at all times. Although one aspect of the third party's business activities may result in connecting depositors to an IDI because deposit accounts are necessary to provide their services, the third parties are not in the business of facilitating the placement of deposits, but of providing an innovative method by which customers can store their money and conduct transactions. These services are wholly unrelated to the business of providing deposit placement services or obtaining FDIC insurance for customers.

Removing the enabling transactions designated business exception could disadvantage underbanked or unbanked individuals by eliminating or making it more expensive to access safe transactional deposit accounts. Because of the negative consequences to IDIs of classifying deposits as brokered, IDIs are likely to be less willing or able to provide deposit accounts to third parties such as prepaid card managers that serve these communities, or may be willing to do so only at a price that ultimately increases the fees and other costs paid by customers.

Moreover, as discussed further in Section IV.B.1 above, the proposal's rationale for eliminating the enabling transactions exception is based on an incorrect and circular interpretation of the statutory primary purpose exception. The assertion 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"[98] ignores any other purpose that the third party may have for placing deposits with an IDI. The assertion disregards the broader context of the third party's overall relationship with depositors, which is inconsistent with the statute's direction to consider the third party's *primary* purpose. In doing so, the proposal's interpretation of the exception would effectively read the primary purpose exception out of Section 29. For these reasons, the final rule should not eliminate the enabling transactions designated business exception.

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[97] 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(ii).

[98] 89 Fed. Reg. at 68257.

C. Notice and Application Processes

1. The proposed rule's primary purpose exception notice and application processes are administratively unfeasible and may have unintended adverse consequences on consumers

As we described in our 2020 NPR Comment Letter, the FDIC should eliminate any mandatory notice or application process for primary purpose arrangements.[99] The efficient and effective administration of the primary purpose exception would best be served by a framework that consists of (1) bright-line criteria that banks may independently apply and (2) a supplementary, voluntary application process for relationships that do not meet the bright-line criteria. This approach would be more consistent with Section 29, which does not grant the FDIC authority to mandate notices or applications for IDIs or third parties that seek to rely on the statutory exception.

If the FDIC decides to retain mandatory notice and application processes despite these concerns, the final rule must consider the potential costs and burdens that IDIs, third parties, customers and the FDIC will incur, and their potential to significantly disrupt existing relationships and stifle new ones. Further, any significant revisions to the notice and application processes should be accompanied with an explanation as to why existing mechanisms under the 2021 Rule that enable the FDIC to require additional information from an applicant, to require the applicant to reapply for approval or to revoke a primary purpose exception previously granted,[100] are insufficient to address the FDIC's concerns.

a. Providing that only IDIs may submit notices and applications for the primary purpose exception will pose serious challenges, risks and costs for IDIs, which may also have adverse consequences on consumers

Under the 2021 Rule, notices and applications relating to the primary purpose exception may be submitted by either an IDI or a third party that is involved in the placement of deposits.[101] The proposed rule would permit only IDIs to submit primary purpose exception notices and applications.[102] This requirement would significantly increase the costs and risks for IDIs, although, as discussed below, any offsetting benefits are speculative and attenuated.

The proposed notice and application processes would require IDIs to obtain information that often is exclusively within the possession of third parties. For example, any notice or application regarding the broker-dealer sweep exception necessarily would include information regarding the broker-dealer or investment adviser's total assets under management and the percentage of its assets under management that are placed as deposits with IDIs. Where an additional third party is involved, applicants are required to submit a more detailed application that includes "copies of contracts relating to the deposit placement arrangement, including all third-party contracts",[103] including contracts to which the IDI may not be a party. Not only does the nature of the information require IDIs to expend resources in gathering information from the

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[99] *See* 2020 NPR Comment Letter at 12 (attached hereto as Appendix B).

[100] *See* 12 C.F.R. §§ 303.243(b)(3)(ii), 303.243(b)(3)(vi), 303.243(b)(4)(ii)(K), 303.243(b)(4)(iii).

[101] 12 C.F.R. § 303.243(b).

[102] Proposed 12 C.F.R. § 303.243(b).

[103] 89 Fed. Reg. at 68270.

third party, but the third party may also be reluctant to share with IDIs information the third party deems to be commercially sensitive. Because most of the information required to be included with a notice or application for the primary purpose exception will originate from the third party, IDIs may be unable to prepare complete and reliable notices and applications in a timely manner.

In addition, under the proposed rule, an IDI that submits a notice is required to notify the FDIC if any business line that is the subject of the notice no longer meets the applicable designated business exception, and an IDI that submits a notice under the proposed broker-dealer sweep exception is also required to provide quarterly updates to the FDIC.[104] These requirements not only place significant additional burden on IDIs by requiring essentially that the IDI continuously gather information from third parties involved in the placement of deposits at the IDI, but also places a compliance burden on the IDI to constantly monitor the third party's business line based on information to which the IDI does not have immediate access and which the IDI does not have the ability to confirm is accurate. Because the proposed rule does not include any ability for the IDI to rely in good faith on information provided by third parties, the IDI would thus be at risk of failing to comply with its reporting obligations through no fault of its own.

In addition to the costs discussed above, IDIs currently do not have the operational capacity to prepare and submit the volume of notices and applications, and related reviews and updates, that would be required under the proposed rule, and would incur significant additional costs in building such operational capacity. Although IDIs currently conduct good faith due diligence over the notices and applications prepared and submitted by third parties under the 2021 Rule, being the principal preparer of the notices and applications involves greater logistical obstacles. IDIs would need to develop new processes and procedures to gather information from third parties, conduct due diligence to confirm the accuracy of such information to the extent possible and monitor third parties on an ongoing basis, all of which will require significant time and resources.

The FDIC has also underestimated the amount of time that would be required for IDIs to complete the required notices and applications. For instance, the NPR estimates that a notice for the broker-dealer sweep exception will take three hours of labor to complete and that a broker-dealer sweep application will take ten hours of labor to complete.[105] However, a survey conducted by BPI among its member banks found that BPI's member banks, when weighted by their estimated value of affected deposits, expect to spend an average of 82 hours of labor to complete each primary purpose exception notice and application.

Third parties will also face significant costs in working with IDIs to provide information to prepare notices and applications. Under the 2021 Rule, a third party could file a single application for itself on which IDIs could then rely. However, under the proposed rule, the third party will need to provide a significant amount of information to each IDI with which it does business, thereby substantially increasing the third party's costs. Furthermore, it is likely that the third parties will pass along all or most of these additional costs to the IDIs. These costs and the number of applications that IDIs will be required to submit were grossly underestimated

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104 Proposed 12 C.F.R. §§ 303.243(b)(3)(vi)–(vii).

105 89 Fed. Reg. at 68262.

in the NPR's cursory costs-benefits analysis,[106] as discussed in more detail in Section IV.D.2 below.

Due to the administrative burdens, costs and risks associated with submitting a notice or application for the primary purpose exception, IDIs may decide to forgo pursuing a deposit placement arrangement with a new third party, which would require a new application. Instead, IDIs may decide to transact only with third parties with whom the IDI has already received an approval, given that in those circumstances, the IDI's only additional obligation would be ongoing reporting obligations, if any, required by the FDIC as part of its approval. The skewed incentives created by the proposed rule would thereby limit competition and potentially increase an IDI's reliance on a smaller number of third parties.

The potential benefits of allowing only IDIs to file notices and applications are speculative and, in any event, outweighed by these significant costs. The FDIC cites to gaps in existing applications and some IDIs inaccurately relying on third-party approvals that did not apply to the IDI's particular deposit placement activity with the third party.[107] However, the FDIC does not explain why the FDIC's existing ability under the 2021 Rule to monitor these relationships, including the ability to require additional information from an applicant, require the applicant to reapply for approval and revoke a primary purpose exception previously granted,[108] is insufficient to address the FDIC's stated concerns. In addition, the FDIC does not explain why less extreme alternatives are insufficient to address the FDIC's concerns. For example, the FDIC could include IDIs in all channels of communication between a third-party applicant and the FDIC, which could increase the IDI's understanding of the particular exception sought and also buttress the IDI's due diligence of the relationship. In another attempt to propose an overbroad solution to a narrow concern, the proposed rule would discard a more tailored process established under the 2021 Rule in favor of an onerous, one-size-fits-all approach requiring all notices and applications to be submitted by IDIs. The proposed solution significantly magnifies costs for all parties with no clear benefit.

For these reasons. BPI continues to urge the FDIC to eliminate any mandatory notice or application process for designated business exceptions and instead adopt a framework that consists of (1) bright-line criteria that banks may independently apply and (2) a supplementary voluntary application process for relationships that do not meet the bright-line criteria. However, if the FDIC retains mandatory notice and application processes in the final rule, it should retain the processes in the 2021 Rule. Further, if the final rule will not allow third parties to file notices and applications for themselves, the FDIC should, at a minimum, explicitly permit IDIs to rely in good faith on information provided by third parties and provide a conformance period that allows time for IDIs to build out the necessary processes to ensure that IDIs can acquire all necessary information from third parties.

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106 *See id.* at 68259–62, 68264.

107 *See id.* at 68254 ("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; these misunderstandings have contributed to problems with IDIs filing accurate Call Reports.").

108 *See* 12 C.F.R. §§ 303.243(b)(3)(ii), 303.243(b)(3)(vi), 303.243(b)(4)(ii)(K), 303.243(b)(4)(iii).

b. The proposed rule significantly lengthens the maximum period of review of both notices and applications by the FDIC, which would cause disruptions for IDIs, third parties and customers

Under the 2021 Rule, applicants could (1) immediately rely upon the applicable designated business exception upon the FDIC's receipt of notice and (2) have greater certainty that the FDIC would complete its review of a primary purpose exception application within a defined period of time. The proposed rule would, in contrast, allow applicants to rely upon the revised broker-dealer sweep designated business exception only if the FDIC has not disapproved the notice, and the FDIC would have up to a total of 180 days from the filing of a complete notice to disapprove the notice, with the ability for the FDIC to delay the process indefinitely because of the FDIC's unlimited discretion to determine whether a notice is "complete".[109] Applications (which, if the proposed rule is adopted, would be required any time an additional third party is involved in the arrangement) would be delayed even longer, as the proposed rule would grant the FDIC up to a total 240 days to review an application, and would also allow the FDIC to extend its application review period indefinitely even in circumstances where the FDIC has determined an application is "complete".[110] These changes would cause significant delays in IDIs and third parties establishing new relationships and may act as a deterrent entirely given the significant costs and substantial uncertainty.

The 2021 Rule's notice provision modernized and streamlined IDIs' and third parties' entry into specified designated business exception transactions. IDIs could conclude in good faith that the primary purpose exception was available, and immediate effectiveness of a notice helped give IDIs and third parties certainty and predictability when entering into new relationships. The FDIC fails to explain in the NPR why, despite retaining clear criteria for the broker-dealer sweep exception, IDIs must wait up to 180 days before they are able to rely on the exception, even in cases where compliance with the requirements of the exception is clear. If the objective is to remedy the gaps in information set forth in the notices as discussed in Section IV.C.1.a above, the FDIC does not make any effort to explain why its existing ability to require additional information from a notice filer or to revoke a primary purpose exception previously granted is similarly insufficient to remedy such gap.[111] In view of the significant costs such a delay would impose on IDIs and customers, the speculative and attenuated benefits of introducing this new system are far outweighed. The NPR fails to engage in an even rudimentary analysis of the costs and benefits.

Moreover, the FDIC's ability to extend the period of its review of applications indefinitely is unrealistic and completely disregards the significant uncertainty and delay that would be imposed on applicants. An IDI would have to manage the possibility of an indefinite review period each time it wants to establish a new but identical business relationship that cannot rely on a designated business exception. The large number of applications expected upon the proposed rule's effectiveness only heightens these concerns. The FDIC's lack of sufficient

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109 *See* Proposed 12 C.F.R. § 303.243(b)(3).

110 *See* Proposed 12 C.F.R. § 303.243(b)(4)(iv) ("The FDIC may extend the 120-day timeframe to complete its review of a complete application, if necessary, with notice to the applicant, for 120 additional days. *If necessary, the FDIC may further extend its review period.*") (emphasis added).

111 *See* 12 C.F.R. §§ 303.243(b)(3)(ii), 303.243(b)(3)(vi).

resources to timely process the expected volume of applications,[112] coupled with the ability to extend its review period indefinitely, risks creating a backlog of applications and undermining the value of the exception or, at worst, functionally eliminating the exception altogether. Such delay and uncertainty would have a catastrophic effect on well-settled business relationships.

A significant delay in IDIs' ability to rely on both the notice and applications also has adverse effects on the consistency and reliability of Call Reports. Because the proposed rule does not specify how IDIs should report deposits while a notice or application is pending, a lengthy waiting period could result in significant variances in the levels of brokered deposits reported on Call Reports from quarter to quarter depending on whether a notice or application is pending with the FDIC. Such variability will exist whenever an IDI enters into new business relationships with third parties as well. This volatility in reporting could reduce the reliability of Call Report data.

At a minimum, the final rule should allow for a notice or application to be approved automatically if the FDIC has not acted within a specified amount of time and, in any case, no more than 30 to 60 days. The final rule should also propose a maximum period for the FDIC's review of the applications that is based on a realistic assessment of the FDIC's ability to review and process the requested applications in a timely manner. Further, the final rule should clarify that IDIs would be permitted to report deposits subject to a notice or application as non-brokered during the period the notice or application is pending with the FDIC.

c. The final rule should include procedural protections for notice filers or applicants in the event the FDIC decides to revoke the exception in its sole discretion

Under the 2021 Rule, the FDIC is able to revoke a primary purpose exception in its sole discretion by providing a cursory notice.[113] The proposed rule would retain the same framework.[114] As we described in our 2021 NPR Comment Letter,[115] this framework significantly reduces the predictability of the brokered deposits regulation, as it does not require the FDIC to provide any reasoning or justification for the revocation and does not afford an IDI or third party an opportunity to respond. In order to preserve parties' expectations in establishing business arrangements and consistent with principles of due process, the final rule should, at minimum, (1) require the FDIC to include in any notice to revoke a primary purpose exception a detailed explanation of the FDIC's analysis for concluding that the applicable third party no longer meets the criteria to rely on the exception and (2) provide the notice filer or applicant no less than 30 days to respond to the FDIC's notice. The primary purpose exception

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112 *See* Statement by Travis Hill, Vice Chairman, FDIC, on the Notice of Proposed Rulemaking on Brokered Deposits Restrictions (Jul. 30, 2024) *available at* https://www.fdic.gov/news/speeches/2024/statement-vice-chairman-travis-hill-notice-proposed-rulemaking-brokered-deposit ("Given (1) the number of deposit arrangements that may be newly scoped in by the rule, (2) the more subjective standard by which the FDIC will judge applications, and (3) the lack of grandfathering of existing arrangements, I suspect an enormous avalanche of applications may hit the FDIC on day 1, which the agency is completely unequipped to process in any sort of timely or efficient manner.").

113 12 C.F.R. § 303.243(b)(3)(vi).

114 Proposed 12 C.F.R. § 303.243(b)(3)(viii).

115 *See* 2020 NPR Comment Letter at 15 (attached hereto as Appendix B).

should then be revoked only if the FDIC determines, after an adequate review of the response, that the applicable third party no longer meets the criteria to rely on the exception.

D. Grandfathering and Conformance Period

Notwithstanding the proposed rule's sweeping changes to the existing brokered deposits regulation, the FDIC did not provide for grandfathering of any existing relationships or a conformance period. Rather, the proposed rule would repeal all existing primary purpose exception approvals and implement all provisions of the rule with immediate effect. The result would be to disrupt many existing business relationships and to re-classify a significant amount of deposits as brokered, the consequences of which the FDIC has not attempted to quantify.[116] Even if the proposed rule is adopted, this extraordinary and unjustified approach must be modified.

1. Existing deposit relationships should be grandfathered

Deposit placement relationships previously entered into on the basis of the primary purpose exception or the exclusion for exclusive relationships under the 2021 Rule, and that have not been separately revoked by the FDIC for failing to continue to meet the standards set forth in the 2021 Rule, should be grandfathered under any final rule. Deposits resulting from these relationships should not be classified as brokered. IDIs and third parties have expended significant resources in establishing these relationships in reliance on the 2021 Rule, and elements of the relationships, such as prices charged to consumers, have been established on the basis that resulting deposits would not be classified as brokered. In addition, as described throughout this letter, the FDIC has provided no evidence that these existing relationships pose any significant or immediate risks that Section 29 was designed to address. Nevertheless, the proposed rule would disrupt each of these relationships by immediately implementing the revised definition of deposit broker and revoking all notices and approvals made under the 2021 Rule. Again, this is an excessively broad and blunt approach, and the FDIC ignores less disruptive alternatives.

In particular, grandfathering existing relationships would minimize disruptions to relationships that were entered into in good faith on the basis of the 2021 Rule, while allowing the FDIC to impose the final rule on new relationships. If the FDIC decides not to grandfather existing relationships, then, given the lengthy maximum period of review for both notices and applications under the proposed rule, the final rule should grandfather existing relationships at least until IDIs have sufficient time to submit notices or applications for each of their existing relationships *and* the FDIC has provided a final determination with respect to each such notice and application.

2. The final rule should not take effect for at least two years after it is adopted

As discussed above, notwithstanding good faith reliance on the FDIC's 2021 Rule, under the proposed rule, all notices and approvals for the primary purpose exception would be revoked with immediate effect. Each IDI that currently relies on a primary purpose exception would be required to reapply for the exception with respect to each deposit placement

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[116] *See* 89 Fed. Reg. at 68259–60 (noting that the FDIC "does not have the data to estimate the amount of deposits that would be reclassified as brokered by the proposed rule at particular IDIs, nor how many IDIs, if any, might make changes to the structures of their liabilities").

relationship it has with a third party.[117] Although the FDIC acknowledged that the proposed rule could result in a "significant increase in PPE applications from IDIs",[118] the FDIC grossly underestimated the number of notices and applications that would be filed. This stems from a significant error in using the number of notices and applications filed under the 2021 Rule as a proxy for the number of notices and applications the FDIC expects to be filed under the proposed rule. As an illustration, the NPR states:

- "The FDIC believes a reasonable proxy for the number of [broker-dealer sweep exception] notices under the proposed rule is the number of '25 percent test' exception notices the FDIC received under the [2021 Rule] for which it did not identify a potential third party";[119]

- "[t]he FDIC believes a reasonable proxy for the number of [broker-dealer sweep exception] applications is the number of "25 percent test" exception notices the FDIC received over the roughly three-year period since the effective date of the [2021 Rule] for which the FDIC believed a third party may be involved";[120]

- "[w]hile the FDIC does not have the information necessary to quantify the potential changes in filings by small IDIs that are likely to occur if the proposed rule is adopted, based on the number of filings received during the roughly three-year period since the [2021 Rule] became effective, the FDIC believes the effect is likely to be modest";[121] and

- "[t]he FDIC does not have the information necessary to quantify the potential changes in filings that are likely to occur if the proposed rule was adopted. Therefore, to quantify the effect of the proposed rule on filing activity, the FDIC made certain assumptions it deemed reasonable based on its experience with administering the [2021 Rule] . . . and relied on the number of filings it received under the [2021 Rule] as proxies for the number of filings it would receive under the proposed rule".[122]

Each of these statements is fundamentally flawed and reveals that the FDIC underestimates the number of notices and applications that would be required under the proposed rule. Looking to the number of notices and applications filed under the 2021 Rule as a proxy for the number of filings that will be made under the proposed rule ignores three of the proposed rule's most significant changes: First, because third parties will not be permitted to file a notice or application, relationships that involve a third party and more than one IDI will result in multiple, duplicative applications. For example, contrary to the FDIC's estimates, a sweep program in which a broker-dealer sweeps deposits to multiple IDIs will not result in one application but several. Second, the proposed rule would eliminate the enabling transactions

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117 *See id.* at 68254 ("[U]nder the proposal, primary purpose exception applications previously approved pursuant to the [2021 Rule] would be revoked. As a result, IDIs and third parties relying on previously approved applications would no longer be able to do so under the proposed rule. IDIs would be required to submit a new application to seek a primary purpose exception . . . ").

118 *Id.* at 68260.

119 *Id.* at 68262.

120 *Id.*

121 *Id.* at 68266.

122 *Id.* at 68261.

designated business exception, potentially resulting in at least one application for every existing relationship that relies on the exception. Where multiple IDIs have a relationship with the third party, multiple applications will be required instead of the single notice the third party is permitted to file under the 2021 Rule. Third, the proposed rule would eliminate the exclusion for exclusive relationships. The FDIC makes no effort to quantify these applications, but BPI believes this could result in a significant amount of applications.

BPI believes the FDIC will receive far more applications than it anticipates in the NPR. BPI shares the concerns of Vice Chairman Hill that the FDIC will not have the capacity to review all applications in a timely manner.[123] This could create a significant backlog of notices and applications, including for relationships that would clearly meet the criteria for a designated business exception. The effects of these delays may be further exacerbated by the FDIC's ability to extend the period of its review indefinitely under the proposed rule, as discussed in Section IV.C.1.b above.[124]

A conformance period would have additional benefits. For example, a conformance period would minimize volatility in Call Reports, which initially may experience large amounts of deposits being reported as brokered when the new brokered deposits framework goes into effect but then may be reported as non-brokered as applications are approved.

For these reasons, the final rule should not take effect immediately, but should include a conformance period of sufficient duration to permit IDIs to build the relevant operational capacity and prepare and submit all necessary notices and applications and for the FDIC to review all notices and applications. This is particularly critical if the FDIC does not adopt the foregoing recommendation to grandfather existing relationships. The conformance period should also allow time for IDIs to make any necessary adjustments to their businesses. BPI believes that, should the FDIC determine to adopt the changes in the proposed rule, a conformance period of at least two years is not only reasonable but is necessary to avoid the significant disruptions the FDIC does not appear to have contemplated. In addition, the FDIC should assess whether an even longer conformance period would be appropriate.

V. Additional Comments and Recommendations

A. The FDIC should exclude third parties from the "deposit broker" definition with respect to deposits placed by the third party with an affiliated IDI

Bank affiliates that generate deposits for the bank are engaged in the business of providing an integrated financial services solution that results in a direct relationship between the affiliated bank and the depositor. These affiliates are not engaged in the business of placing deposits or facilitating the placement of deposits, and therefore should not be classified as deposit brokers. Accordingly, the final rule should clarify that wholly owned subsidiaries of a bank's parent holding company are not engaged in the business of placing or facilitating the placement of deposits with respect to deposits they or their customers place with affiliate banks, and that these deposits, therefore, are not brokered deposits.

Banks and their affiliates frequently offer a full suite of financial services, including broker-dealer, investment advisory and trust services, to meet customer demand for a modern, "one-stop-shop" experience. In these cases, a bank's affiliates are not engaged in the business

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123 *See* Statement by Travis Hill, Vice Chairman, *supra* note 112.

124 *See* 89 Fed. Reg. at 68257.

of placing deposits or facilitating the placement of deposits, but rather are engaged in the business of providing a comprehensive and integrated financial services solution to its customers. The FDIC apparently shared this same view in promulgating the 2021 Rule, noting that the exclusion from the deposit broker definition for exclusive business relationships generally would be available for deposit placement arrangements between an IDI and its affiliates.[125] In addition, because an additional unaffiliated third party could be involved in the relationship between an IDI and an affiliate, the FDIC expressly excluded from the 2021 Rule's matchmaking prong affiliate deposits. Moreover, in the Deposits RFI, issued the same day as the NPR, the FDIC acknowledged, contrary to its assertion in the NPR, that "[i]ntercompany depositors also may have different incentives than unaffiliated depositors with respect to withdrawing funds" (*i.e.*, affiliate deposits may, in fact, be more "sticky" than unaffiliated deposits).[126] Based on our member banks' experiences, affiliate-generated deposits lack the characteristics associated with brokered deposits, and generally result from a bank's desire to establish a relationship, or to deepen an existing relationship, with the customer. As such, a bank affiliate in the context of such "one-stop shop" experience is not a "deposit broker".

Even if the FDIC views these deposits as brokered under the basic definition of deposit broker, the final rule should categorically exclude affiliates from the definition of deposit broker under the primary purpose exception. As discussed above, affiliates place deposits with their affiliated banks with the primary purpose of serving customers' holistic banking needs and providing customers and potential customers with access to a wide suite of banking and other financial services products. Their primary purpose is not the placement of funds with the affiliate IDI.

Similarly, employees of an IDI's affiliates, or employees of the IDI whose salaries are not paid primarily by the IDI, should remain excluded from the definition of deposit broker, even if a portion of the employees' compensation is related to referrals of customers that open deposit accounts with the affiliated IDI. In this scenario, the employee is engaged in referring customers to the affiliated IDI, which, for the reasons discussed in Section IV.A.1 above, should not cause the employee to be treated as a deposit broker. Further, even if deposits generated from such referral activity were properly classified as brokered, the employee's primary purpose in referring depositors to an affiliated IDI is fundamentally the same as the affiliate's purpose (*i.e.*, to provide a holistic financial services relationship to customers, rather than to engage in the business of placing deposits or facilitating the placement of deposits). Accordingly, even if such

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125 *See* 86 Fed. Reg. at 6748 ("Under this final rule, the deposit broker definition does not include third parties that have an exclusive deposit placement arrangement with one insured depository institution. As a result, the proposed expansion of the IDI exception to wholly owned subsidiaries is no longer necessary. This is because, under the proposal, in order to meet the IDI exception, a wholly owned subsidiary would have to place deposits exclusively with the parent IDI among other conditions. As such, wholly owned subsidiaries that would have met the proposed IDI exception will not meet the 'deposit broker' definition under this final rule because they have an exclusive deposit placement arrangement with one bank, their parent bank.").

126 89 Fed. Reg. 63948. The FDIC also states that "[b]ecause banks do not report these categories of uninsured deposits on the Call Report, the FDIC does not have historical data on banking industry trends for these types of deposits, including how depositors for these different types of deposits would behave under conditions of economic or liquidity stress." 89 Fed. Reg. 63948. The FDIC could, however, obtain this data, and, as discussed above, we do not believe it is appropriate for the FDIC to propose these changes to the brokered deposits regulation before obtaining and analyzing this data.

employees were considered to be engaged in the business of placing deposits or facilitating the placement of deposits, they should qualify for the primary purpose exception.

B. The FDIC should include designated business exceptions for activities that satisfy applicable statutory or regulatory requirements

The FDIC stated in the preamble to the 2021 Rule that "[t]he FDIC is aware of other deposit arrangements in which entities place deposits as required under federal or state law. While the FDIC does not have sufficient knowledge of such arrangements to grant designated exceptions for such arrangements in this final rule. . . [t]he FDIC will consider identifying specific such arrangements as designated exceptions in the future if warranted."[127]

We believe that the FDIC should codify a designated business exception for deposits that are placed pursuant to explicit statutory or regulatory requirements to safeguard certain funds. The primary purpose of establishing a segregated account in these circumstances is to comply with applicable legal or regulatory requirements, not to provide a deposit placement service or obtain deposit insurance coverage.

For example, in creating the exception for segregated customer accounts for futures commission merchants under the 2021 Rule,[128] the FDIC intended to preserve arrangements mandated by CFTC rules to protect customer funds. Similar to 17 C.F.R. 1.20(a) that is addressed in the 2021 Rule, 17 C.F.R. 1.20(g) (governing the treatment of futures customer funds by derivatives clearing organizations), 17 C.F.R. 30.7 (governing the treatment of customer funds used to margin, guarantee, or secure foreign futures and foreign options transactions) and 17 C.F.R. Part 22 (governing the treatment of cleared swaps customer collateral) each establish regulatory requirements to deposit customer funds and cash collateral, including at an IDI. However, these regulatory requirements are not currently granted a designated business exception.

Similarly, the primary purpose exception should apply to interest on lawyers' trust accounts ("IOLTA") deposits, which attorneys must establish for the benefit of their clients under applicable laws and professional rules in the state where the attorney practices. Attorneys are required to hold client funds in a segregated account, and, in some cases, are required to pool client funds into a segregated, interest-bearing account. The primary purpose of an attorney in establishing an IOLTA is to comply with applicable requirements, and not to provide a deposit placement service to an attorney's clients.

These examples are not exhaustive and there may be additional legal requirements for safeguarding certain funds, as well as future requirements that we currently cannot foresee that could result in IDIs having to submit numerous primary purpose exception applications in the future. BPI recommends that the final rule adopt a new designated business exception that generally covers deposits placed pursuant to explicit statutory or regulatory requirements, rather than direct references to individual rules. Such an approach would ensure that the designated business exception remains flexible and adaptable to future legislative and regulatory developments.

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127 86 Fed. Reg. at 6753.

128 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(viii).

C. The final rule should clarify the treatment of FDIC guidance introduced prior to the 2021 Rule

Because all interpretive guidance prior to the 2021 Rule was withdrawn by the 2021 Rule,[129] the proposed rule leaves many interpretive questions open without any guidance.[130] If the FDIC proceeds with the proposed changes, IDIs likely will need to submit a significant number of queries and requests for clarification similar to the lengthy Frequently Asked Question processes that occurred prior to the 2021 Rule, including fundamental questions such as whether a third party would be treated as a deposit broker and whether the IDI would need to submit a primary purpose application. This will further strain the FDIC's resources and create more uncertainty about the types of business relationships that may qualify for the primary purpose exception. Accordingly, the FDIC should clarify in the final rule the status of its advisory opinions issued prior to the 2021 Rule and should analyze whether it would be appropriate to reinstate any of its prior guidance.

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[129] 86 Fed. Reg. at 6759.

[130] *See, e.g.,* FDIC, Advisory Opinion No. 92-75 (Nov. 3, 1992, repealed on Apr. 1, 2021 by the 2021 Rule) (providing that more than 50 percent of an employee's compensation must consist of salary in order for the employee's compensation to be "primarily" in the form of a salary); FDIC, *Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits*, A5 (Jun. 30, 2016) (inactive) (providing guidance that a brokered nonmaturity deposit may be reclassified as non-brokered after a 12-month period if certain conditions are met).

* * *

We appreciate the opportunity to provide these comments and would welcome the opportunity to discuss them further with you. If you have any questions, please contact the undersigned by phone at [redacted] or by email at [redacted]

Respectfully submitted,

/s/

Tabitha Edgens
Senior Vice President,
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cc: Doreen Eberley
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Appendix A

2019 ANPR Comment Letter

May 6, 2019

Via Electronic Mail

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary

Re: Brokered Deposits (RIN 3064-AE94)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) advance notice of proposed rulemaking (ANPR)[2] addressing the FDIC's comprehensive review of its regulatory approach to brokered deposits. A fresh look at the brokered deposits framework is important and long overdue because of two major changes the financial services industry has experienced. The first is a revolution in technology, business practices and products since the FDIC's final brokered deposit regulations were issued in 1990[3] and the evolution over time of the FDIC staff's interpretive approach. The second is the expansion in the negative consequences of classification of deposits as brokered to include all banks and not just banks that are less than well capitalized.

Although the FDIC has provided guidance through the issuance of advisory opinions and frequently asked questions, the guidance in many cases does not accommodate market developments and technological advances in the delivery of financial services to customers, and, in certain cases, does not advance Congress' objectives. We believe that there is ample opportunity for the FDIC to clarify and significantly modernize its approach to brokered deposits through rulemaking, and our recommendations suggest a revised framework that would do so in a manner consistent with Congress' purpose in regulating brokered deposits and that promotes safety and soundness.

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1 The Bank Policy Institute (BPI) is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 84 Fed. Reg. 2,366 (Feb. 6, 2019).

3 FDIC, Unsafe and Unsound Banking Practices, Final Rule, 55 Fed. Reg. 39135 (Sep. 25, 1990).

I. Executive Summary.

Interpreting and implementing the language of Section 29 of the Federal Deposit Insurance Act (Section 29) is often complex, as in many cases Section 29 is made archaic by technological and business developments; it is therefore crucial that questions that arise under Section 29 are resolved through the prism of Congressional intent. The legislative intent of Section 29 is clear: to prevent so-called "hot money" from endangering insured depository institutions (IDIs) and the financial system by masking financial difficulties and enabling unsustainable, high-risk asset growth, particularly at banks that were undercapitalized.

Judged against this clear legislative intent, the FDIC's guidance is outdated and overbroad, resulting in the classification (or risk of classification) of a wide range of clearly stable deposits as brokered, even though such deposits have no connection to the gathering of "hot money" deposits at troubled institutions, which was the activity Congress targeted in enacting Section 29. Accordingly, our recommendations are designed to align the FDIC's guidance on brokered deposits with Congress' purpose in enacting Section 29. They allow the FDIC to remove stable deposits from the scope of those classified as brokered, while continuing to regulate classic "hot money" brokered deposits, with a particular focus on innovations in how banks gather deposits that have emerged subsequent to Section 29's adoption. Specifically, we recommend the following:

- The FDIC should not treat dual-hatted, dual and affiliate employees as "deposit brokers."
- The FDIC should revise its treatment of marketing and advertising relationships and referral arrangements to reflect innovations in technology and marketing methods.
- The FDIC should exclude affiliate-generated investment sweep deposits from classification as brokered.
- The FDIC should exclude deposits generated through operating subsidiaries from being classified as brokered.
- The FDIC should reconsider its treatment of deposits associated with prepaid cards.

In addition, the FDIC should address other negative consequences to well capitalized institutions that Congress did not intend to create when it implemented Section 29. Specifically, we recommend the following actions:

- The FDIC should support statutory changes that would treat fully-insured, long-term deposits as core deposits *regardless* of whether the deposits are brokered, and pending such legislation the FDIC should treat these deposits as core deposits for purposes of the FDIC's deposit insurance assessment calculations.
- The FDIC should revise Section 29's interest rate restrictions to reflect the actual market in which banks compete, and should not use interest rates as a proxy for risk in its supervision of IDIs.

II. Background.

Section 29, as implemented by the FDIC's regulations at 12 C.F.R. § 337.6, places restrictions on less than well capitalized IDIs accepting deposits that are obtained through "deposit brokers" and deemed to be "brokered deposits." Section 29 does not directly define the term "brokered deposits," but classifies a deposit as brokered if it

has been obtained by or through a deposit broker. The FDIC's regulations likewise define "brokered deposit" as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker." "Deposit broker" is defined in Section 29 and in the FDIC's regulations as "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."[4]

We recognize the FDIC's concern that deposits classified as brokered may have resulted in greater losses for the Deposit Insurance Fund (DIF) than would have been the case if failed banks had not held brokered deposits.[5] We are not aware, however, of any granular analysis that has attempted to distinguish among the wide variety of deposits that are (or might be) classified as "brokered."[6] The types of deposits, as discussed below, that we recommend should not be classified as brokered, are not likely to result in greater losses for the DIF because they are the result of stable relationships between a bank and its depositor, and are not likely to precipitate bank failures or contravene any other Congressional purpose in enacting Section 29.

We believe that the changes we recommend in this letter would not only better align the FDIC rules with the legislative intent underlying Section 29, but would also address the substantial and unnecessary costs imposed on banks and their customers as the result of an excessively broad scope of the definition of "deposit broker," and by extension "brokered deposits." Banks may be deprived of, or restricted in obtaining, valuable sources of liquidity due to the substantial additional costs of a deposit being classified as brokered. These costs may include higher deposit insurance premiums, requirements to maintain higher levels of high-quality liquid assets, higher capital planning costs and general reputational damage. If the FDIC continues its overbroad view of brokered deposits, bank customers will be deprived of the convenience provided by modern deposit-gathering channels, which will constrain banks' lending capacity.

A. Congress' purpose in promulgating Section 29 of the FDIA was to require increased regulatory scrutiny of "hot money" deposits.

Although there is no statutory definition of a "brokered deposit," the legislative history demonstrates that Congress enacted Section 29 in response to the so-called "hot money" that exacerbated the savings and loan crisis of the 1980s, when troubled institutions with deteriorating loan portfolios and "regulators . . . breathing down [their] throat[s]" would buy funds through third-party brokers as their "only chance for survival."[7] Congress noted that during the savings and loan crisis:

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[4] 12 U.S.C. § 1831f(g)(1); 12 C.F.R. § 337.6(a)(5).

[5] The ANPR states that of the 530 banks (excluding Washington Mutual) that failed and were put into receivership during the period 2007 – 2017, 47 (or about nine percent) relied heavily on brokered deposits (primarily DTC-listed master certificates of deposit for most of the banks) and caused losses to the DIF that triggered material loss reviews. 84 Fed. Reg. at 2,369 – 2,370. *See also* 84 Fed. Reg. at 2,388 (providing a statistical analysis of the FDIC's position that the use of brokered deposits results in higher loss rates to the DIF).

[6] Such a granular analysis is necessary because the fact that certain brokered deposits may have caused a high degree of loss does not mean that all (or even most) of the types of deposits classified as brokered contributed to that higher level of loss.

[7] Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (April 19, 1989).

> There [were] many ways to buy funds, but one way that is very much attributed to the difficulties of the organizations is their ability to go out and buy what they call brokered deposits. [To obtain brokered deposits, brokers will] go out and solicit . . . deposit investors and then go [offer them] to these bank and thrift institutions that have to have deposits to offset the runoff they have had in their core deposits, and these institutions issue certificates of deposit offering a return at a higher-than-market rate [because] they have to have the money.[8]

Senator Murkowski, one of the chief proponents of Section 29, noted that Section 29 was proposed in response to "[u]nsound institutions [that] financed their unrealistic growth by offering above market interest rates on CDs and marketing them nationwide through the use of a broker," and that these institutions used these "deposit proceeds to replace declining core deposits and make risky high yielding investments. As loans go into default, [these] institutions, no longer able to service the interest on the brokered deposits, return once again to the brokered deposit market to obtain liquidity."[9] The Senator also noted that Section 29 was intended to be a "*narrowly drawn* provision that specifically targets the *most flagrant abusers*."[10]

This legislative history demonstrates that Congress' principal concern was troubled institutions' reliance on "hot money" deposit brokers, *i.e.*, those brokers who, for the primary purpose of pecuniary gain based on the volume of deposits placed, actively placed deposits with higher-than-market interest rates on an unsolicited basis, with persons not necessarily having a previous relationship with the banking organization. In other words, these brokers were *engaged in the business of* (1) placing funds, or (2) facilitating the placement of funds. They were not acting to provide customers or potential customers with access to a range of banking and affiliate products, to generate banking relationships, provide access to demand deposit services or generate deposits that have the basic characteristics of core deposits. In the case of brokered deposits, the customer's relationship was with the deposit broker, who was seeking to place the funds at whatever IDI was then offering high interest rates, and not with an IDI selected by the customer.

B. The FDIC's guidance is outdated and results in the classification of far more sources of deposits as brokered than Congress intended.

Over the last nearly three decades, the FDIC has issued a number of advisory opinions, which the FDIC summarized in a series of frequently asked questions issued in 2015 and revised in 2016.[11] The vast majority of the interpretations on which the FAQs are based were issued in the late 1990s and early 2000s—prior to significant advances in business and banking practices and technology. Since the advent of diversified financial services firms, customers often prefer that banks provide a "complete package" of services or a "one-stop shop" experience that includes a number of products and services offered by the IDI and its affiliates, such as not only deposit and loan products, but asset management, broker-dealer services, and insurance products. Because of this transformation, including the development and widespread adoption of online, mobile and digital banking, and the resulting customer

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8 *Id.*

9 Insured Brokered Deposits and Federal Depository Institutions, Hearings before the Subcommittee on General Oversight and Government Investigations of the House Committee on Banking, Housing, and Urban Affairs at 8, Cmte. Print 101-28, 101st Cong., 1st Sess. (May 17, 1989) (remarks of Sen. Murkowski).

10 *Id.* at 10 (emphasis added).

11 FIL-42-2016, Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits (June 30, 2016, revised July 14, 2016) (referred to herein as the "FAQs").

demand for efficient, cost-effective access to banking and financial products and services, in many cases, customers do not open accounts with IDIs in person, but instead do so over the Internet or through other mobile channels.

Notwithstanding Congress' intended objective of Section 29, and the statutory language and legislative history that indicate the definition of "deposit broker" was intended to apply only to those entities *engaged in the business* of either (1) placing funds or (2) facilitating the placement of funds, the FAQs are drafted broadly and arguably capture in the definition of "deposit broker" virtually *any third party*—even an affiliated third party—with almost *any* connection to the depositor in question. For example, the FAQs provide: "When a third party takes *any* actions that connect an [IDI] with depositors or potential depositors, the third party may be 'facilitating the placement of deposits.' Hence, the third party may be a deposit broker."[12]

As a result, the scope of deposits the FDIC has indicated are "brokered" has been significantly expanded beyond what Congress envisioned. Although this overly broad interpretation of the definition of "deposit broker" has long been a concern for banks, in recent years the issue has become increasingly acute. Specifically, because the FDIC's regulations and guidance have not kept pace with technological innovation, market developments and consumer preferences, there is a significant risk that a large amount of deposits that are in fact stable could be classified as brokered simply because technology and business practices have enabled banks to implement more efficient methodologies for sourcing these deposits. These methodologies include some involvement of a third party, but the primary business of the third party is not the placement of deposits and/or its compensation is not tied to the balance of deposits placed or the balance of deposits in a client's account. In most cases, it is the IDI (and not the third party) that maintains a direct banking relationship with the depositor.

The consequence is that banks may forgo potential sources of stable deposit funding in order to avoid increasing the level of deposits they must report as brokered. This results in customers having fewer options for financial services and banks having less lending and earnings capacity. In addition, the lack of clarity has led to confusion and inconsistent treatment in the market regarding whether certain deposits are classified as brokered deposits.

C. An overbroad view of the classification of deposits as brokered results in significant adverse consequences for IDIs and customers.

The FDIC's broad interpretation of what constitutes brokered deposits has significantly expanded consequences for *any* institution that accepts deposits deemed to be brokered, not just those that are less than well capitalized. When Section 29 was enacted, the only real consequence to banks was what Congress intended—that is, to reduce the potential dangers of "hot money" by limiting the ability of less than well capitalized IDIs to accept these deposits and limiting the interest rate the bank could pay on deposits. However, the consequences of accepting brokered deposits are now much broader, and include adverse consequences that are entirely unrelated to the IDI's financial condition. None of these broader consequences is required or even contemplated by Section 29.

First, the amount of an IDI's brokered deposits can increase the IDI's deposit insurance assessment rate. Second, for a banking organization subject to the federal banking agencies' minimum Liquidity Coverage Ratio ("LCR")[13] requirement brokered deposits are automatically assumed to be volatile deposits and require the IDI to

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[12] FAQs question B2 (emphasis added).

[13] *See* 12 C.F.R. Part 329.

maintain an increased amount of high-quality liquid assets, even if such institutions are well capitalized.[14] Third, accepting brokered deposits requires IDIs to expend additional time and resources on capital and liquidity planning; for example, federal banking agency guidance indicates that IDIs that "rely upon" brokered deposits should incorporate PCA-related downgrade triggers into their contingency funding plans, because an IDI may not be able to renew or roll over existing brokered deposits or continue to accept brokered deposits upon such a downgrade and, consequently, may need to access other sources of funding.[15] Fourth, IDIs necessarily factor liquidity costs into the pricing of product offerings that would result in brokered deposits (*e.g.*, prepaid card products), preventing IDIs from offering competitive pricing compared to non-bank competitors, and thereby reducing the number and variety of products and pricing options available to consumers. Fifth, because of the previously discussed consequences that result from accepting "brokered deposits," an IDI often will choose to forgo stable sources of deposits that the FDIC may classify as brokered, reducing the IDI's lending capacity and earnings.

Although each of these consequences may be appropriate for deposits that are in fact volatile and unstable,[16] an overly inclusive definition of brokered deposits has the effect of penalizing banks for accepting certain deposits that are stable and share other characteristics with traditional "core" deposits. Indeed, because the FDIC's approach has had the effect of limiting a bank's access to stable deposit funding solely because of the manner in

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[14] For example, brokered deposits for retail customers or counterparties that are not reciprocal brokered or brokered sweep deposits are assigned a 100 percent outflow rate if they mature within the LCR's 30-day window; reciprocal brokered deposits and brokered sweep deposits are assigned outflow rates of 10 percent, 25 percent and 40 percent depending, in part, on whether the entire amount of the deposit is covered by deposit insurance; but retail deposits that are not brokered deposits are assigned outflow rates of only three percent or 10 percent.

In addition, brokered deposits are assumed to be less stable under the proposed Net Stable Funding Ratio ("NSFR") requirement. Under the NSFR, brokered deposits generally receive lower Available Stable Funding ("ASF") factors than other deposits. For example, retail brokered deposits generally receive an ASF factor of 90 percent, 50 percent or zero percent depending on a number of factors including the remaining maturity of the deposit, while stable retail deposits that are not brokered are assigned an ASF factor of 95 percent regardless of maturity. *See* 81 Fed. Reg. 35,124 (June 1, 2016). Assigning lower ASF factors to brokered deposits would result in banks being required to hold additional stable funding to offset the decrease in the banks' total ASF, notwithstanding that many categories of brokered deposits behave in the same way as stable retail deposits or other types of deposits assigned higher ASF factors than similar brokered deposits.

We note that, under the LCR requirement, brokered sweep deposits are treated as volatile sources of funding even if they are excluded from the definition of "deposit broker" under Section 29 (*e.g.*, because of the primary purpose exception). The proposed NSFR shares definitions with the LCR and thus would similarly apply lower ASF factors to brokered sweep deposits. This treatment of sweep deposits results from a broader philosophy of treating all brokered deposits as risky and volatile sources of funding notwithstanding that, for reasons discussed in this letter, many of these deposits are in fact stable and do not implicate the concerns raised by Congress in enacting Section 29. For these reasons, the FDIC (and other regulators) should also revisit the treatment of brokered sweep deposits under the LCR and proposed NSFR.

[15] *See* Interagency Policy Statement on Funding and Liquidity Risk Management (March 17, 2010), at 13, *available at* http://www.federalreserve.gov/boarddocs/srletters/2010/sr1006a1.pdf. This could also have the effect of creating a false alarm, forcing the IDI into remedial actions that are not merely unnecessary but that could precipitate undue marketplace concerns.

[16] For example, in the adopting release for the LCR final rule, the banking agencies noted that "brokered deposits are more easily moved from one institution to another, as customers search for higher interest rates" and that "brokered deposits have the potential to exhibit greater volatility than funding from stable retail deposits." (79 Fed. Reg. 61,440, 61,491 (Oct. 10, 2014).)

which a bank's customer first comes into contact with the bank, banks elect not to take advantage of marketing or referral arrangements and other partnership opportunities that would generate a lasting, personal relationship with the depositor and more broadly deepen the customer's relationship with a financial services organization. For example, as discussed in greater detail below, banks may choose not to accept deposits referred by their broker-dealer or other affiliates because of the potential treatment of such deposits as "brokered," notwithstanding that these deposits are referred to the bank as part of a "one-stop," holistic financial services solution that provides greater convenience for consumers and strengthens the relationship between the bank and the depositor.[17] Similarly, banks may be reluctant or unwilling to partner with commercial firms to develop mobile applications or to market deposits through the Internet and other mobile channels, even though these efforts create direct customer relationships between the bank and the depositor and strengthen those relationships by providing better services to, and more convenience for, the bank's customers. Banks' ability to partner with other companies also may be limited. For example, offering consumers a centralized method for viewing balances and effectuating transactions across accounts may cause the deposits in the account to be deemed to be brokered if a third-party partner has continued access to deposit account or other information for purposes unrelated to the deposits (*e.g.*, marketing or data analytics).[18] These inefficiencies are particularly acute in light of innovations in how other financial products, such as loans, are offered and marketed to consumers, resulting in asymmetric customer experiences and a lack of transparency and convenience.

None of the relationships described above involves the true deposit "broker" that Congress was seeking to curtail. And none of these relationships produces the "hot money" that was the focus of Congressional concern.[19]

III. The FDIC should reconsider and modernize its treatment of various third parties that currently are or may be classified as deposit brokers as a result of the FDIC's historic interpretative positions.

The FDIC staff's interpretations of Section 29 have strayed far from Congress' original purpose. As part of its comprehensive review of its brokered deposits regulations, the FDIC should revise the regulations and guidance to accommodate technological developments and modern banking practices, and, more generally, to be consistent with the Congressional purpose underlying Section 29.[20] The FDIC has the flexibility under the existing statute to

[17] Even the FDIC has recognized that deposits generated through affiliates are likely to be stable, and do not behave like volatile brokered deposits that the FDIC believes are more likely to leave for higher interest rates or when the bank is under stress. (*See infra* note 33 and accompanying text.)

[18] *See, e.g.*, FDIC Advisory Opinion No. 93-30 (noting that a factor in determining if an affinity group is "facilitating" the placement of deposits, and is, therefore, a deposit broker, is whether the group "know[s] which members have made deposits with the [b]ank, . . . [or] keep[s] any records of the amounts, rates or maturities of the deposits"). It is not clear whether the FDIC would deem such continued access to be facilitating the placement of deposits through "active marketing" and, therefore, as resulting in brokered treatment. *See* FAQs question B8 (indicating that "active marketing" results in brokered deposits).

[19] To ensure consistency across regulations, the FDIC (and other regulators) should reflect any changes to the FDIC's treatment of brokered deposits in other regulations that reference "brokered deposits."

[20] We note that the FDIC has authority to revise its interpretations of Section 29, and will be afforded deference in doing so, as long as it provides a "reasoned analysis" for its revised positions. *See Motor Vehicle Manufacturers Ass'n of the United States v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983). The developments in technology and business practices that have occurred since Congress enacted Section 29 provide the FDIC with sufficient justification to revise its prior interpretations.

revisit its interpretations, and should (1) recognize that the involvement of a third party in placing, or facilitating the placement of, deposits does not cause that party to be a deposit broker where the party is not "engaged in the business" of a deposit broker, and (2) re-evaluate the FDIC's views of the statutory exceptions to the definition of "deposit broker," including the "primary purpose" exception, such that the exceptions are consistent with Congress' intent and thereby available for a broader array of activities of third parties. Unless those exceptions are so interpreted, the restrictions will not be "narrowly drawn."[21]

With respect to the definition of deposit broker, the FDIC states in the ANPR that a deposit broker is a third party who "is in the business of either (1) placing funds, or (2) facilitating the placement of funds . . . of another third party (such as its customers)."[22] We fully endorse this reading of Section 29 and the FDIC's regulatory definition, and believe that the words "engaged in the business of" in the statute and regulation should be given meaning.

In many cases, however, staff Advisory Opinions have seemingly ignored the important statutory concept that a deposit broker is one "engaged in the business" of placing deposits or facilitating the placement of deposits. For example, in a 2017 Advisory Opinion, after quoting the statutory and regulatory definition of "deposit broker," FDIC staff nonetheless stated, "Based on the information provided in your letters, the companies you describe appear to be placing or facilitating the placement of deposits at the Bank and would therefore meet the definition of deposit broker unless covered by one of the statutory or regulatory exceptions," apparently without any consideration of the statutory and regulatory element of the definition of a deposit broker as one "engaged in the business of."[23] Similarly, in a 2016 Advisory Opinion, after quoting the definition of "deposit broker," staff went on to state, "The term 'facilitating the placement of deposits' is interpreted broadly to include actions taken by third parties to connect [IDIs] with potential depositors."[24] This interpretation again appeared to disregard completely the important concept of a deposit broker as one *engaged in the business* of placing deposits or facilitating the placement of deposits.

The FDIC's interpretations have also expansively construed the term "facilitating" to include virtually any action that makes it easier for a customer to make a deposit unless the FDIC has taken a position to the contrary. In a 1992 Advisory Opinion, FDIC staff stated that "[Section 29] covers scenarios where the broker 'facilitates the placement of deposits' . . . . In common usage, the term 'facilitate' means 'to free from difficulty or impediment; to make easy or less difficult.'"[25] This interpretation is inconsistent with the legislative history of Section 29, which demonstrates that Congress intended Section 29 to apply not to those who take any action to make the placement of any deposit easier, but to those who are engaged in the business of facilitating the placement of "hot money" deposits. Literally applied, such an interpretation of Section 29 also leads to absurd results. For example, companies that provide ATMs for lease to banks make it easier for customers to make deposits by providing account access at any hour through the ATM. Similarly, the postal service makes it easier for customers to make deposits by transmitting mail-in deposits. Clearly, such entities are not deposit brokers. "Facilitate" must therefore be read more narrowly than the FDIC set forth in its 1992 Advisory Opinion, *i.e.*, it must be read to mean something other than simply "to make easy or less difficult." Based on the legislative history and rational statutory construction, the term

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[21] *See supra* note 10 and accompanying text.

[22] 84 Fed. Reg. at 2,371.

[23] FDIC, Advisory Opinion No. 17-02 (June 19, 2017).

[24] FDIC, Advisory Opinion No. 16-01 (May 19, 2016).

[25] FDIC, Advisory Opinion No. 92-79 (Nov. 10, 1992).

"engaged in the business of facilitating" is more properly read to refer to acting as something akin to a classic broker of deposits by actively steering clients to IDIs, with which such clients have no previous relationship, to place funds in high-interest-rate accounts, and not simply to taking any action that would make it easier for customers to place, or for banks to raise, deposits.

As a result of the FDIC's interpretations, the definition of "deposit broker" has historically been construed so broadly that any deposit to which any third party has any connection is potentially deemed to be brokered. For the reasons described above, this is inconsistent with both the plain statutory language and with the statute's purpose, and the FDIC should, as it did in describing a deposit broker in the ANPR, view only third parties that are *engaged in the business* of (1) placing or (2) facilitating the placement of deposits as deposit brokers.

In order to assure that the application of Section 29 would be limited "to the most flagrant abusers,"[26] Congress chose to exclude certain persons from the definition of deposit broker, including those persons acting as an agent or nominee and whose primary purpose is not the placement of deposits with IDIs. That is, Congress limited Section 29 to the type of "business" that exacerbated the savings and loan crisis, namely persons whose "primary" purpose was to place (or facilitate the placement of) "hot money" deposits. Notwithstanding the criticality of the primary purpose exception and the breadth and clarity of the statutory language, the FDIC has historically taken such a narrow view of its availability, with no apparent basis, as to render it largely unavailable. Indeed, in the 2015 version of the FAQs, the FDIC went so far as to expressly state this:

> [T]he primary purpose exception applies only infrequently and typically requires a specific request for a determination by the FDIC. On those rare occasions when [the primary purpose exception] may apply, the FDIC may also impose restrictions on the activity involved, routine reporting requirements, and regular monitoring. These conditions may be critical to the primary purpose exception determination.[27]

Although the FDIC revised the FAQs to state instead that "the FDIC considers each request to review and interpret [the primary purpose] exception on a case-by-case basis,"[28] the 2015 version of the FAQs appears to demonstrate an underlying FDIC view that was modified only after industry comment objecting to that original statement of policy as contrary to the statute and the FDIC's regulations.

Unfortunately, the change in wording did not produce any meaningful change in the FDIC's approach. The FAQs provide little guidance on the application of the primary purpose exception. In fact, other than narrow examples relating to prepaid cards used to deliver corporate rebates or funds to beneficiaries of government programs, all other guidance on the primary purpose exception in the FAQs describes circumstances where the exception is <u>not</u> available.[29] The ANPR notes that in determining whether a third party is "engaged in the business of" placing or facilitating the placement of deposits, and therefore within the definition of a deposit broker, staff considers whether the third party receives volume-based fees and whether the fees can be justified as solely compensation for administrative or similar services.[30] In then discussing the availability of the primary purpose

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[26] *See supra* note 10 and accompanying text.

[27] FIL-2-2015, Guidance on Identifying, Accepting and Reporting Brokered Deposits (Jan. 5, 2015) at question E6.

[28] FAQs question E9.

[29] *See* FAQs questions E10 through E14.

[30] 84 Fed. Reg. at 2,371.

exception, the ANPR notes that the staff considers exactly the same factors. Thus, the very factors that make a third party a deposit broker, in the staff's analysis, render the primary purpose exception unavailable, thereby eviscerating the exception. In our view, this is not a reasonable interpretation of the statute. For the reasons we discuss in more detail below, the FDIC's highly restrictive view of the primary purpose exception needs to be revisited.

We discuss below five issues of particular concern for BPI:

- the treatment of dual, dual-hatted and affiliate employees;
- the FDIC's treatment of marketing and advertising relationships and referral arrangements;
- classification of affiliate-generated sweep deposits;
- classification of deposits generated through operating subsidiaries; and
- treatment of deposits associated with prepaid card programs.

A. The FDIC should not treat dual-hatted, dual and affiliate employees as "deposit brokers."

Since the promulgation of Section 29 and much of the FDIC's related guidance, banks have greatly expanded their affiliations with non-bank financial companies, largely as a result of customer preference and convenience. Concomitantly, IDIs have increasingly shifted to the use of dual employees (individuals employed jointly by the IDI and an affiliate of the IDI),[31] dual-hatted employees (individuals employed exclusively by the IDI but who perform services for an affiliate of the IDI)[32] and/or affiliate employees (individuals employed exclusively by an affiliate of the IDI) (as permitted under applicable regulation) and frequently share office space with their affiliates. These arrangements allow IDIs and their affiliates to provide customers with a complete financial services experience as well as enabling those services to be provided in a more personally tailored and cost-efficient manner. For example, an IDI employee who is also licensed with an affiliate broker-dealer may sell securities to clients and recommend deposit products.

None of these three employee arrangements is covered by the basic definition of "deposit broker" in Section 29. Under the plain meaning of Section 29, the definition of "deposit broker" does not encompass deposits that result from customer assistance provided by dual or dual-hatted employees, or deposits referred from an affiliate employee, in connection with those employees' providing access to a full complement of banking and affiliate products, because such employees are not "engaged in the business" of either (1) placing or (2) facilitating the placement of deposits.

The Congressional and regulatory concerns with brokered deposits are inapplicable to the deposit relationships resulting from typical, ordinary-course customer interactions with dual, dual-hatted and affiliate employees. The deposit accounts that result from depositor interactions with such employees are generally due to the IDI's desire to establish a relationship, or to deepen an existing relationship, with the depositor. Indeed, as the FDIC noted in its 2011 Study, "[affiliate] referrals are *ancillary* to the affiliates' legitimate businesses and are usually based upon a relationship between the customer and the affiliate," and "because depositors have a relationship with

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31 *See* FAQs question E3.

32 *See* FAQs question E4.

an affiliate of the bank, these deposits may behave more like deposits where the bank itself has a relationship with the depositor, and thus may be more stable and less likely to leave for higher rates or when the bank is under stress."[33]

In the normal course, dual, dual-hatted and affiliate employees are not engaged in the business of an archetypal deposit broker, and, therefore, are not the "deposit brokers" envisioned by Congress. FDIC regulations could make it clear, however, that any departure from this norm would result in classification of the employee as a deposit broker. Stated differently, the general regulatory rule (or presumption) should follow the normal situation rather than the abnormal situation.

Excluding these arrangements from classification as brokered as a result of the basic definition of "deposit broker" cannot be voided by the fact that the literal language of the "employee" exception in Section 29 would not encompass most of these employment arrangements.[34] There is no indication in the statutory language or legislative history that the employee exception was actually intended to expand the definition of deposit broker by limiting the requirement that a deposit broker must be "engaged in the business" of either placing or facilitating the placement of deposits. Instead, the employee exception should be properly read as an exception that described the standard role of a bank employee at the time Section 29 was enacted.

If an exception were necessary for these types of affiliate employment arrangements (and the employee exception were not available, *i.e.*, because of the narrow definition of "employee"), the FDIC could apply the "primary purpose" exception to deposits placed by dual, dual-hatted and affiliate employees. Under Section 29, the term "deposit broker" does not include "an agent or nominee whose primary purpose is not the placement of funds with depository institutions." To qualify for the primary purpose exception, the person or entity placing deposits must satisfy two criteria: (1) the person or entity must be an "agent" or "nominee," and (2) the person's or entity's primary purpose must not be the placement of funds with depository institutions. Dual, dual-hatted and affiliate employees who place deposits on behalf, and at the instruction, of the customer as part of meeting the customer's broader financial needs, are, therefore, acting as the customer's agent with respect to such deposits.[35]

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[33] 2011 Study at 56-57 (emphasis added).

[34] Section 29 contains an exception from the definition of deposit brokers for employees, but contains a narrow definition of employee, which, because employees of the IDI may not be employed exclusively by the IDI or may frequently share office space with the IDI's affiliates, may often render the employee exception inapplicable to the employee relationships described above. Under Section 29 and the FDIC's regulations, employees of IDIs are not deposit brokers with respect to deposits placed at the employing IDI, if the employee:

- is employed exclusively by the IDI;
- receives compensation that is primarily in the form of a salary;
- does not share his or her compensation with a deposit broker; and
- has a specific place of business that is used exclusively for the benefit of the IDI.

[35] In some cases, such as in the case of an employee of an affiliate broker-dealer, there may be a formal agreement that explicitly sets forth an agency relationship.

In interpreting the "primary purpose" element of the exception, the FDIC has historically considered a number of factors. The FDIC has considered the structure of fees paid to the entity placing deposits, *i.e.*, whether fees are based (directly or indirectly) on the amount of deposits or the number of deposit accounts opened, and whether there is a formal or contractual agreement between the IDI and an entity to place or steer deposits to the IDI.[36] The ANPR notes that the FDIC has not considered the overall business purpose of the agent or the amount of revenue that the deposit placement activity generates, but instead has interpreted primary purpose to refer to the "primary intent" of the agent in placing the deposit, *i.e.*, whether the third party is placing a deposit for a substantial purpose other than to obtain deposit insurance coverage for a customer or provide a deposit-placement service to a customer.[37] In our view, this interpretation of the exception is overly narrow. Even assuming, however, a narrower reading of the exception, the primary purpose of dual, dual-hatted and affiliate employees is not the placement of deposits. These employees place deposits to serve customers' holistic banking needs and to provide customers and potential customers with access to a wide suite of banking and other financial services products, providing customers with information and solutions concerning a wide variety of financial products that may include an affiliate IDI's deposit offerings. As a result, the deposits generated through these arrangements serve to deepen the relationships between customers and the IDI and its affiliates, and do not exhibit the characteristics of "hot money" that Section 29 was intended to regulate.

Similarly, the FDIC staff's focus on fees is misguided in respect of employees. Compensation programs among different institutions vary widely and serve the organization's broader business purpose and culture. Scorecards of metrics tied to various relationships with a customer, referral fees or measures related to overall incentive compensation are just a few examples of compensation methodologies. In each of these cases, the primary purpose of the referral is the development and enhancement of the customer relationship, not the placement of deposits.

For these reasons, the FDIC should revise its regulations to clarify that dual, dual-hatted and affiliate employees are not engaged in the business of placing or facilitating the placement of deposits, *i.e.*, are not deposit brokers, unless they are employed by an affiliate whose primary business is the placement of deposits with IDIs.

B. The FDIC should revise its treatment of marketing and advertising relationships and referral arrangements to reflect innovations in technology and marketing methods.

IDIs frequently have the opportunity to work with third parties to market or assist with the marketing of their deposit products and to receive referrals. Under the FDIC's existing guidance, if the FDIC views the third party as taking an active role in assisting with deposit marketing, such deposits can frequently be deemed to be brokered unless an exception applies, particularly, the primary purpose exception. As an element of the highly restrictive approach to the primary purpose exception, the FDIC has suggested that this exception apparently is not available if the third party receives any volume-based fees[38] or markets deposits other than on a passive and indirect basis.[39]

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36 *See, e.g.*, 84 Fed. Reg. at 2,371.

37 *See, e.g.*, *id.* at 2,372; FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005).

38 *See, e.g.*, FAQs question B4 ("Some [IDIs] attempt to attract new depositors through advertising or referrals by third parties . . . in exchange for volume-based fees. In these cases the FDIC has taken the position that the third party is 'facilitating the placement of deposits' by connecting the [IDI] with new account holders. Hence, the third party is a deposit broker and the deposits would be brokered.").

39 FDIC, Advisory Opinion No. 93-71 (Oct. 1, 1993).

This approach ignores the basic statutory requirement that a deposit broker be "engaged in the business of" placing or facilitating the placement of deposits, and focuses entirely on compensation and the minutiae of marketing methods rather than the third party's actual business and the characteristics of the resulting deposits and relationships. In effect, the FDIC has conflated the very different concepts of marketing and brokerage, and thereby limited the opportunity for banks to establish long-term relationships built around deposits.

For example, in 1992, the FDIC staff found a deposit broker relationship to exist where affinity groups (i) endorsed an IDI's credit and deposit products, (ii) sold advertising space in their publications to the IDI at standard rates, (iii) allowed the IDI to include deposit solicitations in direct mailings to association members, (iv) placed brochure racks relating to the IDI's credit and deposit products in association offices, and (v) included information about the IDI's products in new member kits.[40] A 1993 Advisory Opinion issued in response to an "updated factual statement" regarding these same affinity groups refined the FDIC's guidance by focusing on placing brochure racks in the affinity group's offices and including information about the IDI's deposit products in new member kits. Because the FDIC deemed these activities to be "something other than 'passive and indirect' marketing activity," the associations were deemed to be deposit brokers because they facilitated the placement of deposits.[41] The FDIC later cited the 1993 Advisory Opinion as the source for its FAQ stating that production or distribution of an IDI's marketing materials could result in brokered deposits.[42]

These broad statements, effectively prohibiting any indirect referral or touchpoint, make it difficult or impossible to conclude that even the most tenuous connection between a potential customer and a third party does not at least raise the question of whether any resulting deposits are brokered. In each of these cases, the FDIC's guidance ignores that the depositor has created a stable, direct relationship with the IDI. In contrast to relationships with brokers of "hot money" deposits, a marketing or referral relationship results in direct relationships between an IDI and depositors, with the third party often having no ongoing relationship with the customer as it relates to the deposit accounts.

The FDIC notes in the ANPR that "in determining whether deposits placed through modern deposit placement arrangements are brokered, staff has looked to precedents involving the definition of 'deposit broker' and has attempted to consistently apply that analysis to these new products."[43] Unfortunately, this analysis has the effect of extending a very problematic and limited view of marketing relationships and reducing banks' ability to take advantage of modern methods of marketing and partnering with third parties to identify potential long-term, stable deposit customers. The concept in the existing guidance that marketing must be passive and indirect to avoid resulting in brokered deposits is, of course, nowhere found in Section 29. Ultimately, this constrains customer access to banking services and unfairly penalizes IDIs that use digital marketing methods and other marketing channels to highlight their services to potential customers.

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[40] FDIC, Advisory Opinion No. 92-79 (Nov. 10, 1992).

[41] FDIC, Advisory Opinion No. 93-71 (Oct. 1, 1993). This Advisory Opinion also clarified that the selling of advertising space in membership publications at standard rates would not cause the affinity groups to be deposit brokers.

[42] FAQs question B8 ("[An] endorsement cannot appear in promotional materials produced or distributed by the individual or the group [making the endorsement]. Rather, the endorsement must appear in promotional materials produced and distributed by the bank. Otherwise the individual or group providing the endorsement will be a deposit broker, and the deposits would be brokered.").

[43] 84 Fed. Reg. at 2,372.

Current technologies—including the Internet, mobile phones and social media—allow IDIs to reach new customers by marketing their products and services through the websites, applications, social media platforms and emails of marketing partners, advertisers and affinity groups. If the existing guidance is extended to deposits marketed using standard, current marketing methods, those deposits may be deemed brokered for three principal reasons:

- Internet advertising is based on pricing models such as cost-per-acquisition, which allows an IDI to generate cost savings by focusing advertising on those individuals with demonstrated or reasonably expected interest in the IDI's products and services, or residing in a relevant geographic market. These pricing models have no impact on the stability of the deposits generated. For example, IDIs can leverage a social media platform's data analytics capability to target their advertisements to a particular customer segment that may be more responsive to an IDI's products. In the cost-per-acquisition model, however, the deposits associated with these marketing channels may result in fees that are dependent on the number of accounts opened by a customer or the volume of deposits that result from customers clicking through to the IDI's website or mobile application;

- because the endorsement of the IDI is done through the marketer's or affinity group's website and/or email and by using the marketer's data or analytics, such endorsements may be viewed as "active" marketing, and, therefore as facilitating the placement of deposits; and

- if the marketing will be hosted on a marketer's website, or distributed through a podcast or other platform controlled by the marketer, many marketers will often seek to have a view on the style, look or messaging of a particular marketing campaign to provide visual and thematic consistency across the marketer's platform. Under the FDIC's existing guidance, particularly FAQs question B8, this could also be viewed as active, *i.e.*, unacceptable, marketing because the third party may be involved in the production process of the IDI's marketing materials.[44]

In these marketing arrangements, depositors establish and maintain their deposit relationships directly with the IDI. The third party is not involved in the deposit relationship other than to provide a marketing platform as described above, which represents marketing practices that have become standard in both the financial services industry and across the retail industry more generally. Nevertheless, for the reasons noted above, because of the FDIC's expansive guidance, many of these relationships could be viewed as resulting in brokered deposits.

In addition to the difficulty of applying the FDIC's guidance to modern marketing methods, banks face other difficulties in determining whether many marketing relationships result in brokered treatment. The FDIC has noted that "the most important factor used by the FDIC to determine when a particular affinity group is 'facilitating the placement of deposits'. . . has been whether the affinity group is engaged in active marketing on behalf of the bank."[45] Putting aside the question of whether the focus on "active marketing" is even appropriate, the FDIC has

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[44] FAQs question B8 provides that an endorsement "must appear in promotional materials produced and distributed by the bank. Otherwise, the individual or group providing the endorsement will be a deposit broker . . . ." It is unclear from the FDIC's guidance what degree of involvement a third party may have in the production of a bank's advertising before that party would be deemed to be a deposit broker, thereby creating additional difficulty for banks in analyzing their marketing and referral relationships.

[45] 2011 Study at 24.

provided little guidance on what constitutes "active marketing" versus "passive marketing," which leaves IDIs with no clear method for evaluating potential marketing partnerships and referral opportunities.

The FDIC's historical broad reading of the definition of "deposit broker" has caused banks to classify other sources of stable deposits as brokered as well. For example, banks may market deposits through non-profit groups that sponsor financial education or other programs that refer participants to the bank to open deposit accounts. The non-profit group may or may not receive a fee, or may have other relationships or programs with the bank. Depending on the particular arrangement, banks may be required to treat these groups as generating brokered deposits. This is despite the fact that the deposit accounts are opened directly with the bank, because such groups may be engaged in what the FDIC may conclude would be deemed to be "active marketing" of the bank's deposit products.

Another example of traditional sources of stable deposits that may be inappropriately captured by the FDIC's approach to evaluating marketing relationships is campus programs in which banking organizations partner with colleges and universities to offer student deposit accounts. Depending on the nature of the marketing relationship with the college or university and the fee arrangements, these programs may also be inappropriately captured by the FDIC's restrictive interpretations. These programs are not, however, focused on *deposit* acquisition, but rather are mainly focused on *customer* acquisition, with the intent to develop deeper banking relationships with students for which the accounts opened often represent their first entry into the banking system. New banking relationships with students typically result in low balance demand deposit accounts offered not for purposes of attracting a large volume of deposits, but to establish a robust customer relationship with individuals entering the banking system for the first time. In the ordinary course of business, banks may also work with other third parties to help banks identify and reach consumers to introduce them to deposit products. Section 29 should not be interpreted in a way that impedes banks' ability to engage in customer outreach to establish stable, traditional relationships with new customers.

Going to first principles, the notion that a third party's advertising a bank's selection of account and deposit offerings results in that third party being a deposit broker simply as a result of fees tied to whether or not a customer opens a deposit account—irrespective of the third party's overall business[46] or its relationship with the bank or the potential bank customer—is misguided. This is particularly so when one considers the deposit brokers at which the legislation was directed; namely, brokers who primarily marketed high-interest-rate retail certificates of deposit and/or so-called "Master Certificates of Deposit."[47] As noted in the ANPR, the FDIC identifies three primary concerns as relevant to the restrictions on brokered deposits:

- Rapid growth (*i.e.*, "the extent to which deposits can be gathered quickly and used imprudently to expand risky assets or investments");

- Volatility (*i.e.*, "the extent to which deposits might flee if the institution becomes troubled or the customer finds a more appealing interest rate or terms elsewhere"); and

[46] *See, e.g.*, 84 Fed. Reg. at 2,372; FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005) ("[T]he FDIC has taken the position that 'primary purpose' means 'primary intent.'").

[47] *See* 84 Fed. Reg. at 2,368.

- Franchise value (*i.e.*, "the extent to which deposits will be attractive to the purchasers of failed banks, and therefore not contribute to losses to the DIF").[48]

None of these is implicated in the scenarios described above.

Moreover, such an interpretation of the definition of deposit broker would have the perverse effect of automatically capturing a third party website on which a bank advertises its deposit accounts in exchange for fees tied to the number of accounts opened if visitors to the website click through to the bank's website and open accounts, *but with no possible exception available*.[49] Because web advertising models frequently are based on a cost-per-acquisition model, such fees arguably can be viewed as volume-based, particularly if, as is often the case, the website's or bank's analytics allow for measurement of whether the customer ultimately opens a deposit account. Considering the purpose of Section 29, this simply is not a reasonable construction of the statute.

An analysis resulting in a determination that the types of marketing and referral relationships described above result in brokered deposit treatment is based on guidance that cannot be applied to modern marketing methods. Under existing FDIC guidance, active marketing may not include selling advertising space at standard rates.[50] In contrast, active marketing does include a third party placing posters and brochure racks relating to an IDI's deposit products in the third party's office or endorsing an IDI's products in a publication produced or distributed by the party providing the endorsement.[51] It simply is not possible to apply these interpretations to modern marketing practices in a logical and consistent manner. For example:

- There may be no standard, flat rate that marketers charge for Internet advertising, but, as described above, one of the "standard rates" instead is arguably also a volume-based fee.

- Mobile and Internet-based marketing partners often require retaining some level of creative or other input on advertisements that they host on their platforms, but, based on existing guidance, IDIs cannot be sure if the FDIC will view this as the marketing partner "producing and distributing"

48 *Id.* at 2,369.

49 The primary purpose exception is only available to an "agent or nominee," and it is difficult to see how the third-party website is an agent or nominee of the depositor.

50 *See* Advisory Opinion No. 93-71 (Oct. 1, 1993) ("We do not regard the selling of advertising space in membership publications to be direct marketing of the [IDI's] products, particularly because . . . the [affinity groups] charge the [IDI] standard rates for the advertisements.").

51 *See Id.* ("[P]ermitting [an IDI] to place posters and brochure racks in [affinity groups'] offices and including information and materials on [the IDI's] deposit products in new member packets may constitute something other than "passive and indirect" marketing activity for the IDI. . . . Thus, . . . [the affinity groups] are acting as "deposit brokers" within the meaning of [Section 29] in connection with their relationship with the [IDI] . . . ."); FAQs question B8 ("[T]he endorsement [provided by a person or group] cannot appear in promotional materials produced or distributed by the individual or the group. Rather the endorsement must appear in promotional materials produced and distributed by the bank. Otherwise, the individual or group providing the endorsement will be a deposit broker, and the deposits would be brokered.").

> the bank's promotional materials and, therefore, as facilitating the placement of deposits through "active marketing."[52]

Moreover, the FDIC should not expand its guidance to classify deposits raised through such marketing efforts as brokered unless necessary to effectuate Congressional purpose.

Marketing partners of the kind described above are not engaged in the business of facilitating the placement of deposits, but as an incident to their actual business may advertise or endorse a variety of products to their members or the public. Any facilitation of the placement of deposits is merely incidental to their actual businesses. In other words, unlike the business of the archetypal deposit brokers that Section 29 was intended to capture, the business of marketing partners is not primarily to connect depositors with IDIs or to facilitate the placement of deposits, particularly the "hot money," above-market-rate certificates of deposits that concerned Congress, and the selling of advertisement services to an IDI and/or distributing an IDI's marketing materials are activities that are merely incidental to the primary business of marketing partners.[53] As a result, such marketing partners cannot reasonably be considered to be engaged in the business of placing or facilitating the placement of deposits, and, therefore, are not "deposit brokers" within the meaning of Section 29. For these, and other reasons discussed above, rather than attempt to apply its outdated guidance to modern marketing practices, the FDIC should clarify the application of Section 29 to these modern relationships.

The FDIC should exclude marketing and advertising partners (including affinity groups) that simply market deposits on behalf of, or otherwise refer potential customers to, IDIs from the definition of "deposit broker," regardless of the fee arrangement, unless such partners are, in fact, engaged in the business of either (1) placing or (2) facilitating the placement of deposits. The FDIC should similarly narrow its interpretation of "facilitating" to exclude marketing and referral partnerships that result in the customer entering into a banking relationship directly with the IDI.

C. The FDIC should exclude affiliate-generated investment sweep deposits from classification as brokered.

A sweep account consists of free cash balances in investment accounts, frequently held by an affiliate of an IDI, that are swept into a deposit account with the IDI. These deposits are typically placed as part of providing customers with holistic banking and investment solutions, and help to create deeper relationships between financial services firms and their customers. Under existing guidance, the FDIC has permitted sweep deposits to affiliate IDIs to be classified as non-brokered if (i) the swept funds did not exceed 10 percent of the total assets in the investment

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52 *See supra* notes 43 – 44 and accompanying text. The FDIC's current guidance does not prevent IDIs from "actively" marketing their own deposits through neutral channels such as television and radio or through proprietary websites, applications and/or social media platforms, and at least some distribution of advertising produced by the IDI clearly does not result in the advertiser being deemed to be a deposit broker. (*See, e.g.*, FAQ D3 ("A similar analysis [that does not result in the treatment of deposits as brokered] applies to communications companies (such as radio or television stations of Internet Web sites) that run advertisements for [IDIs]. If the advertising platform is operated in a neutral manner, so that any [IDI] could run advertisements, the FDIC would not treat the communications company as a deposit broker.").) However, in some cases it may not be clear to what extent advertisers may be involved in the production and/or distribution of advertising before they would be treated as being engaged in the "active marketing" of the IDI's deposits and, therefore, as deposit brokers.

53 Indeed, the business of some marketing partners, particularly affinity groups, involves connecting members and the general public to a wide variety of financial, and even more so, non-financial services.

account for consecutive months or for more than three months during any 12-month period and (ii) the fees paid were a flat per-account fee and were not dependent on the volume of deposits.[54] In the Sweeps Opinion, the FDIC noted that sweep deposits meeting these conditions were not brokered because the primary purpose of the registered broker-dealer providing the sweep feature to customers was not to provide a deposit-placement service, but rather to facilitate the trading of securities. The Sweeps Opinion itself does not distinguish between affiliated and unaffiliated programs; the FDIC, however, has subsequently indicated that the application of the primary purpose exception to sweep deposits is limited to affiliate programs.[55]

The Sweeps Opinion addressed whether a broker-dealer offering sweep deposits in connection with brokerage and similar investment accounts qualify for the primary purpose exception, assuming that these entities are deposit brokers.[56] However, in our view, the FDIC should not treat broker-dealer affiliates that offer sweep features on investment accounts as deposit brokers because they are not engaged in the *business* of placing or facilitating the placement of deposits, but of broker-dealer and similar investment activities. These entities place deposits as part of a single activity that is incidental to their business of managing funds that are held for investment, and are not engaged in the business of placing deposits, as Congress understood that business for purposes of Section 29.

Even if the FDIC views entities as being engaged in the business of placing deposits, they should not be considered to be "deposit brokers" by reason of the primary purpose exception without imposing the restrictions of the FDIC's Sweeps Opinion. As discussed above, an important exception from the definition of "deposit broker" is the "primary purpose" exception, and, to qualify for the exception, the person or entity placing deposits must satisfy two criteria: (i) the person or entity must be an "agent" or "nominee," and (ii) the person's or entity's primary purpose must not be the placement of funds with depository institutions. Under the plain meaning of this exception, deposits that affiliates place through a sweep feature should not be classified as brokered. Affiliates that offer a sweep feature on their brokerage or similar investment accounts typically are indisputably acting in an agency capacity, as they make investments and conduct other activities at the instruction of their clients.

In interpreting the "primary purpose" element of the exception, the FDIC has not considered objective standards such as the agent's overall business purpose or the percentage of total revenue that the deposit placement activity generates, but has instead interpreted primary purpose subjectively to refer to the agent's "primary intent" in placing the deposit. This subjective approach to interpreting the statute has resulted in an overly narrow application, and the conditions placed on sweep deposits for such deposits not to be classified as brokered are unnecessary and cause some stable deposits to be classified as brokered. The FDIC should revisit this approach, and should consider the affiliate's overall business purpose and the overall relationship between the affiliate and the

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[54] *See* FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005) (hereinafter referred to as the "Sweeps Opinion").

[55] *See, e.g.*, 84 Fed. Reg. at 2,372 ("[W]hen certain conditions are observed, the primary purpose of a broker-dealer in sweeping customer funds into deposit accounts at its affiliated IDI is to facilitate the customers' purchase and sale of securities. . . . The IDI is permitted to pay fees to the affiliated broker-dealer but the fees must be a flat fee . . . .").

[56] *See* Sweeps Opinion ("A 'deposit broker' is 'any person engaged in the business of placing deposits, or facilitating the placement of deposits . . .'. This definition is subject to several exceptions, including [the primary purpose exception]. In this case, the issue is whether X satisfies the 'primary purpose exception.' If not, then the funds placed by X at the affiliated banks will be 'brokered deposits.'").

depositor in evaluating the availability of the primary purpose exception. A plain reading of the statute compels this conclusion.

A fundamental canon of statutory interpretation is that words should be interpreted as having their plain meaning unless they are otherwise defined.[57] There is substantial precedent for interpretation of "primary" as "first" or "foremost," but there can be no possible debate that term means at least "one of the most important" or "substantial."[58] Therefore, based on even the narrowest plain reading of the primary purpose exception, the exception must be available to third-party agents or nominees unless one of the most important purposes of their overall business is to place deposits with IDIs. The legislative history further indicates that the main or principal purpose must not merely be to place deposits with IDIs, but to place volatile, "hot money" deposits with IDIs, and that is clearly not the case with sweep deposits.

Brokerage and similar investment accounts are primarily designed to provide for securities to be bought and sold on a fully paid-in basis or on margin, and are not designed to provide a deposit-placement service. The sweep feature is ancillary to these benefits, and is only relevant to serve as a short-term investment vehicle for funds that are uninvested or unused. The sweep feature is specifically designed to provide a return on, and access to, funds awaiting investment. In addition, the interest rate structure on the deposit accounts into which funds are swept are based on overnight market rates, not above-market, long-term contractual rates found in brokered certificates of deposit, which are indicia of the "hot money" deposits Congress intended to capture under Section 29, and customers are not incentivized to place more funds into the deposit account as opposed to other investments available through the brokerage or similar investment account.

As a result, affiliate sweep programs serve to deepen and create long-lasting relationships between the depositor and the IDI and its affiliates, and, therefore, do not exhibit the volatility that characterizes the brokered deposits Congress intended to restrict.

For these reasons, the FDIC should revise its regulations to permit an IDI's affiliates to sweep funds from brokerage and other investment accounts to the affiliated IDI, in connection with an overall product offering related to an investment purpose other than the deposit account (such as a securities brokerage account) and regardless of the percentage of total assets in the investment account represented by the deposits or the fee structure, without classifying such deposits as brokered, where there is a primary relationship between the affiliated financial services provider and its customer other than the placement of the deposits and the deposit account is an integrated part of the overall financial services product offering.[59]

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57 *See Perrin* v. *United States*, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.") (citation omitted).

58 *See, e.g., Malat* v. *Riddell*, 383 U.S. 569, 572 (1966) ("We hold that, as used in § 1221(1) [of the Internal Revenue Code of 1954], 'primarily' means 'of first importance' or 'principal.'"); *Thomas* v. *United States*, 758 F.Supp. 529, 540 (E.D. Mo., 1991) ("Primary is defined as meaning of first importance or principally . . . ."); *Marshall* v. *Burger King Corp.*, 504 F.Supp. 404, 409 (E.D.N.Y., 1980) ("[P]rimary is much more plausibly interpreted in its usual sense as meaning chief, principal, or first of several functions."); *Koehring Co.* v. *Adams*, 452 F.Supp. 635, 638 (E.D. Wis., 1978) ("The plain and ordinary meaning of the word 'primarily' is 'first' or 'foremost.'").

59 The FDIC should also review and consider revisions to its treatment of affiliates more broadly. As discussed in connection with affiliate-generated sweep deposits, broader affiliate relationships that provide customers a holistic, "one-stop" shop approach to financial services serve to deepen relationships between the depositor and the IDI and its

D. **The FDIC should exclude deposits generated through operating subsidiaries from being classified as brokered.**

The FDIC's existing guidance creates regulatory uncertainty with respect to the treatment of deposits placed by operating subsidiaries. Section 29 and the FDIC's regulations exclude from the definition of deposit broker an IDI, "with respect to funds placed with that [IDI]." However, as the FDIC notes in the ANPR, "for some purposes the subsidiary is treated as part of the parent IDI (*e.g.*, certain financial reporting); whereas for other purposes—such as the Bank Merger Act and for receivership purposes—they are treated separately."[60] The FDIC's guidance has not clarified whether operating subsidiaries that place deposits under an exclusive relationship with their parent IDIs are excluded from the definition of "deposit broker" under the IDI exception.

The FDIC has the flexibility to, and should, apply the IDI exception to further the Congressional purpose underlying Section 29 and the basic concept of an operating subsidiary. Operating subsidiaries of an IDI are under the exclusive control of the parent IDI, engage only in activities permissible for an IDI and are treated as a division of the IDI for the vast array of regulatory purposes other than the limited exceptions noted in the ANPR, which are for extraordinary, non-operating events.[61] Because the activities of operating subsidiaries (including generating deposits for a parent IDI) are activities in which the IDI could engage directly, deposits placed by operating subsidiaries (and their employees) with the parent IDI are essentially deposits generated by the parent IDI itself. Any other treatment that would characterize deposits placed by operating subsidiaries as brokered deposits serves no substantive purpose. Such treatment unnecessarily penalizes IDIs solely for their choice of corporate form (which may have been selected for operational efficiencies or other benefits) to carry out certain activities, and not because the deposits represent volatile, "hot money" deposits. For these reasons, the FDIC should revise its regulations to clarify that operating subsidiaries of an IDI are not deposit brokers with respect to deposits placed with the parent IDI.

E. **The FDIC should reconsider its treatment of deposits associated with prepaid cards.**

To date, the FDIC has not issued an advisory opinion relating to whether deposits underlying prepaid cards would be treated as brokered deposits. Under FDIC guidance provided in the FAQs, however, the FDIC views almost all deposits placed in connection with prepaid card programs (other than cards issued under certain benefit

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affiliates. Having these multiple touchpoints with a single customer through affiliate relationships is likely to reduce the probability that the customer will leave the IDI during periods of stress or to seek higher interest rates. As a result, these relationships do not result in the volatile deposits that Congress intended Section 29 to restrict.

[60] 84 Fed. Reg. at 2,372.

[61] *See, e.g.*, Office of the Comptroller of the Currency, Interpretative Letter No. 971 (Jan. 16, 2003) ("Because the activities of an operating subsidiary are limited to activities in which the parent bank could engage directly, an operating subsidiary is in practice a separately incorporated division or department of the parent bank. Thus, the OCC's standards in examining [operating subsidiaries] are the same standards that apply to OCC examinations of the Bank."); Board of Governors of the Federal Reserve System, FRB Interpretive Letter, 2000 WL 35539974, at *1 (Aug. 16, 2000) ("In 1968 the Board determined that . . . a state member bank may acquire the stock of an operations subsidiary, a company that engages only in activities in which the parent bank may engage directly . . . and subject to the same limitations as if the bank were engaging in the activities directly. The Board reasoned that such authority could reasonably be interpreted as within a bank's incidental powers to 'organize its operations in the manner that it believes best facilitates the performance thereof,' where the subsidiary essentially constitutes a separately incorporated division or department of the bank. The 1968 interpretation, therefore, . . . authorized state member banks to establish wholly owned operations subsidiaries, *since a wholly owned subsidiary is functionally indistinguishable from a division or department of the bank*.") (emphasis added).

plans or in connection with certain corporate rebate programs) as brokered.[62] Although the ANPR does not discuss the factors the FDIC considers when examining these relationships, based on the 2011 Study and the FAQs, it appears that the FDIC would generally determine prepaid deposits are not brokered only if the prepaid program is structured such that either (1) the IDI sells prepaid cards directly to the cardholders or (2) a third-party company places its own corporate funds with the IDI to be accessed by cardholders through cards that the company distributed as part of a rebate program.[63] In both cases, the FDIC appears to analyze whether a third-party agent or custodian is involved in placing the deposits.[64]

In the 2011 Study, the FDIC stated that "some [prepaid] deposits may qualify as brokered deposits while others may not."[65] The 2011 Study goes on to describe three scenarios, one of which results in brokered deposits.[66] The scenario that results in brokered deposits is described as a program that is structured such that a third-party card distributor acts as an agent for cardholders in placing or holding deposits at an IDI. The 2011 Study provided no legal analysis for this treatment, but simply concluded that this type of program would result in brokered deposits "unless the agent is covered by one of the exceptions to the definition of 'deposit broker' (such as the 'primary purpose' exception)."[67]

The FAQs assume the same conclusion as the 2011 Study, *i.e.*, that agents who distribute general purpose prepaid cards are deposit brokers, without providing any discussion of the issue or legal analysis of the reason for this result.[68] Even less credibly, the FAQs go on to state unequivocally that operators of general purpose prepaid card programs do not qualify for the primary purpose exception because "[t]he general purpose prepaid card and the deposit account are inseparable, in that the card is a device that provides access to the funds in the underlying

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62 *See* FAQs questions E10 – E13 (determining that general purpose prepaid card programs and certain programs involving a college's issuance of a prepaid debit card to its students result in the program manager being classified as a deposit broker).

63 2011 Study at 32; FAQs questions E13.

64 *See, e.g.*, 2011 Study at 32 ("In the absence of a third-party agent or custodian, the deposits held by the bank would not qualify as brokered deposits."); FAQ E13 ("[I]f a third party (not the corporation) is involved in the placement of the corporation's funds into the account at the [IDI], the third party would be a deposit broker."). The FDIC has also determined that certain deposits underlying funds disbursed to beneficiaries of government programs through prepaid cards are not brokered deposits. The primary purpose exception was determined to apply in these cases because the primary purpose of the government agency was "simply to discharge the government's legal obligations to the beneficiaries." FAQs question E14.

65 2011 Study at 32.

66 *Id.* According to the 2011 Study, the scenarios that do not result in brokered deposits include those where the IDI itself sells prepaid cards directly to cardholders or where a third party places its own corporate funds with the IDI to be accessed by cardholders when they use their cards at merchant point-of-sale terminals.

67 *Id.*

68 *See, e.g.*, FAQs questions E10 and E11, which discuss the application of the primary purpose exception to operators of prepaid card programs without ever addressing the necessary antecedent question of whether such parties are deposit brokers.

deposit account. Because of this relationship, prepaid card companies are not covered by the primary purpose exception."[69]

These interpretations of the "deposit broker" definition and the primary purpose exception are overbroad and exceedingly restrictive, respectively, and are not supported by either the plain language of the statute or the legislative history. In particular, the FAQs' interpretation of the primary purpose exception, *i.e.*, that the exception is not available where the deposit account is inseparable from the service being provided, is, for the reasons discussed below, inconsistent with the statutory language and the legislative history. Although the FDIC has never provided a public legal analysis for its conclusion that operators of general purpose prepaid card programs are deposit brokers, presumably this conclusion is a result of the FDIC's reading of the definition of "deposit broker," and the application of its interpretation of "facilitating the placement of deposits."[70] The Congressional purpose underlying Section 29 is to limit troubled institutions' ability to raise deposits through an archetypal deposit broker, thereby requiring the question of whether such prepaid card program managers are deposit brokers to be determined by whether they are *engaged in the business* of either (1) placing deposits, or (2) facilitating the placement of deposits.

Prepaid card program managers are not engaged in such business. Although one aspect of their business activities may result in connecting depositors to an IDI, deposits associated with prepaid cards are not connected to the type of business that Section 29 is intended to capture. Prepaid card program managers are not in the business of facilitating the placement of deposits, but of providing an innovative method by which customers can store their money and conduct transactions. These services are wholly unrelated to the business of providing deposit-placement services or obtaining FDIC insurance for customers.

Even if the FDIC were to determine that prepaid card program managers are in the business of placing or facilitating the placement of deposits, the primary purpose exception should generally apply under a plain reading of the exception. Prepaid card program managers are clearly acting in the capacity of an agent with respect to their customers, as they only deposit funds to "load" a card at the instruction of the owner of the funds. Furthermore, the primary purpose of prepaid card program managers is not to place, or facilitate the placement of, deposits. Their primary purpose is to provide customers who may not otherwise be able to access banking services with an alternative, secure method to store their money and make ordinary course payments.[71] Although a deposit account is necessary to provide this service, placement of the deposits is not the program manager's primary purpose.

Similarly, third parties offering prepaid cards tied to deposit accounts at a financial institution, including employers using prepaid cards for payroll purposes (including for unbanked or underbanked employees), should not be classified as "deposit brokers." Employers offering prepaid cards as an alternative to a traditional deposit account are not "engaged in the business of" (1) placing or (2) facilitating the placement of deposits. These employers are simply offering their employees an alternative way to access their wages—including the ability to use the prepaid card to pay bills and pay for goods and services. These prepaid cards can, in many ways, replicate the features of a

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69 FAQs question E11.

70 *See supra* notes 23 – 24 and accompanying text.

71 *See, e.g.,* FDIC, 2017 FDIC National Survey of Unbanked and Underbanked Households at 34 - 36, *available at* https://www.fdic.gov/householdsurvey/2017/2017report.pdf ("Some consumers use general purpose reloadable prepaid cards to address their financial transaction needs. . . . Use of prepaid cards in 2017 was most prevalent among unbanked households . . . . Overall, approximately half . . . of households that used prepaid cards in 2017 were either unbanked or underbanked . . . .").

demand deposit account, such as the ability to set up automatic bill payments. Prepaid cards provide an alternative that bridges the gap for consumers without access to traditional deposit accounts who need to access the banking system to receive payments and purchase goods and services. Customers, including, for example, both the employers who offer payroll cards and the employees who wish to use them, are benefitted by this alternative. Designating these deposits as brokered, and the resultant impact on the cost of funds, inappropriately inhibits financial institutions' ability to provide this service, at least at a reasonable cost.

The ANPR also notes that in examining prepaid deposit relationships, FDIC staff has not distinguished between "(1) acting with the purpose of placing deposits for other parties, and (2) acting with the purpose of enabling other parties to use deposits to make purchases."[72] The absence of such distinction is not tenable, particularly in light of Congress' purpose in enacting Section 29. First, a plain reading of the primary purpose exception requires the FDIC to distinguish between "acting with the purpose of placing deposits for other parties" and all other purposes. On its face, the primary purpose exception is available to agents and nominees unless their primary purpose is to place deposits with IDIs. Based on a plain reading of the statute, if the primary purpose of the third-party agent is any purpose other than the placement of funds with IDIs, then the primary purpose exception applies. Second, Congress' purpose was to restrict "hot money" that is volatile and used to fuel rapid growth. Deposits underlying prepaid cards exhibit none of the characteristics of "hot money." In fact, that the primary purpose of these relationships is to enable parties to make purchases (which the FDIC apparently recognizes based on the language of the ANPR) demonstrates that the deposits are not made by depositors seeking above-market interest rates, and the FDIC has provided no analysis to show that depositors would move their prepaid deposits in a stress event or in search of higher interest. For these reasons, the FDIC's views of deposits associated with prepaid cards, particularly those expressed in the FAQs, are overbroad and result in the misclassification of deposits underlying general purpose and other prepaid cards involving a third-party agent as brokered.

In addition, the classification of prepaid deposits as brokered has unintended negative consequences on unbanked and underbanked consumers who rely on prepaid cards to store money and gain access to a transaction account. Because of the negative consequences to IDIs of classifying deposits as brokered, IDIs may be unwilling to provide deposit accounts to prepaid card managers, or may be willing to do so only at a price that ultimately increases the fees and other costs paid by prepaid card users. This result would further limit the utilization of IDIs by unbanked and underbanked individuals, thereby limiting their ability to meet their economic needs safely and securely within the banking system.

Therefore, the FDIC should revise its regulations to clarify that prepaid card program managers are not entities engaged in the business of placing or facilitating the placement of deposits, and, therefore, are not "deposit brokers." Alternatively, the FDIC should revise its regulations to apply the primary purpose exception to prepaid card program managers, unless there is clear evidence that the program manager is acting with the primary purpose to place deposits with the IDI. As discussed above, the integral nature of a deposit account in a prepaid debit card program does not make the account the primary purpose. Rather, it is an incidental feature.

IV. The FDIC should support statutory changes that would treat fully-insured, long-term deposits as core deposits regardless of whether the deposits are brokered, and pending such legislation the FDIC should treat these deposits as core deposits for purposes of the FDIC's deposit insurance assessment calculations.

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72 84 Fed. Reg. at 2,374.

Fully-insured deposits with a remaining term to maturity of more than one year, regardless of whether they are brokered deposits, can be a stable source of funding and are an important asset-liability management tool for some banks. These long-term brokered deposits allow banks to access deposit markets outside their geographic footprint to fund the bank's upcoming needs and match assets and liabilities, particularly with respect to maturities. Importantly, because long-term deposits have a remaining term to maturity of more than one year, they cannot result in near-term liquidity stress for a bank. Moreover, these deposits generally cannot be withdrawn prior to maturity and, therefore, cannot be transferred to another institution to chase higher interest rates or if the bank were to become troubled. The FDIC itself has recognized that:

> The duration of a deposit can present or mitigate the problem of a deposit leaving a bank for higher rates or when the bank is under stress. The longer a deposit's remaining time to maturity and the stricter the limitations on early withdrawal, the less likely it is to be withdrawn when the institution is under stress.[73]

In addition, we are not aware of any FDIC analysis of the effect of remaining term to maturity on the correlation between brokered deposits and bank failure. An analysis undertaken for one of BPI's members of 377 banks that failed between January 1, 2008, and December 31, 2011, shows, using publicly available data as of December 31, 2007, that failed banks' brokered deposits primarily comprised deposits with a remaining term to maturity of less than one year, with these short-term deposits equaling over 70% of the brokered deposits held by the failed institutions.

With respect to the other concerns expressed by the FDIC in the ANPR, namely rapid growth and franchise value, long-term, fully-insured deposits are not likely to fund rapid growth of high-risk assets and are likely to have significant franchise value. Although brokered deposits, including long-term deposits, can be raised quickly (which is an important element of their usefulness as an asset-liability management tool), the enhanced supervisory and regulatory framework that was implemented following the financial crisis creates an environment in which a bank cannot easily use such deposits to fund high-risk assets. As noted in the ANPR, Congress was concerned with brokered deposits because "(1) [s]uch deposits could facilitate a bank's rapid growth in *risky assets without adequate controls* [and] (2) once problems arose, a problem bank could use such deposits to fund additional risky assets to attempt to 'grow out' of its problems . . . ."[74] However, banks today are subject to a number of capital, liquidity and risk management requirements that did not exist at the time Section 29 was enacted, including, for example, requirements to maintain appropriate levels of capital against the bank's risk-weighted assets and to establish robust risk management policies that are designed to prevent taking risks that are not commensurate with the bank's size and sophistication (including the risky lending that brokered deposits were used to fund during the savings and loan crisis). Therefore, banks are discouraged from using long-term brokered deposits to fund rapid growth of high-risk assets, and any potential risk to the DIF of raising long-term brokered deposits is substantially mitigated. In addition, because long-term brokered deposits are stable sources of funding, they likely would maintain significant franchise value at bank failure, particularly compared to short-term deposits that are not as stable. The FDIC's view of long-term brokered deposits should be revised to recognize that such deposits generally are not used to fund rapid growth of high-risk assets, but as an efficient and effective asset-liability management tool, subject to a robust regulatory and supervisory framework.

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73 2011 Study at 51.

74 84 Fed. Reg. at 2,366 (emphasis added).

We recognize that excluding long-term brokered deposits from treatment as brokered under Section 29 would require a statutory change, and urge the FDIC to undertake a full, data-based examination of the effects of such deposits, particularly as compared to short-term brokered deposits that apparently contributed to, or are at least correlated with, bank failure at much greater rates than long-term brokered deposits (if the latter contributed to bank failure at all). If the results of such examination prove our hypothesis, as we expect it would, that long-term brokered deposits are not connected to bank failure, we urge the FDIC to support statutory changes that would exclude long-term, fully-insured deposits from Section 29's restrictions.

At a minimum, the FDIC should revise its deposit insurance assessment calculations under 12 C.F.R. Part 327 that penalize long-term brokered deposits. Currently, the FDIC's deposit insurance assessments penalize long-term brokered deposits in three provisions: (i) the Core Deposits to Total Liabilities ratio in section 327.9(b), as further described in Appendix A to Subpart A of 12 C.F.R. Part 327; (ii) the brokered deposit adjustment in section 327.16(e)(3); and (iii) the Brokered Deposit Ratio in section 327.16(a)(1). Because long-term brokered deposits are not volatile, are not likely to be used to fund rapid growth of high-risk assets and likely retain significant franchise value at bank failure, they are not likely to cause more harm to the DIF than stable, non-brokered certificates of deposit with similar maturities. As a result, the FDIC should not penalize such deposits by treating them as brokered for purposes of the above provisions, even if such deposits would be "brokered" under Section 29 and the FDIC's implementing regulations as they stand today. Therefore, the FDIC should amend its deposit insurance assessment regulations to (i) treat brokered deposits with a remaining term to maturity of more than one year as core deposits for purposes of the Core Deposits to Total Liabilities ratio, (ii) exclude such deposits from the brokered deposit adjustment and (iii) deduct such deposits from brokered deposits for purposes of the Brokered Deposit Ratio.

V. The FDIC should revise Section 29's interest rate restrictions to reflect the actual market in which banks compete, and should not use interest rates as a proxy for risk in its supervision of IDIs.

Under Section 29, as implemented by the FDIC's regulations at 12 C.F.R. § 337.6(b), an IDI that is adequately capitalized is prohibited from soliciting deposits by offering rates of interest that are "significantly higher than the prevailing rates of interest on deposits offered by other [IDIs] in such [IDI's] normal market area."[75] As noted in the ANPR, the purpose of this restriction is to prevent institutions from "avoiding the prohibition against the acceptance of brokered deposits by soliciting deposits internally through 'money desk operations'."[76] Section 29 does not define a number of terms that are critical to interpreting the interest rate restriction, including "national rate," "significantly higher" and "market area." These terms are defined, however, under the FDIC's regulations, which provide that an IDI's market rate is presumed to be the national rate,[77] and that the national rate is "a simple average

75 12 U.S.C. § 1831f(g)(3). An IDI that is undercapitalized is also prohibited from soliciting deposits "by offering rates of interest that are significantly higher than the prevailing rates of interest on insured deposits . . . in the market area in which such deposits would otherwise be accepted." 12 U.S.C. § 1831f(h).

76 84 Fed. Reg. at 2374.

77 12 C. F.R. § 337.6(f).

of rates paid by all [IDIs] and branches for which data are available."[78] A rate is "significantly higher" than another rate if it exceeds the second rate by more than 75 basis points.[79]

The FDIC currently calculates the national rate using data gathered by RateWatch, and posts the rate to the FDIC's website each week. RateWatch conducts a survey of the interest rates offered on various deposit products by IDIs. According to the FDIC, the information is collected from between 45,000 and 81,000 locations.[80] The FDIC's calculation of the national rate has become outdated, and does not represent a true market rate. For example, as the FDIC has acknowledged in its ANPR, "because the national rate is an average for all banks and branches, the largest banks with large numbers of branches have had a disproportional effect on average interest rates."[81] Small but important market segments must use this skewed average as the baseline for determining whether the interest rate offered in those segments is "significantly higher" than the market rate. The FDIC's regulations provide a mechanism for the FDIC to determine that a bank's market rate is higher than the national rate, but this determination is based solely on limited geographical factors, and does not consider the actual market in which a bank competes.[82]

The FDIC's current approach to the national rate calculation has consequences even for healthy, well capitalized institutions. We are concerned that examination and supervisory staff will take (or already takes) the view that a bank that is offering interest rates that are "significantly higher" than the national rate (*i.e.*, more than 75 basis points above the national rate) is funding its operations with "high risk," volatile deposits.[83] We are also concerned that supervisory staff may require a bank's liquidity stress tests to account for this "high risk" funding, and will require the bank to hold increased amounts of liquidity against it. The underlying rationale for the interest rate restrictions is to prevent a bank from circumventing the brokered deposits restrictions by funding rapid growth through volatile deposits that it raises through its own money desk operations, and should not be used as a supervisory tool to penalize well capitalized banks for raising deposits in a manner that is permitted by both Section 29 and the FDIC's regulations. Furthermore, the offering of an interest rate that is more than 75 basis points above the national rate is not necessarily indicative of an unsafe or unsound practice, but is a reflection of an outdated national rate calculation, and may simply result from competition in the bank's actual market. As a result, the FDIC's method for calculating the national rate creates unnecessary regulatory stigma for well capitalized institutions where such supervisory concerns are not warranted.

For the foregoing reasons, the FDIC should revise its calculation of the national rate to consider the actual market in which an IDI competes.

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[78] 12 C.F.R. § 337.6(b)(2)(ii)(B).

[79] *See e.g.*, 12 CFR 337.6(b)(2)(ii); 84 Fed. Reg. at 2374.

[80] FDIC's Weekly National Rates and Rate Cap – Weekly Update, note 1, *available at* https://www.fdic.gov/regulations/resources/rates/index.html.

[81] 84 Fed. Reg. at 2,375.

[82] 12 C.F.R. § 337.6(f) ("A market is any readily defined geographical area . . . .").

[83] For example, the FDIC has made public statements that indicate it considers "high-rate" deposits to be "potentially non-stable funding sources" that contribute to a "a risk-building environment." FDIC, *Underwriting Trends and Other Highlights from the FDIC's Credit and Consumer Products/Services Survey*, 14 SUPERVISORY INSIGHTS, Winter 2017, at 18, *available at* https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin17/si-winter-2017.pdf.

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The Bank Policy Institute appreciates the opportunity to provide its comments, and would welcome the opportunity to discuss them further with you. If you have any questions, please contact the undersigned by phone at [redacted] or by email at [redacted].

Respectfully submitted,

Dafina Stewart
Senior Vice President,
Associate General Counsel
Bank Policy Institute

cc: Doreen Eberley
Nicholas Podsiadly
(Federal Deposit Insurance Corporation)

Appendix B

2020 NPR Comment Letter

June 5, 2020

Via Electronic Mail

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary

Re: Brokered Deposits (RIN 3064-AE94)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's notice of proposed rulemaking[2] relating to the FDIC's regulatory framework for brokered deposits. BPI has been an advocate of reform in this important area for many years.[3] Chairman McWilliams' and the FDIC staff's thoughtful review and study of brokered deposits issues are evident in both the Advanced Notice of Proposed Rulemaking[4] and the NPR. We agree that revisions to the brokered deposits framework are necessary and appropriate in light of the major advances in technology, business practices and products that have occurred since the FDIC's final brokered deposit regulations were issued in 1990.[5]

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1 BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans and are an engine for financial innovation and economic growth.

2 FDIC, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, Notice of Proposed Rulemaking and Request for Comment, 85 Fed. Reg. 7453 (Feb. 10, 2020) (the "NPR").

3 *See* Letter to FDIC, from the Bank Policy Institute re: Comments to the FDIC's Brokered Deposits ANPR (May 6, 2019) (the "ANPR Comment Letter"); Letter to FDIC, from The Clearing House Association L.L.C. (one of BPI's predecessor organizations), the American Bankers Association, the Financial Services Roundtable (one of BPI's predecessor organizations), the Independent Community Bankers of America, and the Institute of International Bankers re: Financial Institutions Letter FIL (51-2015): Request for Comment on Frequently Asked Questions Regarding Identifying, Accepting, and Reporting Brokered Deposits (Dec. 28, 2015); Letter to Charles Yi, General Counsel, FDIC, from The Clearing House Association L.L.C., the American Bankers Association, and the Institute of International Bankers re: Comments to January 5, 2015 Financial Institutions Letter (FIL-2-2015) (Aug. 11, 2015).

4 FDIC, Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019).

5 FDIC, Unsafe and Unsound Banking Practices, Final Rule, 55 Fed. Reg. 39135 (Sep. 25, 1990).

We strongly support many of the revisions proposed in the NPR, as described below. However, further, critical change is warranted in several areas, and we suggest revisions in those areas. Our recommendations are intended to bring additional clarity to the brokered deposits framework, and to do so in a manner that promotes banks' safety and soundness, protects the Deposit Insurance Fund and is consistent with Congress's purpose in regulating brokered deposits, while allowing for the framework to meet the convenience and needs of consumers and to accommodate the current structure and needs of the financial services industry and future developments in technology and business practices.

I. Executive Summary.

BPI appreciates the FDIC's efforts to clarify and modernize the brokered deposits framework. We support many aspects of the proposed rule, but there are a number of critical changes that the FDIC should adopt in the final rule. In particular, the final rule should reflect the following changes:

- The definition of "deposit broker" should be revised.
  - The final rule should codify the FDIC's description in NPR's preamble (the "Preamble") of when a third party is "engaged in the business of placing deposits" as when "a person has a business relationship with its customers, and as part of that relationship, places deposits on behalf of the customer (e.g., acting as custodian or agent for the underlying depositor)".[6]
  - The proposed definition of "engaged in the business of facilitating the placement of deposits" is overly broad and should be revised so that persons that are not actually engaged in the business of facilitating the placement of deposits are not inappropriately classified as deposit brokers.
    - The third party information sharing prong should be removed.
    - The FDIC should revise the third prong of the definition of "engaged in the business of facilitating the placement of deposits" by deleting the term "provides assistance" and clarifying the meaning of the term "involved in".
    - The text of the final rule should provide that a third party must have a business relationship with a customer and facilitate the placement of the customer's deposits as part of that relationship in order to be deemed to facilitate the placement of deposits.
    - The FDIC should confirm that certain relationships identified in this letter do not result in a person being engaged in the business of facilitating the placement of deposits under the regulation.
  - The final rule should clarify that dual and dual-hatted employees are not typically considered to be engaged in the business of placing or facilitating the placement of deposits because they are not "engaged in business" for purposes of the deposit broker definition.
- The primary purpose exception should be revised.

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6 85 Fed. Reg. at 7457.

- The FDIC should eliminate the mandatory application process and instead provide bright-line criteria for the primary purpose exception and a supplementary voluntary application process to qualify under the exception for other activities.

- The final rule should eliminate ongoing reporting or monitoring requirements for arrangements that qualify for the primary purpose exception.

- The final rule should provide that the FDIC will modify or withdraw an approval for the primary purpose exception only if there has been a material change in circumstances.

- The final rule should clarify certain aspects of the 25 percent of customer "assets under management" primary purpose exception.

  - The final rule should provide that a "business line" is determined by reference to a person's reasonable determination of its own business lines in the ordinary course of business.

  - The final rule should use a term other than "assets under management".

- The final rule should include certain additional arrangements that we identify in this letter that would qualify for the primary purpose exception.

- The "IDI exception" should be revised.

  - A subsidiary of an insured depository institution ("IDI") should qualify for the IDI exception with respect to deposits placed with its parent regardless of whether the subsidiary also places deposits with other banks.

  - The final rule should clarify that the requirement to place deposits of retail customers exclusively with the parent bank does not prohibit the subsidiary from placing non-retail deposits with its parent bank or another bank.

  - The final rule should not require the operating subsidiary to be wholly owned.

- The final rule should include additional changes that would clarify important areas of the brokered deposits framework.

  - The final rule should exclude affiliate-generated deposits from the definition of "deposit broker".

  - The FDIC should codify or rescind advisory opinions only after notice of the specific guidance to be codified and an opportunity to comment.

  - BPI would support the codification of certain advisory opinions and other guidance after appropriate opportunity for notice and comment.

  - BPI would support the rescission of certain advisory opinions and other guidance after appropriate opportunity for notice and comment.

  - The FDIC and other regulators should revise other regulations that refer to brokered deposits to align the treatment of deposits in those regulations with the FDIC's brokered deposit regulations.

II. Background.

The legislative history of Section 29 of the Federal Deposit Insurance Act ("Section 29") demonstrates that Congress enacted Section 29 in response to the so-called "hot money" that exacerbated the savings and loan crisis of the 1980s, when troubled institutions with deteriorating loan portfolios and "regulators . . . breathing down [their] throat[s]" would buy funds through third-party brokers as their "only chance for survival".[7] Congress's principal concern was troubled institutions' reliance on "hot money" deposit brokers, *i.e.*, those brokers who, for the primary purpose of pecuniary gain based on the volume of deposits placed, actively placed deposits with higher-than-market interest rates on an unsolicited basis, with persons not necessarily having a previous relationship with the banking organization. In other words, these brokers were engaged in the business of (1) placing funds, or (2) facilitating the placement of funds, and the customer's relationship was with the deposit broker, who was seeking to place the funds at whichever IDI was then offering high interest rates, and not with an IDI selected by the customer.

When Section 29 was enacted, the only real consequence to banks was what Congress intended—to reduce the potential dangers of "hot money" by limiting the ability of less than well capitalized IDIs to accept these deposits and limiting the interest rate the bank could pay on deposits. In contrast, the consequences today of accepting deposits classified as brokered are much broader, and include adverse consequences that are entirely unrelated to the IDI's financial condition.[8] None of these consequences is required or was even contemplated when Section 29 was enacted, and the negative consequences of brokered deposits accrue to *all* institutions that accept deposits classified as brokered, not just those that are less than well capitalized.

Chairman McWilliams described the NPR as intended to clarify that many arrangements that result in a direct relationship between a customer and a bank do not also result in brokered deposits: "The first goal [of the proposed rule] is to develop a framework that encourages innovation . . . and allows banks to serve customers the way customers want to be served. . . . The proposal [clarifies] that various types of existing partnerships in which a consumer maintains a relationship directly with a bank generally would not result in a brokered deposit".[9] BPI strongly supports this goal, and our comments are intended to improve the proposed rule to better achieve it, consistent with Congress's objective in enacting Section 29, protection of the Deposit Insurance Fund, bank safety and soundness, and the convenience and needs of consumers.

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7 Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (April 19, 1989). Please refer to the ANPR comment letter at 3-4 for a more detailed discussion of the legislative history of Section 29.

8 These can include (1) higher deposit insurance assessment rates, (2) requirements to maintain additional liquid assets to offset the higher outflow rates assigned to brokered deposits under the liquidity coverage ratio (brokered deposits also are generally assigned lower Available Stable Funding factors under the proposed net stable funding ratio), (3) expending additional time and resources on liquidity planning (*e.g.*, incorporating PCA-related downgrade triggers into contingency funding plans), and (4) reduced ability to compete with non-bank competitors that are not required to factor liquidity costs into product offerings that would result in brokered deposits for a bank (*e.g.*, prepaid cards). Please refer to the ANPR Comment Letter at 5-6 for a more detailed discussion of the adverse consequences associated with accepting brokered deposits.

9 "Brokered Deposits in the Fintech Age", Brookings Institution, Wash. D.C. (Dec. 11, 2019) (Keynote Remarks by Chairman Jelena McWilliams), at 4.

III. Discussion of comments on the NPR.

A. The Definition of "Deposit Broker".

The FDIC should ensure that its effort to revise the definition of "deposit broker" is effective over the long term by clarifying the various elements of the definition with specific and objective standards and criteria.

1. The final rule should codify the FDIC's description in the Preamble of when a third party is "engaged in the business of placing deposits".

The FDIC states in the Preamble that it would view a person as being "engaged in the business of placing deposits" if the person "has a business relationship with its customers, and as part of that relationship, places deposits on behalf of the customer".[10] BPI supports this interpretation and suggests that the proposed rule be revised to set forth this specific definition in the regulation. The FDIC's formulation makes clear that a person must have a business relationship with another person that is the first person's customer and must place deposits on that customer's behalf in order to be a deposit broker under this prong of the deposit broker definition.[11]

The text of the proposed rule does not include a definition of "engaged in the business of placing deposits", however, which could lead to uncertainty and ambiguity, and leaves open the possibility of future interpretations that do not take the FDIC's intended interpretation into account. The final rule should include a specific definition of the phrase so that parties subject to the brokered deposits rules are able to plan their activities and products in reliance on a clear regulation.

2. The proposed definition of "engaged in the business of facilitating the placement of deposits" is overly broad and should be revised so that persons that are not actually engaged in the business of facilitating the placement of deposits are not inappropriately classified as deposit brokers.

BPI strongly supports including in the text of the regulation a clear and specific definition of "engaged in the business of facilitating the placement of deposits" (the "facilitation definition").[12] Under the FDIC's current regime, the lack of a clear interpretation of this aspect of the deposit broker definition has resulted in varying staff opinions that extend the scope of the phrase beyond what was contemplated by Congress, as well as confusion and inconsistent treatment in the market regarding whether deposits associated with particular arrangements are reported as brokered deposits.

The enumerated activities in the proposed rule that constitute a third party being "engaged in the business of facilitating the placement of deposits" are so broad as to lead to perverse, presumably unintended, results. Certain aspects of the definition are ambiguous and should be clarified to avoid inconsistencies in interpretation. The proposed definition should be revised to capture only persons actually (1) engaged in the business of (2) facilitating the placement of deposits. It is critical that the scope of the facilitation definition is appropriately tailored because only an agent or nominee of a depositor can qualify for the primary purpose exception.[13] The proposed facilitation

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[10] 85 Fed. Reg. at 7457.

[11] The FDIC contrasts this with facilitation activity: "In contrast to the first prong of the definition, the 'facilitation' prong of the deposit broker definition refers to activities where the person does not directly place deposits on behalf of its customers with an insured depository institution". 85 Fed. Reg. at 7457.

[12] Proposed section 337.6(a)(5)(ii), 85 Fed. Reg. at 7472.

[13] *See* 85 Fed. Reg. at 7459 (noting that "in evaluating whether a person meets the primary purpose exception, staff has focused on the relationship between the depositor *and the person acting as agent or nominee for that depositor*") (emphasis added). Although the FDIC states in a footnote in the Preamble that "[p]ersons that meet the deposit broker

definition could be interpreted to capture a broad range of third parties, resulting in a dramatic expansion of the deposit broker definition, contrary to the FDIC's stated expectation of the proposed rule's impact.[14]

a. BPI supports defining account control as an activity that constitutes facilitating the placement of deposits.

BPI supports adopting proposed section 337.6(a)(5)(ii)(B) in the final rule. That prong would provide that a person is engaged in the business of facilitating the placement of deposits if, while engaged in business, the person has legal authority, contractual or otherwise, to close the deposit account or move the third party's funds to another bank. We agree that having this authority indicates a sufficient level of ongoing influence and control over the deposit account even after it is open, as described in the Preamble. Indeed, this is indicative of the type of active and meaningful relationship that we recommend should be required to find that a third party is a deposit broker under either of the first two prongs of the deposit broker definition.[15] As a technical comment, we suggest inserting "deposit" before "account" and "in the account" after "third party's funds" for the sake of clarity.

b. The third party information sharing prong should be removed.

We are particularly concerned about proposed section 337.6(a)(5)(ii)(A) (the "information sharing prong"), which would include in the facilitation definition a person that, while engaged in business, "directly or indirectly shares any third party information with the insured depository institution".[16] This prong should be removed from the facilitation definition. Such a broad and vague standard would be inconsistent with the FDIC's intent to bring more clarity to the brokered deposits regulatory framework.[17] It would also contravene the FDIC's stated goal of encouraging innovation and bringing the brokered deposit regulations in line with developments in technology and business practices.[18]

Adopting the information sharing prong as proposed would, in fact, *broaden* the scope of the FDIC's existing interpretations to capture arrangements that the FDIC has previously determined do not result in brokered deposits,

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definition because they are 'facilitating the placement' of deposits would also be eligible to submit an application under [the application] process", 85 Fed. Reg. at 7460 n. 16, the application process itself is available only for a "third party", defined as "an agent or nominee that is applying to be excluded from the definition of deposit broker pursuant to the primary purpose exception". Proposed section 303.243(b)(2)(i). The FDIC's discussion in the Preamble is consistent in referring to agents and nominees as eligible for the primary purpose exception. Thus, a person captured by the facilitation prong that is not an agent or nominee would appear not to be eligible to apply under the proposed primary purpose exception.

14 *See, e.g.*, 85 Fed. Reg. at 7463-4 (noting that the "proposed rule creates a new framework for analyzing certain provisions of the statutory definition of 'deposit broker'", the effect of which "likely would be some amount of deposits currently designated as brokered deposits [would] no longer be so designated").

15 See section III.A.2.c below for further discussion of the types of relationships that we recommend should be included in the deposit broker definition, specifically under the "facilitation" prong of the definition.

16 85 Fed. Reg. at 7472. In addition to our other concerns with the information sharing prong, the literal language of the proposed regulation does not specifically refer to third-party information about a potential depositor, or require that the information shared is even tangentially related to any deposit account.

17 *See, e.g.*, 85 Fed. Reg. at 7464 ("The proposed rule would benefit insured institutions and other interested parties by providing greater legal clarity regarding the treatment of brokered deposits".).

18 *See* 85 Fed. Reg. at 7453 ("Through [the proposed changes to the brokered deposit regulations], the FDIC intends to modernize its brokered deposit regulations to reflect recent technological changes and innovations that have occurred".).

such as listing services that transmit messages between potential depositors and banks but that are not compensated through volume-based fees,[19] as these types of arrangements necessarily involve the provision of some third-party information. The proposed information sharing prong would also prohibit other arrangements, including referral relationships in which a third party (including a bank's affiliate) may provide contact information to the bank for purposes of the bank's own marketing efforts to potential depositors, even if those arrangements result in a direct relationship between the bank and the depositor. We see nothing in the Preamble or Chairman McWilliams' public statements to suggest that the FDIC intended to expand coverage of the deposit broker definition in this manner.[20] In addition, doing so would disrupt longstanding relationships and business practices (and justified reliance on FDIC precedent and guidance) with no corresponding benefit to the safety and soundness of banks or the protection of the Deposit Insurance Fund.

The FDIC notes in the Preamble that the facilitation definition is "intended to capture activities that indicate the person takes an active role in the opening of an account or maintains a level of influence or control over the deposit account even after the account is opened".[21] We assume that a "level of influence or control" means something more than a modicum of influence or control, and the final rule itself should be consistent with this. Simply sharing information about a potential depositor with a bank does not indicate that the third party takes an active role in opening an account or that it maintains influence or control over the account after it is opened. In addition, such information sharing arrangements have become more commonplace with advancements in technology, particularly with the advent of application programming interfaces, or APIs, which are third-party software interfaces that involve the seamless sharing of content and data between parties for purposes unrelated to placing deposits. Banks routinely use such data sharing arrangements to deliver critical banking infrastructure, including fraud detection and other controls, and frequently leverage similar arrangements for marketing and other purposes. Such arrangements have been, and will continue to be, vital to delivering modern solutions to consumers that are responsive to their demands for convenience and transparency.

These types of arrangements do not, by their nature, provide a third party with a level of influence or control over a customer's deposit account that should result in the third party being a deposit broker. Under these

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[19] *See* FAQs D2 (stating that a listing service is not a deposit broker if it (1) is compensated solely by means of subscription fees that are "not calculated on the basis of the number or dollar amount of deposits"; (2) performs only certain functions relating to the gathering and transmission of information and messages in exchange for its fees; and (3) is not involved in the physical placement of deposits).

[20] The FDIC describes the change to its interpretation of facilitation as a "refinement" of current interpretations of the activities that result in a person being engaged in the business of facilitating the placement of a third party's deposits, which in no way suggests an expansion of the scope. 85 Fed. Reg. at 7457. In fact, quite to the contrary, the Preamble also states that "[t]he FDIC recognizes that, under this proposal, numerous categories of deposits that are currently considered brokered would instead be nonbrokered". 85 Fed. Reg. at 7463. The Preamble goes on to note, in the analysis of the expected effects of the proposal, "[c]hanges and innovations in deposit placement activity . . . could include the use of technology services that help enable payments and online marketing services that refer customers to certain banks. *To the extent that the proposed rule would treat such deposits as nonbrokered*, it could support ease of access to deposit placement services for U.S. consumers". 85 Fed. Reg. at 7464 (emphasis added). Similarly, Chairman McWilliams has indicated that one of the proposed rule's purposes is, in fact, to clarify that many relationships do not result in brokered deposits: "The first goal [of the proposed rule] is to develop a framework that encourages innovation . . . and allows banks to serve customers the way customers want to be served. . . . The proposal [clarifies] that various types of existing partnerships in which a consumer maintains a relationship directly with a bank generally would not result in a brokered deposit". Remarks by Chairman Jelena McWilliams, *supra* note 9, at 4.

[21] 85 Fed. Reg. at 7457. The FDIC should clarify that its formulation of "a level of influence or control" should be read to mean something more than a minimal level of influence or control. As articulated in the Preamble, the standard is very unclear and potentially problematic, as it is subject to expansive interpretation that could potentially result in classifying as a deposit broker a third party with *any* connection to a deposit account.

arrangements, the depositor selects its bank, opens and funds its account directly with the bank and, at all times, retains control over the funds in the account. The FDIC also notes that where the needs of the depositor are the primary drivers of the selection of the bank, it would not view a third-party relationship as facilitating the placement of deposits.[22] We agree with this view, and do not believe that simply "shar[ing] any information" is sufficient to demonstrate that the needs of the depositor are not the primary driver of the deposit relationship. The final rule therefore should not include the information sharing prong.

c. **The FDIC should revise the third prong of the definition of "engaged in the business of facilitating the placement of deposits".**

Under the proposed rule, a person that, while engaged in business, "provides assistance or is involved in setting rates, fees, terms, or conditions for the deposit account" would be "engaged in the business of facilitating the placement of deposits of third parties with insured depository institutions".[23] BPI agrees that setting the rates, etc. of a deposit account is an appropriate activity to include as a type of "facilitation" because those activities would involve "tak[ing] an active role"[24] in opening an account. The inclusion of the words of "providing assistance" is both unnecessary and confusing because of its ambiguity and, therefore, the final rule should delete "provides assistance" from the third prong of the facilitation definition.[25]

The term "provides assistance" is not necessary because the proposed rule would cover anyone "involved in" setting rates, etc.[26] The term is also ambiguous because it could be read broadly to encompass the provision of virtually any assistance to the depositor relating to the deposit account, instead of, more logically, being limited to providing assistance in setting rates, fees, terms or conditions of a deposit account.[27] The rule should not be construed to capture those that may provide assistance more generally, such as financial planning apps that allow customers to view deposit account balances and other account information at banks with which the customer has a direct relationship. The deletion of this phrase would be more consistent with the FDIC's stated purpose to apply the deposit broker definition to a person that takes an active role in the opening of a deposit account or maintains influence or control over the account. For these reasons, the final rule should clarify that a person is not engaged in the business of facilitating the placement of deposits merely because the person provides some assistance to depositors (or the bank), by deleting the phrase "provides assistance".

The final rule also should clarify the scope of "involved in", as it relates to setting the rates, fees, terms or conditions of a deposit account, so that the phrase is appropriately limited to activities that demonstrate an active role in opening the deposit account or maintaining a meaningful level of influence or control over the deposit account after

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22 85 Fed Reg. at 7457.

23 85 Fed. Reg. at 7472. In contrast to the application process regulation (which provides a definition of "third party"), the term "third party" is used in the definition of deposit broker in section 337.6 to refer in various places to both the ultimate depositor and to a third party that is placing deposits on behalf of a depositor. See proposed section 337.6(a)(5). The FDIC should clarify that the definition of third party for purposes of section 303.248 is exclusive to that section.

24 85 Fed. Reg. at 7457.

25 Proposed section 337.6(a)(5)(ii)(C), 85 Fed. Reg. at 7472.

26 This would still be the case if the FDIC adopts our proposal to change "involved in" to "actively engaged in", as described immediately below.

27 The Preamble provides, as an example of covered facilitation, that "if a person assists in setting rates, fees or terms, that person would be a deposit broker", 85 Fed. Reg. 7457, indicating that "assistance" should be read as limited to setting these features, but the language of the proposed regulation is ambiguous and this example is not exclusive.

the account is opened. BPI therefore suggests changing "involved in" to "actively engaged in" to clarify that the person's role with respect to the account must involve some action and should not be interpreted to include, for example, facilitating the sharing of information about an account's terms, such as passively exchanging such information between a bank and a depositor.

d. The text of the final rule should provide that a third party must have a business relationship with a customer and facilitate the placement of the customer's deposits as part of that relationship in order to be deemed to facilitate the placement of deposits.

As discussed in section III.A.1 above, the FDIC discusses in the Preamble its view that a person is "engaged in the business of placing deposits" if the person "has a business relationship with its customers, and as part of that relationship, places deposits on behalf of the customer".[28] The final rule should provide that this same concept applies to the facilitation definition: a person is *engaged in the business* of facilitating the placement of deposits only if the person has a business relationship with the customer and, as part of that relationship, facilitates the placement of that customer's deposits.

e. The FDIC should confirm that certain relationships do not result in a person being engaged in the business of facilitating the placement of deposits under the regulation.

Based on both the FDIC's historical positions and its stated purposes in proposing the revised brokered deposit regulations, we assume that that the FDIC would not view certain relationships as falling within the proposed "facilitating" definition. In particular, the FDIC should confirm that the following relationships do not result in a person being engaged in the business of facilitating the placement of deposits:

- Listing services: Under FAQ D2, listing services are not engaged in the business of facilitating the placement of deposits if (1) the listing service is "compensated solely by means of subscription fees . . . and/or listing fees"; (2) "the fees paid by depository institutions are flat fees, not calculated on the basis of the number or dollar amount of deposits accepted by the depository institution as a result of the listing or posting of the depository institution's rates"; (3) "the listing service performs no services except: ([a]) the gathering and transmission of information concerning the availability of deposits; and/or ([b]) the transmission of messages between depositors and depository institutions including purchase orders and trade confirmations"; and (4) "the listing service is not involved in the physical placement of deposits". The FDIC should confirm that listing services that meet these criteria are not within the "facilitating" definition.

- Marketing/advertising arrangements: Chairman McWilliams has stated that "[t]he proposal [clarifies] that various types of existing partnerships in which a consumer maintains a relationship directly with a bank generally would not result in a brokered deposit".[29] Marketing and advertising arrangements may take many forms, but banks base these arrangements on consumer demands and expectations in an increasingly automated and technology-driven environment. Examples include the APIs noted above, which may allow customers to transition seamlessly between a third-party site or application and the bank's website and, in some cases, pre-populate account applications with information entered on the third-party site; advertising on third-party websites and applications; and third-party programs where multiple banks advertise the details of their deposit products. Each of these and other marketing and advertising relationships are arrangements that generally result in direct customer relationships between the bank and a depositor. The FDIC

[28] 85 Fed. Reg. at 7457.

[29] Remarks by Chairman Jelena McWilliams, *supra* note 9, at 4.

should confirm that marketing arrangements are not within the "facilitating" definition, as long as the arrangement results in a direct relationship between a depositor and a bank (*i.e.*, the advertiser does not receive funds from a customer for deposit with a bank), and the advertiser does not have an ongoing contractual or other right to move the depositor's funds to another bank.

- Affinity groups: Under the FDIC's Advisory Opinions 93-30 and 93-71 and FAQ B4, affinity groups that entered into marketing programs with banks were not deposit brokers, based on a number of factors, including (1) the affinity groups were non-financial institutions; (2) the affinity groups did not directly market deposit products for the banks; (3) affinity group members placed deposits directly with the banks; (4) the affinity groups had exclusive relationships with the respective banks and did not endorse deposit products of other institutions; (5) the affinity groups did not receive volume-based fees in exchange for endorsing the banks' deposit products (although they received royalties that represented "a fraction of the market rate" paid to traditional deposit brokers); (6) the banks treated the deposits obtained from the affinity group relationships as core deposits and did not use the deposits to replace core deposit run-off; (7) the affinity groups did not know which members made deposits with the bank, nor did they keep any records of the amounts, rates or maturities of the deposit; and (8) any advertising space the banks purchased in the affinity groups' publication was sold to the banks at market rates. The FDIC should confirm that affinity group relationships that meet these criteria are not within the "facilitating" definition.

- Power of attorney: The final rule should confirm that general powers of attorney granted to lawyers and other advisers as part of the attorney's or adviser's broader relationship to provide a client with legal and/or advisory services are not within the "facilitating" definition. The proposed rule would provide that a person is engaged in the business of facilitating the placement of deposits if, while engaged in business, the person has legal authority, contractual or otherwise, to close the deposit account or move the third party's funds to another bank. BPI supports this standard, but is concerned that it could be read to include an attorney or other adviser who has been provided a general power of attorney over a client's assets and affairs that gives the attorney or adviser the legal authority to move a client's funds from one bank to another. This activity would be done as part of the attorney's or adviser's role as the client's agent and not as part of a business relationship to place deposits, and should not result in brokered deposit treatment.

- Fund administrators: Certain hedge funds and other similar funds engage fund administrators to perform the fund's administrative duties. As part of these duties, the fund administrator may recommend to the fund potential banks at which the fund may establish a transactional account, and may assist the fund in opening the account by providing the bank with documentation and due diligence information during the account opening process. The fund, however, enters into the account agreement directly with the bank and the fund retains control at all times over whether deposits will be withdrawn from the account for investment or other purposes. The bank may pay market interest rates or an "earnings credit rate", which is frequently below the market interest rate, on the same terms offered to corporate clients generally. These rates are offered as a convenience to the fund to cover the costs of the bank's transaction fees and are not offered as a method to attract deposits. The bank does not pay a finder's fee or any other remuneration to the fund administrator. The FDIC should confirm that fund administrators are not engaged in the business of facilitating the placement of deposits with respect to accounts that are placed at a bank selected by the fund and over which the fund retains control.

3. **The final rule should clarify that dual and dual-hatted employees are not typically considered to be engaged in the business of placing or facilitating the placement of deposits because they are not "engaged in business" for purposes of the deposit broker definition.**

Since the promulgation of Section 29 and much of the FDIC's related guidance, banks have expanded their affiliations with non-bank financial companies, largely as a result of customer preference and convenience. Concomitantly, banks have increasingly shifted to the use of dual employees (individuals employed jointly by the bank and an affiliate of the bank)[30] and dual-hatted employees (individuals employed exclusively by the bank but who perform services for an affiliate of the bank),[31] and frequently share office space with their affiliates. These arrangements allow banks and their affiliates to provide customers with a complete financial services experience and enable those services to be provided in a more personally tailored and cost-efficient manner. For example, a bank employee who is also licensed with an affiliate broker-dealer may sell securities to clients and recommend deposit products.

Neither of these employee arrangements is covered by the basic definition of "deposit broker" in Section 29. Under the plain meaning of Section 29, the definition of "deposit broker" does not encompass deposits that result from customer assistance provided by dual or dual-hatted employees in connection with those employees' providing access to a full complement of banking and affiliate products, because such employees are not "engaged in the business" of either (1) placing or (2) facilitating the placement of deposits.

BPI assumes that the FDIC did not intend to include dual and dual-hatted employees in the definition of "deposit broker" under the proposed rule. Dual and dual-hatted employees engage directly with depositors on behalf of the bank in which the depositor is opening or has an account. These employees do not place a third party's deposits, but rather act on behalf of the bank in receiving the third party's deposits and, therefore, are not engaged in the business of placing deposits. In addition, these employees do not have a contractual or other right to close an account or move the depositor's funds to another institution and are not involved in setting rates, fees, terms or conditions for the deposit account (other than in their capacity as employees of the bank) and, therefore, are not engaged in the business of facilitating the placement of deposits.

Because of the FDIC's historically broad interpretation of Section 29, particularly with respect to the "facilitating" prong of the deposit broker definition, there has been substantial confusion as to whether the FDIC might consider deposits generated through dual and dual-hatted employment arrangements to be brokered. This confusion has been exacerbated by an exception for employees in Section 29 and the FDIC's regulations that would not encompass most of these employment arrangements.[32] For these reasons, the final rule should clarify that dual and dual-hatted employees are not engaged in the business of (1) placing deposits or (2) facilitating the placement of deposits, *i.e.*, that such employees are not deposit brokers, with respect to deposits placed with an employer or affiliated bank.

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[30] *See* FAQs question E3.

[31] *See* FAQs question E4.

[32] Section 29 contains an exception from the definition of deposit brokers for employees, but contains a narrow definition of employee, which, because employees of the IDI may not be employed exclusively by the IDI or may frequently share office space with the IDI's affiliates, may often render the employee exception inapplicable to the employee relationships described above. Under Section 29 and the FDIC's regulations, employees of IDIs are not deposit brokers with respect to deposits placed at the employing IDI, if the employee:

- is employed exclusively by the IDI;
- receives compensation that is primarily in the form of a salary;
- does not share his or her compensation with a deposit broker; and
- has a specific place of business that is used exclusively for the benefit of the IDI.

B. The "Primary Purpose Exception".

BPI strongly supports the FDIC's review of the primary purpose exception. Section 29 was intended to apply to only the most "flagrant abusers",[33] and the primary purpose exception plays an important role in limiting the statute's application to agents or nominees that may be captured by the definition of deposit broker but that have a primary purpose other than placing deposits of the type that concerned Congress in enacting Section 29. The existing brokered deposits framework, however, has been inconsistently applied, with overly restrictive views regarding the exception. The FDIC's review and amendment of the brokered deposit regulations is welcome, but we suggest several modifications to the proposed rule. Specifically, the FDIC should eliminate the mandatory application, and include in the rule bright-line criteria that banks may independently apply to specific arrangements that would qualify for the primary purpose exception. We also suggest changes to the particular criteria proposed and discuss additional exceptions that the FDIC should include in the final rule.

1. The FDIC should eliminate the mandatory application process and instead should provide bright-line criteria for the primary purpose exception and a supplementary voluntary application process to qualify under the exception for other activities.

The FDIC should eliminate the application requirement for the primary purpose arrangements described in the proposed rule and instead adopt bright-line criteria for the primary purpose exception.[34] The efficient and effective administration of the primary purpose exception would best be served by a framework that consists of (1) bright-line criteria that banks may independently apply and (2) a supplementary voluntary application process for relationships that do not meet the bright-line criteria.

BPI agrees that bright-line criteria are generally appropriate standards by which the primary purpose exception should be evaluated; however, each depository institution should be able to evaluate its individual circumstances and should not be required to obtain the FDIC's approval or concurrence with the bank's analysis and determination. The banks would, of course, be required to make good-faith determinations, and those determinations would be subject to review in the examination process. This approach is consistent with other regulatory frameworks under which banks and their parent companies operate, such as determinations of whether certain activities are part of the "business of banking" for purposes of the National Bank Act or whether a company "controls" another company for purposes of the Bank Holding Company Act.

Banks routinely are permitted and expected to make judgments—which are subject to review during the examination process—about the permissibility of their activities and their compliance with laws and regulations. This regulation should be no different. Requiring the FDIC to approve every relationship that relies on these criteria is not necessary to protect the Deposit Insurance Fund or preserve safety and soundness. We also note that, unlike some other statutes, Congress has not seen the need to require prior approval of the FDIC in Section 29 for reliance on the primary purpose exception,[35] or provided any basis for treating the primary purpose exception differently from the

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[33] Insured Brokered Deposits and Federal Depository Institutions, Hearings before the Subcommittee on General Oversight and Government Investigations of the House Committee on Banking, Housing, and Urban Affairs at 8, Cmte. Print 101-28, 101st Cong., 1st Sess. (May 17, 1989) (remarks of Sen. Murkowski) (noting that Section 29 was intended to be a "narrowly drawn provision that specifically targets the most flagrant abusers").

[34] Specifically, proposed 12 C.F.R. § 303.243(b) should be deleted. The proposed primary purpose exception at 12 C.F.R. § 337.6(a)(ii)(I) should also be revised to delete "if and to the extent, the FDIC determines that the agent or nominee meets this exception under the application process in 12 CFR 303.243(b)", and instead include subsections that set forth the specific criteria for the non-exclusive list of relationships that qualify for the primary purpose exception, including the specific criteria listed in the application process in proposed 12 C.F.R. § 303.243(b)(4) (modified as we propose in section III.B.4), as well as the voluntary application process we propose below.

[35] *Compare* 12 U.S.C. § 1842 (requiring prior approval of the Federal Reserve to become a bank holding company or for a bank holding company to acquire more than five percent of a bank's voting shares); 12 U.S.C. § 1828b (requiring

other exceptions from the definition of deposit broker, each of which may be relied on by banks *without* a formal application to the FDIC.

Because no list of criteria can be complete or sufficiently farsighted, particularly as the overall environment in which banks operate changes, BPI suggests a supplementary application process through which banks can voluntarily seek the FDIC's confirmation that certain relationships that do not meet the criteria set forth in the final regulation qualify for the primary purpose exception. In those cases, a voluntary application process, through which application decisions are made public, could provide substantial clarity for affected parties and the FDIC. This supplemental process would also result in additional consistency in the application of the primary purpose exception by providing banks with consistent public guidance.

In addition to being consistent with the statute and other bank regulatory frameworks, BPI's proposed approach also comports with practical realities. Adopting the requirement to obtain specific FDIC approval to rely on the primary purpose exception would require the FDIC to reconsider *thousands* of reasoned decisions on the primary purpose exception that banks and third parties have reached based on a careful analysis of Section 29 and the FDIC's existing regulations and interpretive guidance. This would also require agents or nominees to whom the FDIC has already affirmatively determined the primary purpose exception specifically applies to re-obtain the FDIC's approval to continue existing relationships. As examples of how broadly disruptive and burdensome the FDIC's proposed approach would be:

- Many banks rely on existing FDIC interpretive letters to apply the primary purpose exception to sweep deposits that a broker-dealer affiliate places with the bank.[36]

- Many banks rely on the primary purpose exception for deposits placed by broker-dealers pursuant to Rule 15c3-3 of the SEC's regulations,[37] as described in Advisory Opinion No. 94-39.[38]

- Using the rationale in Advisory Opinion No. 94-39, some banks apply the primary purpose exception to interest on lawyers trust accounts ("IOLTA") deposits, which attorneys must establish for the benefit of their clients under applicable professional rules.

Notwithstanding decades of reliance on the FDIC's guidance, under the proposed rule, each of these broker-dealers and attorneys would be required to apply for the primary purpose exception, potentially for multiple "business lines".[39] As a result, adoption of the proposed rule would require third parties and banks to inundate the FDIC with applications, many of which should not be necessary.

Beyond the need to review these numerous prior decisions, the FDIC may have substantially underestimated the volume of applications that would be required for banks seeking approval for new relationships that are eligible under one of the new bright-line application processes. For example, some banks have thousands of

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prior written approval of the appropriate federal regulator for an insured depository institution to merge or consolidate with another bank); 12 U.S.C. § 36 (requiring prior approval of the Office of the Comptroller of the Currency for a national bank to open a new branch); 12 U.S.C. § 1831a (requiring the FDIC's prior approval for a state bank to engage in activities that are not permissible for a national bank).

[36] *See* FDIC, Advisory Opinion No. 05-02 (Feb. 3, 2005).

[37] 17 C.F.R. § 240.15c3-3.

[38] As discussed in section III.B.5, the FDIC should adopt specific exceptions from the deposit broker definition, as part of the primary purpose exception, for these arrangements and for IOLTA deposits.

[39] Please see section III.B.4.a for a discussion of certain issues relating to "business lines".

prepaid card customers, such as employers that offer prepaid payroll disbursements. Each of these customers would potentially be required to submit an application for the primary purpose exception *even though the arrangement meets the conditions to qualify for the primary purpose exception under the "enabling transactions" application process in the proposed rule*.[40] Rather than go through a burdensome and uncertain process, the parties simply may determine that the effort is not worthwhile, either foregoing providing the service altogether or treating the deposits as brokered, with the attendant negative consequences.

If the FDIC nevertheless determines to adopt the mandatory application process, relationships previously entered into on the basis of an existing FDIC interpretive letter on the primary purpose exception should be grandfathered. In particular, banks that have received the FDIC's approval to exclude certain affiliated sweep deposits from brokered treatment, as outlined in the FDIC's Advisory Opinion 05-02, should be able to continue to rely on those interpretive letters without a requirement to re-apply for approval under the proposed application process. Consistent with the proposed rule, the 10 percent ratio described in those approvals should be increased to 25 percent without any further action from the banks or the FDIC.[41] If the existing relationships based on the primary purpose exception are not grandfathered under the final rule, there would be a disruption of numerous existing relationships that the FDIC has already determined qualify for the primary purpose exception or to which the parties have concluded, in good faith, that the primary purpose exception is available. This result would impose substantial burden on banks and those with whom they have business relationships without providing any meaningful improvement to the brokered deposits framework or to safety and soundness.[42] Given that the FDIC expects the proposed rule to *expand* the availability of the primary purpose exception,[43] existing relationships that are not currently treated as brokered should not cause concern.

Finally, if the final rule includes any application process (whether mandatory or voluntary), the final rule should clarify the timing for approval. Although the NPR provides that the FDIC will provide a written determination within 120 days of receiving a "complete" application, there is no clarity on when an application will be deemed complete. In fact, each of the three application processes outlined in the proposed rule require the applicant to submit "*any* other information that the FDIC requires to initiate its review and *render the application complete*".[44] As a result, the timing of the review and for rendering a decision is entirely at the discretion of the FDIC. The final rule should therefore provide additional clarity by outlining the FDIC's process for reviewing whether an application is complete. We propose that the final rule provide that the FDIC would (1) review an application for completeness within 30 days, (2) submit a request for additional information within one week thereafter, (3) review additional

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40 *See* proposed 12 C.F.R. § 303.243(b)(4)(ii).

41 Although the requirement in Advisory Opinion 05-02 refers to the amount of assets in a single investment account, as opposed to the "assets under management" for a particular business line, increasing the ratio of assets that can be swept to IDIs to 25 percent would be consistent with the proposed rule. In the NPR, the FDIC proposes that "business line" would refer to accounts that provide a sweep feature. *See* 85 Fed. Reg. at 7461. Under the proposed rule, a broker-dealer could place at an IDI 25 percent of the assets in an investment account that provides a sweep feature, because placing 25 percent of the assets in each such account at an IDI would result in placing 25 percent of the total assets in all such accounts (i.e., in the "business line", as the FDIC proposed to define that term with respect to the "25% of AUM" exception). As a result, codifying the guidance in Advisory Opinion 05-02, but increasing the permissible ratio to 25 percent, would both be consistent with the proposed rule, and would permit banks to continue relationships that the FDIC has already reviewed and approved without being required to go through a separate, and unnecessary, application process.

42 For similar reasons, the final rule should also include an implementation period during which banks would have sufficient time to prepare and submit applications and make any necessary adjustments to their businesses.

43 85 Fed. Reg. at 7459 ("[The] proposed amendment to the primary purpose exception would expand the number of entities that meet the exception".).

44 85 Fed. Reg. at 7471 (emphasis added).

information for completeness within 15 days of receipt, and (4) reach a decision, absent serious deficiencies in the information provided, within 120 days.

2. The final rule should eliminate ongoing reporting or monitoring requirements for arrangements that qualify for the primary purpose exception.

Under the proposed rule, an agent or nominee that receives FDIC approval under the primary purpose exception application process, or a bank that applies on behalf of the agent or nominee, would be required to provide reports to the FDIC, the contents and frequency of which would be decided by the FDIC as part of the application process for the primary purpose exception. This requirement should be eliminated. The proposal to require banks to provide reports on or monitor third parties' continued eligibility or compliance is inappropriate and unworkable as a practical matter. In many cases, banks rely on representations from, and agreements with, third parties that the third party meets and will continue to meet the criteria required to qualify for the primary purpose exception. Banks could continue to rely on such representations and agreements, but, in most cases, would not have access to the information needed to prepare reports on behalf of third parties, and third parties would be at best reluctant to share needed information with a bank.

If, notwithstanding the significant difficulties inherent in such a requirement, the FDIC determines to include in the final rule a reporting and/or monitoring requirement for parties applying to the FDIC under any application process, it should, at most, require the original applicant to submit a periodic affirmation that the arrangement continues to meet the applicable criteria for the primary purpose exception. In cases where a bank has applied on behalf of a third party and is responsible for providing the affirmation, a bank should be permitted to rely on certifications from the third party that the third party's activities meet the relevant criteria and would continue to qualify for the primary purpose exception as originally analyzed or approved, and the bank should have no liability for the third party's representations (assuming the bank is acting in good faith in relying on the representations). This approach would allow the FDIC to monitor ongoing compliance without creating undue burden.

If the final rule includes reporting requirements, it should, at the very least, eliminate the proposed *ad hoc* system. As proposed, the FDIC would "describe any reporting requirements as part of its written approval for the primary purpose exception".[45] This would create an *ad hoc* system of reporting that would be contrary to the FDIC's goal of bringing clarity and transparency to its brokered deposit framework. This type of process would also impose burdensome and unnecessary costs on banks because the nature of the process would prevent banks from developing automated or standardized systems to monitor relationships and prepare reports. If, contrary to BPI's recommendations, the final rule retains a reporting requirement, the FDIC should develop a reporting form so that the frequency and contents of reports are uniform and capable of efficient monitoring and administration.[46] This would provide additional clarity and enable banks to develop systems to collect and report required information.

3. The final rule should provide that the FDIC will modify or withdraw an approval for the primary purpose exception only if there has been a material change in circumstances.

Under the proposed rule, the FDIC can modify or withdraw any approval it grants through the application process for the primary purpose exception "with notice and adequate justification". In order to preserve parties' expectations in establishing business arrangements and consistent with principles of due process, the final rule should provide that the FDIC would modify or withdraw an approval only if there is a material change in the facts or circumstances relied on by the FDIC in granting its initial approval.

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[45] Proposed section 303.243(b)(9), 85 Fed. Reg. at 7471.

[46] Any reporting form that the FDIC develops should be consistent with the requirements of the Paperwork Reduction Act, including notice and a meaningful opportunity for comment.

4. The final rule should clarify certain aspects of the 25 percent of customer "assets under management" primary purpose exception.

As discussed in section III.B.1, the FDIC should eliminate the mandatory application process in proposed section 303.248(b) and instead adopt the criteria described in subsection 303.248(b)(4)(i) as an exception from the definition of deposit broker within the primary purpose exception itself, *i.e.*, as part of section 337.6(a)(5)(iii)(I). Whether the FDIC retains the application requirement for the primary purpose exception or adopts BPI's suggested approach, the criteria should be revised as follows.

a. The final rule should provide that a "business line" is determined by reference to a person's reasonable determination of its own business lines in the ordinary course of business.

Assuming adoption of the proposed criteria for the "25% of AUM" exception that the FDIC would view as qualifying for the primary purpose exception, the final rule should provide that a business line may be defined in a way that is consistent with the person's ordinary course of business, such as the person's risk management and reporting structures. The FDIC's stated intent with respect to the term "business line" is to refer to "the business relationships an agent or nominee has with a group of customers for whom the business places or facilitates the placement of deposits".[47] The FDIC also notes in the Preamble that the determination of a particular business line "depends on the facts and circumstances of a particular case", and that the FDIC "retains discretion to determine the appropriate business line to which the primary purpose exception would apply".[48]

Although the regulation itself does not limit or define the term "business line", we are concerned that the Preamble's example of a business line—*i.e.*, in the context of broker-dealers, treating accounts that offer a sweep feature as a separate business line from one that does not[49]—does not comport with any usual understanding of a business line. Defining "business line" by reference to a single feature of a particular product is not consistent with how financial services companies evaluate, manage or market their businesses. The primary purpose exception should be defined in a way that permits banks to make reasonable determinations about whether the exception applies to a particular relationship, without seeking the FDIC's concurrence in every case.

For these reasons, the final rule should define "business line" as a business line determined by the person in the ordinary course of business for risk management purposes, reporting purposes or other identifiable criteria relevant to the person's business. With respect to a broker-dealer relying on the "25% of AUM" exception, for example, "business line" may refer to all aspects of a brokerage business through which a broker-dealer manages client assets, including, for example, sweep programs and investment management programs (including management provided by both individual and robo-advisers).

b. The final rule should use a term other than "assets under management".

Under the proposed "25% of AUM exception", applicants can seek the primary purpose exception "based on the placement of less than 25 percent of the amount of customer assets under management by the third party, for a particular business line, at depository institutions".[50] The NPR notes that "[i]n determining the amount of customer

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47 85 Fed. Reg. at 7461.

48 85 Fed. Reg. at 7461.

49 *See* 85 Fed. Reg. at 7461 ("[A] company that offered brokerage accounts to various types of customers that allowed customers to buy and sell assets, with a traditional cash sweep option, would be considered a business line. Brokerage accounts that did not offer a cash sweep option would not be considered part of the business line . . .".).

50 Proposed section 303.248(b)(4)(i), 85 Fed. Reg. at 7471.

assets under management by an agent or nominee, for a particular business line, the FDIC would measure the total market value of all financial assets (including cash balances) that the agent or nominee manages on behalf of its customers that participate in a particular business line".[51] This definition should be revised because it could be read as limiting the scope of the exception in ways that are inconsistent with the FDIC's historical application of the primary purpose exception to broker-dealers. Specifically, the FDIC has permitted broker-dealers to rely on the primary purpose exception, subject to several conditions.[52] This advisory opinion did not limit application of the primary purpose exception to deposits swept from accounts for which the broker-dealer exercised investment discretion.

The phrase "assets under management" in the proposal could be interpreted to refer only to assets that are held in managed accounts. BPI recommends that the final rule refer to "assets under management or administration", to include customer assets held in both managed accounts and accounts for which an asset manager or broker-dealer does not exercise investment discretion, which is a more accurate measure of an asset manager or broker-dealer's business.

5. The final rule should include additional arrangements that would qualify for the primary purpose exception.

In the Preamble, the FDIC solicits comment on additional arrangements where the primary purpose of the third party is not the placement of funds with depository institutions for which the FDIC should provide additional clarity.[53] The final rule should clarify the treatment of a number of arrangements by including as part of the primary purpose exception additional exceptions for those arrangements, as described below. Banks should be able to apply each of these exceptions without submitting an application or obtaining the FDIC's prior approval.[54]

a. Health savings accounts (HSAs).

HSAs are tax-advantaged trust or custodial accounts that must be used in conjunction with high-deductible health plans, as defined under tax law, and that must be held by a trustee or custodian that is approved by the United States Department of the Treasury.[55] Deposits in an HSA typically are placed by a third-party administrator that provides employers with HSA administrative services. Because HSAs are limited by statute to being used to pay for or reimburse qualified medical expenses, they are, by definition, designed for a primary purpose other than the placement of deposits—the payment of medical expenses.[56]

The Preamble notes that several commenters on the ANPR requested that the FDIC clarify that HSA deposits qualify for the primary purpose exception, but the proposed rule does not address this important type of deposit. The FDIC should adopt a specific provision under the primary purpose exception for HSAs. As noted above, deposits are placed by third-party administrators in HSAs on behalf of participants for the purpose of allowing the participants to pay or be reimbursed for their medical expenses. The primary purpose of the administrator is not

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51 85 Fed. Reg. at 7459.

52 *See* FDIC, Advisory Opinion No. 05-02 (Feb. 3, 2005) (determining that brokerage accounts with a sweep feature qualify for the primary purpose exception, subject to limitations on the percentage of total assets in the account that could be swept into deposit accounts at affiliated IDIs).

53 85 Fed. Reg. at 7461.

54 See section III.B.1 above for a detailed discussion of why the final rule should not include an application requirement.

55 26 U.S.C. § 223.

56 *See* 26 U.S.C. § 213.

to place deposits, but rather to comply with applicable tax law and provide a means for depositors that have high-deductible health plans to pay or be reimbursed for medical expenses in a tax-advantaged manner. HSAs cannot be used for general savings purposes because contributions to these accounts are limited by tax law, and funds from these accounts may only be used to pay for or reimburse qualifying health-related expenses. Therefore, deposits placed into HSA accounts should qualify for the primary purpose exception as long as they are based on, and come within the limits of, applicable Internal Revenue Code provisions, and the FDIC should include in the final rule a self-executing exception for these deposits as part of the primary purpose exception.

b. Broker-Dealer "Special Reserve Bank Accounts for the Exclusive Benefit of Customers".

"Special Reserve Bank Accounts for the Exclusive Benefit of Customers" are accounts established by broker-dealers pursuant to Rule 15c3-3 of the SEC's regulations.[57] Rule 15c3-3 is intended to safeguard customer funds and securities held by brokers and dealers by requiring every broker-dealer to maintain with an IDI a segregated account in which cash and/or qualified securities in amounts required by Rule 15c3-3 are held for the benefit of the broker-dealer's customers. As the FDIC staff recognized in Advisory Opinion No. 94-39, the primary purpose of the broker-dealer in depositing funds into "Special Reserve" accounts is to satisfy the regulatory requirements applicable to the broker-dealer, and not to provide a deposit placement service to its customers.[58] The final rule should codify this guidance by providing a primary purpose exception from the definition of deposit broker for broker-dealers with respect to deposits placed into "Special Reserve Bank Accounts for the Exclusive Benefit of Customers" pursuant to Rule 15c3-3.

c. IOLTA Deposits.

IOLTAs are accounts maintained by attorneys pursuant to applicable laws and professional rules in the state where the attorney practices.[59] Attorneys are required to hold client funds in a segregated account, and, in some cases, are required to pool client funds into a segregated, interest-bearing account (an IOLTA). Similar to the "Special Reserve" accounts maintained by broker-dealers, the primary purpose of an attorney in establishing an IOLTA is to comply with applicable requirements, and not to provide a deposit placement service to an attorney's clients, and many banks rely on the primary purpose exception in treating deposits placed in IOLTAs as non-brokered. The final rule should codify this treatment by providing a primary purpose exception from the definition of deposit broker for attorneys with respect to deposits placed into IOLTAs pursuant to applicable laws and professional rules.

d. Deposits placed by "middle market" companies.

Under the FDIC's Advisory Opinion No. 17-02, deposits placed in connection with a bank's relationships with a number of "middle market" companies satisfy the primary purpose exception, as long as the company does not maintain a contractual or other "programmatic" arrangement with the bank to place deposits with the bank, and the company is not compensated directly or indirectly by the bank. The final rule should codify this guidance by providing a primary purpose exception from the definition of deposit broker for the following relationships. The final rule should also clarify that "programmatic" arrangement means a written agreement or similar formal arrangement whereby the third party steers depositors to a particular bank in exchange for volume-based fees from the bank.

- Property management firms: Banks receive deposits from property management firms that assist property owners with the maintenance, upkeep, collection of rent and other tasks related to the

57 17 C.F.R. § 240.15c3-3.

58 FDIC, Advisory Opinion No. 94-39 (Aug. 17, 1994).

59 *See, e.g.*, New York Judiciary Law § 497.

management of property. These firms place deposits at banks to assist their clients in the managing of their properties.

- Mortgage servicers: Mortgage servicers collect funds from borrowers to fulfill certain lender requirements, and frequently deposit borrower funds with banks only for the purpose of servicing mortgages.

- Residential/commercial escrow services: Title insurance companies offer various services to facilitate real estate transactions, including the provision of escrow services. Deposits are placed in escrow accounts at banks in connection with, and for the purpose of, providing these services.[60]

- CFTC customer segregated funds: CFTC-registered futures commission merchants place deposits to comply with applicable CFTC requirements that mandate customer funds be placed into segregated accounts.[61]

- Qualified intermediaries: Some deposits are placed by "qualified intermediaries" to allow third parties to satisfy applicable tax requirements.[62]

C. Proposed Revisions to the "IDI Exception".

BPI strongly supports the FDIC's proposal to include operating subsidiaries of an IDI in the "IDI exception". In particular, we agree with the FDIC's view that "there is little practical difference between deposits placed at an IDI by a division of the IDI versus deposits placed by a wholly owned subsidiary of the IDI",[63] and believe that operating subsidiaries should be treated as if they are the parent institution for purposes of the brokered deposit regulations.[64] Below, we suggest changes that would substantially improve the clarity of the application of the exception.

1. The final rule should permit a subsidiary of an insured depository institution to qualify for the IDI exception with respect to deposits placed with its parent regardless of whether the subsidiary also places deposits with other banks.

Under the proposed rule, a subsidiary of an IDI would qualify for the IDI exception if, among other criteria, the subsidiary "places deposits of retail customers exclusively with its parent insured depository institution".[65] We

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60 More generally, the final rule should provide a primary purpose exception from the deposit broker definition for third parties with respect to deposits placed into all forms of escrow accounts, as funds are placed into those accounts for the purpose of securing the funds in connection with some other transaction and are not placed for the purpose of providing a deposit placement service.

61 *See* 17 C.F.R. § 1.20 (requiring futures commission merchants to deposit customer funds into a segregated account with a bank or trust company, a derivatives clearing organization or another futures commission merchant).

62 Qualified intermediaries facilitate the exchange of "like kind" properties on behalf of clients. 26 C.F.R. § 1.1031(k)-1(g)(4).

63 85 Fed. Reg. at 7458.

64 This treatment is also consistent with other regulations, *e.g.*, operating subsidiaries generally are not treated as affiliates of their parent bank for purposes of Regulation W. *See* 12 C.F.R. § 223.3(k) (defining "depository institution" to include the institution's operating subsidiaries).

65 Proposed section 337.6(a)(5)(iii)(A), 85 Fed. Reg. at 7472. In addition to the criterion noted above, to qualify for the IDI exception, the subsidiary must also meet the following criteria: "the parent insured deposit institution owns 100 percent

assume that the FDIC intends "exclusively with its parent insured depository institution" criterion to mean that the subsidiary qualifies for the new exception from the definition of deposit broker with respect to those funds it places with its parent institution, but would not qualify with respect to funds placed into another depository institution, including a "sister bank" of its parent. The FDIC should clarify this in the final rule.

This clarification would be consistent with Section 29 and the FDIC's existing regulations, which exclude an IDI from the definition of deposit broker with respect to funds placed with that IDI.[66] There is no requirement that the IDI cannot place funds at another IDI. In other words, an IDI can be excluded from the deposit broker definition with respect to placing its own deposits while, at the same time, be captured by the definition of deposit broker with respect to funds placed at other institutions.

2. **The final rule should clarify that the requirement to place deposits of retail customers exclusively with the parent bank does not prohibit the subsidiary from placing non-retail deposits with its parent bank or another bank.**

As noted above, to qualify for the IDI exception, a bank subsidiary must, among other criteria, place deposits of "retail customers" exclusively with its parent IDI.[67] As drafted, it is not clear if this is intended to require a subsidiary to place all retail deposits with its parent in order to qualify (*i.e.*, the subsidiary can place non-retail deposits with other institutions and still qualify for the IDI exception), or if the subsidiary is permitted to place with its parent bank only retail deposits (and not wholesale deposits) in order to qualify. The Preamble does not shed any further light on the FDIC's intention in referring to "retail deposits".

The final rule should clarify that an operating subsidiary may place wholesale deposits with its parent institution (or another institution) and qualify for the IDI exception with respect to both the wholesale and retail deposits it places with its parent institution. The statutory IDI exception does not distinguish between wholesale and retail deposits, nor does the NPR provide any reason to disallow application of the exception to an operating subsidiary that places wholesale deposits.

In addition, there is no basis for treating an operating subsidiary differently from its parent institution. An insured depository institution is not a deposit broker with respect to placement of either retail or wholesale deposits at that institution, and, likewise, the IDI exception should apply to an operating subsidiary with respect to deposits placed at its parent bank, regardless of whether they are retail or wholesale deposits.

3. **The final rule should not require the operating subsidiary to be wholly owned.**

Under the proposed rule, only wholly owned subsidiaries of an IDI would qualify for the IDI exception.[68] BPI submits that there is little practical difference between a wholly owned operating subsidiary of an IDI and an operating subsidiary that is not wholly owned.

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of the subsidiary's outstanding stock" and the subsidiary "engages only in activities permissible for the parent insured depository institution".

[66] 12 U.S.C. 1831f(g)(2)(A) ("The term 'deposit broker' does not include an insured depository institution, with respect to funds placed with that depository institution".). 12 C.F.R. 337.6(a)(5)(ii)(A) (repeating the statutory exception with no changes).

[67] Proposed section 337.6(a)(5)(iii)(A), 85 Fed. Reg. at 7472.

[68] Proposed section 337.6(a)(5)(iii)(A)(*1*)(*i*) ("A wholly owned operating subsidiary is considered part of the parent insured depository institution . . . if it meets the following criteria: The parent insured depository institution owns 100 percent of the subsidiary's outstanding stock; . . . ".).

Under current regulatory frameworks, banks frequently establish operating subsidiaries that are not wholly owned. For example, national banks are permitted to invest in operating subsidiaries as long as the bank (i) has the ability to control the management and operations of the subsidiary (and no other person or entity exercises operating control over the subsidiary or has the ability to influence the subsidiary's operations to the same or greater extent as the bank); (ii) owns and controls more than 50 percent of the voting interest of the subsidiary (or otherwise controls the subsidiary and no other party controls a percentage of the subsidiary's voting interest greater than the bank's); and (iii) the operating subsidiary is consolidated with the bank under GAAP.[69]

Because banks control the operations of operating subsidiaries (and an operating subsidiary may engage only in activities permissible for the parent bank), an operating subsidiary is the functional equivalent of the parent bank, even if it is not wholly owned. Treating wholly owned operating subsidiaries differently from other operating subsidiaries in effect penalizes banks for their choice of ownership arrangements, which is determined for a variety of reasons, without any benefit to safety and soundness. The final rule should therefore remove the requirement for the parent bank to own 100 percent of the subsidiary's outstanding stock for the subsidiary to qualify for the IDI exception, so long as the subsidiary qualifies as an operating subsidiary of the bank under applicable law.

IV. Additional Recommendations.

A. The final rule should exclude affiliate-generated deposits from the definition of "deposit broker".

The final rule should exclude from the definition of brokered deposits any deposits sourced from a bank's affiliate, including an affiliated bank or trust company, where the bank and the affiliate are both wholly owned by the same holding company. Banks and their affiliates frequently offer a full suite of financial services, including broker-dealer, investment advisory and trust services, to meet customer demand for a modern, "one-stop-shop" experience. In these cases, a bank's affiliates are not engaged in the business of placing deposits or facilitating the placement of deposits, as the FDIC has proposed to interpret those terms, but rather are engaged in the business of providing a comprehensive and integrated financial services solution to its customers.

Affiliate-generated deposits lack the characteristics associated with brokered deposits, and generally result from a bank's desire to establish a relationship, or to deepen an existing relationship, with the depositor. Customer relationships with bank affiliates tend to be deep and long lasting, and, as a result, such customers view themselves as customers of the entire firm and are inherently less likely to demonstrate the volatility associated with brokered deposits. For example, as the FDIC noted in its 2011 Study on Core Deposits and Brokered Deposits, "[affiliate] referrals are *ancillary* to the affiliates' legitimate businesses", and "because depositors have a relationship with an affiliate of the bank, these deposits may behave more like deposits where the bank itself has a relationship with the depositor, and thus may be more stable and less likely to leave for higher rates or when the bank is under stress".[70]

Because affiliates that generate deposits for an affiliate bank are engaged in the business of providing an integrated financial services solution that results in a direct relationship between the affiliated bank and the depositor, the final rule should clarify that wholly owned subsidiaries of a bank's parent holding company are not engaged in the business of placing or facilitating the placement of deposits with respect to deposits they or their customers place with affiliate banks, and that these deposits, therefore, are not brokered deposits. If, however, the FDIC views these deposits as brokered under the basic definition of deposit broker, affiliates should be categorically excluded from the definition of deposit broker under the primary purpose exception. As discussed above, affiliates place deposits with their affiliated banks to serve customers' holistic banking needs and to provide customers and potential customers with access to a wide suite of banking and other financial services products, providing customers with information

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[69] 12 C.F.R. § 5.34(e)(2).

[70] FDIC, 2011 Study on Core Deposits and Brokered Deposits (July 8, 2011), at 56-57 (emphasis added).

and solutions concerning a wide variety of financial products that may include an affiliate bank's deposit offerings. As a result, their primary purpose is not the placement or facilitating the placement of deposits.

B. The FDIC should codify or rescind advisory opinions only after notice of the specific guidance to be codified and an opportunity to comment.

The NPR notes that as part of the rulemaking process,

> [T]he FDIC intends to evaluate existing staff opinions to identify those that are no longer relevant or applicable based on any revisions made to the brokered deposit regulations. The FDIC plans as part of any final rule to codify staff opinions of general applicability that continue to be relevant and applicable, and to rescind any staff opinions that are superseded or obsolete or are no longer relevant or applicable.

The FDIC does not describe what opinions or other guidance it considers "relevant or applicable", or how any such guidance will be implemented in the final rule. By not providing any indication of the guidance that will be codified or repealed, or how codified guidance will impact the text of the proposed rule, the FDIC has not provided the public the ability to comment meaningfully on a significant aspect of the proposed rule. For example, there are a number of advisory opinions in which the FDIC has determined that certain relationships qualify for the primary purpose exception.[71] The proposed rule does not indicate which, if any, of these opinions would be codified in the final rule, whether an application process would be required (or what information would be required for an application), or if any of the criteria in the opinions would be modified. This is inconsistent with the spirit of the Administrative Procedure Act, which is intended to provide for public participation in the in the rulemaking process.[72] For these reasons, the specific details of all changes to the proposed rule that would result from codification of the FDIC's existing guidance, and the repeal of any existing guidance, should be published for notice and comment.

C. BPI would support the codification of certain advisory opinions and other guidance after appropriate opportunity for notice and comment.

The FDIC has provided helpful guidance through its FAQs and advisory opinions with respect to a number of deposit relationships. BPI would support the codification of certain FAQs and advisory opinions, after a notice and comment period that provides a meaningful opportunity for the public to comment.

1. Listing services.

As discussed in Section III.A.2.e above, FAQs D2 should be codified to exclude listing services that meet the criteria in the FAQs from the definition of "deposit broker". Banks also rely on FAQs D1 and D3 in determining whether a third party is a listing service and for additional guidance on when the FDIC would treat a listing service as a deposit broker. The FDIC should codify this guidance so that banks have clear criteria for treating deposits placed through a listing service as non-brokered.

2. Distribution of prepaid cards.

Under FAQ E13, companies that distribute prepaid cards as part of a corporate rebate program are not deposit brokers. The FDIC should codify this guidance so that banks have clear examples of programs that would not result in a third party being deemed to be a deposit broker.

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71 *See, e.g.*, FDIC, Advisory Opinion Nos. 94-39, 05-02 and 17-02.

72 *See, e.g.*, Attorney General's Manual on the Administrative Procedure Act (1947), at 9.

3. Treatment of funds disbursed to beneficiaries of government programs.

Under FAQ E14, federal, state and local agencies qualify for the primary purpose exception with respect to certain deposits that are placed at IDIs and disbursed to beneficiaries of government programs through debit or prepaid cards. Although these agencies could continue to qualify for the primary purpose exception by placing deposits into transaction accounts, the proposed rule would require the agencies to apply for the exception. For the reasons discussed in section III.B.1 above, the final rule should not include an application requirement for the primary purpose exception. If, however, the final rule does include such a requirement, the FDIC should codify FAQ E14 and continue to permit agencies meeting the criteria set forth in the FAQ to qualify for the primary purpose exception without the need for an application.

4. Reclassification of certificates of deposit as non-brokered.

Under FAQ F2, a bank can reclassify a brokered certificate of deposit as non-brokered, if no third party "is involved with the account" at the time the certificate of deposit is renewed or rolled over. Many banks rely on this guidance, and the FDIC should codify FAQ F2, so that banks have clear criteria for reclassifying brokered certificates of deposit as non-brokered.

5. Reclassification of non-maturity deposits as non-brokered.

Under FAQ F3, a brokered non-maturity deposit (*e.g.*, a deposit placed into a demand deposit account) can be reclassified to non-brokered after 12 months have passed, if, during that 12-month period, no third party is "involved with the account". Guidance in FAQ F3 should be codified, so that banks continue to have clear criteria for reclassifying brokered non-maturity deposits as non-brokered.

D. BPI would support the rescission of certain advisory opinions and other guidance after appropriate opportunity for notice and comment

1. Guidance relating to "active" versus "passive and indirect" marketing should be repealed, after appropriate notice and comment.

Because of the revised definition of "engaged in the business of facilitating the placement of deposits", the NPR appears to supersede the FDIC's prior guidance relating to marketing relationships. In particular, it appears that the distinction between "active" and "passive and indirect" marketing is no longer applicable. For the sake of clarity, FAQs B4 and B8 and Advisory Opinion 93-71 (with respect to its discussion of "passive and indirect marketing"), should be rescinded.

2. Guidance relating to the definition of "deposit broker".

The FDIC should rescind FAQs A5 and B2 and Advisory Opinions 92-79 and 94-15 because the factors the FDIC set forth in that guidance for determining whether a third party is engaged in the business of placing or facilitating the placement of deposits are inconsistent with the definitions provided in the NPR and are no longer applicable.

3. Guidance relating to the primary purpose exception.

The FDIC should rescind FAQs E9 through E12 because (1) the FDIC has indicated that it will now examine the primary purpose exception on the basis of the business relationship between the agent or nominee and its

customers, as opposed to the intent of the third party in placing deposits,[73] and (2) the NPR's exception for deposits placed into transaction accounts supersedes the FAQs' guidance that distributors of general purpose prepaid cards and multi-purpose debit cards generally do not qualify for the primary purpose exception.

E. The FDIC and other regulators should revise the liquidity coverage ratio ("LCR"), the proposed net stable funding ratio ("NSFR") and the G-SIB surcharge to align the treatment of deposits with the FDIC's brokered deposit regulations.

Under the LCR requirement and the proposed NSFR, brokered sweep deposits are treated as volatile sources of funding even if they are not brokered deposits under Section 29 (*e.g.*, because of the primary purpose exception). Similarly, brokered sweep deposits are not excluded from the short-term wholesale funding calculation for purposes of the G-SIB surcharge or the banking agencies' tailoring rules[74] even if they are not brokered deposits under Section 29. This treatment of sweep deposits results from a broader philosophy of treating all brokered deposits as risky and volatile sources of funding notwithstanding that many of these deposits are in fact stable and do not implicate the concerns raised by Congress in enacting Section 29. For these reasons, the FDIC and other regulators should, as applicable, revisit the treatment of brokered sweep deposits under the LCR, the proposed NSFR, the G-SIB surcharge and the tailoring rules. Please refer to BPI's prior comment letters on the LCR, NSFR, G-SIB surcharge and tailoring rules for additional details.[75]

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[73] *See* 85 Fed. Reg. at 7459 ("The FDIC is proposing to set forth regulatory changes to the primary purpose exception. Specifically, the FDIC is proposing that the application of the primary purpose exception be based on the business relationship between the agent or nominee and its customers.").

[74] Under the tailoring rules, all retail deposits identified as brokered deposits and brokered sweep deposits under the LCR are reported on Form FR Y-15 as retail brokered deposits and sweeps for purposes of the tailoring rules' weighted short-term wholesale funding indicator. 84 Fed. Reg. 59230, 59242 (Nov. 1, 2019).

[75] *See* Letter to OCC, FRB and FDIC, from The Clearing House Association L.L.C., the American Bankers Association, the Securities Industry and Financial Markets Association, the Institute of International Bankers, the International Association of Credit Portfolio Managers, the Structured Finance Industry Group and the Financial Services Roundtable re: Liquidity Coverage Rate: Liquidity Risk Management, Standards, and Monitoring (Jan. 31, 2014), at 43-47; Letter to OCC, FRB and FDIC, from The Clearing House Association L.L.C., the Securities Industry and Financial Markets Association, the Financial Services Roundtable, the American Bankers Association, the CRE Finance Council and the Institute of International Bankers re: Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements (Aug. 5, 2016), at 27-31; Letter to the FRB, from The Clearing House Association L.L.C., the Securities Industry and Financial Markets Association and the Financial Services Roundtable (Apr. 2, 2015), at 39-40; Letter to OCC, FRB and FDIC, from BPI and the American Bankers Association re: Proposed Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries (June 21, 2019) at 19.

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The Bank Policy Institute appreciates the opportunity to provide its comments, and would welcome the opportunity to discuss them further with you. If you have any questions, please contact the undersigned by phone at (202) 589-2424 or by email at *dafina.stewart@bpi.com*.

Respectfully submitted,

Dafina Stewart
Bank Policy Institute

cc: Doreen Eberley
Nicholas Podsiadly
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Appendix C

The FDIC's Proposed Brokered Deposit Reclassification: An Empirical Evaluation

The FDIC's Proposed Brokered Deposit Reclassification: An Empirical Evaluation

11.21.24

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The FDIC's brokered deposits framework was created in 1989 in response to the savings and loans crisis of the 1980s. Section 29 of the Federal Deposit Insurance Act aimed to protect the Deposit Insurance Fund by restricting less-than-well-capitalized banks' ability to accept brokered deposits at above-market rates.[1]

Over time, the FDIC interpreted the definition of deposit broker expansively, leading to deposits being considered brokered that did not bear the same characteristics of the "hot money" that was the target of Section 29. And the consequences of this expansive interpretation extend further by penalizing banks for holding "brokered deposits" even if the bank is well capitalized.[2]

In 2020, the FDIC adopted revised rules to address the scope of the regulatory definition of brokered deposits given technological innovations and the modern provision of financial services. Among the types of deposits addressed by the FDIC's 2020 rule are so-called "sweep" deposits. These are programs where broker-dealers place customers' investment account cash balances with insured depository institutions (banks) for safekeeping. These banks may or may not be affiliated with the broker-dealer, and these arrangements provide investors a safe place for their investment account's free cash balance. The FDIC's 2020 rule clarified that deposits from sweep programs are not brokered if less than 25 percent of customer total assets were placed in banks, reasoning that such broker-dealers do not have the "primary purpose" of placing funds at banks.[3]

The FDIC's 2024 proposal would substantially narrow the availability of this exclusion. For example, under the proposed "fee prong," any additional third party receiving compensation for sweep program services would be classified as a deposit broker, unless the FDIC approves an exception through an application process. The proposal would also make two other significant changes to the primary purpose exclusion for sweeps: it would reduce the asset threshold from 25 percent to 10 percent and base calculations on "assets under management," instead of "assets under administration." This shift could restrict the exclusion to only actively managed accounts, excluding self-directed investment accounts where investors control their investments.

Furthermore, the FDIC has solicited comments on more stringent alternatives. These include the complete elimination of the designated business exception for broker-dealer sweeps or limiting it exclusively to deposits placed at affiliated banks. These restrictions would apply across all business lines, thus making these alternatives even more stringent. Under either alternative scenario, broker-dealer sweep deposits to unaffiliated banks would be universally classified as brokered unless specifically exempted through an FDIC-approved primary purpose exception application.

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[1] Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (Apr. 19, 1989).

[2] These penalties include (1) higher deposit insurance assessment rates; (2) requirements to maintain additional liquid assets to offset the higher outflow rates assigned to brokered deposits under the liquidity coverage ratio (brokered deposits also are generally assigned lower Available Stable Funding factors under the net stable funding ratio); (3) for GSIBs, higher GSIB surcharges that require GSIBs to hold higher levels of total loss absorbing capacity; (4) for Category III and Category IV institutions, potentially higher liquidity coverage ratio and net stable funding ratio requirements than would otherwise apply; (5) expending additional time and resources on liquidity planning (*e.g.*, incorporating PCA-related downgrade triggers into contingency funding plans); and (6) reduced ability to compete with nonbank competitors that are not required to factor liquidity costs into product offerings that would result in brokered deposits for a bank (*e.g.*, money market mutual funds).

[3] The statute excludes deposits from being considered brokered if the "primary purpose" of the third party "is not the placement of the funds with depository institutions." 12 USC 1831f(g)(2)(I).

This note examines the empirical relationships observed during the March 2023 stress event between bank risk and two deposit categories: brokered deposits and non-brokered sweep deposits. The note then evaluates the FDIC's proposed regulatory changes in light of these findings. For the purposes of this analysis, "brokered deposits" and "sweep deposits" refer to deposits classified as such on the call report. Any regulatory reclassification of these deposit programs would raise costs for banks and broker-dealers and, in turn, for investors. Furthermore, such changes could also limit the availability of these sweep programs and the benefits they provide to investors.

Our analysis significantly undermines the rationale for the FDIC's proposed rule. First, the FDIC cites the substantial decline in reported brokered deposits—from $996 billion to $652 billion between March and June 2021—as evidence of potential underreporting. Our analysis demonstrates that 10 institutions account for approximately 90 percent of this decline. Of these, the two largest contributors—accounting for 80 percent of the decline—received a primary purpose exception for broker-dealer sweep arrangements in the second quarter of 2021. Thus, the reclassification of sweep deposits to non-brokered status explains the majority of the observed decline in brokered deposits following the implementation of the 2021 final rule.

Second, our empirical analysis shows that non-brokered sweep deposits exhibit no statistically significant correlation with bank risk after accounting for bank-specific characteristics, indicating fundamentally different risk characteristics from traditional brokered deposits. In contrast, and consistent with academic research, there is a positive correlation between reliance on brokered deposits and bank risk, particularly for banks below $100 billion in assets.

Notably, the FDIC's proposal contains no contrary analysis in support of its requirements, relying instead on anecdotal evidence. Our systematic analysis suggests that sweep deposits and brokered deposits exhibit distinctly different risk characteristics. This empirical evidence indicates that maintaining separate regulatory treatment for these deposit categories may be more appropriate than the proposed consolidation under the 2024 proposal.

The Temporary Drop in Brokered Deposits Post-2021 Final Rule

The 2024 brokered deposits proposal seeks to reverse the changes to the definition of brokered deposits made by the 2021 final rule, which had provided new exclusions from the "deposit broker" definition. The FDIC's concern appears to stem from the possibility that these reclassified deposits may retain characteristics and risks traditionally associated with brokered deposits, despite their modified regulatory treatment. Of particular significance, the 2021 final rule established a 25 percent threshold, whereby institutions could place up to a quarter of their customer funds on deposit without triggering deposit broker classification. This provision notably expanded banks' capacity to accommodate asset managers' sweep account deposits without incurring the regulatory implications associated with brokered deposit classification.

The goal of the 2024 proposal is to reverse some of these modifications, citing significant shifts in reported brokered deposit levels as evidence of underreporting of brokered deposits and its consequences for the Deposit Insurance Fund. Specifically, banks' call reports show that total brokered deposits declined from $996 billion to $652 billion—a reduction of approximately $350 billion—between March 31, 2021, and June 30, 2021 (illustrated by the solid line in Figure 1). This substantial decline coincides with the implementation period of the 2021 final rule.

Table 1 shows the 10 banks that reported the largest declines in brokered deposits during the period of March 31, 2021 to June 30, 2021. These institutions collectively account for approximately 90 percent of the aggregate decline in brokered deposits during this interval, with the two banks at the top of the list representing nearly 80 percent of the total reduction. Data provided by the FDIC indicate that this substantial decline in brokered deposits

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is attributable to the institutions' eligibility for a primary purpose exception under the 2021 final rule, specifically for their broker-dealer sweep arrangements. Notices were filed by these institutions in April and June 2021.

Around the same time the 2021 final rule became effective, the FFIEC also adopted changes to the call report to collect more information on sweep deposits, specifically because those deposits would no longer be reported as brokered.[4] This data suggests that the observed decline in brokered deposits in the second quarter of 2021 may be partially attributable to the reclassification of these sweep deposits as non-brokered. As shown in Table 1, a significant proportion of the institutions contributing to the decline in brokered deposits concurrently reported substantial amounts of sweep deposits in the new line items on the call report that took effect as of the Sept. 30, 2021 report date.

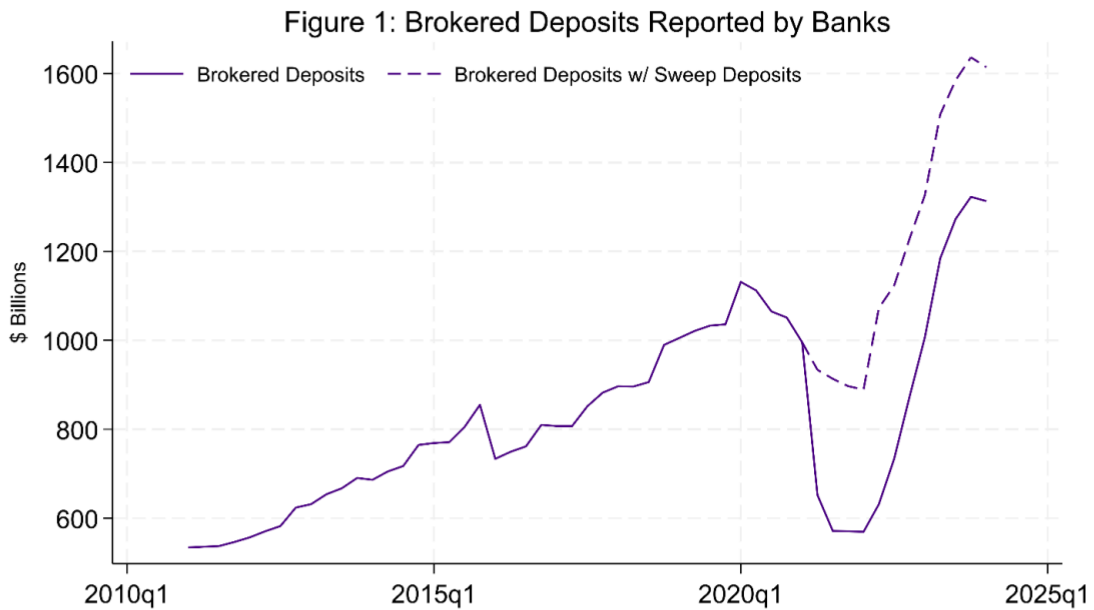
Table 1: Top 10 Decrease in Brokered Deposits: March 31, 2021 to June 30, 2021

Bank Name	(1) Change in Brokered Deposits ($ Billions)	(2) Non-Brokered Sweep Deposits ($ Billions)	(3) Affiliated Sweep Deposits ($ Billions)	(4) Non-Affiliated Sweep Deposits ($ Billions)
The Toronto-Dominion Bank	-153	142	143	0
Bank of America Corporation	-90	203	203	0
Citigroup Inc.	-20	21	3	67
Wells Fargo & Company	-13	113	105	20
The PNC Financial Services Group, Inc.	-8	5	5	4
Morgan Stanley	-6	214	213	5
Pathward Financial, Inc.	-5	0	0	0
Citizens Financial Group, Inc.	-5	6	1	7
HSBC Holdings plc	-4	3	0	13
Capital One Financial Corporation	-4	0	0	0
Totals	**-309**	**706**	**672**	**116**

Note: Since some affiliated and non-affiliated sweep deposits may still be classified as brokered, the sum of columns (3) and (4) exceeds column (2).

The dashed line in Figure 1 represents a counterfactual analysis that estimates brokered deposits level absent the regulatory reclassification of sweep deposits to non-brokered status. This counterfactual analysis demonstrates that the reclassification of sweep deposits represents the main explanation for the observed decline in brokered deposits following the implementation of the 2021 final rule.

[4] 86 FR 6742, 6761 (noting "institutions will be required to report to the FDIC or on the Call Report certain types of deposits that will not be considered brokered deposits under the final rule" and "[t]he FDIC plans to monitor the data resulting from such reporting and will consider in the future whether modifications to deposit insurance assessment pricing related to certain types of funding concentrations are warranted, consistent with the statutory requirement that the assessments be risk-based); 86 FR 8480, 8484 (describing agencies' intent "to update the Call Report to obtain data that will assist in better evaluations of funding stability for sweep deposits over time to determine their appropriate treatment under applicable liquidity regulations and to assess the risk factors associated with sweep deposits for determining their deposit insurance assessment implications, if any.")



The 2024 proposal points to the fact that brokered deposits declined under the 2021 rule as support for the proposed changes. However, the decline in brokered deposits on its own does not provide any evidence of the need for changes and warrants more systematic empirical investigation.

Empirical Analysis

This section examines the relationship between banks' reliance on brokered deposits and sweep deposits and their stock returns (as a proxy for bank risk) during the significant stress event of the March 2023 mid-sized bank crisis.

Our primary analysis focuses on bank equity returns during March 2023, a period characterized by significant stress in mid-sized banking institutions following Silicon Valley Bank's failure. SVB's collapse was idiosyncratic but led to market focus on other institutions that shared certain similar characteristics and many of those institutions experienced considerable market stress.

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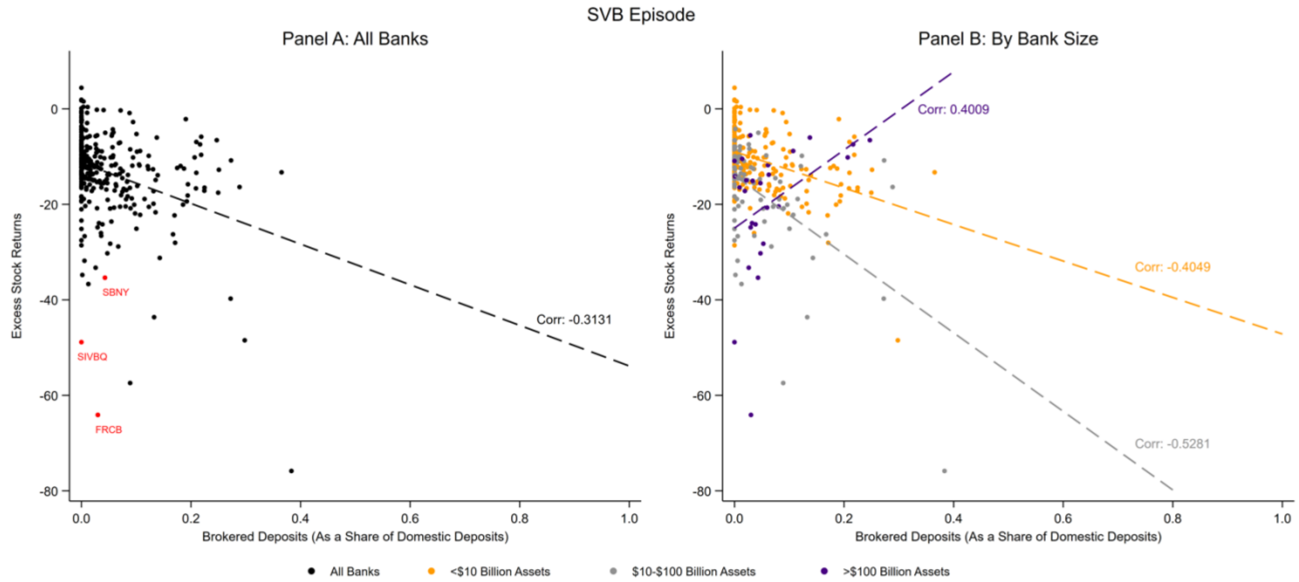
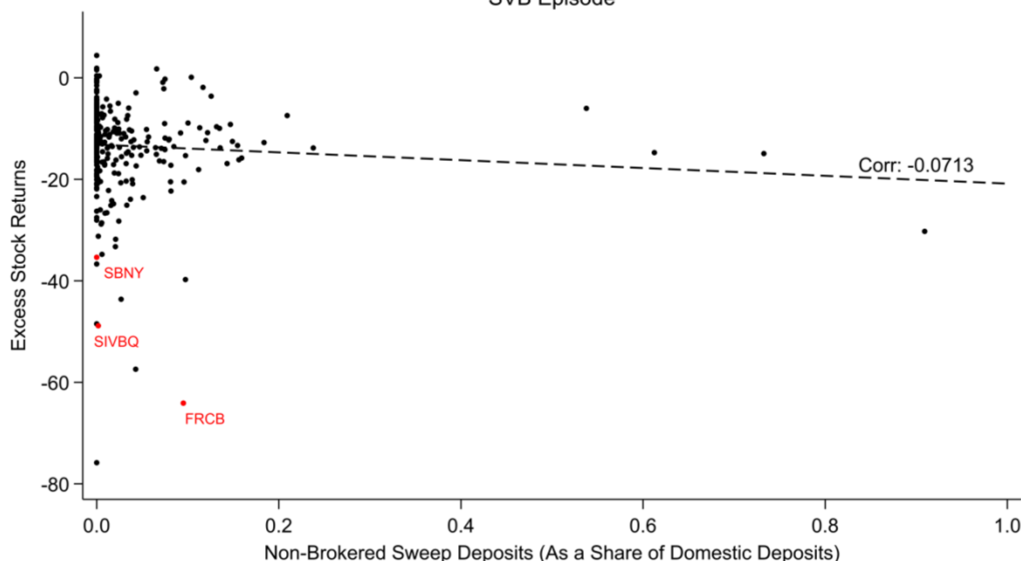


Source: FFIEC Call Reports and Y-9C Reports.

Panel A of Figure 2 illustrates the negative relationship between bank holding companies' equity returns during March 1-13, 2023, and their ratio of brokered deposits to total domestic deposits as of Dec. 31, 2022.[5] As shown in Panel B, however, the correlation between stock returns and reliance on brokered deposits varies significantly by bank size. The correlation is only negative for banks with less than $100 billion in assets, particularly those between $10 billion and $100 billion. Our regression results below demonstrate that the negative correlation exists independently of the adverse press coverage smaller banks received during the March 2023 mid-sized bank crisis. Conversely, banks above $100 billion in size exhibit a positive correlation between stock returns and reliance on brokered deposits.[6]

[5] The choice of dates follows recent academic literature analyzing the March 2023 mini-banking crisis. For example, Acharya, Viral V and Chauhan, Rahul S and Rajan, Raghuram and Steffen, Sascha, "Liquidity Dependence and the Waxing and Waning of Central Bank Balance Sheets", National Bureau of Economic Research, Working Paper number 31050, March 2023, available at http://www.nber.org/papers/w31050.

[6] The sample includes 201 publicly traded banks with less than $10 billion in assets, 78 banks between $10-100 billion, and 25 banks exceeding $100 billion in total assets.



By contrast, Figure 3 demonstrates that sweep deposits not classified as brokered deposits showed virtually no correlation with bank stock performance during the March 2023 stress period for banks in any size category. This finding suggests that markets viewed these sweep arrangements differently from traditional brokered deposits, likely due to their distinct operational characteristics and customer relationships. The lack of correlation persists across different bank size categories (not shown).

To formally test these relationships, we estimate the following regression specification:

$$r_i = \alpha + \gamma Z_{i,1} + \theta Z_{i,2} + \sum_{j=1}^{N} \beta_j X_i + \varepsilon_i \tag{1}$$

The dependent variable, r_i, represents cumulative excess returns for bank holding company i, while our key explanatory variables $Z_{i,1}$ and $Z_{i,2}$ denote the ratios of brokered deposits and total sweep deposits that are not brokered deposits to total domestic deposits, respectively. The vector X_i includes all variables that are important to include in the regression to analyze the relationship between brokered and sweep deposits and bank risk.

We control for bank size by segmenting the sample into three categories: banks with less than $10 billion in assets, those between $10-$100 billion, and banks exceeding $100 billion in total assets. The amount of high-quality liquid assets inclusive of unrealized losses (measured as a percentage of total assets) captures the bank's ability to meet short-term obligations and withstand funding shocks. We included the amount of unrealized losses on all securities since this factor drove much of the negative press coverage around banks during the March 2023 stress period.

We also include uninsured deposits (measured as a percentage of total assets). While this publicly available metric gained attention during the spring 2023 banking stress, it's important to note that it may not accurately reflect funding stability. Different business models, particularly those of banks where deposits are primarily operational in nature, may maintain higher levels of uninsured deposits without necessarily indicating increased risk. Other types of uninsured deposits such as collateralized and affiliate deposits also have features that are likely to make them

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more stable than other types of uninsured deposits. We include this measure because it was a key metric that market participants focused on during that period.

Return on assets serves as a proxy for operational efficiency and earnings capacity. Finally, the Tier 1 leverage ratio controls for capital adequacy and loss-absorption capacity.[7]

Table 2 presents our regression estimates. The first two columns examine the relationship between brokered deposits and equity returns. Column (1) reports results for the placebo period (Jan. 1 – Feb. 28, 2023), while Column (2) presents findings for the period of market stress (March 1-13, 2023). The coefficient estimates indicate that prior to the March 2023 banking crisis, the reliance on brokered deposits exhibited a positive association with stock returns. However, this relationship reversed significantly during the crisis period, with the coefficient becoming negative and both economically and statistically significant.

Specifically, a 10-percentage-point increase in the ratio of brokered deposits to total deposits is associated with a nearly 3-percentage-point decline in stock returns during the crisis period, representing approximately a decline from the median stock return to the first quartile stock price decline observed during the March 2023 period. Moreover, the coefficient on sweep deposits not classified as brokered is statistically insignificant, suggesting no discernible relationship with bank risk.

The estimated coefficients of the remaining control variables largely align with our expectations. The coefficient on high-quality liquid assets is positive and statistically significant at the 5 percent level, indicating that banks with stronger liquidity positions experienced less severe declines in stock returns during the period of market stress. Consistent with market focus during this period, the coefficient on uninsured deposits is negative and statistically significant at the 1 percent level, suggesting that banks with higher proportions of uninsured deposits experienced larger declines in their stock returns. Profitability, as measured by return on assets, exhibits a positive and statistically significant relationship with stock returns, implying that more profitable institutions demonstrated greater resilience during the stress period. Notably, the Tier 1 leverage ratio coefficient lacks statistical significance, suggesting that regulatory capital levels did not meaningfully influence market perceptions of bank risk during this period.

The remaining columns in Table 2 expand our analysis by examining how brokered deposits relate to bank risk when segmented by bank size (columns 3 and 4). This segmented analysis confirms the findings illustrated in Figure 2: the positive correlation between reliance on brokered deposits and bank risk is observed only for banks below $100 billion in assets. As in the baseline case, the coefficient on sweep deposits not classified as brokered remains statistically insignificant, suggesting no discernible relationship with bank risk. This distinct behavior of non-brokered sweep deposits during the period of market stress supports the current regulatory treatment that allows most sweep deposit arrangements to be classified separately from brokered deposits.

Columns (5) and (6) in Table 2 further disaggregate sweep deposits into affiliated and non-affiliated components. During the crisis period, the coefficient estimates for both types of sweep deposits are statistically indistinguishable from zero at conventional significance levels. This demonstrates that both affiliated and non-affiliated sweeps did not have a discernible relationship with bank risk.

[7] Not all banks in our sample report risk-based capital ratios, as some opted into the community bank leverage ratio framework. We also included a measure of commercial real estate loans concentration (measured as a percentage of total assets) to control for sectoral exposure vulnerability—particularly relevant given the significant impact of the COVID-19 pandemic on this asset class. In addition, the nonperforming loans ratio was included to capture asset quality and credit risk. However, these two variables were never statistically significant, so they were dropped from the final specification.

In summary, the findings reported in Table 2 show a fundamental difference between sweep deposits and brokered deposits, casting doubt on the justification for recent regulatory proposals that would expand the classification of sweep deposits as brokered deposits.

Table 2: Brokered Deposits, Non-Brokered Sweep Deposits, Affiliated vs Non-Affiliated Sweeps and Bank Risk: March 2023 - SVB Episode

	Panel A: Brokered Deposits		Panel B: Brokered Deposits x Bank Size		Panel C: Affiliated vs Non-Affiliated Sweeps	
	(1) Excess Returns 3rd Jan. - 28th Feb. 2023	(2) Excess Returns 1st Mar. - 13th Mar. 2023	(3) Excess Returns 3rd Jan. - 28th Feb. 2023	(4) Excess Returns 1st Mar. - 13th Mar. 2023	(5) Excess Returns 3rd Jan. - 28th Feb. 2023	(6) Excess Returns 1st Mar. - 13th Mar. 2023
Brokered Deposits (% of Domestic Deposits)	0.1774*** (0.0552)	**-0.2715***** (0.0891)	–	–	–	–
Brokered Deposits * $1_{\text{Assets <\$10 Billion}}$	–	–	0.1079 (0.0664)	**-0.3129***** (0.0998)	0.1406** (0.0660)	**-0.2973***** (0.0866)
Brokered Deposits * $1_{\text{Assets \$10-\$100 Billion}}$	–	–	0.3887*** (0.1219)	**-0.4643**** (0.2053)	0.4515*** (0.1148)	**-0.4372**** (0.2087)
Brokered Deposits * $1_{\text{Assets>\$100 Billion}}$	–	–	0.1597 (0.2393)	0.5951* (0.3105)	0.2305 (0.2384)	0.6362** (0.3188)
Non-Brokered Sweep Deposits (% of Domestic Deposits)	-0.0743 (0.0692)	-0.0442 (0.0607)	-0.0789 (0.0719)	-0.0597 (0.0533)	–	–
Affiliated Sweep Deposits (% of Dom. Deposits)	–	–	–	–	-0.0674 (0.0862)	-0.0653 (0.0603)
Non-Affiliated Sweep Deposits (% of Dom. Deposits)	–	–	–	–	-0.1766** (0.0792)	-0.0879 (0.1039)
HQLA (% of Assets)	0.0326 (0.0650)	0.1749** (0.0819)	0.0335 (0.0664)	0.1339* (0.0759)	0.0247 (0.0669)	0.1313* (0.0767)
Uninsured Deposits (% of Assets)	-0.0222 (0.0353)	-0.1317*** (0.0382)	-0.0216 (0.0348)	-0.1080*** (0.0340)	-0.0186 (0.0350)	-0.1075*** (0.0340)
Unrealized Losses on Securities	-0.0004 0.0042	-0.0032 (0.0070)	-0.0001 (0.0046)	0.0007 (0.0076)	-0.0003 (0.0046)	0.0008 (0.0076)
Return on Assets	0.4423** (0.1755)	1.7395*** (0.2070)	0.6561*** (0.2112)	1.4513*** (0.2968)	0.7130*** (0.2022)	1.4778*** (0.3044)
Tier 1 Leverage Ratio	0.3331 (0.3476)	0.3600 (0.2713)	0.3445 (0.3532)	0.3219 (0.2665)	0.3012 (0.3571)	0.3051 (0.2708)
Number of Observations	284	283	284	283	284	283
R-Squared	0.4735	0.8067	0.4818	0.8173	0.4878	0.8179

Note: All regressions include indicator variables for each bank group: less than $10bn, between $10bn-$100bn, and greater than $100bn. Standard errors are robust to heteroskedasticity.

Conclusion

Our empirical analysis of the 2024 brokered deposits proposal provides two important findings regarding the reversal of the narrowing of the types of deposit related activities that are considered to be brokered.

- Based on a counterfactual analysis, we show that the reclassification of sweep deposits from brokered to non-brokered status likely accounts for most of the observed $350 billion decline in reported brokered deposits following the implementation of the 2020 Final Rule.
- Econometric analysis of bank performance during a period of market stress—specifically the March 2023 mini-banking crisis—indicates that sweep deposits exhibit markedly different risk characteristics compared to brokered deposits. While smaller banks with higher concentrations of brokered deposits experienced significant negative excess returns during stress periods, we find no statistically significant relationship between sweep deposit concentrations and bank risk when controlling for relevant bank characteristics among banks of any size.

These empirical findings raise substantive questions about the FDIC's proposed regulatory changes, which seek to reverse the 2021 final rule's treatment of brokered deposits based primarily on anecdotal evidence from recent bank failures. Our systematic analysis suggests that maintaining the changes adopted in the 2021 final rule better reflect the underlying risk characteristics of brokered and sweep deposits.