By Electronic Mail

November 21, 2024

James P. Sheesley, Assistant Executive Secretary
Attention: Comments–RIN 3064–AF99
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Notice of Proposed Rulemaking: Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions, RIN 3064-AF99

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the proposal ("Proposal")[2] by the Federal Deposit Insurance Corporation (the "FDIC") to revise its regulations implementing Section 29 of the Federal Deposit Insurance Act ("FDI Act"), which impose restrictions on the ability of less than well-capitalized insured depository institutions ("IDIs") to accept brokered deposits, and define the scope of parties that constitute deposit brokers. Consistent with SIFMA's membership and organizational focus, this letter focuses on the Proposal's application to securities broker-dealers ("broker-dealers") and their brokerage customers, as well as investment advisers ("advisers") and their clients.

Broker-dealers often assist their clients in allocating cash to deposit accounts at one or more IDIs, including via brokerage accounts that automatically transfer, or "sweep", customers' uninvested cash balances into deposit accounts at IDIs. Like broker-dealers, advisers also may offer their clients a cash deposit sweep option. This option is usually offered as a part of wrap account programs managed by the adviser. These accounts—which are predominantly used by retail investors—bundle management, administrative, and trading

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation, and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 Fed. Reg. 68244 (Aug. 23, 2024).

costs into a single annual fee. Sweep and wrap accounts offer a valuable funding source for IDIs and, despite short-term movement at the individual account level, sweep and wrap programs tend to result in the deposit of stable aggregate amounts of funds at IDIs. Employees of broker-dealers and advisers also regularly refer customers who wish to access traditional banking products to depository institutions. Relationship-driven deposits sourced through these referrals are another important and stable funding source for IDIs.

In late 2020, the FDIC issued a final rule on brokered deposits which went into effect in 2021 ("2021 Final Rule") that attempted to modernize the existing brokered deposit restrictions, in part by creating targeted exceptions from the definition of deposit broker for broker-dealers that provide sweep deposit services.[3] This modernization was based, in part, on a rigorous study of brokered deposit risks conducted by the FDIC in 2011 and updated in 2019. The FDIC also issued an advanced notice of proposed rulemaking in 2019, providing an additional round of engagement with the public prior to the issuance of the notice of proposed rulemaking for the 2021 Final Rule. The 2021 Final Rule codified and superseded FDIC advisory opinions spanning several decades creating exceptions for common market practices, including certain sweep deposit arrangements.

The Proposal generally would eliminate or significantly narrow the exceptions that were created or codified by the 2021 Final Rule. The FDIC has proposed these changes, however, without providing evidence that the current exceptions are no longer appropriate.[4] While the Proposal references recent bank failures (Silicon Valley Bank and First Republic) as part of the rationale for revisiting the existing rule, FDIC and Federal Reserve studies of the spring 2023 bank failures did not point to brokered deposits as a cause of such failures. To the contrary, the material loss reviews of First Republic Bank, Signature Bank and Silicon Valley Bank that were undertaken by the relevant Inspectors General point to high concentrations of uninsured deposits as a key factor.[5] The Proposal does not assess whether the 2023 failures are indicative of broader trends or how the specific proposed revisions to the brokered deposits framework would have led to different outcomes.

Nor does the Proposal point to support in any data or updated studies that were developed since the finalization of the 2021 Final Rule as a basis for its proposed changes. Indeed, the FDIC put out a request for information ("RFI") on deposit behavior on the same day as the Proposal, suggesting the FDIC in fact does not believe it has a full understanding of

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[3] Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg. 6742 (Jan. 22, 2021).

[4] *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.

[5] 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; 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 (Sep. 25, 2023), available at https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-summary-sep2023.pdf.

the relevant data and facts.[6] The extended comment period for the RFI on deposit behavior will close after the also-extended comment period for the Proposal. Without sufficient evidence of changed circumstances or new data that indicate the measures put in place in 2020, many of which were individually endorsed by decades of FDIC practice prior to 2020, are no longer suitable, the Proposal lacks a sufficient empirical basis and, accordingly, should be withdrawn.

The Proposal also admits to a lack of data to estimate its impacts: "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."[7] This statement is particularly concerning given the potentially negative consequences of the Proposal. Categorizing deposits from broker-dealer customers as brokered deposits under FDIC regulations would likely make it more difficult for even well-capitalized IDIs to accept these funds on behalf of customers and result in lower interest rates paid to sweep deposit account holders in order to offset higher deposit insurance assessment rates applicable to brokered deposits, as well as the increased cost of funding for IDIs subject to liquidity requirements such as the liquidity coverage ratio and net stable funding ratio. These dynamics could reduce customer returns and safe banking options, compromise a stable source of deposit funding for IDIs and deter the allocation of excess customer cash to low risk deposits. Indeed, the preamble of the Proposal notes that "[customers] might experience changes in interest rates on those funds, or costs associated with placing those funds with different entities."[8] Similarly, the Proposal notes that it lacks the data to reliably estimate the compliance costs of the Proposal for IDIs, but the FDIC nevertheless asserts that it expects those costs to be modest. The adverse consequences of the Proposal cannot be properly imposed without a sufficient evidentiary justification that they are necessary to alleviate specific and sizable risks.

I. Executive Summary

We respectfully request that the FDIC withdraw the Proposal due to the lack of evidence justifying its proposed revisions and failure to consider relevant factors. These issues are discussed in detail in Section II below. As proposed, the contemplated changes would likely be arbitrary and capricious under the Administrative Procedure Act ("APA").

If the Proposal is not withdrawn, we recommend the FDIC revise the Proposal as outlined below, and discussed further in Sections III-VII:

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[6] FDIC, Request for Information on Deposits (Jul. 30, 2024), available at https://www.fdic.gov/news/financial-institution-letters/2024/request-information-deposits; *see also* Request for Information on Deposits; Extension of Comment Period, 89 Fed. Reg. 80899 (Oct. 4, 2024).
[7] 89 Fed. Reg. 68244, at 68260 (Aug. 23, 2024).
[8] 89 Fed. Reg. 68244, at 68261 (Aug. 23, 2024).

A. Retain the existing 25% assets under administration test, which would resolve a number of issues with the Proposal.

1. A 25% assets under administration threshold (also referred to as the 25% Test) for determining primary purpose is more consistent with prior interpretations of the brokered deposit statute, market behavior and safety and soundness.
2. The elimination of the 25% Test would result in the classification of many non-sweep relationships as brokered that lack the risks of current brokered deposits.
3. The proposed assets under management measure for calculating deposit placement ratios is needlessly limiting, and the existing assets under administration measure more appropriately captures relevant activity.
4. Restriction of the test to SEC-registered broker dealers scopes out entities not registered with the SEC despite them exhibiting similar profiles/risks.
5. The alternatives to the broker dealer sweep exception ("BDSE") considered by the Proposal are even less suitable than the BDSE.

B. Retain the current Primary Purpose Exception ("PPE") notice and application processes, as the proposed notice and application processes are unworkable.

1. The proposed notice and application requirements would create significant burdens for IDIs, broker-dealers and the FDIC.
2. Limiting the PPE notice procedure to relationships not involving third parties is counterproductive and unnecessary.

C. The proposed changes to the scope of and application/notice processes for the PPE would create significant transition costs that should be addressed.

1. The lack of a transition period following the recission of existing PPE exceptions would lead to significant disruption, including inaccurate fluctuations in call report data (a problem the Proposal intends to address not exacerbate).
2. Any changes to existing exceptions should be accompanied by a transition period of at least two years.

D. The proposed changes to the deposit broker definition are not risk-based, make the definition overinclusive and are unlikely to address operational challenges.

1. The revision of the "matchmaking" sub-prong of the deposit broker definition could capture many low-risk activities and does not clearly address the operational issues that motivate the change.
2. The elimination of the carve out for affiliate matchmaking is not risk-based and inconsistent with past practice.
3. The new independent sub-prong related to fees in the definition of deposit broker is overinclusive and inconsistent with past practice.

E. Other well-established exceptions should be retained.

1. The exception for exclusive deposit placement relationships should be retained.
2. The exception for when 100% of funds are placed into transactional accounts that do not pay any fees, interest, or other remuneration to the depositor (the "Enabling Transactions Exception") should be retained.

II. The Proposal, if adopted, likely would be arbitrary and capricious regulatory action and in excess of the FDIC's statutory authority.

The APA requires that, when engaging in rulemaking, an administrative agency must articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made.[9] In particular, "the agency must explain the data that is available…Generally, one aspect of that explanation would be a justification for rescinding [an existing] regulation before engaging in a search for further evidence."[10] An agency must also consider all relevant factors and data before taking action. Finally, agency rulemaking must be consistent with its statutory authority.[11] The Proposal does not satisfy these requirements.

A. The Proposal should be withdrawn due to the lack of evidence justifying its proposed revisions.

First, the Proposal would significantly alter the FDIC's brokered deposit framework, and reverse existing statutory interpretations by the agency, all without sufficient or transparent data or a robust explanation of its policy rationale. [12] The primary policy justification for the Proposal is that "the changes made by the [FDIC's] 2021 Final Rule [on brokered deposits] have narrowed the types of deposit-related activities that are considered brokered; in the FDIC's view, this narrowing is problematic because these deposits continue to present the same risks as before the 2021 Final Rule."[13] While the preamble to the Proposal cites certain evidence in support of its proposed changes, the cited facts do not support this justification and are not sufficiently connected to the changes proposed.

- The Proposal lacks any general statistical evidence that the types of deposits it would reclassify as brokered present heightened risks or even the same risks as deposits currently classified as brokered. The preamble asserts that 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."[14] Notably, the cited studies are the same studies that supported the FDIC's

[9] *Motor Vehicles Ass'n of U.S. v. State Farm Mutual Auto Ins. Co.,* 463 U.S. 29, 43 (1983).
[10] *Id.* at 52.
[11] 5 U.S.C. § 706(2)(c).
[12] *See* Statement by Jonathan McKernan, at n. 4 above ("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.").
[13] 89 Fed. Reg. 68244, at 68244 (Aug. 23, 2024).
[14] 89 Fed. Reg. 68244, at 68244 (Aug. 23, 2024).

previous rulemaking. In the preamble to the 2021 Final Rule, the FDIC explicitly acknowledged that these studies did not sufficiently distinguish between deposit types and that certain relationships, such as sweep deposit relationships, may actually be less risky.[15] Indeed the updated study released by the FDIC in 2019 found brokered deposits to have similar effects as other uninsured deposits and states: "brokered deposits can be substituted for other bank liabilities without any statistically measurable effect on a bank's failure probability, provided that a bank's share of equity and core deposit funding and its asset risk characteristics remain unchanged."[16] Thus, the FDIC's assertion that its prior studies support identical treatment of deposit types formerly classified as brokered and deposit types currently classified as brokered overstates the conclusions of those prior studies. Even if the assertion were consistent with those prior studies, the Proposal does not address why the FDIC now rejects its prior interpretation of those studies, especially with respect to sweep deposits.

- The Proposal's citations to certain recent events are largely unconnected to its proposed changes. The Proposal references three developments since the 2021 Final Rule as evidence for its proposed changes.

    - The Proposal discusses the "FDIC's experience, [that] the decline in reported brokered deposits is also due, in part, to some IDIs misunderstanding and misreporting deposits under the 2021 Final Rule."[17] In particular, the FDIC has apparently observed that some IDIs are relying on the 25% Test to report sweep deposits as non-brokered without sufficiently understanding the role of third parties that are involved in the sweep arrangement. However, the FDIC does not describe the magnitude of these operational challenges. Indeed, the Proposal cites to only a single supervisory appeal as an example of an IDI misclassifying a third-party deposit broker.[18] Furthermore, as we discuss below, the FDIC does not explain why these operational challenges necessitate such a comprehensive rewriting of the 2021 Final Rule. It also fails to explain the need to revise the substance of the 25% Test and PPE notice/application procedures, and especially why the revisions are necessary even if no third party is involved. Presumably a more efficient way to address any misunderstanding would be to provide clear guidance on the FDIC's interpretation of how the current rule

[15] Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg. 6742, 6762 (Jan, 22, 2021) ("Historical experience has been that higher use of deposits currently reported to the FDIC as brokered has been associated with higher probability of bank failure and higher DIF loss rates. [citing to 2011 and 2019 studies] The funding characteristics of brokered deposits, however, are non-uniform. For example, brokered CDs are often used by bank customers searching for relatively high yields and safety with deposit insurance, rather than as part of a relationship with a bank, and as such these deposits may be less stable and more subject to deposit interest rate competition. The behavior of other types of deposit placement arrangements, such as deposits placed through certain deposit sweep arrangements or that underlie prepaid card programs, may be more based on a business relationship than on interest rate competition. Given limitations on available data, however, historical studies have not been able to differentiate the experience of banks based on the different types of deposits accepted.")

[16] *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366, 2386 (Feb. 6, 2019).

[17] 89 Fed. Reg. 68244, at 68245 (Aug. 23, 2024).

[18] 89 Fed. Reg. 68244, at 68245 (Aug. 23, 2024) (citing FDIC, Decision of the Supervision Appeals Review Committee, In the Matter of * * *, Case No. 2022-02 (Apr. 26, 2023)).

should be applied.

  - The Proposal discusses the 2023 bank failures, especially the failure of First Republic Bank, which saw a decline in uninsured affiliated sweep deposits in the quarter leading up to its failure. However, the Proposal does not assess whether this example is indicative of broader trends or how the specific proposed revisions to the brokered deposits framework would have led to different outcomes. In particular, it does not address the possibility that the run was primarily caused by the fact that the sweep deposits at issue were uninsured deposits rather than brokered deposits. The FDIC's own report on the First Republic failure does not discuss brokered deposit concerns but does mention uninsured deposits.[19] The FDIC report also notes that First Republic Bank was classified as well-capitalized through the examination cycle prior to its failure,[20] suggesting a change in deposit classification would not have restricted First Republic's ability to accept such deposits.

  - The Proposal also discusses the failed crypto company, Voyager, which was not considered a deposit broker because of its exclusive relationship with a single bank. The Proposal fails to assess whether this example is indicative of broader trends or how the Proposal would have reduced the risks the FDIC believes the Voyager case exemplifies. The Brokered Deposit Rule is intended to address the risks of banks bidding for volatile, expensive deposits that increase the risks and costs of failure. The Voyager example presented a wholly different, and in some ways opposite, risk that funds placed at Voyager were unsafely kept at Voyager because of customer confusion about FDIC insurance coverage. It is also worth noting that Voyager was not itself an IDI and Voyager's former bank partner continues to operate despite any adverse impacts of the Voyager failure.[21]

- Finally, the Proposal also states that the "FDIC is concerned that [the narrowing of the brokered deposit definition and operational challenges leading to potential underreporting] expose IDIs individually and the banking system more broadly to the type of risk the brokered deposit restrictions are intended to address—namely that a less than well-capitalized institution could rely on less stable third-party deposits for rapid growth that may weaken the safety and soundness of IDIs and the banking system and expose the FDIC to increased losses."[22] However, the Proposal provides zero new evidence on this point. As discussed above, the Proposal cites to studies that existed when the current brokered deposit regulations were adopted. The limited set of subsequent one-off experiences discussed by the Proposal are related to uninsured deposit volatility. None indicates an increase in reliance on third-party deposits to drive

[19] 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.
[20] *Id.* at *34.
[21] *See* Metropolitan Bank Holding Corp., Form 10-K (Feb. 28, 2024).
[22] 89 Fed. Reg. 68244, at 68245 (Aug. 23, 2024).

unsafe growth. The Proposal asserts but does not provide evidence that significant under reporting is occurring.[23] Nor does it explain why addressing such under reporting requires sweeping changes to existing regulations including deposits arrangement where third party is not involved.

The Proposal's flawed empirical basis is particularly concerning given other evidence suggesting it paints with far too broad of a brush. For example, some literature concludes that sweep deposits in general are more stable than other deposits.[24] The banking agencies have also previously asserted, and based prior rulemakings on, the proposition that fully insured sweep deposits and sweep deposits from affiliates are more likely to be stable across market conditions than traditional brokered deposits.[25] The presence of sweep deposits is also generally associated with stronger banks. As the FDIC has already been made aware, banks that have accepted sweep deposits have been less than half as likely to have ever become less-than-well capitalized as compared to banks that have not accepted sweep deposits, and more than three times less likely to become less-than-well capitalized when compared with banks that accept other forms of brokered deposits.[26]

In summary, the Proposal does not establish a rational connection between the limited new data it cites and the changes it contemplates. It also fails to explain its new interpretation of its prior brokered deposit studies. These deficiencies alone result in the Proposal failing to satisfy the APA's requirements for reasoned decision-making. Moreover, the Proposal also fails to satisfy the expectation that, in the face of such limited information, an agency will address whether it is appropriate to gather additional data before proceeding. This is particularly concerning given the extensive, multiyear initiative that preceded the 2020-2021 rulemaking, a process which included multiple rounds of public comment and outreach to industry, policymakers and a variety of stakeholders. It is also not clear why the FDIC feels it is appropriate to proceed in revising the brokered deposit rule when it has an outstanding RFI on deposit behavior issued concurrently with the brokered deposits proposal, particularly given that the now-extended comment period for the RFI closes after comments are due on the Proposal.[27] While the RFI on deposit behavior does not seek all of the granular data on brokered deposit behavior that would be needed to support the type of changes now contemplated in the proposal, the deposit behavior RFI and brokered deposits proposal address similar questions about bank liquidity risk and the differential behavior of deposit

[23] The Proposal does discuss a significant drop-off in the volume of brokered deposits reported following the adoption of the 2021 Final Rule, but it fails to consider the obvious possibility that this was due to the appropriate application of the new regulations created by the 2021 Final Rule rather than under reporting.

[24] *See* Mark L. Mitchell *et al*, Runs to Banks: The Role of Cash Sweeps During Market Downturns, SSRN (Sept. 9, 2020), available https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3690525.

[25] *See* Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 86 Fed. Reg. 9120, 9146 (Feb. 11, 2021). For the avoidance of doubt, we do not support the inclusion of an "affiliate condition," which would not comport with the statute.

[26] *See* Total Bank Solutions, Letter to Robert E. Feldman, FDIC regarding RIN 3064-AE94-ANPR for Comment re 12 C.F.R. Part 337, Unsafe and Unsound Banking Practices (Brokered Deposits); Comprehensive Review of Regulatory Approach to Brokered Deposits (May 7, 2019), available at 2019-unsafe-and-unsound-banking-practices-3064-ae94-c-064.pdf.

[27] FDIC, Request for Information on Deposits, 89 Fed. Reg. 63946 (Aug. 6, 2024) (the "Deposits RFI"). The Deposits RFI states that IDIs "do not report comprehensive data on the composition of insured and uninsured deposits," including in respect of intercompany deposits. *Id.* at 63948.

types, including during periods of stress.[28] Indeed, the deposit behavior RFI underscores the FDIC's own view that it lacks the data needed to support the conclusions which would justify the Proposal. It also reflects an inconsistency in the FDIC's analysis of recent events. The deposit behavior RFI characterizes the bank failures in 2023 as grounds for the reevaluation of the risks of different deposit types, not conclusive evidence of such risks.[29]

The FDIC, jointly with other agencies, also has a separate RFI outstanding on bank fintech relationships that could further inform the Proposal, but the comment period for the fintech RFI will close only shortly before the now-extended period for comments on the Proposal.[30]

B. The Proposal fails to consider all relevant factors.

Leaving aside the lack of reasoned explanation and support, the Proposal suffers from other procedural shortcomings. When an agency engages in rulemaking, the APA requires it to consider all relevant factors, which typically include cost and any reliance interests that would be impacted by the change.[31] The Proposal does not fully consider a number of potential costs. One notable omission is the impact on consumers, especially retail depositors. Main street retail investors represent a significant portion of sweep deposit customers. The Proposal could significantly increase the costs to these investors of safekeeping brokerage funds because such customers typically maintain a cash balance in brokerage accounts. Yet the Proposal provides only two short paragraphs discussing impacts on consumers and simply predicts unspecified changes in consumer behavior.[32] Even if the APA did not require it, sound policy judgment would demand greater consideration of the impacts on this important constituency. Nor does the Proposal address the changes in technology and business practices since the 2021 Final Rule was adopted, in many cases in reliance on the exceptions granted under that framework, or seriously consider how the proposed changes would affect the availability and costs of services available to customers. The Proposal also does not fully address the costs of its requirement that only IDIs can file notices or applications for the PPE. Such a requirement would create material unnecessary operational burdens for broker-dealers as it necessitates individually sharing confidential information, such as administrator contracts, between a broker-dealer with each IDI participating in a sweep program. It also creates inefficiency for IDIs, which would be required to submit additional notices or applications, as well as for the FDIC itself, which would have to review dozens of duplicative submissions from IDIs instead of just one from the broker-dealer.

[28] *See* Acting Comptroller of the Currency Michael J. Hsu, Statement at the FDIC Board Meeting (July 30, 2024), *available at* https://www.occ.gov/news-issuances/news-releases/2024/nr-occ-2024-86a.pdf.

[29] *Compare* Deposits RFI, 89 Fed. Reg. 63946, at 63947, *with* Proposal, 89 Fed. Reg. 68244, at 68245 (Aug. 23, 2024).

[30] Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses; Extension of Comment Period**,** 89 Fed. Reg. 76913 (Sep. 19, 2024).

[31] *See Michigan v. EPA*, 576 U.S. 743, 750 (2015); *FCC v. Fox Television Studios*, 556 U.S. 502, 515 (2009); *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 742 (1996).

[32] *See* 89 Fed. Reg. 68244, at 68261 (Aug. 23, 2024).

C. The Proposal, if adopted, would exceed the statutory authority granted to the FDIC.

Finally, the proposed changes to the PPE go beyond the statutory authority granted to the FDIC.[33] Section 29 of the Federal Deposit Insurance Act provides that "an agent or nominee whose primary purpose is not the placement of funds with depository institutions" is not a deposit broker.[34] A plain reading of that statutory exception would include a broker-dealer or adviser who places customer funds at IDIs to facilitate is objective of providing its customers with access to securities markets. Under the Proposal, however, the PPE will only apply "when an agent or nominee *whose primary purpose* in placing customer deposits at IDIs *is for a substantial purpose* other than to provide a deposit-placement service or FDIC deposit insurance."[35] The words "substantial purpose" are found nowhere in the statute or the FDIC's existing regulations. They add an additional hurdle to qualifying for the PPE without any foundation in statutory text. Likewise, the Proposal would condition the BDSE upon a broker-dealer satisfying a 10% of assets under management cap despite the absence of any such numeric cap in the statute.

For all of the above reasons, the Proposal should be withdrawn. Without sufficient evidence of changed circumstances or new data that indicate the measures put in place in 2020 are no longer appropriate, and a thorough cost-benefit analysis of the proposed changes, the Proposal lacks a sufficient empirical basis for its changes. The proposed changes also would exceed the FDIC's statutory authority. A court of law would not uphold these changes without a rational basis, especially because, as described below, they involve a number of unexplained reversals in prior FDIC interpretations and determinations.

III. The FDIC should retain the 25% Test to alleviate a number of issues with the Proposal.

Under the existing brokered deposit regulations, an agent or nominee that places less than 25% of assets under administration for customers in a particular business line with IDIs will not be considered to have the placement of deposits at IDIs as its primary purpose and will not be a deposit broker with respect to that business line.[36] This has become known as the 25% Test.

The Proposal would effectively replace the 25% Test with the BDSE, narrowing the scope of the PPE.[37] The eligibility threshold for the BDSE would be lowered from 25 percent of assets under administration being placed at IDIs for the relevant business line to 10 percent of assets under management (which appears to be a narrower denominator). Unlike under the

[33] *See* 5 U.S.C. § 706(2)(c).
[34] 12 U.S.C. § 1831f(g)(2)(I).
[35] 89 Fed. Reg. 68244, at 68253 (Aug. 23, 2024) (emphasis added).
[36] 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(i).
[37] The Proposal describes this change as "revis[ing] the '25 percent test' and renam[ing] it." *See* 89 Fed. Reg. 68244, at 68255 (Aug. 23, 2024). However, the terms of the BDSE are so different from the existing 25% Test, we think this is more accurately described as a replacement.

existing 25% Test, only Securities and Exchange Commission ("SEC")-registered broker-dealers and investment advisers would qualify for the BDSE. These changes would potentially and unnecessarily narrow the types of deposits that would qualify for a deposit-placement-ratio-based exception to only sweeps from advisory accounts. Finally, reliance on third parties in administering a sweep deposit relationship would require the submission of an application rather than reliance on a notice procedure. All of these changes have significant negative consequences, which would be addressed by retaining the 25% Test. As discussed above, we believe the Proposal should be withdrawn in its entirety, but if not the 25% Test should still be retained in any final rule.

A. A 25% assets under administration threshold for determining primary purpose is more consistent with the FDIC's prior interpretations of the brokered deposit statute, market behavior and safety and soundness.

According to the Proposal, it is the FDIC's view that "placing less than 10 percent [rather than 25 percent] of customer funds at IDIs would be 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 (e.g., uninvested funds) that are awaiting reinvestment" rather than to provide deposit insurance or deposit placement services.[38] Notably, the FDIC characterizes this 10% 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." The FDIC also believes that reducing the threshold to 10% may reduce potential risks to safety and soundness and to the Deposit Insurance Fund ("DIF"), but the Proposal does not specify those risks or clarify how the proposed changes would address them.

The Proposal does not explain why a 10% threshold is more consistent with safety and soundness or the statutory test—a primary purpose other than to place deposits at IDIs—than a 25% assets under administration threshold. It also does not explain what experience or data has led to a reversal of the position taken in the 2020 notice of proposed rulemaking creating the 25% Test, that "[i]t is the FDIC's view that the primary purpose of a third party's business relationship with its customers is not the placement of funds with depository institutions if the third party places less than 25 percent of customer assets under management for its customers, for a particular business line, at insured depository institutions."[39] The Proposal does reference certain operational challenges in administering the 25% Test, such as difficulty in assessing the status of third party administrators, but these are unrelated to the threshold for assets under administration. It is also unclear how the modifications would make the test more operationally workable. It is not clear why the FDIC's claim that a 10% threshold indicates a "de-minimis" amount of funds are swept to IDIs for a purpose other than to

[38] 89 Fed. Reg. 68244, at 68256 (Aug. 23, 2024).

[39] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453, 7459 (Feb. 10, 2020). The 2021 Final rule changed the "assets under management" to "assets under administration" in response to public comments.

provide deposit placement or insurance is relevant at all. The brokered deposit statute does not discuss volume.

In our view, placing 25% or less of assets under administration with IDIs is consistent with a broker-dealer having a primary purpose other than the placement of deposits. As explained by FDIC Vice Chairman Hill:

> "The statute is quite clear: if a person's primary purpose is something other than the placement of deposits, the person is not a deposit broker…I also disagree with replacing the '25 percent test.' 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."[40]

As Vice Chairman Hill points out, the key analysis in determining applicability of the PPE is if a person has the primary intent to place deposits. The test is statutory and not one the FDIC has authority to narrow. The statute makes no mention of a volume threshold, and we do not think a court would take the view that broker-dealers—whose business is providing retail clients with access to securities markets and investments or providing institutional clients with market services—have a primary purpose of placement of funds with IDIs. We also think any reviewing court would take a skeptical view of the unexplained change in course with respect to the deposit placement threshold contemplated by the Proposal.

Market and consumer behavior are also inconsistent with a 10% threshold. In the first place, the Proposal fails to consider that the ratio of deposits placed by broker-dealers at IDIs is correlated with market stress. During periods of market uncertainty or volatility, investors tend to allocate more of their portfolio to cash to reduce risk and maintain liquidity. This increases the amount of customer funds held at IDIs; however, it does not change the fact that the primary purpose for placing those funds at IDIs is the temporary safekeeping of funds awaiting reinvestment.

By ignoring this correlation, the Proposal may create additional risks to safety and soundness if it reduces the incentive to sweep cash to IDIs during periods of stress. During the early stages of the COVID-19 pandemic, financial markets saw a flight to cash and short-term assets.[41] As a result, the amount of cash swept to IDIs increased. Such an increase is a response to customers' demand for liquidity in stress and not an IDI-driven decision. If a similar event occurred again and the proposed BDSE were in place, broker-dealers and IDIs would have less incentive to offer broker-dealer customers opportunities to move funds to IDIs out of a desire to avoid crossing the 10% threshold than if a 25% asset threshold were in

[40] Statement by Vice Chairman Travis Hill on the Notice of Proposed Rulemaking on Brokered Deposit Restrictions (Jul. 30, 2024), available at https://www.fdic.gov/news/speeches/2024/statement-vice-chairman-travis-hill-notice-proposed-rulemaking-brokered-deposit.

[41] *See* SEC Staff Report on U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock, at 2 (Oct. 2020), available at https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf.

place.[42] For example, funds could be invested in cash equivalents, such as money market mutual funds, rather than bank deposits. This would have the unintended effects of incentivizing customers to over allocate cash balances to investment opportunities outside the banking system, thereby reducing diversification for investors and the stable deposit funding that is available to IDIs. An overbroad brokered deposit definition would also create an inaccurate signal that an IDI's deposit base is less stable than in reality, potentially increasing the risk of an irrational run.

Secondly, consumer behavior reveals a preference for allocating even more than 10% of assets to cash. The September 2024 Asset Allocation survey by the American Association of Individual Investors indicated that on average investors in September 2024 had about 17% of their assets in cash, which is actually below the historical average of 22.5%.[43] A 10% threshold would likely force IDIs to classify many cash deposits as brokered even in normal market conditions.[44]

The 25% assets under administration threshold gives IDIs needed flexibility to accommodate market dynamics and consumer preferences. It allows large buffers in normal market conditions and enables broker-dealers to accommodate customers in stress periods like the pandemic. Ignoring this reality would result in the unintended consequence that even broker-dealers whose sweep programs have a primary purpose other than placing funds with depository institutions, i.e., the group the FDIC intends to be covered by the BDSE, would face heightened burdens in maintaining ordinary course reserves at IDIs and operating sweep programs.

B. The elimination of the 25% Test would result in the classification of many relationships as brokered that lack the risks of current brokered deposits.

If the 25% Test were eliminated, only SEC-registered broker-dealers and investment advisers would have the chance to benefit from the BDSE. As with a lower deposit placement ratio, this could lead the Proposal to treat a number of entities as deposit brokers that are functionally similar to relationships covered by the BDSE and do not present the same risks as the hot money relationships targeted by the brokered deposit statute.[45] The Proposal does not discuss, for example, why the BDSE should not be available to entities that benefit from an

[42] The flight to cash during the COVID-19 pandemic occurred prior to the creation of the 25% Test in the FDIC's 2021 Final Rule. However, the FDIC temporarily modified the threshold from 10% to 25% in March 2020 in response to the COVD-19 pandemic. *See* Letter from SIFMA to Robert E. Feldman, FDIC re: SIFMA Comment on Proposal Revising Brokered Deposits Restrictions, at 8, n. 21 (Apr. 10, 2020) (citing FDIC Advisory Opinion 20-01 (Mar. 19, 2020) (temporarily increasing the permissible ratio contemplated in Advisory Opinion 05-02)), available at SIFMA-Brokered-Deposits-Comment-Letter-FINAL-4.10.2020.pdf.

[43] AAII Staff, August AAII Asset Allocation Survey: Cash Allocations Increase (Sep. 3, 2024) (covering August 2024), available at https://www.aaii.com/latest/article/239077-september-aaii-asset-allocation-survey-stock-allocations-decrease.

[44] In times of market, stress, such as the COVID-19 pandemic, rapid declines in securities held in brokerage accounts also correspondingly reduce the value of the brokerage accounts, (the denominator of the 25% Test under the PPE with the BDSE) and cause the broker dealer's permissible ratio to increase independently of any actions by the broker dealer or an affiliated bank to increase sweep deposits.

[45] *See* Insured Brokered Deposits and Federal Depository Institutions: Hearing Before the Subcomm. on Gen. Oversight & Investigations of the Comm. on Banking, Fin. & Urban Affairs, 101st Cong. 9–10, 74 (May 17, 1989) (testimony and prepared statement of Sen. Frank H. Murkowski) (indicating a focus on hot money).

exemption from SEC registration, but which operate programs that are functionally similar to registered entity sweep deposit programs.

Another unintended disparity could occur under the BDSE with respect to broker-dealers that have deposit arrangements that are not sweep deposits with IDIs. For example, many broker-dealer employees regularly refer customers seeking banking products to IDIs. Often, such referrals lead to the customer opening a deposit account. These relationship deposits are an important investment option for customers and are generally quite stable. However, such arrangements would not be eligible for the BDSE under the Proposal even though the purpose of the broker-dealer employee is to serve their customer, not to place funds at an IDI. Currently, such relationship deposits benefit from the flexibility created by the 25% Test and lead to the maintenance of significant cash balances by broker-dealer customers at IDIs. Eliminating the 25% Test in favor of the BDSE would significantly disrupt these business models without any indication they pose a heightened risk. This problem is exacerbated by the Proposal's elimination of the carve out for affiliate deposit relationships in the matchmaking prong of the deposit broker definition and the exception for exclusive deposit arrangements. If this change is adopted as proposed, many non-sweep relationships currently eligible for the 25% Test would no longer benefit from either these exceptions or the carve outs in the deposit broker definition.[46] These changes would result in illogically disparate classifications of relationship deposits sourced from broker-dealers and make an important source of stable deposits more costly for IDIs.

If the Proposal is not withdrawn, any final rule should address these concerns by retaining the existing 25% Test and clarifying that referral relationships, and other relationships that indirectly result in broker-dealer customers opening accounts or placing funds at IDIs under their own initiative, generally fall outside the definition of deposit broker and fit within the 25% Test.[47]

C. The assets under management standard is needlessly limiting.

The Proposal would substitute the current measure of the denominator of the deposit placement threshold—"assets under administration"—for "assets under management." The Proposal defines "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."[48] This definition is similar to Form ADV's definition of "regulatory assets under management."[49] Form ADV is a mandatory filing for all investment advisers registered with the SEC. It contains certain information about, among other things, the

[46] 89 Fed. Reg. 68244, at 68252 (Aug. 23, 2024).
[47] If the 25% Test is not retained, the Proposal should at minimum be modified to make clear that the numerator of the BDSE does not include such referral relationships so as to not exacerbate the issues with the low BDSE deposit placement ratio discussed in the prior sub-section.
[48] 89 Fed. Reg. 68244, at 68256 (Aug. 23, 2024).
[49] *See*, Form ADV -General Instructions at p. 19, available at https://www.sec.gov/files/formadv-instructions.pdf ("In determining the amount of your regulatory assets under management, include the securities portfolios for which you provide continuous and regular supervisory or management services as of the date of filing this Form ADV.")

adviser's business operations and disciplinary history. It is not used by broker-dealers. To calculate regulatory assets under management, an adviser must calculate the value of the securities portfolios for which it provides "continuous and regular supervisory or management services."[50] An adviser provides these services when it has either (a) discretionary authority over an account or (b) an ongoing responsibility to provide investment recommendations to a client and effect the recommendations approved by the client.[51] These activities are not within the remit of broker-dealers who focus on transaction-based activities (e.g., buying and selling securities, executing trades, underwriting securities, etc.) rather than providing ongoing investment advice.

If the term assets under management were interpreted similarly in the context of the brokered deposit regulations to how it is used on Form ADV, this new denominator could potentially exclude assets held in a brokerage, custodial or fiduciary capacity. For example, a broker-dealer would likely not be considered to regularly "manage" a non-discretionary brokerage account, though it does "administer" such an account. As a result, eligibility for volume-based PPEs, such as the 25% Test or BDSE, would be narrowed.

The Proposal justifies the switch to "assets under management" because the existing terminology, "assets under administration", captures "a broader group of business relationships and business lines" than services provided by broker-dealers and investment advisers.[52] It does not, however, explain why excluding these activities is necessary or appropriate. The Proposal provides no data on why deposits sourced through other activities of broker-dealers or investment advisers, such as non-advisory activities or the offering of non-discretionary brokerage accounts, presents distinct risks from the deposits connected to managed accounts. There is no statutory basis for this distinction.

The assets under management formulation in the Proposal also ignores how broker-dealers and investment advisers' businesses actually operate. The FDIC recognized as much in the preamble to the 2021 Final Rule when it declined to implement an assets under management denominator in response to comments.[53] Most larger providers of wealth management services in the U.S. provide both securities brokerage and investment advisory services, usually through the same agents and to the same customers. Investment advisory accounts would likely be considered managed but not all brokerage accounts would be. It is common for individual customers to maintain both securities brokerage and investment advisory accounts with the same firm. Customers generally view their relationship with the firm holistically, rather than making distinctions based on holdings in each type of account. With a few limited exceptions, bank sweep arrangements are utilized for all accounts (securities brokerage and investment advisory) maintained by the firm for customers. Applying the framework in the Proposal would create an artificial distinction between deposits originating in

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[50] *See*, Form ADV -General Instructions at *19, Appendix B.
[51] *See*, Form ADV -General Instructions at *20.
[52] 89 Fed. Reg. 68244, at 68256 (Aug. 23, 2024).
[53] 86 Fed. Reg. 6742, at 6751 (Jan. 22, 2021) ("The FDIC is finalizing the proposed '25 percent' test generally as proposed but, in response to comments, is revising the phrase 'assets under management' to 'assets under administration.'").

different types of accounts. This could lead to firms adopting different economic features for different types of accounts and could create confusion on the part of customers. To be consistent with the brokered deposits statute and the actual behavior of businesses and customers, customer "assets under administration" should remain the key measure in calculating ratios for designated exceptions under the PPE, ideally through withdrawal of the Proposal in its entirety but, if not, through revision of the proposed changes before issuance of any final rule.

D. The alternatives to the BDSE considered by the Proposal are even less suitable.

As discussed above, the BDSE suffers from multiple issues that make it a poor substitute for the existing 25% Test. The two alternatives to the BDSE in the Proposal are no better. The first alternative would eliminate the 25% Test with no replacement, requiring IDIs to apply for a case-by-case PPE exception for each instance of participation in a sweep deposit program.[54] This would compound transition costs, flood the FDIC staff with additional applications and increase uncertainty as to whether any broker-dealer would benefit from an exception. This alternative also suffers from a similar lack of evidentiary support as the other changes and lack of statutory basis. The Proposal does not discuss why a sweep deposit program composing even a small share of total assets under management or administration is inconsistent with having a primary purpose other than providing deposit insurance. Arguably, the bar for evidentiary justification is even higher in this case as the FDIC's position that placing less than 10% of assets under administration reflects a purpose other than to serve as a deposit broker is longer standing than the 25% Test. Moreover, some form of this exclusion has existed dating back nearly 20 years to guidance issued by the FDIC in 2005.[55] This alternative would be another unjustified and arbitrary and capricious change in course.

The Proposal's second alternative would be to restrict the BDSE to arrangements only involving sweep programs placing less than 10% of a broker-dealer's total assets under management (across the entire firm, not just a business line) with affiliated IDIs and for which the broker-dealer's compensation is structured as a flat fee for administrative services and not deposit placement. This alternative would also suffer from similar challenges as it would also eliminate the existing 25% Test and be another unexplained change in course.[56] The conditions the FDIC proposes in this alternative have no statutory basis and would not withstand judicial scrutiny.

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[54] The Proposal explains: "…an IDI would be required to submit the required information listed under the general primary purpose exception application process as described in the proposed rule to demonstrate that the deposit-placement activity of the sweep arrangement, including those with an additional third party, is for a substantial purpose other than to provide deposit insurance or a deposit placement service." 89 Fed. Reg. 68244, at 68258. As we explain above, this language has no basis in statute.

[55] *See* FDIC, Study on Core Deposits and Brokered Deposits, 18, 26 (Jul. 8, 2011) (discussing Advisory Opinion No. 05-02 issued on February 3, 2005 finding sweep program within PPE), available at https://archive.fdic.gov/view/fdic/6706.

[56] The Proposal describes the designated affiliate sweep alternative as "similar to the FDIC's treatment of affiliated sweep deposit arrangements," prior to the 2021 Final Rule. 89 Fed. Reg. 68244, at 68258.

IV. The proposed PPE application and notice processes are unworkable.

Currently, third parties or IDIs may submit an application for a case-by-case PPE. For the 25% Test and for the Enabling Transactions Exception, existing regulations provide for a streamlined procedure through which IDIs or third parties may submit a notice to the FDIC of the applicability of the 25% Test or Enabling Transactions Exception and may rely upon the relevant PPE upon the FDIC's acknowledgement of receipt of the notice.[57] This notice procedure was introduced in the 2021 Final Rule and has significantly reduced administrative burdens on IDIs and broker-dealers. Importantly, the notice procedure is currently available to any agent or nominee or IDI participating in a business line qualifying for the 25% Test or Enabling Transactions Exception regardless of whether other parties are involved.

The Proposal would prohibit broker-dealers from submitting a PPE application. Only IDIs could submit such an application, even though the application would be required to contain information more readily available to a broker-dealer such as information on its assets and sweep program. The Proposal would also prohibit any party other than an IDI from submitting a notice of eligibility for the BDSE. Instead, IDIs would be required to submit a notice for each instance of reliance on the BDSE which will result in potentially many more notices for the FDIC to process.

The Proposal would create an application process for IDIs that wish to invoke the BDSE when additional third parties are involved in the arrangement so that the FDIC can evaluate the role of additional third parties as part of sweep programs. If the additional third party meets the deposit broker definition, then the FDIC would deny the application and the deposits being placed through the sweep program would be brokered notwithstanding the broker-dealer itself qualifying for a PPE.

A. The Proposed application and notice processes would create significant burdens and inefficiencies.

The requirement that only IDIs may submit a PPE application or notice has the potential to place significant additional burdens on IDIs and the FDIC through increased application volumes and is at cross-purposes with the Proposal's stated goal of operationally simplifying the PPE notice process. Under the Proposal, IDIs would be required to include information that only a broker-dealer would be privy to in BDSE notices and PPE applications, such as information on intermediary contracts. It would be considerably more efficient, and reduce demands for broker-dealers to needlessly share confidential information, if broker-dealers could file such applications and notices themselves. Moreover, because broker-dealer sweep programs are generally consistent across the program IDIs, it is not clear what benefit is gained by requiring each IDI in the same sweep program to submit a redundant application containing largely the same information. Significant time and resources could be saved through a

[57] FDIC, Questions and Answers Related to Brokered Deposits Rule, at D.1 (Jul. 15, 2022), available at https://www.fdic.gov/sites/default/files/2024-03/brokered-deposits-qa.pdf.

consolidated application from a broker-dealer pertaining to all the IDIs in a sweep or similar deposit program as under the 2021 Final Rule.

B. Limiting the notice procedure to deposit relationships not involving third parties would be counterproductive.

Broker-dealers frequently engage service providers to assist them in managing their sweep programs or other, non-sweep deposit-placement products. Broker-dealers may engage such service providers for any number of reasons, including that the broker-dealer lacks the required technological capabilities to manage its sweep program in-house. In the case of broker-dealers that are not deposit brokers under the PPE, the Proposal could create an unjustifiable disparity in treatment between a broker-dealer that manages its own sweep program and a broker-dealer that outsources aspects of management of its sweep program to an intermediary. There is no clear reason why the Proposal should penalize the outsourcing of certain activities that would otherwise be permissible if conducted directly by a broker-dealer.

Moreover, any intermediary agent remains subject to its broker-dealer-principal's control. It follows that if the broker-dealer-principal is not a deposit broker (under the PPE or another exception), the intermediary-agent also should not be a deposit broker. The existing brokered deposit rule reflects this approach as it allows for principals, such as broker dealers, to submit valid PPE notices even if a third-party intermediary is involved. The Proposal would, instead, default to a posture of assuming third-party intermediaries are not under a principal's control, as evidenced by the mere presence of a third-party intermediary eliminating the ability of an IDI to use the notice procedure.

V. The proposed changes to the PPE scope and application process would create significant transition costs.

The preamble of the Proposal states that "concurrent with the finalization of the proposed rule, the FDIC would rescind notices and applications approved under the 2021 Final Rule and would eliminate the ability of non-IDIs to file applications or notices. Therefore, the FDIC expects that the proposed rule could result in a significant increase in PPE applications from IDIs, especially in the period immediately following the effective date if the proposed rule were adopted."[58] It is unclear, however, how IDIs should treat deposits currently benefiting from an exception during this transition period, i.e., after the rescission of the current notices/approved applications and before new notices/applications are approved by the FDIC.

[58] 89 Fed. Reg. 68244, at 68260 (Aug. 23, 2024).

A. The lack of a transition period following the recission of existing PPE exceptions would lead to significant disruption, including temporarily inflated call report data.

This lack of a transition period would have significant costs for IDIs and broker-dealers. Unless their sweep and non-sweep deposit programs qualified for one of the narrow remaining designated PPE exceptions, broker-dealers would have to wait for their bank partners to either (1) submit a notice to rely on the BDSE and for that notice to be accepted by the FDIC, a process which could take as long as 180 days, or (2) submit a PPE application and for that application to be approved by the FDIC, a process which could take as long as 240 days. During this period, IDIs could be forced to classify all sweep deposits as brokered, even those that might ultimately benefit from an exception. This change would result in multiple quarters of inflated brokered deposit levels on call reports and would affect liquidity coverage ratios in public filings. The fluctuation in call report data could lead to higher deposit insurance assessments or a reluctance to accept sweep deposits at all or in the same amount. Those effects would, in turn, create increased costs for broker-dealers and reduce options for broker-dealer customers to safely store their funds. According to data provided by the Proposal, sweep deposits represent roughly 7.5% of all domestic deposits.[59] They are also a not insignificant portion of broker-dealer assets. The abrupt change also could have contractual consequences if, for example, a broker-dealer made representations to an IDI about having filed an effective PPE notice.

B. Any changes to existing exceptions should be accompanied by a transition period of at least two years.

The FDIC should quantify these costs and, if the Proposal is adopted, work to minimize them, including by retaining the 25% Test. In all events, IDIs and broker-dealers should have at least two years to reapply for an exception under any requirements once they become effective. During this time, IDIs and broker-dealers should be able to rely on their existing exceptions. A re-filing transition period was also provided during the implementation of the 2021 Final Rule, which was critical to allow institutions the ability to appropriately assess impacts.

VI. The proposed changes to the definition of deposit broker are not risk-based, make the definition overinclusive and are unlikely to address operational challenges.

A. The revision of the "matchmaking" sub-prong of the deposit broker definition could capture many low-risk activities and does not clearly address the operational issues that motivate the change.

The Proposal would eliminate the "matchmaking activities" prong in the deposit broker definition, including the affiliate carve out provided by the matchmaking activities prong of the

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[59] *See* 89 Fed. Reg. 68244, Appendix 1, Part III (Aug. 23, 2024) (providing data for December 2023).

2021 Final Rule. In its place, the Proposal would add a new prong that defines a deposit broker to include a "person that proposes or determines deposit allocations at one or more [IDIs] (including through operating or using an algorithm, or any other program or technology that is functionally similar)."[60] Although the FDIC asserts that the current matchmaking definition has proven difficult to implement in practice, it is not clear that this revision would create greater certainty. The Proposal does not define or limit the meanings of "algorithm" or "functionally similar technology." Consequently, the proposed revised definition could indiscriminately capture a large array of intermediary-agents not currently covered by the deposit broker definition that provide technology services with little bearing on the relative risk of the deposits placed by their principals.

The preamble to the Proposal states that the references to the use of an algorithm or similar technology is meant to capture situations where the algorithm "proposes or determines deposit allocations among IDIs by directing the flow, or facilitating the flow, of third-party funds."[61] However, this comes close to circularity, defining a regulatory sub-definition in terms highly similar to the primary language ("engaged in the business of placing or facilitating the placement of deposits") it is meant to elucidate.[62]

The Proposal also fails to account for contractual obligations between a broker-dealer and IDI that may further limit the influence of any third party. For example, it is typical for sweep deposits to be placed pursuant to contracts directly between IDIs and broker-dealers that govern the rates to be paid, the amount of the deposits and duration during which the deposits must be maintained. Even if a broker-dealer uses a third-party vendor to administer its program, the aggregate amount of funds is controlled by the broker-dealer-IDI agreement. The broker-dealer may even be subject to penalties for not maintaining a stable balance. If the Proposal is not withdrawn, any final rule should provide additional certainty to intermediaries providing technology services to broker-dealers and others about whether they fall within or outside the definition of deposit broker. Otherwise, the revised definition may prove even more operationally cumbersome than the FDIC believes the existing matchmaking definition is.

B. The elimination of the carve out for affiliate matchmaking is not risk-based and inconsistent with past practice.

In addition, under the current rule, matchmaking activities would not include persons that engage in activities that would otherwise satisfy the matchmaking prong if the activities are conducted between an IDI and an affiliated party. The new "proposes allocations" prong described above, however, would not exclude third parties that provide these services between affiliated entities. Thus, the FDIC would no longer view deposit allocation functions of third parties as administrative in nature due to the affiliated relationship between the person placing

[60] 89 Fed. Reg. 68244, at 68251 (Aug. 23, 2024).
[61] 89 Fed. Reg. 68244, at 68252 (Aug. 23, 2024).
[62] 12 U.S.C. § 1831f(g)(2)(I).

or facilitating the placement of deposits and the IDI. Rather, according to the FDIC, recent experience has demonstrated that, third parties do propose or determine deposit allocations at both unaffiliated and affiliated IDIs and that deposits from affiliates do not seem to be stickier just because there is an affiliation between a broker and an IDI.

As discussed above, the single example cited by the Proposal in support of this proposition—the failure of First Republic Bank—is wholly insufficient to support this change. In the first place, the FDIC's own report on the failure does not discuss affiliate sweeps.[63] Rather, the FDIC's material loss report on First Republic points to uninsured deposits as a key cause, suggesting that affiliation was a confounding not causal factor. Secondly, the decision to include the affiliate carve out in the 2021 Final Rule was made after careful consideration and considerable industry comment. The FDIC received 16 comments stressing the need for an affiliate carve out in response to its 2019 advanced notice of proposed rulemaking, including two from members of Congress.[64] And the FDIC intentionally retained the affiliate carve out in order to avoid disrupting longstanding business practices.[65]

If the Proposal is not withdrawn, we believe the FDIC should retain the existing matchmaking prong or, at a minimum, retain an affiliate carve out in the proposed deposit allocation prong.

C. The new independent sub-prong related to fees in the definition of deposit broker is overinclusive and inconsistent with past practice.

Under the Proposal, a person would be considered to be engaged in the business of placing or facilitating the placement of deposits if they have "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]."[66]

The preamble frames this proposed change as a return to pre-2020 practices where the FDIC considered fees as part of case-by-case determinations of deposit broker status, but it may prove to be an undue expansion of the definition that could newly capture a significant amount of deposits. Prior to 2020, the FDIC regularly considered fees in deposit broker advisory opinions, but fees were often one factor out of many and not all fees were considered an indication of heightened risk.[67] Under the Proposal, however, the receipt of any compensation in exchange for deposits may prove dispositive, and the FDIC does not provide a rationale for this change in practice.

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[63] 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.
[64] 85 Fed. Reg. 7453, at 7456 (Feb 10, 2020).
[65] 86 Fed. Reg. 6742, at 6747 n. 23 (Jan. 22, 2021).
[66] 89 Fed. Reg. 68244, at 68252 (Aug. 23, 2024).
[67] *See* FDIC, Study on Core Deposits and Brokered Deposits, 19 (Jul. 8, 2011) (discussing fees in the context of listing services), available at https://archive.fdic.gov/view/fdic/6706.

Ideally, this change should be withdrawn along with the rest of the Proposal. If the FDIC does retain the fee prong in the definition of deposit broker, it should clarify that payment of purely administrative fees will not trigger the deposit broker definition. Currently, the Proposal indicates subscription fees paid to listing services are not in exchange for or related to the placement of deposits. It should also clarify that fees for recordkeeping, calculation of deposit balances and similar administrative actions paid in exchange for independent services are not related to the placement of deposits.

VII. Other well-established exceptions should be retained.

A. The exclusive deposit relationship exception should be retained.

The preamble to the Proposed Rule expresses a concern that exclusive deposit placement relationships could lead to a less than well-capitalized IDI relying on a single counterparty for 100% of its deposits. The FDIC also claims that an IDI could have multiple exclusive third-party deposit placement relationships without any of the deposits being considered brokered. The existence of an exclusive deposit placement arrangement runs counter to the notion that the third party is engaged in the deposit broker business. In addition, the exclusive deposit arrangement exception benefits cash sweep programs between a broker-dealer subsidiary and an IDI affiliate, where the broker-dealer does not sweep funds to any other IDI, a low-risk activity that is unlikely to be materially disrupted in the event of stress. As such, the Proposal should be withdrawn and this exception retained. If the Proposal is not withdrawn, any final rule should retain the exclusive deposit arrangement exception.

B. The Enabling Transactions Exception should be retained.

The Proposal would also eliminate the Enabling Transactions Exception. In the FDIC's view, the current Enabling Transactions Exception is inconsistent with overarching changes made by the Proposal to the primary purpose exception because 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.[68] Again, this change is not risk-based. The Proposal does not provide any evidence that deposits placed under the existing Enabling Transactions Exception pose any greater risk to safety and soundness or the DIF than the designated PPE exceptions that are retained by the Proposal. We also believe there are relevant differences in the purposes of an agent who places funds in transaction accounts to enable customers to make purchases and an agent who places funds with an IDI to provide deposit insurance. First, if an agent's primary goal was to secure deposit insurance for its customers it would be very unlikely to place depositors' funds above the deposit insurance limit in transaction accounts that do not pay any interest or other remuneration to a depositor, as required by the existing Enabling Transactions Exception. Such behavior would irrationally deprive the customer of compensation that could be obtained through savings or other

[68] 89 Fed. Reg. 68244, at 68257 (Aug. 23, 2024).

accounts. Second, because the Enabling Transactions Exception requires that the relevant account does not pay any interest, there is no incentive for "hot money" to chase the highest interest paying deposit account, which was a core concern of the drafters of the brokered deposit statute.[69] For these reasons, we believe the requirement to place all deposits in non-paying accounts remains a workable test for determining the primary purpose of an agent. The FDIC should withdraw the Proposal and retain this exception. If the Proposal is not withdrawn, any final rule should retain the existing Enabling Transactions Exception.

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SIFMA appreciates the FDIC's consideration of these comments and would be pleased to discuss any of these views in greater detail if it would assist with their deliberations. Please contact Guowei Zhang at [redacted] or at [redacted] if you wish to discuss the points raised in this letter further.

Very truly yours,

[redacted]

Guowei Zhang

Managing Director, Head of Capital Policy

SIFMA

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[69] *See* Insured Brokered Deposits and Federal Depository Institutions: Hearing Before the Subcomm. on Gen. Oversight & Investigations of the Comm. on Banking, Fin. & Urban Affairs, 101st Cong. 9–10, 74 (May 17, 1989) (testimony and prepared statement of Sen. Frank H. Murkowski) (indicating a focus on hot money).