Statement by Vice Chairman Travis Hill on the Notice of Proposed Rulemaking on Brokered Deposit Restrictions

July 30, 2024

I expressed my high-level concerns regarding the brokered deposits framework last week.[1] The term "brokered deposits" encompasses many different types of deposits with very different characteristics and risks. The deposit landscape has become too complex to continually decide which arrangements are brokered and which are not in a fair and risk-sensitive way. And I am generally skeptical of sweeping rules that cut banks off from certain types of funding as their condition deteriorates, as is the case with brokered deposits.

I will vote against the proposal. Revamping this rule is a major undertaking that, in my opinion, is a poor use of our time and resources. While I disagree with many provisions in the proposal, I will focus my statement on a few specific ones.

Primary Purpose Exception

To start, I strongly disagree with the revised approach to the primary purpose exception. 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.[2] For example, a prepaid card network places its customer funds in a bank, not because it is in the business of helping customers open or put money in bank accounts, but because it needs the banking system to move money from place to place. The prepaid card network's primary purpose is to provide customers a mechanism to make payments and transactions, not to help customers place their funds at banks.

The 2020 rule created a new standard and framework for implementing the primary purpose exception. Prior to the 2020 rule, the FDIC did not have a consistent standard or framework; instead, the agency generally decided whether to apply the exception based on a subjective value judgment of the underlying motivation behind the deposit arrangement at the time the arrangement was first presented before the FDIC.

The proposal generally reverts back to the pre-2020 approach,[3] though using different words and with a different process. The proposal greatly expands the 2020 rule's application

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[1] *See* Travis Hill, Reflections on Bank Regulatory and Resolution Issues ("AEI speech") (July 24, 2024).

[2] *See* 12 U.S.C. § 1831f(g)(2)(I).

[3] *See, e.g.,* Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking—Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions ("Proposal"), p. 38 ("The proposed interpretation of the primary purpose exception would be similar to how the FDIC historically interpreted the exception before 2020.").

process, adding more subjectivity to the process, and, critically, makes adjustments to the standard by which the FDIC analyzes whether an entity qualifies for the exception. Under the current rule, the FDIC looks at whether the primary purpose of the entity's business relationship with its customers is the placement of deposits,[4] an easy-to-understand analysis that is consistent with the plain meaning of the statute. The proposal would instead analyze whether the primary purpose of an entity's relationship with *the bank* is for a *substantial* purpose other than a "deposit-placement service or FDIC deposit insurance."[5] This new standard is harder to understand, harder to meet, and farther removed from the words of the statute.

The proposal also requires that, in order for any deposits to qualify under the primary purpose exception, unless the deposits qualify for one of the limited designated exceptions, every bank that accepts such deposits will have to apply separately to the FDIC.[6] This means, for example, that if an entity works with 10 banks, every single bank would need to apply individually and receive approval from the FDIC to treat the arrangement as non-brokered under the primary purpose exception. 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.

I also disagree with eliminating the "enabling transactions" designated exception.[7] As an example, as noted above, the primary purpose of a prepaid card network is to provide customers a mechanism to make payments, whereas placing deposits is an ancillary, but necessary, part of

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[4] *See* 86 Fed. Reg. 6,742, 6,750 (Jan. 22, 2021) ("The primary purpose exception, . . . with respect to a particular business line, [applies 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. Whether an agent or nominee qualifies for the primary purpose exception will be based on an analysis of the agent's or nominee's relationship with those customers."). *See also* 12 C.F.R. § 303.243(b)(4)(v)(B) ("The FDIC will approve an application … if the FDIC finds that the applicant demonstrates that, with respect to the particular business line under which the third party places or facilitates the placement of deposits, the primary purpose of the third party's business relationship with its customers is a purpose other than the placement or facilitation of the placement of deposits.").

[5] Proposal, *supra* note 3, § 303.243(b)(4)(v)(B) ("The FDIC will approve an application … if the FDIC finds that the applicant demonstrates that, with respect to the particular business line under which the third party places or facilitates the placement of deposits, the primary purpose of the third party's business relationship with the insured depository institution is for a substantial purpose other than to provide a deposit-placement service or FDIC deposit insurance for customer funds placed at the insured depository institution.").

[6] *Id*. at p. 40 ("[T]he FDIC proposes to no longer allow third parties to apply for a primary purpose exception. As proposed, each IDI wishing to rely on a primary purpose exception would be required to submit an application for the specific deposit placement arrangement that it has with the third party involved.").

[7] Under the enabling transactions test, where 100 percent of customer funds that have been placed at depository institutions, with respect to a particular business line, are placed into transaction accounts, and no fees, interest, or other remuneration is provided to the depositor, the agent or nominee may rely on the enabling transactions designated exception. *See* 12 C.F.R. § 337(a)(5)(v)(I)(1)(2).

the business. I also disagree with replacing the "25 percent test."[8] 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.

Fees and Remuneration

The proposal would also add a new criterion providing that a "person" is a "deposit broker" if that person receives "a fee or … other remuneration in exchange for or related to the placement of deposits."[9] This is a broad, sweeping criterion that – if applied literally and consistently – would capture a wide range of businesses that have any involvement in deposit placement arrangements.

However, the preamble also notes that "passive listing services"[10] would not be captured by the proposal because the fees they charge to customers are for "information on the [deposit] rates gathered by the listing service," and the fees they charge to banks are for the "opportunity to list or 'post' the IDIs' [deposit] rates."[11] I think it is reasonable to create a brokered deposits regime that does not include listing services, but if a listing service is not accepting fees "in exchange for or related to the placement of deposits," then I am not sure who is.

Why would the proposal establish a sweeping new criterion for a deposit broker, but then exempt a deposit arrangement that seems to obviously meet it? Two explanations jump out to me. First, I think many supervisors believe listing service deposits are an important liquidity source for banks that are subject to brokered deposits restrictions, and do not want to cut banks off from that potential safety valve.[12]

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[8] The "25 percent test" provides that the primary purpose of an agent's or nominee's business relationship with its customers will not be considered to be the placement of funds at a depository institution if less than 25 percent of the total assets that the agent or nominee has under administration for its customers, in a particular business line, is placed at insured depository institutions. *See* 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(i).

[9] Proposal, *supra* note 3, p. 32 ("[T]he proposed rule would add that a person is 'engaged in the business of placing or facilitating the placement of deposits of third parties' if that person has a relationship or arrangement with an IDI or customer where the IDI, or the customer, pays the person a fee or provides other remuneration in exchange for or related to the placement of deposits."). The preamble states on several occasions that fees or remuneration "in exchange for or related to" the placement of deposits is captured, while the regulatory text only encompasses fees or remuneration "in exchange for" the placement of deposits. *See* Proposal, § 337.6(a)(5)(ii)(E).

[10] An example of a passive listing service is a company that compiles information about the interest rates offered by banks on deposit products, posts the rates each bank offers on a website, and sends trade confirmations between depositors and banks.

[11] Proposal, *supra* note 3, p. 34-35.

[12] *See* AEI speech, *supra* note 1 ("Banks are sometimes encouraged by supervisors to seek out listing service deposits once they become subject to brokered deposits restrictions, which I think demonstrates that this whole regime does not work."). I will also add that critiques about other types of deposits involving intermediaries that are not currently considered brokered could equally be made of listing service deposits. *See, e.g.*, Martin Gruenberg,

Second, I am confident that if listing service deposits were first exempted from the rule in 2020, there would not be a carveout in the proposal. I think this reveals the true motivation underlying much of this proposal.

Conclusion

For those reasons, and others, I will vote no. While I think certain refinements of the 2020 rule might be warranted based on our experience over the past three-and-a-half years, the proposal goes too far. Nonetheless, thank you to staff for their continued work on this issue over many years.

Statement on the Final Rule: Brokered Deposits and Interest Rate Restrictions (December 15, 2020) ("The bank could fall below well capitalized and still rely on those third party placed deposits for one hundred percent of its funding without any of those deposits considered brokered, effectively an end-run around the statutory prohibition on less than well capitalized banks receiving brokered deposits."). The statement quoted is a reference to deposits placed as part of an exclusive relationship, but could apply equally to listing service deposits.