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FDIC’s Proposed Brokered Deposit Rule Could Adversely Impact Fintech-Bank Partnerships

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In late July 2024, the **Federal Deposit Insurance Corporation (FDIC) board of directors proposed a rule** that would revise its standards on banks accepting brokered deposits. The proposed rule would expand the definition of brokered deposits, including by eliminating certain broad exceptions to the rule, and subject more bank deposits to heightened regulation as brokered deposits. If finalized, the proposed rule could bring broad swaths of fintech companies under the umbrella of deposit brokers.

FDIC board member and Consumer Financial Protection Bureau **Director Rohit Chopra offered support for the proposed rule**, stating that it would “promot[e] the stability of the banking system and protect[] the Deposit Insurance Fund,” as well as close loopholes put in place by the 2020 brokered deposit rule. On the other hand, FDIC Vice Chairman Travis Hill criticized the rule for “cut[ting] banks off from certain types of funding as their condition deteriorates,” arguing that the deposit landscape is now “too complex” to decide which arrangements should be considered brokered – and which should not – in a fair and risk-sensitive way.

Background and 2020 rule

In 1989, in part as a response to the savings and loan crisis of the 1980s, Congress introduced Section 29 of the Federal Deposit Insurance Act to regulate brokered deposits in connection with insured depository institutions (IDIs). Section 29 defines “deposit broker” as “any person engaged in the business of placing third-party deposits, or facilitating the placement of third-party deposits, with IDIs or the business of placing deposits with IDIs for the purpose of selling interests in those deposits to third parties.” The statute provides several exceptions to a deposit broker, including a primary purpose exception (PPE) for entities whose primary purpose is not the placement of funds with depository institutions.

The statute, however, does not define a “brokered deposit.” In interpreting Section 29, the FDIC defines a “brokered deposit,” in part, as “any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.” Generally speaking, brokered deposits are viewed by regulators as riskier compared to core deposits, which are composed of deposit types considered to be more stable and lower in cost, such as checking accounts, savings accounts, and certificates of deposit held by individuals. As a result, banks that accept brokered deposits are subject to heightened regulatory requirements.

In particular, Section 29 imposes specific restrictions on banks’ use of brokered deposits. Banks that are not well capitalized are either prohibited from accepting brokered deposits or significantly limited in their ability to do so. In addition, the acceptance of brokered deposits can increase a bank’s FDIC insurance premium assessments, result in potential unfavorable treatment under liquidity rules, and accentuate the general risk that a regulatory examiner views such deposits as being overly risky.

The FDIC last updated the brokered deposit rules in December 2020. The 2020 rule greatly narrowed the types of deposits that are considered brokered deposits by restricting the definition of a deposit broker to agents or entities having deposit placement arrangements with at least two IDIs and designating several specific fact patterns as qualifying for the PPE for agents engaged in certain business lines. Two such fact patterns from the 2020 rule that currently qualify for the PPE are the 25% exception and the enabling transactions exception.

Key aspects of FDIC's proposed rule

The proposed rule would essentially reverse much of the framework established by the 2020 rule. Below are some of the key revisions to the brokered deposit rules that would be implemented if the proposed rule is finalized in its current form.

Redefine 'deposit broker'

Combine provisions

The 2020 rule currently defines two prongs of activity that make one a deposit broker: "placing" and "facilitating the placement" of deposits. The proposed rule would combine these prongs into one provision, thereby defining a "deposit broker" as "[a]ny person engaged in the business of placing or facilitating the placement of deposits of third parties" with IDIs. According to the FDIC, this proposed change is an effort to make the definition more straightforward for IDIs and other stakeholders to apply.

Replace matchmaking activities with determination of deposit allocations

The current rules define "facilitation" to include engagement in "matchmaking activities." The proposed rule would remove the reference to matchmaking activities and replace it with a test of deposit allocations. Under the proposed rule's deposit allocation test, an agent who proposes, determines or otherwise directs the flow of third-party funds to particular IDIs, using an algorithm or otherwise, would be facilitating the placement of deposits.

Add condition regarding fees or remuneration

The proposed rule would add to the definition of a deposit broker any agent who is paid a fee by the IDI or a customer-depositor in exchange for placing the deposit at one or more IDIs.

Eliminate exclusive deposit placement arrangement exemption

The 2020 rule clarified that any agent holding a deposit placement arrangement with only one IDI is not a deposit broker. This means that an entity can partner with an IDI to place all of its customer's funds with the IDI, but as long as the entity exclusively places its customer funds at only that one IDI, it is not considered a deposit broker, and the funds it places are not considered brokered deposits. The proposed rule would remove this exemption. Under the proposed rule, an agent holding a deposit placement arrangement with only one IDI would be considered a deposit broker.

Rein in the general PPE

Reorient scope of general PPE analysis

The PPE analysis under the 2020 rule inquires about the primary purpose of the agent's relationship with its customers. Under the proposed rule, the inquiry would expand to consider an additional facet: the primary purpose of the agent's relationship with the IDI. The proposed PPE only would cover an agent that places its deposits for a substantial purpose other than to provide a deposit-placement service or FDIC deposit insurance for its customers.

Add three new factors to PPE analysis

The proposed rule adds three new factors for the FDIC to consider in determining whether an agent is placing funds for a substantial purpose other than to provide a deposit-placement service or access deposit insurance: fees, discretion and legal obligation. “Fees” refers to whether the IDI pays fees to the agent in return for its placement of deposits with the IDI. “Discretion” refers to whether the agent has discretion to choose the IDIs into which agent customer funds will be placed. “Legal obligation” refers to whether the agent is mandated by law to disburse funds to deposit accounts.

Restrict who can apply for PPE

Currently, qualifying agent activity does not automatically receive the PPE; the agent or IDI must apply to the FDIC for the exception. Under the proposed rule, the PPE would remain application based. However, while the 2020 rule directs **agents** to apply to the FDIC for the exception, then report their nonbroker status to IDIs, the proposed rule would require and only permit IDIs to apply for the exception.

Revise previously designated fact patterns qualifying for PPE

Replace 25% designated PPE with broker-dealer sweep exception

The 2020 rule implemented a list of specific exceptions that have been designated as meeting the PPE. One such exception exists for an agent that places less than 25% of its total assets under administration at an IDI. The proposed rule would lower this threshold to less than 10% of the agent’s total assets under management, and make this exception available only to broker-dealers or registered investment advisers.

Eliminate designated PPE for enabling transactions

Another specific exception that is designated as meeting the PPE under the current rules is for agents placing deposits for the purpose of allowing their customers to make transactions. Under the proposed rule’s framework, this exception would no longer satisfy the general primary purpose test because, according to the proposed rule, placing deposits into transactional accounts does not alone prove the agent’s substantial purpose other than accessing deposit insurance.

What’s next

The FDIC is accepting written comments on the rule until **October 22, 2024.**

The proposed rule could be impacted by the Congressional Review Act (CRA), which gives Congress the ability to review and potentially rescind new federal rules issued by government agencies. A key component of the CRA in this context is the 60-day “look-back” window, which opens 60 legislative days from the final adjournment of the 118th Congress. During the look-back window, the rules that a government agency finalizes are subject to review by the next session of Congress, which will begin in January 2025. This look-back period allows the new Congress to review and potentially disapprove rules made at the end of the previous administration to prevent so-called midnight regulations that may be unfavorable to the incoming administration. Under the CRA, Congress can move to rescind regulations with a simple majority vote in both chambers on a resolution of disapproval. If Congress passes the resolution and the president signs it, the agency is prohibited from issuing a “substantially similar” rulemaking without further congressional action.

Fintech companies and anyone else who relies on partnering with banks for bank services should consider how the requirements in the proposed rule could affect their business model. If finalized as proposed, the proposed rule would significantly broaden the scope of activities that are considered deposit brokering. This widened scope arguably would cover as deposit brokers many fintechs that are not covered under the current deposit broker rules but utilize banks in connection with third-party funds. In addition, fintechs may subsequently find that bank partnerships are more difficult to achieve based on the heightened regulatory requirements for banks that accept brokered deposits or find the potential new impacts on the fintech's program – such as the end of a partner bank's ability to accept brokered deposits if it should become less than well capitalized – less desirable for other practical business purposes.

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