

Bank Brokered Deposits: New FDIC Guidance on Identifying, Accepting and Reporting Deposits

Meeting FDIC Expectations and Reporting Requirements in an Era of Heightened Scrutiny

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Outline

- I. Overview of the brokered deposit market
- II. Brief history of the brokered deposit restrictions
- III. Sources of FDIC guidance on brokered deposits
- IV. Overview of Statute/Rule
- V. Analysis of FDIC's recent FIL on brokered deposits
 - A. Scope of "deposit broker" definition
 - B. Exceptions from the definition, including "primary purpose" and listing services
 - C. Application of the guidance to pre-paid card deposits
- VI. Consequences of accepting brokered deposits

I. Overview of the Brokered Deposit Market

“A dollar deposited in an insured institution is the same whether obtained directly from a local depositor or through the intermediation of a deposit broker.”

L. William Seidman (1989)
FDIC Chairman 1985-1991

Estimated Size of the Market

Over \$1.3 trillion of deposits are maintained in deposit accounts at FDIC-insured banks that are either held through, referred, or placed by “deposit brokers,” or held through brokered arrangements, e.g., broker-dealer “sweep” programs, that are exempt from the definition of “deposit broker.”

This represents approximately 11.6% of total domestic deposits.

Composition of Brokered Deposit Market

- National brokered CD market (including CDARS)
- “Sweep” deposits from broker-dealers and banks
- Stored value cards
- Referrals from affiliates
- Other

Total Reported Brokered Deposits as of December 31, 2014

\$ 823 Billion

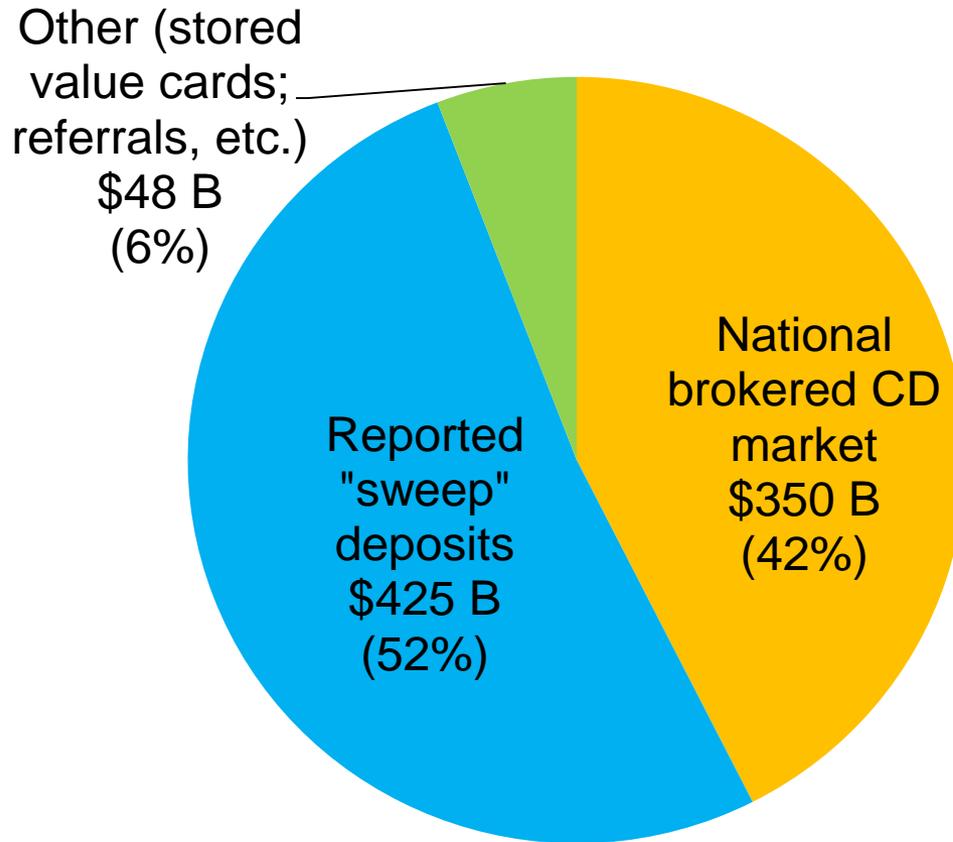
Source: Call Reports

Estimate of Exempt Broker-Dealer “Sweep” Deposits

~\$ 400 - \$450 Billion

Source: S&K estimate

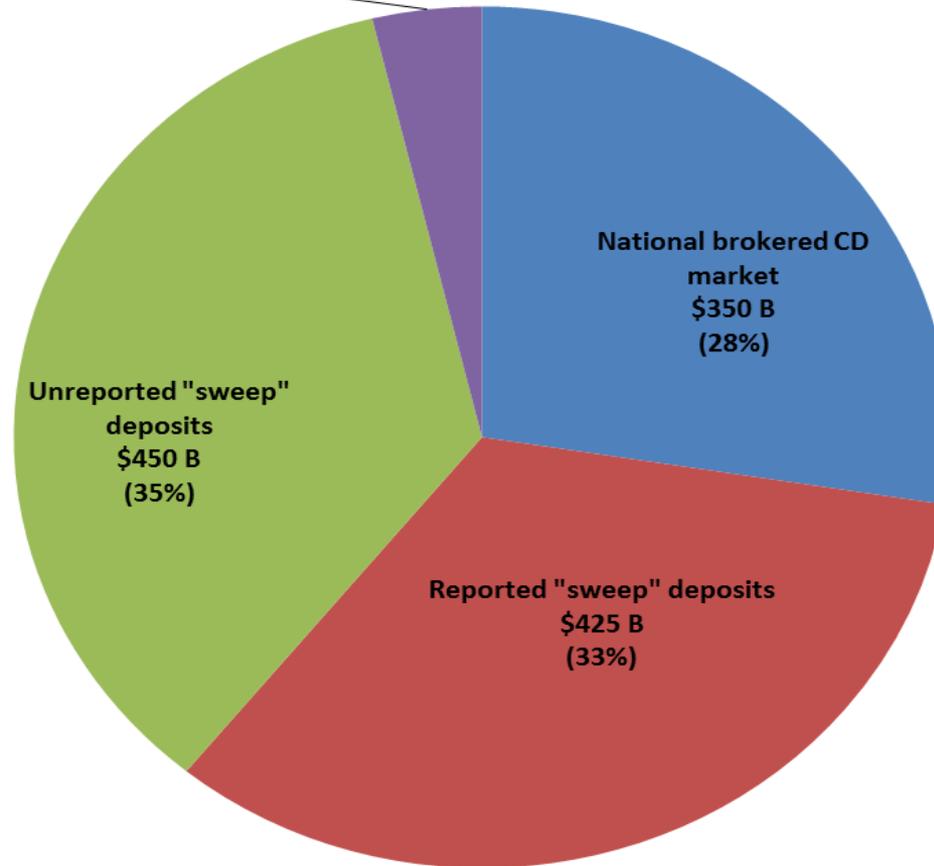
BREAKDOWN OF \$823 BILLION REPORTED BROKERED DEPOSIT MARKET



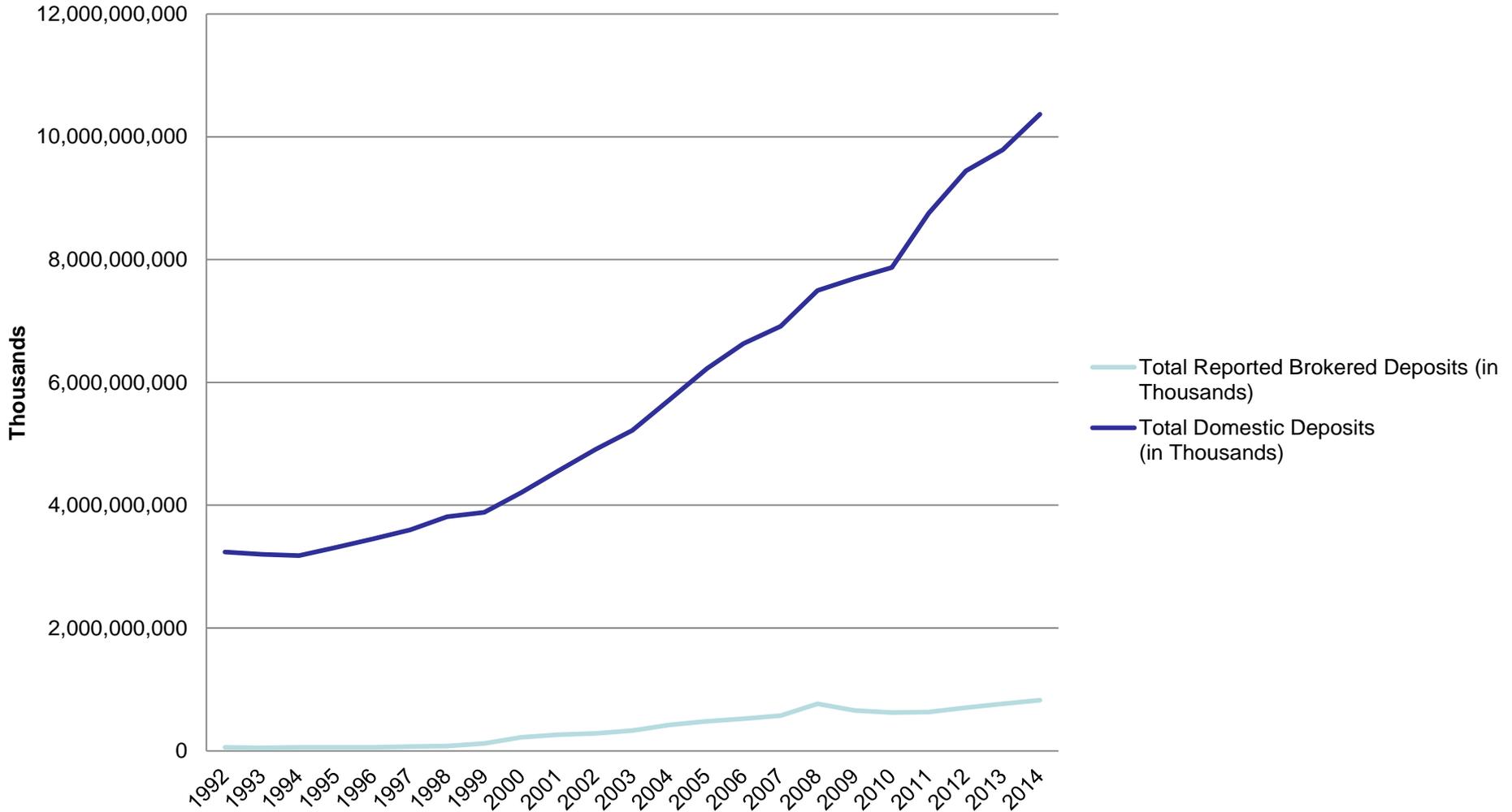
Market Breakdown

Breakdown of \$1.3 Trillion Brokered Deposit Market

Other (stored
value cards;
referrals, etc.)
\$48 B
(4%)

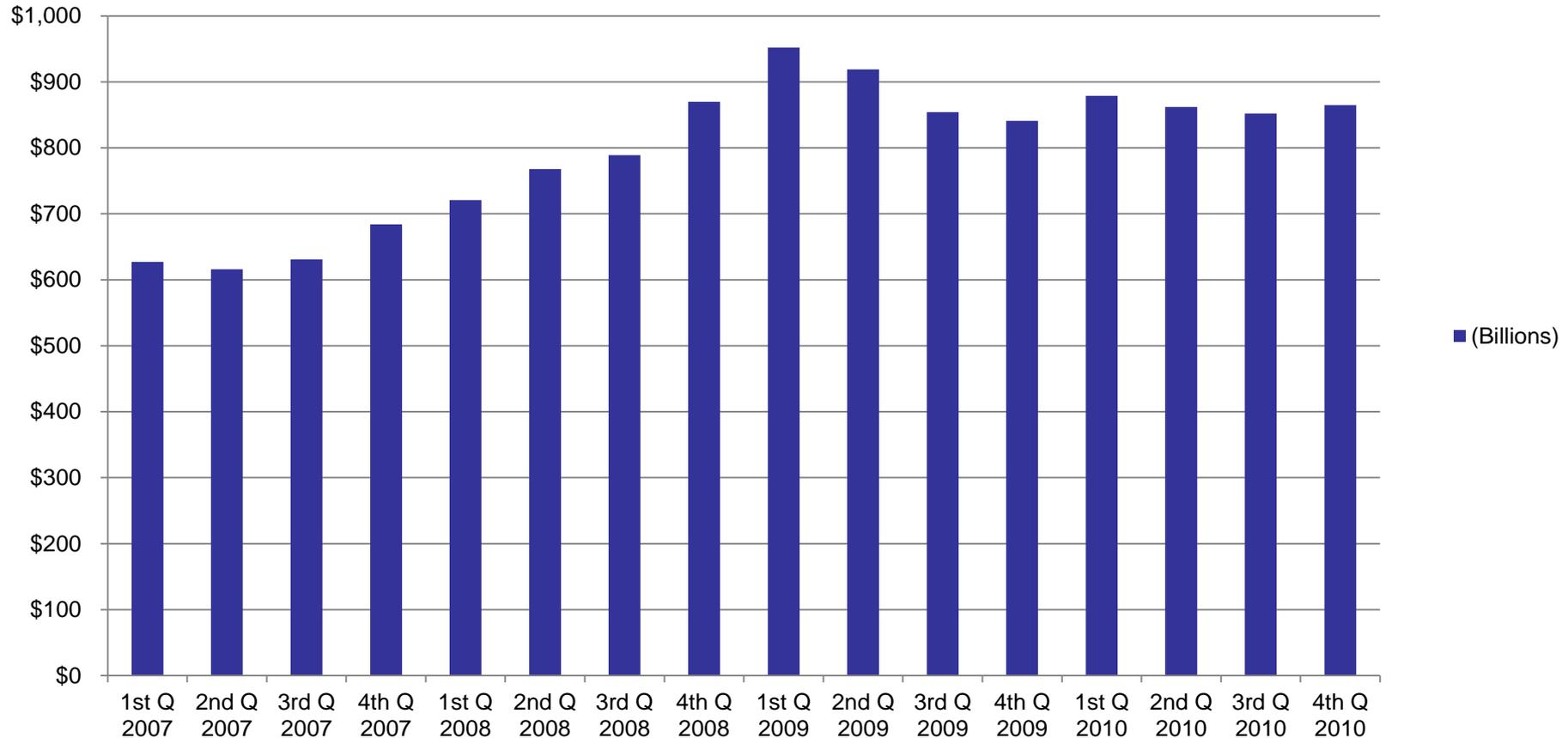


Total Deposits v. Brokered Deposits (1992-2014)



Source: Call Reports

Increase in Brokered Deposits* during the Financial Crisis



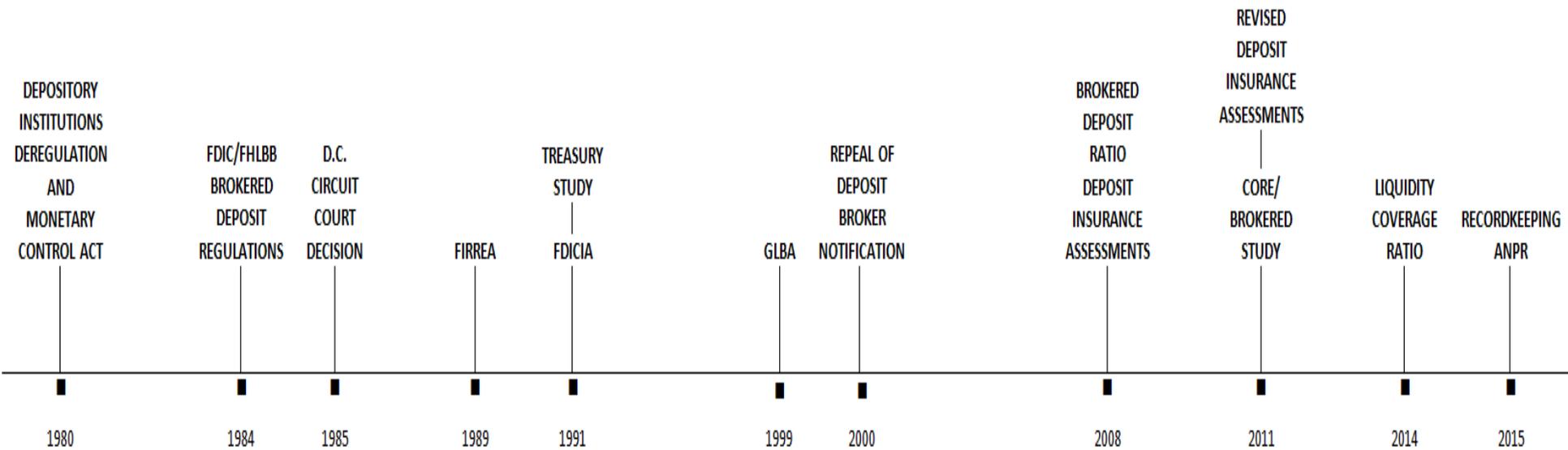
* Includes estimate of unreported "sweep" deposits.

II. History of Brokered Deposit Regulation

“The past is never dead. It's not even
past.”

— William Faulkner, *Requiem for a Nun*

TIMELINE



FDIC/FHLBB 1984 Regulations

- Did not prohibit brokered deposits, but eliminated “pass-through” insurance on brokered deposits
- Defined “brokered deposit” as a deposit accepted through a “deposit broker.” A “deposit broker” was defined as:
 - any person engaged in the business of placing funds, or facilitating the placement of funds, of third parties in accounts issued by an insured depository institution or the business of placing funds in accounts issued by insured institutions for the purpose of selling interests in such accounts to third parties

FAIC Securities, Inc. v. United States

- The FDIC/FHLBB 1984 regulations were overturned by the United States District Court for the District of Columbia, whose judgment was upheld by the United States Circuit Court of Appeals for the D.C. Circuit
- “A general authority to define terms, and the extent of insurance coverage resulting from those terms, does not confer power to *redefine* those terms that the statute itself defines.” (*FAIC Sec., Inc. v. United States*, 768 F.2d 352, 362 ((emphasis in original) (1985))

FIRREA (1989)

- Prohibited “troubled” depository institutions from accepting brokered deposits absent an FDIC waiver
- Adopted brokered deposit restrictions as an amendment on the Senate floor without any committee hearings
- Utilized the definition of “brokered deposits” contained in the FDIC/FHLBB overturned 1984 regulations
- Mandated Treasury Department study on the federal deposit insurance system, including the feasibility of restrictions on brokered deposits

Treasury Department Study (1991)

- Recommended elimination of “pass-through” deposit insurance for brokered deposits
- Concluded that brokered deposits “help insulate depository institutions from the risk-taking checks normally imposed by the market, make it easier to raise insured deposits- and thus increase taxpayer exposure to potential losses.”
- Recommended elimination of multiple insurable capacities.

FDICIA (1991)

- Congress rejected Treasury Department's recommendation to eliminate "pass-through" deposit insurance on brokered deposits
- Adopted "prompt corrective action" capital categories as a basis for eligibility to accept funds from a deposit broker, using FIRREA's definition of "deposit broker":

Capital Category	Ability to accept brokered deposits
"well capitalized"	No restrictions
"adequately capitalized"	Must obtain FDIC waiver
"undercapitalized"	Absolute prohibition

- Required "deposit brokers" to notify the FDIC that they were acting as deposit brokers

Notes re: FDICIA

- During consideration of FDICIA, there were numerous committee hearings and testimony from interested parties. The definition of “deposit broker” was never the subject of a hearing or any party’s testimony. The entire focus was on the brokered CD market and the role of broker-dealers in that market
- FDICIA was considered prior to the substantial growth of bank sweep products, prior to GLBA, which authorized the affiliation of banks and broker-dealers, and prior to stored value cards

Notification Requirement

- Deposit broker notification requirement was repealed by Congress in 2000
- Many of the interpretive letters issued by FDIC staff after FDICIA was adopted addressed whether a party had to notify the FDIC that it was acting as a deposit broker, not whether a bank had to treat certain deposits as brokered deposits

Significant Post-FDICIA Developments

- Adoption of GLBA in 1999, which accelerated the growth of affiliation between banks, brokers and investment advisers
- Development of the Internet and its use to solicit deposits
- Rapid growth of sweep deposits since 2000
- 2004 FDIC staff interpretive letter permitting listing services to facilitate account opening
- 2005 FDIC staff interpretive letter excluding certain broker-dealer sweep arrangements as brokered deposits
- 2008 financial crisis and enhanced regulatory concern about brokered deposits
- 2011 FDIC core-brokered study, which rejected industry requests to eliminate the distinction between brokered and core deposits, or treat some brokered deposits as core deposits

III. Sources of FDIC Guidance on Brokered Deposits

- Statute: FDI Act § 29, 12 U.S.C. 1831f
- Rule: 12 C.F.R. 337.6
- The Rule and Statute are very similar, some shadings added by rule
- Staff interpretations on FDIC Website
- 2015 FAQs

IV. Overview of Statute/Rule

- Prohibits bank from receiving deposits from a “deposit broker” if not “well capitalized”
- FDIC can waive if bank is adequately capitalized
- Less than “adequately capitalized” banks are prohibited from accepting brokered deposits
- New money, renewals and rollovers of time deposits covered
- Definition of “deposit broker”
 - Person engaged in business of placing deposits or facilitating placement of deposits with third party insured depository institution
 - Agent or trustee who uses deposits to fund a prearranged loan
- Banks that are not “well capitalized” are deemed to be accepting brokered deposits if interest rates on deposits exceed 75 basis points over national average posted by FDIC
- Exclusions from definition

Overview of Statute/Rule (cont'd.)

- *Solicitation and acceptance of brokered deposits by insured depository institutions.*
 - A well capitalized insured depository institution may solicit and accept, renew or roll over any brokered deposit without restriction by this section.
 - An adequately capitalized insured depository institution may not accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC.
- A waiver can limit the rates, volume and maturities of brokered deposits.
- An undercapitalized insured depository institution may not accept, renew or roll over any brokered deposit.
- An insured depository institution that is not well capitalized may not solicit deposits by offering an effective yield that exceeds by more than 75 basis points the prevailing effective yields on insured deposits of comparable maturity in such institution's normal market area or in the market area in which such deposits are being solicited.
- The FDIC may, on a case-by-case basis and upon application by an “adequately capitalized” insured depository institution, waive the prohibition.

Overview of Statute/Rule (cont'd.)

- *Brokered deposit* means any deposit that is obtained from or through the mediation or assistance of a deposit broker.
- *Deposit broker* means:
 - (A) Any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions, or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties; and
 - (B) An agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan.

Exclusions from “Deposit Broker”

- An insured depository institution, with respect to funds placed with that depository institution;
- An employee of an insured depository institution, with respect to funds placed with the employing depository institution;
- A trust department of an insured depository institution, if the trust or other fiduciary relationship in question has not been established for the primary purpose of placing funds with insured depository institutions;
- The trustee of a pension or other employee benefit plan, with respect to funds of the plan;
- A person acting as a plan administrator or an investment adviser in connection with a pension plan or other employee benefit plan provided that person is performing managerial functions with respect to the plan;
- The trustee of a testamentary account;
- The trustee of an irrevocable trust that has not been established for the primary purpose of placing funds with insured depository institutions;
- An agent or nominee whose primary purpose is not the placement of funds with depository institutions; or
- An insured depository institution acting as an intermediary or agent of a U.S. government department or agency for a government sponsored minority or women-owned depository institution deposit program.

Definition of “Employee”

- *Employee* means any employee who is:
employed exclusively by the insured
depository institution,
- compensated primarily in the form of a salary
- who does not share compensation with a
deposit broker, and
- whose place of business is used exclusively for
the benefit of the employer depository
institution.

Key FDIC Interpretations

- Letters distinguishing deposit brokers from listing services
 - FDIC Advisory opinions 90-24, 92-50, 02-04, 04-04
- Letters involving affinity groups, marketing services for banks, or referrals of potential depositors to banks
 - FDIC Advisory opinions 92-79, 93-30, 93-31, 93-34, 93-71, 94-37, 94-15, 95-9
- Letters involving broker-dealers, investment advisers, trust companies, including “sweep” deposits and special reserve deposits
 - FDIC Advisory opinions 92-87 (trust company), 94-39 (reserve account), 05-02 (sweep), FDIC General Counsel Opinion No. 8, 73 Fed. Reg. 67155 (prepaid cards)
- Letters interpreting when “pass-through” deposit insurance coverage of brokered deposits is available
 - FDIC Advisory opinions No. 02-02 (debtor/creditor vs agent/custodian), 03-03 (reciprocal bank network sweeps), FIL 29-2010

FDIC Core Deposit Study

- Issued in 2011 under Dodd Frank Act
- Over 120 pages long
- Analysis of “core deposits” and “brokered deposits”
- Summarized FDIC precedents
- Appeared to be moving to a risk-based analysis for policy and away from legalisms
- Focused on “stickiness” of different types of deposits and funding risk in stressed periods
 - Volatility, high rates, ability to fuel rapid growth and increase losses to FDIC, franchise value of customer relationship
 - Reciprocal deposits, sweep deposits, affiliate referrals
 - High rate and listing service deposits
- Rejected requests to narrow the interpretation of the definition of “deposit broker” and to revise the definition of “core deposits”

V. Analysis of FDIC's Recent FIL on Brokered Deposits

- FIL-2-2015 (Jan. 5, 2015)
“Guidance on Identifying, Accepting and Reporting Brokered Deposits/Frequently Asked Questions
- Applicable to all FDIC insured depository institutions
- Call reports must include brokered deposits information
- FDIC continues to receive frequent questions
- FAQs summarize FDIC's guidance and current positions on brokered deposits
- FDIC positions more conservative than suggested by 2011 Core Deposits Study, but generally consistent with prior letters
- FDIC has stated that the FAQs are a “living” document and that updates will be posted on the FDIC website as required
- FDIC has acknowledged that 2 FAQs are wrong and need to be clarified: (1) referrals by insurance agents, lawyers or accountants (FAQ B6) and (2) closing brokered nonmaturity accounts when bank ceases to be well capitalized (FAQ F5)

Analysis of FDIC's recent FIL on brokered deposits (cont'd)

A. Scope of "deposit broker" definition

- Third parties (including affiliates) that place deposits or facilitate placement deposits
- Fee structure relevant but not dispositive (volume-based fee is almost always a trigger)
- "Facilitation" read very broadly by FDIC
- Consideration of overall activity of the third party and how the deposits relate to that business
- Designing & consulting on deposits not a trigger; but marketing, referral, soliciting and connecting are triggers
- Flat fee endorsements not a trigger without more

V. Analysis of FDIC's recent FIL on brokered deposits (cont'd)

- B. Exceptions from the definition, including “primary purpose” and listing services
 - Primary purpose exceptions– FDIC recognizes this exception infrequently and may require a specific request for confirmation
 - » Agent or nominee whose primary purpose is not the placement of funds with banks
 - » Trustee of irrevocable trust not established for primary purpose of placement of deposits
 - » Consider fees, how deposit incidental to some broader activity, other facts
 - » Examples: sweep accounts , pre-paid cards, IOLTA, non-depository trust company
 - Listing services: are they engaged in business of placing deposits, consider fees and context
- Other exceptions:
 - Internal bank referrals (affiliates not within this exception)
 - Bank employees (but narrow “employee” definition)
 - Trust department of an insured depository institution
 - Trustees, administrator, adviser of pension and employee benefit plans
 - Trustee of testamentary trust
- Bank as U.S. government agent to place deposit with women and minority-owned institutions

Analysis of FDIC's recent FIL on brokered deposits

C. Application of the guidance to pre-paid card deposits

- Are the funds held in the card issuer's treasury, and therefore represent general corporate obligations of the card issuer? If so, the deposits are not brokered.
- Is the card issuer placing the funds in a bank as agent for the card holder? If so, the card issuer is a deposit broker unless the primary purpose exception applies.
- **Primary purpose exception is applied narrowly.**
 - General purpose pre-paid cards -- cards that can be used for purchasing a range of products -- will not qualify.
 - Re-load feature and fees paid by bank to issuer will disqualify issuer from exception.
 - Narrow purpose may qualify : debit card issued by college to access student loan proceeds.

VI. Consequences of Accepting Brokered Deposits

- Stay “well capitalized” or get FDIC waiver
- De novo institutions restriction
- Funding/liquidity risk considerations
- Deposits will be non-core deposits
- Possible deposit insurance premium impact on higher risk banks if over 10%
- Call report treatment
- LCR rule, pending NSFR rule, impact on large bank required holdings of liquid assets and profitability