

Navigating the FDIC Brokered Deposit Rule

The Path to Compliance for Banks Seeking Non-Brokered Treatment of Sweep Deposits Using the Primary Purpose Exception (PPE)

Executive Summary

With deep roots in the administration of insured deposit sweep programs, TBS has been actively engaged with regulators, banks and wealth management firms since the FDIC first proposed to revise its brokered deposit regulation, which establishes the criteria for determining whether or not certain types of deposits are to be treated by banks as brokered.

The proposal advanced through the rulemaking process and the Final Rule was approved in December 2020, with significant changes to the provisions regarding insured deposit sweeps from those in the proposed rule published a year earlier. The short time between adoption in December 2020 and the Final Rule's effective date of April 1, 2021 afforded banks receiving the sweep deposits and wealth management firms ("Source Institutions") very limited time to understand the rule and its business impact.

The Final Rule provides an immediate benefit to banks by increasing opportunities to obtain non-brokered treatment of deposits. Non-brokered deposits provide additional benefits to banks that are subject to the interagency Liquidity Coverage Ratio and Net Stable Funding Ratio rules. In addition, increased access to non-brokered deposits, combined with the pandemic-induced reduction in banks' appetite for funding overall, could have profound implications for insured deposit sweep programs that historically have provided a significant source of deposits for banks.

A key component of the rule is the creation of specific eligibility criteria and filing and application requirements for a Source Institution to qualify for the Primary Purpose Exception (PPE). For many Source Institutions obtaining the PPE will provide an immediate benefit in the form of increased access to deposit capacity, a contractual commitment to receive sweep deposits, at banks that seek non-brokered deposits. As of the publication date of this paper, however, Source Institutions remain unclear about the filing requirements due to limited guidance, specifically about how to define the roles and responsibilities of sweep program participants, including third-party administrators such as TBS, for purposes of determining eligibility for the PPE.

The purpose of this paper is to:

- ✓ Summarize the key aspects of the Final Rule as it relates to insured deposit sweep programs and shed light on nuances that have material implications for program participants; and
- ✓ Outline how Source Institutions seeking the PPE and banks needing to rely on the success of Source Institutions maintaining PPE eligibility can map their "Path to Compliance"; and
- ✓ Introduce a "Direct Bank Model" that is designed to help sweep participants achieve and retain the PPE while continuing to engage TBS as a trusted technology and services partner.

About the Final Brokered Deposit Rule

Approved by the Federal Deposit Insurance Corporation (FDIC) Board of Directors on December 15, 2020, the new brokered deposit rule establishes a framework for analyzing whether deposits made through deposit arrangements qualify as brokered deposits, including those between insured depository institutions and technology-driven third-party administrators such as Total Bank Solutions (TBS).

The banking landscape has changed substantially since the “brokered” classification of a deposit was established and the law covering brokered deposits was first enacted in 1989. The FDIC intended its new brokered deposit rule to meet evolving customer needs, modernize the regulatory framework, provide clarity and transparency, and minimize risk to the FDIC Deposit Insurance Fund.

Simply put, a brokered deposit is a deposit placed by a “deposit broker”. Therefore, whether or not a deposit is brokered depends entirely on the intermediary’s involvement in the placement of the deposit.

The Federal Deposit Insurance Act and FDIC regulations include an exception from the definition of “deposit broker” for an agent “whose primary purpose is not the placement of funds with depository institutions.” That exception is referred to as the Primary Purpose Exception (“PPE”).

Until now most deposits placed via insured deposit sweep programs were considered brokered, except for firms that have been granted a PPE. The FDIC had issued private interpretive rulings affirming the availability of the PPE for a limited number of broker-dealers (BDs), but only for sweeps to affiliated banks. With the adoption of the Final Rule, the FDIC has expanded the availability of the PPE for BDs sweeping to Insured Depository Institutions (IDIs/banks) other than their affiliates. As a result, banks should be able to classify more of their deposits as non-brokered, including sweep deposits sourced from unaffiliated broker-dealers under certain conditions.

The Final Rule specifies elements that must be included in a sweep program to permit banks to treat the deposits as non-brokered. Since a deposit is considered brokered if it is placed by an entity deemed to be a “deposit broker,” it is critical that neither the Source Institution nor the sweep administrator be a deposit broker. The Final Rule specifies when such parties would be regarded as triggering the “facilitation” prong of the “deposit broker” definition and provides clarity as to how a Source Institution may utilize the PPE to the definition of “deposit broker” for an entity whose primary purpose is not the placement of deposits.

If a bank is indifferent toward the classification of the deposits it receives from deposit sweep programs, there is no requirement to change the way it engages with Source Institutions.

The Final Rule created one self-effectuating exception. Specifically, if a Source Institution has a sweep relationship with only one bank, it will not meet the definition of “deposit broker”; however, that would mean that only \$250,000 of FDIC deposit insurance would be available to each customer.

Compliance Timeline

- **December 15, 2020:** Final Rule announcement.
- **April 1, 2021:** Effective date.
- **January 1, 2022:** Extended compliance date for institutions that rely on previous staff opinions; full compliance required.

FDIC private interpretive rulings affording the PPE to a broker-dealer sweeping deposits to its affiliated bank remain in effect through 2021. By January 1, 2022 such a broker-dealer must file a notice or application to retain the PPE. Such a broker-dealer will need to file earlier if it wants the PPE to sweep deposits to even a single bank in addition to its affiliated bank.

PPE: Before and After

As outlined in the table below, the new rule has ushered in changes to eligibility requirements, application and filing requirements, revised bank affiliation guidelines, clarified the role of sweep administrators and modified AUA guidelines.

	Before	After
PPE Eligibility	No explicit requirements for application or filing to be eligible for PPE Custodial agents requested interpretive rulings for certainty	PPE available only to firms that satisfy new filing or application requirements in Section 303.243(b) of FDIC’s Filing Procedures regulation Private interpretive rulings are rescinded effective 1/1/2022
Bank Affiliation Status	Private interpretive rulings accorded PPE status only for deposits to affiliated banks	Affiliation irrelevant; FDIC addressed this by creating a new exception for sweeps to only a single insured bank
Role of Sweep Administrators	FDIC rules silent regarding roles of sweep administrators	Specifies activities that will cause an administrator to be a “deposit broker,” rendering deposits brokered even if custodial agent is otherwise eligible for the PPE
AUM Guidelines	Custodial agent was eligible for PPE only if sweeps less than 10% of brokerage and retirement account assets	Custodial agent is eligible for PPE upon filing if sweeps will be less than 25% of assets under administration in a line of business

PPE and the 25% AUA Test

The Final Rule created a “designated exception” within the PPE that allows a “third party”, such as a broker-dealer, that sweeps less than 25% of assets under administration (AUA) in each business line to become eligible for the PPE upon filing a notice with the FDIC. The FDIC can revoke the PPE if it subsequently determines that the filer was not eligible under the regulations. A Source Institution that does not qualify for the designated exception – e.g. sweeps more than 25% of AUA in a business line – must file an application that must be approved by the FDIC to be eligible for the PPE.

The TBS FDIC Non-Brokered Deposit Rule Resource Center

While the rule became effective April 1, 2021, additional FDIC clarification regarding certain aspects of the rule is expected.

We’ve created a dedicated resource center at www.totalbanksolutions.com to keep you in the know.

It is important to note that the 25% AUA test is measured at each “business line” level for the entity seeking the PPE, with separate business lines determined if the entity “has a specific type of relationship with its customers.” The FDIC relies on entities to make a good faith determination as to what constitutes a “business line”.

Filing and Reporting Requirements

While the third party placing the deposit (i.e. Source Institution) can file for the PPE, an insured bank is also permitted to file “on behalf of the third party”. TBS believes that while either the Source Institution or the bank can be the notice filer, it is more efficient for the Source Institution to file the PPE and provide notice to the banks that participate in their program. That way, only one filing is needed to cover sweeps from a Source Institution to multiple banks, each of which will be treated identically under the Source Institution’s sweep program. Moreover, it is unclear how banks would receive the information they would need to document the Source Institution’s compliance with the 25% AUA limitation. Regardless of which party files, all parties will need to be coordinated for banks to receive the benefits of the PPE – i.e. non-brokered treatment of the sweep deposits.

Information to be provided in the filing includes AUA by business line, total deposits at all depository institutions, a brief description of the business line, information regarding the involvement of another third party (e.g. an administrator). Also, if the Source Institution is the notice filer, the filing must include a list of the insured banks receiving deposits by or through the business line.

In addition, the notice filer – either the Source Institution or bank on its behalf – must fulfill quarterly reporting obligations to the FDIC affirming that the custodial agent continues to meet the 25% AUA test.

Impact of Administrators on PPE Qualification

As noted above, a deposit is deemed brokered if it is placed by a deposit broker. Therefore, if a Source Institution is eligible for, chooses to avail itself of the PPE, and uses a third party such as TBS to administer its sweep program, the third-party administrator must not act as a deposit broker. The Source Institution will lose eligibility for the PPE if the administrator is a deposit broker, defined as “engaged in the business of facilitating the placement of deposits”.

More specifically, an administrator is deemed to be engaged in such “facilitation” if it: 1) has the authority to close a deposit account or move funds to an account at another bank; 2) negotiates or sets rates, fees, terms or conditions for a deposit account; or 3) is engaged in “matchmaking” which is defined as proposing deposit allocations between multiple banks based upon the particular deposit objectives of a specific depositor or specific banks, except where the depositor’s agent places deposits with a bank affiliated with the agent.

TBS would not be deemed to be facilitating the placement of deposits and, therefore, not be a deposit broker if:

- ✓ TBS does not have authority to close a deposit account or move funds to an account at another bank;
- ✓ TBS does not negotiate or set rates, fees, terms or conditions for a deposit account; and

- ✓ TBS does not engage in “matchmaking”; that is, it would not propose deposit allocations between multiple banks based on deposit objectives disclosed to it by a specific depositor or bank.

Business Implications

Impact on Banks

Non-brokered classification of insured sweep program balances can be advantageous to banks in many ways, including:

- ✓ Improved deposit runoff rates when calculating the Basel III Liquidity Coverage (LCR) and Net Stable Funding Ratios
- ✓ Improved treatment in ALM modeling, including reduced runoff rates and lower sensitivity to interest rate risk
- ✓ Improved liquidity risk metrics
- ✓ Potentially lower FDIC assessments for a bank whose brokered deposits exceed 10% of total assets

To illustrate the magnitude of these changes, consider the impact on the 30 largest US banks. If their brokered sweep deposits were re-classified as non-brokered, under the LCR rule they would then see their run-off rates for those deposits reduced from 25 to 10 percent. These 30 banks currently accept 75 percent of the reported \$1.1 trillion brokered deposit balances.

Impact on Source Institutions and Administrators

While banks are directly affected by classification of a deposit as brokered or non-brokered, the Final Rule impacts Source Institutions and sweep administrators as well because the classification of a deposit is dependent upon whether the Source Institution or any administrator is deemed to be acting as a “deposit broker”. Therefore, these sweep participants must ensure the Source Institution qualifies for the PPE for the banks receiving the sweep deposits to receive non-brokered treatment.

Nonbank participants, including administrators of sweep programs, will be incentivized to preserve PPE eligibility to be able to sweep deposits to banks that will accept only non-brokered deposits.

While the filing requirements for the PPE are clear, there are additional complexities to consider based on a Source Institution’s business model. For example, the filing requirements for self-clearing broker dealers are relatively straightforward, but for other types of wealth management firms there are some aspects of the rule that either do not apply or will require additional clarification. They include:

Clearing Firms – SEC and FINRA rules require that a clearing broker hold the deposit account at a program bank and into which program deposits are swept. Therefore, an introducing broker generally has no direct contractual relationship with a program bank. Instead, the clearing broker has a deposit agreement with the program bank and a clearing agreement with its introducing broker. Introducing broker dealers will need to coordinate with their clearing firms to determine who should file for the PPE and negotiate final capacity and rates with bank(s) in the program.

Independent Trust Companies – Under the Final Rule independent trust companies can apply for the PPE, although the FDIC has noted that trust companies have separate exceptions for trust products, such as pension and other employee benefit plans, testamentary trusts, and irrevocable trusts. However, revocable trust accounts are not covered under the separate trust product exception but could be eligible for PPE. Also, a trust company filing a notice to use the PPE would need to satisfy the 25% AUA test or obtain approval of an application if it cannot meet the 25% test.

Designed for Client Success: TBS Bank & Direct Bank Models

At TBS we know that meeting complex regulatory challenges requires a high degree of flexibility. That’s why we’ve built our Insured Deposit Program (IDP) to be highly configurable. Our commitment to flexibility uniquely positions us to serve the needs with all of our clients by offering two types of sourced capacity models – the traditional TBS Bank Model and the Direct Bank Model – that can be combined or run independently.

Direct Bank Model: Designed for PPE Compliance

The role-based Direct Bank Model enables custodial agents seeking PPE to comply with bank capacity sourcing requirements of the new rule while simultaneously leveraging TBS as a trusted partner to ensure their insured deposit program’s success.



Here’s how it Works:

Source Institution / Custodial Agent Role

The Source Institution will establish bank capacity eligibility and manage the program banks acquisition process. Specific tasks include establishing ongoing eligibility criteria, negotiating capacity, establishing target and maximum rates, executing legal agreements, setting rules and constraints and determining allocation sequence.

TBS’s Role as Your Insured Deposit Partner

Once bank capacity has been secured, TBS provides the technology and operations backbone and end-to-end program management, compliance, and reporting support including:

- ✓ **Bank Analytics & Monitoring** – Capacity forecasting, initial bank screening, ongoing risk reporting, ongoing bank surveillance and bank list maintenance.
- ✓ **Operations, Administration & Support** – Bank reconciliation, interest and fee monitoring, rate indexing, interest factors, money movement daily activity money management and wire instructions,

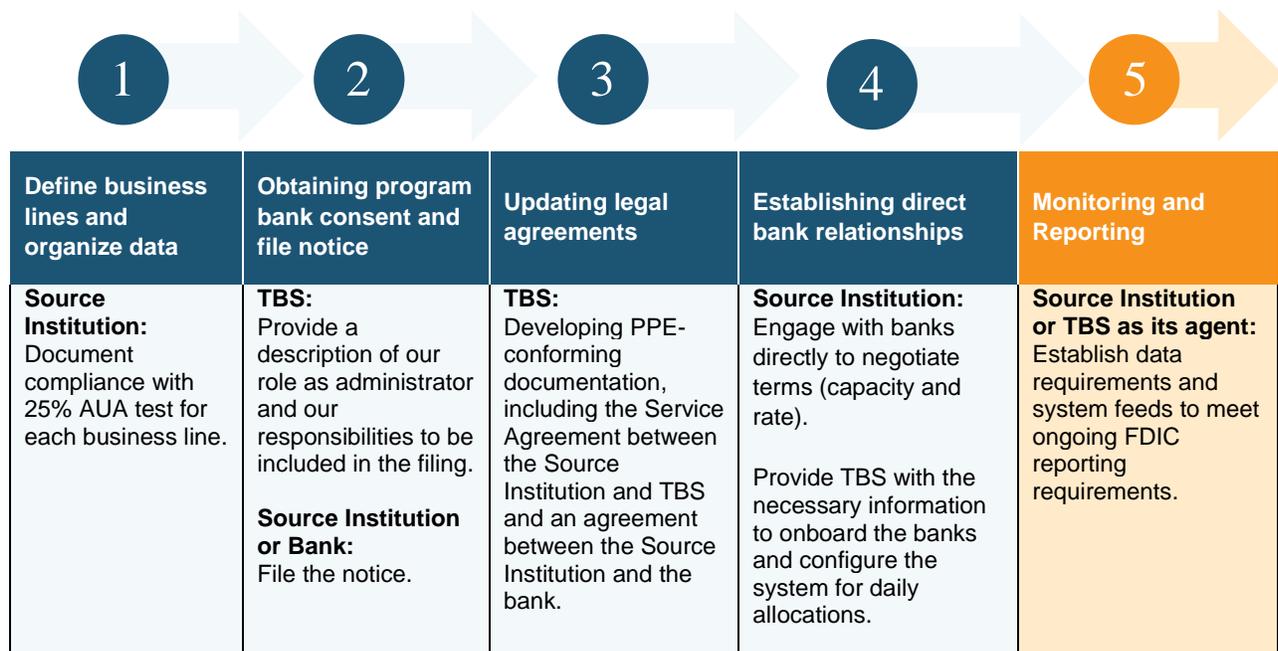
interest paid early processing, bank onboarding via a program deposit account, and creation of processor and bank third-party interfaces.

- ✓ **Program Management** – Establish products, set insurance levels, bank prioritizations and uninsured option, configuring the system for customer rates and tiers (if applicable), account stratification / house-holding, and managing opt in and opt out lists.
- ✓ **Business Logic Systems Parameters** – Configure system to program rules and constraints, configure system to implement allocation sequence, incorporate exception rules such as committed balance agreements and opt outs and run allocations.
- ✓ **Recordkeeping & Reporting** – Sub-accounting recordkeeping per FDIC Regulations (Part 360 or 370, as applicable), invoicing, alerts and notifications, audit records, bank failure procedures, and data for call reports and FDIC PPE compliance.

A Path to PPE Compliance with TBS at Your Side

TBS has developed a five-step “Path to Compliance” to help clients with a smooth transition to achieving non-brokered deposit status, including information to complete the notice filing and legal document templates.

The Five-Step Path to PPE Compliance



In Conclusion

As the industry transitions from the April 1, 2021 effective date of the FDIC Brokered Deposit Final Rule toward the January 1, 2022 extended compliance date for institutions that rely on previous staff opinions, cash sweep program participants are assessing the material implications of the Rule on their business operations. TBS was actively engaged as the Final Rule evolved through the rulemaking process and is committed to helping sweep participants understand how the rule impacts their institution and the path to PPE compliance. The Direct Bank Model is designed to help sweep participants retain the PPE while continuing to engage TBS as a trusted technology and services partner.

Reach Out for More

If your firm is looking to adapt your program to take advantage of the PPE, TBS is here to help you succeed.

**Please contact your TBS sales or account management representative
or email us at info@totalbanksolutions.com**

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