Balance Sheet Insights
PIPER SANDLER FINANCIAL STRATEGIES
January 14, 2021

Brokered Deposit Reform Finalized

*Please see this week's **Rate Sheet** and **Yield Curve Opportunities**.*

On December 15th a recent Federal Deposit Insurance Corporation (FDIC) proposed rule became final relating to brokered deposits. At the highest level, the rule shrinks the scope of what counts as a brokered deposit making more deposits qualify as non-brokered. Institutions with deposits currently categorized as "brokered" should understand these rules and determine if they can redefine their brokered deposits as non-brokered for more accommodative regulatory treatment. Let's dig in:

A Recent History on Brokered Deposit Reform

The FDIC has been mulling brokered deposit reform for the past few years. In December 2018, the FDIC issued an advanced notice of proposed rulemaking seeking comment on how to modernize brokered deposit regulations, which generated 100+ comments.

The following year, in December 2019, FDIC Chair Jelena McWilliams delivered a speech to the Brookings Institution entitled "Brokered Deposits in the Fintech Age," which argued that brokered deposit regulation has not kept pace with innovation in banking. McWilliams argued that the FDIC has faced difficult questions about what constitutes a brokered deposit, to which it has responded typically on a one-off basis, resulting in a "fragmented, opaque legal regime." Following the speech, the FDIC released a proposed rule to modernize brokered deposit regulations. The hope was to bring transparency and consistency to the definition of a deposit broker and, by extension, brokered deposits.

On December 18, 2020 the FDIC released their final rule on brokered deposits, reforming the definition of what constitutes a deposit broker and adopting much of the proposed rule from the prior year.

What is Changing?

There were many changes to the definition of brokered deposits, which now hinges almost solely on the intent of the institution placing the deposits. The most impactful element of that change comes in the placement of deposits from non-banks into banks. If deposits are sourced from a non-bank institution, and the primary purpose of that institution is NOT gathering deposits to send to banks, then they are NOT a deposit broker (ergo the placed deposits are NOT brokered deposits). So how do you determine the "primary purpose"?

There are a few variables, but the most clear definition of "primary purpose" is when the institution has less than 25% of the total "assets under administration" for its customers placed at an IDI (insured depository institution). Meaning if the non-bank's primary business purpose is, for example, managing and investing money for clients, and they only sweep excess liquid funds to IDIs as a convenience or service, and the amount they sweep is less than 25% of their total AUA, then sending deposits to IDIs is not their "primary purpose". Therefore, the example non-bank is not considered a deposit broker and the deposits that are swept will not be considered brokered deposits.

There are additional designation exemptions that also include: health savings accounts; deposits related to certain real estate and mortgage servicing transactions; certain retirement funds; and customer funds held for various regulatory, tax and other government purposes. The FDIC concluded that even though these funds often come from a third party, they are typically stable and sticky and do not fit the intended definition of a brokered deposit.

Another key change is that entities with an exclusive deposit placement arrangement with one IDI are not deposit brokers. Therefore, if an entity is sending deposits to only one IDI, those deposit are not considered brokered.

You are still a deposit broker if you engage in the business or facilitate the placement of deposits with IDIs for the purpose of selling interests in those deposits to third parties. Also, if you send more than 25% of your AUA to insured depositories you are considered a deposit broker.

Timing for the Changes

The final rule is effective April 1, 2021, allowing institutions to adopt the more accommodating definition to start their Q2. There is also a full compliance date of January 1, 2022, meaning all institutions impacted by the rule must report their deposits in line with the regulation at that time. Upon the full compliance date, all previous FDIC staff advisory opinions related to brokered deposits will be moved to inactive status.

The Bottom Line

Banks receiving sweep deposits from brokers, money managers, or fintech companies will no longer count these deposits as brokered if the sending institution sweeps less than 25% of their AUM to IDIs. Also, if a bank is receiving HSA funds, escrow, tax benefit programs, collateral, or other specific funds, these will not be considered brokered any more. Lastly, if a non-bank institution is sending deposits (typically in a sweep relationship) to only one IDI, none of the deposits are considered brokered. It will be important to monitor if the flexibility this rule provides also leads to a shift towards more money being placed at larger institutions.

If any of our observations pique your interest, please contact your Piper Sandler representative or email us at PSFS@psc.com. For derivatives, please email our affiliate, Piper Sandler Hedging Services, LLC, at FSG-Derivatives@psc.com.

GENERAL INFORMATION AND DISCLAIMERS:

This report has been prepared and issued by the Piper Sandler Financial Strategies group of Piper Sandler & Co., a registered broker-dealer and a member of the Financial Industry Regulatory Authority, Inc. Swap introducing broker services are offered through Piper Sandler Hedging Services, LLC, registered with the Commodity Futures Trading Commission and a member of the National Futures Association.

The information contained in this report (except information regarding Piper Sandler & Co. and its affiliates) was obtained from various sources that we believe to be reliable, but we do not guarantee its accuracy or completeness. Additional information is available upon request. The information and opinions contained in this report speak only as of the date of this report and are subject to change without notice.

This report has been prepared and circulated for general information only and presents the authors' views of general market and economic conditions and specific industries and/or sectors. This report is not intended to and does not provide a recommendation with respect to any security. This report does not take into account the financial position or particular needs or investment objectives of any individual or entity. The investment strategies, if any, discussed in this report may not be suitable for all investors. Investors must make their own determinations of the appropriateness of an investment strategy and an investment in any particular securities based upon the legal, tax and accounting considerations applicable to such investors and their own investment objective. Investors are cautioned that statements regarding future prospects may not be realized and that past performance is not necessarily indicative of future performance.

This report does not constitute an offer, or a solicitation of an offer, to buy or sell any securities or other financial instruments, including any securities mentioned in this report. Nothing in this report constitutes or should be construed to be accounting, tax, investment or legal advice. Neither this report, nor any portion thereof, may be reproduced or redistributed by any person for any purpose without the written consent of Piper Sandler & Co.