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By Electronic Submission June 9, 2020

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th St. NW
Washington, DC 20429

Re: FDIC Brokered Deposits Proposal (RIN 3064-AE94)

Dear Sirs and Madams:

Covington & Burling LLP, as counsel for a financial institution with multiple banking subsidiaries, appreciates the opportunity to submit comments on the proposed rulemaking (the "Proposal") by the Federal Deposit Insurance Corporation ("FDIC") to revise its regulations governing brokered deposits under section 29 of the Federal Deposit Insurance Act ("FDI Act").[1]

This letter explains why deposits that an insured depository institution ("IDI") receives from a customer of an affiliated insured depository institution or non-depository trust company (each an "Affiliated Bank"), either directly or through the Affiliated Bank acting as intermediary, should not be deemed to be brokered deposits if the IDI or Affiliated Bank is also providing trust, fiduciary, or other services other than deposit-taking to the customer. Part I of this letter provides background information on these types of relationships. Part II explains why the FDIC has legal authority to adopt regulations that exclude Affiliated Banks from treatment as deposit brokers. Finally, part III explains why the FDIC should exclude Affiliated Banks in these circumstances from treatment as deposit brokers in any rule finalizing the Proposal based on legal and policy principles underlying section 29 of the FDI Act.

I. Background to IDIs' Relationships with Affiliated Banks

Within a banking organization that has multiple banking subsidiaries, it is common for multiple entities each to provide different services to a customer, and/or for an entity to provide services to an affiliate that has a relationship with the customer. The banking organization may structure customer relationships in these ways for several reasons, including to take advantage of each subsidiary entity's specialized expertise or allow an entity with limited powers to accept

[1] 85 Fed. Reg. 7,453 (Feb. 10, 2020).

engagements from customers requiring a broader suite of services than the entity is able to provide directly.

Examples of scenarios in which an IDI may receive deposits from a customer of an Affiliated Bank include the following:

- A customer of an Affiliated Bank may need to make frequent international payments, and the IDI may have correspondent banking relationships with institutions abroad that the Affiliated Bank lacks.

- An IDI may have greater balance sheet capacity than an Affiliated Bank to take on new deposits from the Affiliated Bank's customer.

- Under the terms of a trust instrument bearing on some aspect of an IDI's relationship with a customer, the applicable law of the instrument may require the trustee to be located in a jurisdiction in which the IDI is not located. If an Affiliated Bank is located in that jurisdiction, the Affiliated Bank could serve as the trustee while the IDI continues to provide other services (such as deposit-taking) to the customer.

- If an Affiliated Bank that is a trust company does not accept any deposits, it may direct its customers to use an IDI affiliated with the trust company for that purpose. For instance, trust companies often serve as fiduciaries that invest client funds for trusts or other fiduciary accounts, and that activity generates deposits incidental to the primary activity of investment, in the form of cash awaiting investment or distribution to the beneficiary. In this case, the trust company's primary purpose and source of revenue for these relationships is invoiced fees for services provided rather than income associated with deposits held at the IDI.

In some circumstances, the named depositor at the IDI will be the Affiliated Bank, acting for the benefit of its customer, while in other circumstances, the IDI will have a contractual relationship directly with the Affiliated Bank's customer. Under the current Proposal, the Affiliated Bank could be deemed a deposit broker with respect to its customer deposits held by the IDI in either situation. For that reason and for convenience, we refer in this letter to either situation as the IDI receiving deposits from the Affiliated Bank or as the Affiliated Bank depositing customer funds with the IDI, even though the Affiliated Bank's customer may be depositing its cash directly with the IDI.

II. The FDIC Has Legal Authority to Exclude by Regulation Affiliated Banks from Treatment as Deposit Brokers

Section 29 of the FDI Act establishes the statutory framework that governs an IDI's ability to accept brokered deposits, *i.e.*, deposits received from a deposit broker. Section 29 sets forth: (i) limits on the ability of certain IDIs to accept brokered deposits; (ii) a definition of the term "deposit broker," which includes entities "engaged in the business of placing deposits" or "facilitating the placement of deposits"; and (iii) nine exceptions to that definition, including an "agent or nominee whose primary purpose is not the placement of funds with depository institutions."

Congress charged the FDIC with administering section 29,[2] which it has done by, among other things, adopting brokered deposit regulations in 12 C.F.R. § 337.6. As such, under well-settled principles of administrative law, the FDIC has authority to interpret ambiguity within section 29, and its interpretations of that ambiguity are entitled to substantial deference from courts so long as they are reasonable.[3] The FDIC has recognized this administrative law framework and the value that codifying its reasoned interpretations into bright-line rules can provide regulated entities and the public.[4]

In the context of section 29 of the FDI Act, there is substantial ambiguity with respect to the meaning of the statute's undefined terms "engaged in the business of placing deposits,"

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[2] *See* 12 U.S.C. § 1831f(f) ("The Corporation may impose, by regulation or order, such additional restrictions on the acceptance of brokered deposits by any institution as the Corporation may determine to be appropriate.").

[3] As a general matter, administrative agencies are accorded substantial deference when exercising their delegated rulemaking authority to implement a statute. *See* United States v. Mead Corp., 533 U.S. 218, 219 (2001) ("A very good indicator of delegation meriting *Chevron* treatment is express congressional authorizations to engage in the rulemaking or adjudication process that produces the regulations or rulings for which deference is claimed."). A reviewing court generally evaluates only whether an agency's interpretation of any ambiguity in the statute is reasonable and, if so, defers to such interpretation even if the court would reach a different interpretation of the statute on its own. *See* Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 843-44 (1984); *see also*, *e.g.*, Nat'l Ass'n of Cas. & Sur. Agents v. Bd. of Governors of Fed. Reserve Sys., 856 F.2d 282, 289 (D.C. Cir. 1988) (deferring to Federal Reserve interpretation even where court would reach alternative construction of statute were court confronted with question in first instance).

[4] For instance, when adopting a rule that interprets the term "engaged in the business of receiving deposits other than trust funds" used in section 5 of the FDI Act, the FDIC stated:

> The FDIC believes that it has acted properly in formalizing its interpretation of the FDI Act at this time. Because of the FDIC's statutory responsibility as a federal banking regulator, the FDIC has a strong interest in interpreting the FDI Act and in providing courts and private parties with guidance concerning its interpretation. . . . Additionally, it is appropriate for the FDIC to promulgate its statutory interpretation in the form of a formal regulation, in view of recent Supreme Court decisions restricting judicial deference in situations involving less formal interpretations of a statute.
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> Indeed, this regulation presents a classic example of a federal agency acting appropriately in furtherance of its statutory responsibility. . . . As noted above, the regulation is being issued to eliminate the current uncertainty and provide for consistency in the interpretation of the FDI Act. Consequently, the FDIC believes that it is not only appropriate but essential for the FDIC to issue a regulation clarifying the meaning of the phrase "engaged in the business of receiving deposits other than trust funds."

66 Fed. Reg. 54,645 (Oct. 30, 2001) (internal citations omitted).

"facilitating the placement of deposits," and "agent or nominee whose primary purpose is not the placement of funds with depository institutions," and the application of those key terms to specific fact patterns.

Due to that substantial ambiguity, the FDIC has exercised its authority to interpret and apply those key terms over several decades, during which it has promulgated regulations that implement and interpret section 29 of the FDI Act and issued dozens of advisory opinions under this section of the FDI Act.

As one example, in 1992 the FDIC amended its regulations to add a tenth exception to treatment as a deposit broker, covering "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 program."[5] This regulatory exception is not in section 29 of the FDI Act, does not implement a specific legislative directive,[6] and would be legally void if the FDIC lacked the authority to determine by rule that particular classes of entities are not deposit brokers within the statutory framework.

Indeed, many of the FDIC's advisory opinions have excluded certain entities from being treated as deposit brokers when acting in certain capacities, typically on the basis that such entities are either (1) not "engaged in the business of placing deposits" and not "facilitating the placement of deposits," or (2) have a "primary purpose" that is not the placement of funds with depository institutions. Additionally, some FDIC opinions have treated affiliates of IDIs as not being deposit brokers while treating similarly-situated entities that are *not* affiliated with IDIs as deposit brokers. For example, a series of advisory opinions excludes affiliated broker-dealers that sweep deposits to the IDI in an amount that is not more than 10 percent of the value of the affiliate's Central Assets Accounts and Retirement Accounts from treatment as deposit brokers.[7] These advisory opinions do not apply to non-affiliated broker-dealers.

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[5] 57 Fed. Reg. 23,933 (June 5, 1992) (codified at 12 C.F.R. § 337.6(a)(5)(ii)(J)).

[6] In section 1204 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Congress had required the U.S. Department of the Treasury to consult on methods to increase the use of underutilized minority banks, women's banks, and limited income credit unions as depositaries or financial agents of federal agencies.[6] Given that it adopted the definition of deposit broker in the very same Act, Congress could easily have directed the FDIC to amend the agency's brokered deposit regulations to achieve section 1204's goals, but it did not do so. Accordingly, the FDIC did not suggest in the preamble to the 1992 amendment to its brokered deposit regulations that the amendment fulfilled a statutory requirement or mandate, such as the goals set forth in section 1204. Instead, the FDIC made only the more general claim that it believed section 29 of the FDI Act was not intended to cover IDIs assisting government departments and agencies in the administration of minority and women-owned depository institution deposit programs.[6] In other words, the 1992 amendments to the FDIC's regulations were an instance of the FDIC interpreting Congress's general intent as to the types of entities that should be excluded from the definition of deposit broker – an intent that the FDIC recognized did not manifest in an exhaustive set of statutory exclusions.

[7] FDIC Advisory Opinion 05-02 (Feb. 3, 2005).

In sum, the FDIC has interpreted section 29 of the FDI Act to exclude classes of entities not enumerated in the statute, and it could do so again. The FDIC has ample legal authority to exclude Affiliated Banks from treatment as deposit brokers via regulation or advisory opinion, so long as it reasonably determines that such entities are not "engaged in the business of placing deposits or facilitating the placement of deposits" or have a "primary purpose" that is not the placement of funds with depository institutions. Such a determination would be reasonable for the reasons described below.

III. The FDIC's Regulations Should Exclude an Affiliated Bank from Treatment as a Deposit Broker When the Affiliated Bank and IDI Provide a Suite of Services to the Customer

The preamble to the Proposal suggests that the present rulemaking is intended to narrow the number of entities that qualify as deposit brokers and provide clarity regarding the definition of "deposit broker."[8] As such, the rulemaking presents an ideal setting for the FDIC to clarify the application of that definition to IDIs receiving customer funds from an Affiliated Bank when the IDI and Affiliated Bank together provide a suite of services to the customer, and to exclude Affiliated Banks from treatment as deposit brokers in those circumstances. Such an exclusion would be consistent with the legislative intent of section 29 of the FDI Act and the factors the FDIC has previously found to be relevant when applying the statute.

A. Standards Governing Deposit Broker Definition

The legislative history of section 29 of the FDI Act shows that Congress's primary intent was to regulate "hot money" – *i.e.*, deposits from brokers that are likely to direct those deposits elsewhere when the IDI fails to pay market-leading interest rates or experiences financial distress, creating liquidity risk for the IDI.[9] For instance, Senator Frank H. Murkowski, who introduced section 29 of the FDI Act as an the amendment to FIRREA, described the amendment as a "narrowly drawn" provision intended to "prevent the flagrant abuse of the deposit insurance system by troubled institutions that take excessive risks and leave the taxpayers to suffer the consequences."[10]

In addition to this overarching legislative concern, the FDIC has established several factors that it considers when evaluating whether an entity satisfies the definition of "deposit broker." As described in the 2019 advance notice of proposed rulemaking ("2019 ANPR") that

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[8] For example, the preamble states that the Proposal would "expand the number of entities that meet the [primary purpose] exception."

[9] *See* Letter to FDIC Chairman Jelena McWilliams from Rob Nichols, Chairman and CEO, American Bankers Association (Feb. 28, 2019), *available at* https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/fdic-mcwilliams-brokered-deposit-policies-022819.pdf?rev=4325bfc4707e45c5bc97acb3f31d8cc2.

[10] Testimony of Hon. Frank H. Murkowski, U.S. Senator from the State of Alaska, "Insured Brokered Deposits and Federal Depository Institutions," Hearing before the Subcommittee on General Oversight and Investigations of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 101st Congress, 1st Sess., 7 (May 17, 1989).

preceded the current Proposal, in determining whether a person may be in the business of placing funds of another third party or facilitating the placement of funds of another third party, the FDIC considers the following factors:

- Whether the third party receives fees from the IDI that are based (in whole or in part) on the amount of deposits or the number of deposit accounts.

- Whether the fees can be justified as compensation for administrative services (such as recordkeeping) or other work performed by the third party for the IDI (as opposed to compensation for bringing deposits to the IDI).

- Whether the third party's deposit placement activities, if any, are directed at the general public as opposed to being directed at members (or "affinity groups") or clients.

- Whether there is a formal or contractual agreement between the IDI and the third party (*e.g.*, referring or marketing entity) to place or steer deposits to certain IDIs.

- Whether the third party is given access to the depositor's account, or will continue to be involved in the relationship between the depositor and the IDI.[11]

The FDIC considers similar factors when evaluating whether an entity has a primary purpose that is not the placement of funds with depository institutions. The 2019 ANPR stated that in analyzing the applicability of the primary purpose exception, FDIC staff has considered whether the deposit-placement activity is incidental to some other purpose, which involves a review of the third party's intent, the existence and structure of fee arrangements, and any programmatic relationship between the third party and the insured depository institution.[12] The 2019 ANPR notes that volume based fees may suggest a deposit broker relationship, but this inference can be negated if the fees can be justified as compensation for recordkeeping or other work performed by the third party for the IDI (as opposed to compensation for bringing deposits to the IDI).[13] Additionally, in past guidance, the FDIC has concluded that cash deposited at an IDI by an agent to satisfy a separate legal or business mandate should not constitute a brokered deposit because the agent's primary purpose is not the placement of deposits.[14]

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11 84 Fed. Reg. 2,366, 2,371 (Feb. 6, 2019).

12 *See* 84 Fed. Reg. at 2,372.

13 *Id.*

14 *See* FDIC Advisory Opinion 94-39 (Aug. 17, 1994) (finding that a registered Securities Broker Dealer met the primary purpose exception where it placed customer cash deposits with an IDI to satisfy the requirements of SEC Rule 15c3-3(e)); FDIC Advisory Opinion 94-13 (Mar. 11, 1994) (finding that a bank offering secured credit card loans to its customers met the primary purpose exception where its customers placed deposits at another IDI solely to perfect a security interest in collateral; the amount of the deposit was capped; and the amount of the deposit was linked to the amount of the credit agreement).

B. Reasons Why an Affiliated Bank Does Not Satisfy the Definition of Deposit Broker When The Affiliated Bank and the IDI Provide a Suite of Services to the Customer

Based on Congress's concerns underlying section 29 of the FDI Act, the weight of the factors the FDIC has previously considered when interpreting the definition of "deposit broker," and the intended purposes of the Proposal, the FDIC should exclude an Affiliated Bank from the definition of deposit broker if the Affiliated Bank and IDI together provide a suite of services to the customer.

Such an exclusion would be appropriate for the following reasons:

- **Deposits received from an Affiliated Bank customer are more stable sources of funding.** Because an Affiliated Bank is under common control with the IDI, it has little incentive to withdraw customer funds it or its customers have deposited at the IDI and direct those funds to other, unaffiliated institutions, even if the IDI's interest rates are not set at or near the top of the market for insured deposits. An Affiliated Bank may seek to maximize its revenues, but it is merely one entity within the broader organization that provides integrated financial services, often under a single brand name. The Affiliated Bank is not free to act by setting fees for any deposit-gathering activities or engaging in marketing in a manner that is independent of the IDI's or consolidated banking organization's overall strategy with respect to services provided to the customer. For example, the Affiliated Bank may be less likely than a third party to encourage the IDI to raise its rates, as doing so could lead to less income overall at the consolidated banking organization. In fact, we understand that IDIs' deposit accounts for institutional customers of Affiliated Banks can be non-interest bearing. Due to these incentives and constraints, data shows that deposits received from affiliates are more stable than deposits received from third parties. Analyzing this data, the FDIC has concluded that "[i]n all, sweep deposits from affiliates appear to pose fewer problems compared to brokered deposits in general," and that such deposits "are not rate responsive" and "may not leave when a bank is under stress."[15] In this context, it would be inconsistent with Congress's intent in establishing section 29 of the FDI Act for the FDIC to treat deposits received from Affiliated Banks as brokered.

- **Affiliated Banks do not focus marketing efforts on deposit-taking services, leading to less rate-sensitive customers.** When an IDI receives an Affiliated Bank's customer deposits, the Affiliated Bank will be providing other services to the customer. As such, the Affiliated Bank's marketing activities are likely to highlight the full suite of products and services offered by the consolidated banking organization, rather than focus narrowly on the deposit-taking service provided by the IDI. Accordingly, the Affiliated Bank is less likely to attract customers interested solely in maximizing their return on insured deposits than a traditional deposit broker.

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[15] FDIC, Core and Brokered Deposits Study as Mandated by Section 1506 of the Dodd Frank Wall Street Reform and Consumer Protection Act, p. 55 (July 8, 2011), *available at* https://www.fdic.gov/regulations/reform/coredeposits.html.

Additionally, because the Affiliated Bank is within the same consolidated banking organization as the IDI, the IDI is unlikely to be using the Affiliated Bank as a marketing agent to reach members of the public regarding deposit-taking products and services, as would be the case with a traditional deposit broker. Instead, the Affiliated Bank's marketing efforts are likely to be directed at clients for its own products and services. These are factors in favor of finding that Affiliated Banks are not placing deposits or facilitating the placement of deposits under the standards articulated in the ANPR.[16]

- **Affiliated Banks are less likely to receive volume-based fees for depositing customer funds with the IDI.** A traditional deposit broker receives a volume-based fee for its services, and if a different bank offers to pay the deposit broker a greater volume-based fee, the deposit broker will bring deposit customers and funds to such bank. In contrast, an Affiliated Bank may or may not receive volume-based fees from the IDI that are based in whole or in part on the amount of deposits or number of deposit accounts. If it does, the compensation is likely to be part of a broader services agreement that covers a variety of services provided by the Affiliated Bank to the IDI and vice versa. As such, the fees may be justified as compensation for administrative services performed by the third party for the IDI, suggesting the Affiliated Bank is not placing deposits or facilitating the placement of deposits under the standards articulated in the ANPR.

- **Deposits received from Affiliated Banks generally would not otherwise be brokered.** In virtually all cases where an IDI receives customer deposits from an Affiliated Bank, the deposits would not be classified as brokered under current interpretations of section 29 of the FDI Act if the IDI had received deposits directly from the customer. In these circumstances, treating an Affiliated Bank as a deposit broker would penalize the IDI for using an Affiliated Bank (or vice versa) as part of the suite of services provided to the customer. We are not aware of any policy reason why the FDIC's regulations should penalize IDIs for using this structure.

- **Affiliated Banks are regulated banking institutions.** As banks and trust companies, Affiliated Banks are subject to supervision, regulation, and enforcement by federal and/or state banking regulators. Prudential regulations limit Affiliated Banks' activities to the business of banking and/or fiduciary activities, and prevent them from acting in an unsafe or unsound manner. This added layer of regulation and oversight limits risks to an IDI of accepting customer deposits from an Affiliated Bank, and supports an argument that the business of the Affiliated Bank is not that of a deposit broker.

- **Affiliated Banks may place customer funds with an IDI in order to fulfill a specific legal or business mandate.** As discussed in part I, above, an Affiliated

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[16] In addition, the Proposal states that in evaluating the application of the primary purpose exception to an agent or nominee, the FDIC will consider "whether the agent's or nominee's marketing activities to prospective depositors is aimed at opening a deposit account or to provide some other service, and if there is some other service, whether the opening of the deposit account is incidental to that other service." 85 Fed. Reg. at 7,460.

Bank may lack the legal authority to receive directly the customer deposits that are held by the IDI. These affiliate deposit arrangements may also arise due to an Affiliate Bank's lack of balance sheet capacity to take the deposits, or its inability to provide other services that are tied to deposit-taking (*e.g.*, correspondent banking relationships) and important to the customer. These reasons are similar to the types of legal and business mandates that the FDIC has previously found to be evidence of a deposit not being brokered.

For each of these reasons, the FDIC should determine that an Affiliated Bank is not "engaged in the business of placing deposits or facilitating the placement of deposits" when the Affiliated Bank and IDI together provide a suite of services to the customer.

C. Ways to Determine that an Affiliated Bank Does Not Satisfy the Definition of Deposit Broker When the Affiliated Bank and the IDI Provide a Suite of Services to the Customer

The FDIC could codify the determination that an Affiliated Bank is not "engaged in the business of placing deposits or facilitating the placement of deposits" when the Affiliated Bank and IDI together provide a suite of services to the customer by adding an eleventh exception to the definition of "deposit broker" in 12 C.F.R. § 337.6(a)(5)(ii).

The eleventh exception could read as follows:

> (K) Any bank or trust company that is an affiliate of the insured depository institution, with respect to customer funds placed with that depository institution, when the depository institution or affiliate also is providing other products or services to the customer.

This proposed text would draw the exception narrowly, such that an IDI could not take advantage of the exception to avoid application of the deposit broker definition by interposing an affiliate within a relationship that would otherwise be treated as brokered.

In the alternative, the FDIC should determine, through an amendment to its brokered deposits regulations, that Affiliated Banks have a "primary purpose" that is not the placement of funds with depository institutions, without requiring the submission of an application for it to make this determination. An application process would impose burdens on IDIs, their affiliates, and the FDIC itself, and given the strength of the arguments described above, no purpose would be served by requiring the submission of applications as a prerequisite to determining that Affiliated Banks are not deposit brokers in these circumstances.[17] Further, to the extent the FDIC is creating the application process to gain visibility into the activities of unregulated

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[17] For an extended explanation of why the application process would be burdensome, please see the comment letter filed by the Bank Policy Institute on the Proposal.

deposit brokers, those concerns are not present in the context of Affiliated Banks, which are already within the prudential regulatory perimeter.

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We appreciate the FDIC's consideration of our views. Should you have any questions, please do not hesitate to contact me at (202) 662-5727 or mnonaka@cov.com, or Randy Benjenk at (202) 662-5041 or rbenjenk@cov.com.

Respectfully submitted,

Michael Nonaka