
The FDIC Should Close its Brokered Deposits Loopholes, Not Wait Until After the Next Crisis

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In December, 2020, the Board of Directors (“Board”) of the Federal Deposit Insurance Corporation (“FDIC”) approved a [rule change](#) that significantly weakened important taxpayer protections that Congress put in place more than three decades ago, in response to the savings and loan (“S&L”) and banking crises of the 1980s and early 1990s.

The FDIC issued a [Notice of Proposed Rulemaking](#) (“Proposal”) in August, 2024, that would correct and undo the most dangerous parts of the changes it approved in 2020. As described in [our comment letter](#), Better Markets strongly supports the Proposal and urges the FDIC to finalize it. Not doing so will increase the severity and cost of the next banking crisis, to the significant detriment of Main Street America.

Risks to Taxpayers

The safety and financial stability benefits of deposit insurance are considerable. The safety of insured deposits is a two-edged sword, however, since it can allow even weak or nonviable banks to access large volumes of insured deposits, bundled and placed by deposit brokers. Risky bets placed with these deposits can deepen the bank’s insolvency and increase the cost of the bank’s failure.

The potential high cost to taxpayers of banks’ misuse of brokered deposits has been amply demonstrated by experience. For example, the [cost of resolving failed S&Ls](#) exceeded \$160 billion, with \$132 billion of those losses borne by ordinary taxpayers. The losses were so high partly because nonviable S&Ls were able to use brokered deposits to expand their assets rapidly in an attempt to grow out of their problems, [regardless of their poor financial condition](#). As a result, losses grew much higher than they would have been had problems been dealt with promptly.

As part of its response to the S&L crisis and the wave of bank failures that was also occurring at that time, in 1989 and 1991 Congress implemented [statutory restrictions on the use of brokered deposits](#) by weak banks. Events since, including experience with bank failures occurring in the years 2007-2017, have demonstrated the wisdom and importance of these restrictions: namely, heavy use of brokered deposits has consistently been associated with a higher probability of failure and a higher cost of failure. This is documented in the [preamble](#) to the FDIC’s current Proposal; in a Congressionally mandated [2011 FDIC study](#); in the FDIC’s [2017 study of the 2008 banking crisis](#); and in the FDIC’s 2019 [advance notice of proposed](#) rulemaking that preceded its 2020 rule.

The Taxpayer Safeguards in Law

In its landmark [legislative responses](#) to the S&L and banking crises of the 1980s and early 1990s, Congress forbade banks that do not meet minimum capital requirements from accepting brokered deposits. Other banks that are not well capitalized must obtain a waiver from the FDIC to be allowed to accept brokered deposits, and well-capitalized banks face no restrictions on accepting brokered deposits. Brokered deposits are deposits a bank receives from a “deposit broker.” “Deposit brokers” include persons who place deposits, or facilitate the placement of deposits, at banks. Finally, Congress defined nine exceptions in which a person is not a deposit broker, including an exception for a person whose primary purpose is not the placement of deposits.

The 2020 Brokered Deposit Loopholes and How the FDIC’s Proposal Would Address Them

The FDIC’s styled its [2020 changes](#) as modernizing its regulations and accommodating evolving industry practices. The effect of these changes, however, was to substantially weaken the taxpayer safeguards Congress put in place over three decades ago. As noted in the [Proposal](#), the dollar amount of reported brokered deposits immediately plunged after the 2020 changes; **reported** brokered deposits dropped about \$350 billion or roughly 32 percent during the quarter following the effective date of the rule, but the risk remained.


Why is this important? It is important because whole classes of insured deposits that brokers can bundle in large quantities for placement at banks are now fair game for weak banks to accept without restriction. These banks can grow their balance sheets and place risky bets, all without regard to their financial condition. The next banking crisis will be far more costly as a result. And for banks that take advantage of the loopholes, their Call Reports, by not reporting these deposits as brokered, will mask the extent of the liquidity risk they face, to the detriment of bank supervisors and the public, including investors and other counterparties.

Better Markets’ observations about selected aspects of the 2020 loopholes, and the Proposal’s response to them, follow.

Exclusive deposit placement arrangements

The 2020 changes created a brokered deposit loophole for so-called exclusive deposit placement arrangements of the type used by a partner bank and the crypto firm [Voyager Digital Holdings, Inc.](#), before that crypto firm’s [July, 2022 bankruptcy](#). The Proposal would appropriately eliminate this loophole. The loophole allows a weak bank to obtain, and grow, up to 100 percent of its deposits in the form of third-party deposits placed by a variety of fintech entities that are acting in economic substance as deposit brokers. These third-party deposits are in no sense stable relationship deposits, since if the bank gets into serious trouble, the deposit placing entity would most likely search for another bank partner and wind down its placements with the troubled bank.

This change, which fundamentally reinterpreted the Federal Deposit Insurance Act, had not even been included in the FDIC’s [notice of proposed rulemaking](#) that preceded the 2020



changes. Reportedly, the provision was only inserted into the preamble to the final rule for distribution to FDIC Board members [the day before they voted on the rule](#). Had the FDIC inserted in the final rule such a material and surprising *tightening* of its rule without having solicited public comment, banking industry groups would doubtless have sued immediately. On procedural grounds alone, the exclusive deposit placement exception never should have been finalized.

Enabling transactions exception

The 2020 changes state that if 100 percent of deposits that an entity places into a bank are in transaction accounts that do not pay interest or fees to the depositor, then the FDIC will conclude that the primary purpose of the arrangement is to facilitate transactions, not to place deposits, and therefore the deposits will not be considered to be brokered.

Transaction accounts, including non-interest-bearing transaction accounts, have historically been large and important categories of bank deposits. Congress could have excluded the placement of these deposits from triggering the definition of a deposit broker, but it did not. The enabling transaction exception thus appears to fundamentally reinterpret and weaken the application of the statute.


Once again, were a bank receiving these deposits to get into serious trouble, the entities placing the funds would likely begin to search for another bank and take steps to wind down placements to the troubled bank. In short, the transactions deposits are in substance brokered, they are likely to act as “hot money” in a crisis, and the Proposal’s requirement that they be reported as brokered is warranted.

25 percent broker-dealer sweep exception

Many broker-dealers offer sweep accounts to their customers as a way to earn interest on uninvested cash. The uninvested funds are swept into bank accounts, or money market funds, at the end of each day, with the interest earnings split between the broker-dealer and the customer. Reportedly, [broker-dealers often keep most of the interest income](#) on their customers’ sweep account and return only a relatively small amount to the customers.

Before 2005, the FDIC generally viewed all [broker-dealer sweeps](#) as brokered deposits. From 2005 to 2020, the FDIC generally excluded sweeps from being brokered deposits if the amount of swept funds did not exceed 10 percent of the total amount of program assets handled by the brokerage firm on a monthly basis, but then only if certain other conditions were met, including that the broker-dealer is affiliated with the bank, and earns only flat fees for the deposit placement. The 2020 changes increased the 10 percent threshold to 25 percent and eliminated the conditions regarding flat fees and affiliation with the bank. The Proposal would restore the 10 percent numerical threshold.

Apart from being accommodative to a standard industry practice, there is little other substantive justification for **any** primary purpose exception for sweep accounts. These are third party deposit placement arrangements for the purpose of earning interest at insured banks and they are advertised to customers as part of the services provided by the broker-



dealer. Broker-dealers earn considerable remuneration from these deposit placement arrangements in the form of a portion of the interest income from the swept balances that they keep. Were the bank to get into serious trouble, any responsible broker-dealer would most likely quickly wind down its sweep accounts with that bank. Indeed, as the Proposal notes, First Republic Bank experienced a [run on its affiliated sweeps](#) before its 2023 failure.

For these reasons, Better Markets does not support a designated business exception for broker-dealer sweeps, and believes that any such exception that is granted should be crafted as narrowly as possible. Consequently, we support the proposed change in the numerical threshold for this exception from 25 percent, to its pre-2020 value of 10 percent.

[Receipt of fees by the person placing deposits](#)

Prior to the 2020 changes, a person's receipt of fees or other compensation was a factor used by FDIC staff in reaching decisions about whether that person was a deposit broker. The 2020 changes excludes a person's receipt of fees as a factor in determining whether that person is a deposit broker. The Proposal would—appropriately—include fees in this list of factors.

In the law, deposit brokers include persons in the business of placing deposits or facilitating the placement of deposits at banks. The receipt of fees or other compensation is a common-sense test that is consistent with the ordinary meaning of “being in the business.” Moreover, satisfaction of this definitional criteria for “in the business” would not bar the person from qualifying for one of the statutory or designated exceptions to the definition of deposit broker.

In the interest of brevity, we have not listed all the ways in which the FDIC's 2020 rule weakened the important brokered deposit safeguards that Congress established. For further details, see the [Proposal](#) and Better Markets' [comment letter](#).



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