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Brokered Deposits and the National Rate Cap

Enacted in 1989, Section 29 of the Federal Deposit Insurance Act restricts the acceptance of brokered deposits by institutions with weakened capital positions and directs the FDIC to calculate a national rate cap, which sets a ceiling on the interest rates weaker institutions may offer on deposits. Section 29 does not define brokered deposits, rather the classification is based on the FDIC's interpretation of the statutory definition of "deposit broker."

Over the 30 years since its passage, there have been significant technological and other developments that have fundamentally changed the business of banking and the markets in which banks operate. These changes include an enhanced regulatory and supervisory framework, an increasing diversity of financial affiliations and significant technological advancements that have allowed for the creation and growth of online and mobile banking.

The current statute, however, does not accommodate these changes and allows an overly broad interpretation of who is considered a "deposit broker," and by extension, what deposits are considered brokered.

Why it Matters

Congress enacted Section 29 after the S&L crisis to prohibit failing institutions from gathering unstable and high cost funding to try to grow their way out of difficulty. Section 29, then, aims to identify a specific type of funding that is distinct from, and perceived to be more volatile than, other types of deposits. Today, however, due to an overly broad interpretation that does not reflect modern banking, many deposits that are classified as "brokered" are, as a practical matter, stable relationship deposits. The result is that well capitalized banks are discouraged from holding otherwise stable funding by the prospect of higher deposit insurance assessments, unnecessarily heightened scrutiny from bank examiners, and negative treatment by credit rating agencies and bank counterparties. Moreover, there is a stigma around the holding of "classic" brokered deposits that doesn't reflect their risk.

Legislative change is needed to accommodate advancements in technology and the way consumers want to access their deposits. The FDIC is doing what it can to modernize the brokered deposit regulations through rulemaking, but it is constrained by statutory language into which modern banking doesn't fit. A better approach, first suggested by FDIC Chairman McWilliams, would be a statute that prevents rapid growth of troubled institutions by addressing the risky lending side of the equation directly, instead of attempting to slot various funds into an outdated category.

Recommended Action Items

- **Repeal Section 29 of the FDIA.** Strengthening the FDIC's ability to limit asset growth for troubled banks while repealing Section 29 would achieve the same public policy goal of preventing the weakest banks from doubling down on risky investments in times of trouble, but without penalizing healthy banks for sourcing deposits through modern means.

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