The liquidity coverage ratio ("LCR") rule, adopted in final form by the federal banking agencies in September 2014, is the latest installation to a large, growing and complex body of statutes, rules and court decisions governing bank deposits. This area of overlapping and intersecting legal requirements presents a number of structuring, documentation and drafting complexities for bank deposit programs. We discuss the new LCR rule in a separate client bulletin "U.S. Federal Banking Agencies Adopt Final Rule Requiring Large Banks to Maintain a Liquidity Coverage Ratio" dated October 14, 2014. Below is a short outline listing some of the key governing statutes, rules and areas of law affecting bank deposits.

What is a "Deposit" and What Entities Can Accept Deposits?

A deposit includes an obligation (normally of a bank) to repay money on demand, another debt instrument if labeled or held out by issuer as a “deposit,” a debt obligation issued by a bank that is not clearly designated as something other than a deposit, or a debt obligation that functions like a short-term or demand deposit accepted by a person or entity engaged in the business of receiving deposits not related to some trade balance from another line of business and not regulated under some other regulatory program.

Only banks and similar regulated depository institutions are permitted to accept deposits. Accepting deposits is a "core" banking function that is definitional to the regulated "business of banking" as well as to what bank offices are “branches.”

A deposit creates a debtor/creditor relationship between bank and depositor-- not a fiduciary relationship.

There are three broad categories of deposits: demand deposits (payable on demand), savings deposits (no term, payable on request, but bank can defer payment for 7 days), time deposits (deposits with a stated contractual maturity date).

“Omnibus deposits” are deposit accounts owned by many people that are issued by the bank to a fiduciary or custodian for the benefit of its customers through a single omnibus bank account. The fiduciary or custodian handles the sub-accounting to track how much belongs to each of its customers and sends out account documents and statements to its customers and handles tax reporting on its
customers. If done properly, depositors get FDIC deposit insurance on a “pass through” basis where each depositor is separately entitled to full coverage up to FDIC deposit insurance limits.

“Sweep deposits” are deposit products designed to hold excess cash balances from a brokerage account, custody account, or another bank deposit account above a threshold amount. The balances are “swept” as needed back to the brokerage, custody or other bank account, or from the brokerage, custody or other bank account back to the sweep account.

“Yankee CDs” are large-denomination (generally $250,000 or more) time deposits at a U.S. branch of a non-U.S. bank. Generally not FDIC-insured, may trade in secondary markets. May be denominated in dollars or another currency. Generally not a “security” under 1933 Act, 1934 Act.

“Euro” deposits are large denomination deposits issued by non-U.S. branches of U.S. or non-U.S. banks. Called “Eurodollar” deposits if denominated in U.S. dollars. Not subject to Regulation D reserve requirements or FDIC deposit insurance premiums. Generally not FDIC-insured. Intended for institutional investors, may trade in secondary markets. Not a “security” under 1933 Act, 1934 Act if issuer is a U.S. bank. May or may not be a “security” if issuer is a non-U.S. bank.

Disambiguation—things that are not bank “deposits.”

- American Depositary Receipts (ADRs) and “certificate of deposit for a security.”
- Special deposits & custody of things other than money.
- Broker-dealer “free credit balances.”
- “Notes” & short term debt instruments.
- Repurchase agreements (repos).
- Money market mutual funds & other liquid asset funds (not debt instruments; regulated under securities laws).

Emerging issues -- Federal Reserve, FSOC and Financial Stability Board have focused on what they term as “shadow banking,” including acceptance of what they view as “deposit like” instruments by non-banks. Overall concern about overreliance of financial system on short-term funding, liquidity & maturity transformation, and relationship of “runs” on this funding to systemic risk issues.

**Documents Commonly Used In Deposit Programs**

Customer-facing documents:
- Deposit agreement (establishes contractual terms of deposit).
Disclosure or “Truth In Savings” document.
- Rate and fee schedule (separate document with current information on interest rates and fees).
- Signature card or similar document by which customer agrees to terms on deposit.
- Account application form capturing basic data on customer (name, address, tax ID number, as well as CIP/KYC/AML information).
- Monthly or quarterly statements.
- Notice of change in terms, or of maturity or renewal of time deposit.

Additional documents commonly used when accounts offered through third parties:
- Deposit brokerage agreement.
- Omnibus account agreement.
- Administrative agreement.
- Agreement with custodial or transfer agent.
- Agreement with DTC and master certificate (for CDs traded in secondary market).

**Deposit-Taking and Definition of a Bank “Branch,” CRA Assessment Area, Applicability of BHC Act**

- “Branch” is an office established by a bank where checks are cashed, deposits received or money lent 12 U.S.C. §§ 36, 81, 1813(o).
- Bank is “located” where it has a main or branch office (choice of law consideration).
- “Representative office” is not a branch-- does not engage in above activities, but does customer outreach and servicing.
- ATMs are not “branches” even if they accept deposits.
- ATMs that accept deposits, however, and branches, define the CRA assessment area of a depository institution.
- Prohibition on interstate branches primarily for deposit production 12 C.F.R. §§ 25.61 et seq.
- Definition of a “bank” in BHC Act excludes non-depository trust companies, certain “non-bank banks” that do not accept deposits 12 U.S.C. § 1841(c), (for some purposes excluding trust deposits held internal to trust department and not moved to a commercial side that also accepts non-fiduciary deposits, see 12 C.F.R. § 204.2(a)(2)(i)), 12 U.S.C. §§ 1813(l)(2), 1813(p), 1815(a)(1), 1841(c)(2)(D).
- Foreign banks may have a U.S. representative office, U.S. non-depository trust company subsidiary, but no U.S. “branch” or “agency” office, U.S. bank subsidiary or commercial lending subsidiary, without becoming subject to BHC Act restrictions on U.S. operations; prior approval required for almost all U.S. locations/activities.
• NY representative office definition captures affiliates of foreign banks; prohibits representative office from soliciting deposits or “deposit-like” instruments (apparently meaning demand instruments even if not labeled as deposits” rather than commercial paper).

State Considerations On Location of Where Bank Is "Engaged in the Business" of Banking

• State laws prohibit unauthorized entities from "engaging in the business of banking" in the state.
• Poorly defined: what constitutes unauthorized banking by an out-of-state bank with no local office?
• “Bricks and mortar” one test, although not clear that all states follow. Retail outreach and advertising in state sometimes a factor. Or simply know it when regulator sees it.
• Tendency of states to more aggressively pursue the issue if the entity is not a bank licensed by some credible state or federal bank regulator.
• Interstate supervision compacts for state banks.
• Federally-chartered banks and preemption.
• Competitive equality of state banks & local protectionism (e.g., New York home office protection law).

FDI Act and Deposit Insurance

• FDI Act definition of a “deposit” 12 U.S.C. § 1813(l).
• Restrictions on collateralization of deposits & exceptions for trust deposits, government deposits, 12 U.S.C. §§ 92a(d), 1813(m)(4), 1821(a)(2)(C), 1823(e)(2), 12 CFR 9.10(b) & (c).
• Standard Maximum Deposit Insurance Coverage (currently $250,000 per depositor in aggregate per institution for all deposits held by depositor in same right and capacity; $500,000 for joint deposits, and significantly more for certain revocable trust and trust-like deposits) 12 C.F.R. § 330.
• D’Oench doctrine, and required contemporaneous internal documentation of certain account terms to ensure enforceability against FDIC as receiver. 12 U.S.C. § 1823(e)
• “Special Deposits” in a receivership.
• Deposit insurance assessments (premiums charged by FDIC to bank) affected by amount, structure and nature of deposits and other liabilities of the bank. 12 C.F.R. § 327.
• FDIC-insured deposits can be denominated either in U.S. dollars or in foreign currency.
Regulatory Reporting Requirements for Deposits

Require tracking, categorization, reporting of deposits:

- Call Reports-- FFIEC 31, 41.
- Reserve requirement reporting -- FR 2900.

AML, CIP and OFAC Requirements Applicable to Deposit-Taking

- Must have customer identification program (CIP) and screen new customers.
- Must have anti-money laundering program to screen for suspicious activity in accounts.
- Must file suspicious activity reports (SARs).
- Must file currency transaction reports (CTRs) on certain large cash transactions.
- Must maintain records of certain funds transfers (“Travel Rule”).
- Restrictions on accepting deposits from or transferring money to certain blocked nations and their citizens.

Consumer Privacy

- Customer disclosure requirements on privacy policies (Regulation P 12 C.F.R. § 216).
- Restrictions on use, transfer of confidential consumer information.
- Regulation of credit bureaus-- can be triggered by sharing and use of certain information.
- Policies, procedures and controls needed to prevent unauthorized access, data breach.
- Policies procedures and controls needed on disposal of documents and data.
- Reporting requirements for data breaches.

Anti-Gambling- 12 C.F.R. § 233 (Regulation GG)

- Prohibits use of bank accounts or money transfer systems to transfer funds to illegal online gambling operations
- Requires policies, procedures and controls
- Requires disclosures to customers
Restrictions on Interbank Liabilities—12 C.F.R. §§ 206, 1005 (Regulation F)

- Requires banks to have internal limits and policies on exposures to other banks, including correspondent banks and deposits

Affiliate Transaction Restrictions

- Section 23 A (12 U.S.C. § 371c), Regulation W (12 C.F.R. § 223)
  - Carve outs for extensions of credit fully secured by deposit at same bank
  - Exemptions for correspondent banking deposits, clearing and collection (relevant to deposited items)

Anti-Tying Rules and Traditional Bank Product Exemption

Prohibits a bank conditioning the availability, price or terms of credit, property or service on the requirement that the customer obtain some additional credit, property or service from the bank or its affiliates (subject to a variety of exemptions and exclusions in the statute, rules or case law). Among the exclusions are exemptions for tying to traditional bank products, including deposits, and a regulatory exemption for combined balance discounts that must count deposits towards combined balance trigger, at least as favorably as other product balances. 12 U.S.C. §§ 1971 et seq., 12 C.F.R. § 225.7.

Federal Regulation D—Reserve Requirements (12 C.F.R. § 204)

- Defines various categories of deposits—transaction accounts (demand deposits “DDAs” and negotiable order of withdrawal “NOW” accounts and certain pending balances), time deposits, savings deposits, etc.
- Transaction accounts (DDA and NOW accounts) subject to 10% reserve requirement.
- DDA can accept all categories of depositors; no requirement for bank to reserve right to defer payment.
- NOWs available only to individuals, personal trusts, non-profits, state and local governments, certain others, not for-profit businesses. 12 U.S.C. § 1832(a).
- Until 2010, DDAs could not bear interest, but NOWs could pay interest. Since 2010 both DDAs and NOWs can pay interest.
- Time deposits and savings deposits (MMDAs, savings accounts, CDs, time deposits) not subject to reserve requirements.
- Reserve requirements must be calculated and reported to Federal Reserve and cash placed on reserve by bank with Federal Reserve Bank at relatively low rates of interest (currently 25 basis points per annum), which creates financial incentive for banks to minimize amounts of transaction accounts they hold.

- Much of Regulation D devoted to distinguishing categories of deposits for reserve requirement purposes, based on either a term of more than seven days or a reserved bank right to defer withdrawal requests for seven days.

**Liquidity Coverage Ratio ("LCR") Rule** 12 C.F.R. §§ 50, 249, 329 (Regulation WW)

- Implements Basel III Requirement; a formal numerical approach to liquidity requirements. US LCR rule stricter than Basel III.
- Applicable to banking organizations with $50 billion or more in assets.
- Banking organizations with $250 billion or more in assets subject to highest requirements.
- Measures assumed outflows of bank’s near term obligations, netted against near term inflows.
- Bank required to hold “high quality liquid assets” (HQLAs) to match the assumed net outflows. The low market interest rates on HQLAs create a financial incentive for banks not to hold deposits that require holding more HQLAs.
- Different types of depositors (core retail, noncore retail, wholesale, financial entities) have increasingly higher outflow assumptions.
- Deposits with balances over FDIC insurance coverage have higher outflow assumptions.

**Disclosure Requirements** -- Truth In Savings, 12 C.F.R. § 1030 (Regulation DD), State Laws

- Applies to consumer deposits-- those held by natural person for personal, family or household purposes.
- Requirements for specific disclosures at account opening, in statements, before terms changes, in advertising.
- Interest rate and Annual Percentage Yield ("APY") disclosure requirements.
- Model forms of disclosure language at end of rule.
- Prohibits certain deceptive and fraudulent practices.
- Certain additional disclosure requirements under Reg E, CC, other federal laws.
- New York has disclosure requirements for certain types of deposits that are similar to Regulation DD requirements-- 3 NY CCR Part 13 (“Truth In Savings”) apply to deposits below $100,000 accepted from a U.S. resident depositor in a New York branch. Disclosure requirements met if bank provides federal Regulation DD deposit disclosures to customers.
Unfair, Deceptive or Abusive Acts or Practices (12 U.S.C. § 5531)

- Provides authority to CFPB to address disclosures and practices related to consumer financial products, including deposits.
- A free-form enforcement tool that CFPB may use broadly on deposit products and related practices and disclosures it does not like, even where specific disclosure requirements have been satisfied.

Brokered Deposits; “Core Deposits”

- Implications for de novo banks -- cannot accept brokered deposits unless in approved business plan or waiver obtained from FDIC.
- Implications for less-than-well capitalized banks-- adequately capitalized banks cannot accept brokered deposits without a waiver (12 C.F.R. §337.6(b)(2)), (c); undercapitalized banks generally cannot accept brokered deposits (12 C.F.R. § 337.6(b)(3)), although the possibility of a waiver may be available (12 C.F.R. §337.10).
- Call Report implications -- line item reporting for brokered deposits.
- Liquidity Regulation implications -- brokered deposits get worse treatment under LCR rules, higher assumed run ratio; need to address funding risk in liquidity plan.
- LCR rule looks to FDIC brokered deposit rules and interpretations for definition of what is a “brokered deposit” but not for what is a “brokered sweep deposit.”
- Implications for FDIC deposit insurance assessments: may increase cost of deposit insurance to bank that accepts a lot of brokered deposits.
- FDIC 2005-02 (Feb. 3, 2005) interpretation on when sweep deposits are “brokered deposits.”

Foreign Branch Deposits & U.S. Branch Deposits Denominated in Foreign Currency

- Deposits of insured U.S. branch can be denominated in a foreign currency and are still insured deposits.
- 12 U.S.C. § 1831r restricts use of domestic assets to make payments on foreign branch deposits.
- Question of whether a foreign branch deposit is by contract payable by U.S. offices or guaranteed by U.S. offices of the bank drives whether it is an insured deposit, affects applicability of Regulation D reserve requirements, FDIC deposit insurance assessment charges.
Transfers by a Bank of Deposit Obligations to Another Bank

A bank may transfer a portion of its deposit obligations to another FDIC-insured bank. This commonly occurs as part of a sale of a branch or line of business to another bank. A Bank Merger Act application and regulatory approval is required for the receiving bank (but not if the customers or a fiduciary standing in shoes of the customers moves the deposits), and notice provided to the depositors. Typically a “premium” is “paid” by the receiving bank in that the selling bank transfers cash and other assets to the receiving bank with a value less than the principal balances on the assumed deposits.

Lifeline Deposit Accounts

- 12 U.S.C. §§ 1817(a)(6), 1834 (lifeline deposits) low cost small transactional accounts that qualify for reduced FDIC assessment, CRA credit.
- New York requires banks to make lifeline deposit accounts available, to allow direct deposit of benefits and access to basic banking services.

Funds Availability -- Regulation CC (12 C.F.R. § 229)

- Specifies time periods within which bank must make deposited funds available for withdrawal.
- Requires certain disclosures to deposits on funds hold periods.

Electronic Fund Transfers -- Regulation E (12 C.F.R. § 205)

- Imposes disclosure requirements, contains model disclosure form language.
- Some substantive protections and terms requirements.
- New requirements on overseas funds transfers.

Treatment under Federal & State Securities Laws

“Identified bank product” exemption from Broker-Dealer Definition/1934 Act exclusion from definitions of a securities “broker” and “dealer” permitting banks to engage in deposit transactions without broker-dealer registration. 1934 Act §§ 3(a)(4)((B)(ix), 3(a)(5)(C)(iv); Gramm-Leach-Bliley Act § 206(a)(1).

Deposits of Non-U.S. Banks in their non-U.S. branches—courts look to regulatory regime in home country and degree to which it provides protections similar to U.S. banking laws. Deposits in U.S. branches of non-U.S. banks are treated for securities law purposes same as deposits in a U.S. bank.

Investment Company Act & Investment Advisers Act Treatment

- Domestic bank exclusion from definition of an “investment company” 1940 Act Section 3(c)(3).
- SEC Rule exempting foreign banks from definition of an “investment company” 17 C.F.R. § 270.3a-6.
- Bank exemption from definition of an “investment adviser” and federal preemption of state investment adviser regulation of “banks.”
- DDAs, NOWs, MMDAs and Savings Deposits as “cash” rather than a “security.”
- Status of CDs and other term deposits as “securities” is potentially more ambiguous under 1940 Act than under 1934 Act.
- Omnibus deposits -- when is it a “pool”? 17 C.F.R. § 270.3a-4 as guidance.

Municipal Advisor Regulatory Considerations

- Accepting deposits from a municipal entity does not make a bank a “municipal advisor.”
- Providing advice to municipal entities about investments, including in deposits, may trigger municipal advisor registration and regulation by SEC, MSRB.
- Exemption for banks providing advice about deposits and certain other bank products.
- 17 C.F.R. § 240.15Ba1-1.

SEC broker-dealer liquidity/customer reserve account rules. SEC rules applicable to broker-dealers regarding liquid assets reserves (“customer reserve bank deposits” and PAB reserve bank deposits) required for amounts owed to customers can be met by qualifying deposits at banks, if requirements of the rule met. 17 C.F.R. § 240.15c3-3.

SEC rules also impose requirements on broker-dealers regarding disclosures and notices of changes for sweep deposits holding customer cash balances. 17 C.F.R. § 240.15c3-3(j).
Treatment Under Federal Commodities Laws

- Regulation of hybrid instruments establishes exemption for deposits that have commodity-based features in interest paid. 17 C.F.R. Part 34.
- Regulation of swaps -- identified banking product/traditional bank product exemption generally excludes bank deposits from being regulated as swaps by CFTC.

Deposit Exemption Under Volcker Rule

- Bank deposits are not financial instruments subject to Volcker proprietary trading restrictions.
- Deposits are not 1934 Act "securities" and are not swaps or derivatives under CEA, and therefore not financial instruments subject to Volcker Rule.
- Traditional bank product exemption.

Fiduciary, ERISA/Internal Revenue Code Self-Dealing Considerations

- Deposit of fiduciary funds for short term in same or affiliated bank 12 C.F.R. § 9.10.
- Exemption from ERISA/IRC prohibited transaction allows self-deposit.
- Must bear a reasonable rate of interest.
- Not available to get fees to place deposits with third-party banks.

Some Special Sweep Deposit and Omnibus Deposit Issues

- Sweep deposits are commonly structured through an omnibus deposit account issued by a bank and held by a broker-dealer, trust company or bank which does sub-accounting to identify how much of deposit. Need to conform to FDIC pass-through deposit insurance rules to get insurance covered for each end customer. 12 C.F.R. § 330.5.
- May link a demand deposit account (DDA) or negotiable order of withdrawal (NOW) account with a money market deposit account (MMDA) as two paired subaccounts.
- Protocols in place to limit withdrawals and outbound transfers from the MMDA to not more than six per month with the final withdrawal a transfer to the DDA or NOW. Balances transferred back
from DDA or NOW to MMDA at start of next month. Checks, withdrawals, outbound transfers and payments made from the DDA or NOW rather than directly from the MMDA, and may be moved from the DDA or NOW to the brokerage account or custody account for outbound payments.

- May have target balance mechanism to maintain some amount in the DDA so as to reduce the likelihood that the entire balance will get transferred from the MMDA to the DDA or MMDA, and as a result minimize average amount in DDA/NOW transaction account and reduce the amount required to be kept on reserve by the bank.
- SEC Rules on broker-dealer disclosure and use of sweep products, require certain disclosures and advance notice of changes. 17 C.F.R. § 240.15c3-3(j).
- FDIC 2005-02 Interpretation (Feb. 2005) on when sweep deposits are “brokered deposits.”
- FDIC Staff position that banks should discuss sweep deposit programs with FDIC to determine whether they are brokered deposits.
- LCR rule establishes outflow rates for “brokered sweep deposits” without regard to whether deemed to be “brokered deposits” under FDIC rules and interpretations. Looks to whether fully insured, retail and whether from an affiliated entity to establish outflow rates for sweep deposits.
- Investment Company Act consideration on whether the omnibus account is an unregistered investment company.
- Other sweep products include sweeps to offshore branch of bank, MMFs, repos. FDIC guidance on customer disclosures regarding non-insured status of those types of sweeps.

**Uninsured Deposits**

- Non-U.S. banks generally are not FDIC-insured (even in U.S. branches unless grandfathered).
- Restrictions on who can be a depositor in a non-insured U.S. branch of a foreign bank, and amount of deposit generally must be over $250,000.
- Offshore branch deposits of U.S. and foreign banks not FDIC-insured (unless payable in U.S.).
- FDI Act Section 43 (12 U.S.C. § 1831t) contemplates a regime for U.S. banks to issue uninsured deposits, which has never really taken hold. CFPB rules require certain disclosures and impose other requirements on these deposits. 12 C.F.R. § 1009.

**Additional State Issues**

- Deposits are contracts, and their interpretation and enforcement are governed by state laws, including state contract law, the Uniform Commercial Code and other state laws.
- Set-off: common law, statutory or contractual right of bank to set off its deposit obligation against money owed to the bank by the depositor.
• Escheat: after a period of account inactivity and lack of customer contact specified in applicable state laws, the bank must give the customer money to the state government.
• Customer can recover the money from the state later on.
• State regulation of pre-dispute arbitration clauses currently preempted by Federal Arbitration Act, but CFPB might seek to restrict arbitration clauses.
• State disclosure requirements and state Unfair Business Practices Act attempts by states to limit arbitration clauses, impose disclosure or substantive requirements on deposit products.

**Former Regulatory Provisions Regarding Deposits That Appear in Older Interpretations**

These since repealed regulatory provisions often are mentioned in older decisions and interpretations, and as a result are worth knowing about:

• Regulation Q -- former Federal Reserve rule establishing interest rates on deposits and prohibiting payment of interest on DDAs. Formerly codified at 12 C.F.R. § 217. Many of old Federal Reserve interpretations under Regulation Q were transferred to Regulation D (reserve requirements).
• Unlimited FDIC deposit insurance: from October 2008 through December 2012, non-interest bearing demand deposits were eligible for an unlimited amount of FDIC deposit insurance. This was a temporary program designed to prevent bank runs during the 2007-2009 Financial Crisis.
• Loss of pass-through deposit insurance on pension accounts held in banks if proper disclosures were not made. Under the original regime of deposit broker regulation, pass-through deposit insurance could be lost for certain omnibus deposits of pension and employee benefit plans if the proper account disclosures were not made.
• Registration of deposit brokers: deposit broker regulations formerly required “deposit brokers” to register as such with the FDIC (former 12 U.S.C. § 1831f-1). This is no longer the case.

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