January 16, 2024

Via Electronic Mail

James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: Comments—RIN 3064-AG07

Re: Recordkeeping for Custodial Accounts (RIN 3064-AG07)

Ladies and Gentlemen:

The Bank Policy Institute,[1] American Bankers Association,[2] and Association of Global Custodians, Americas Focus Committee[3] are writing in response to the Federal Deposit Insurance Corporation's Notice of Proposed Rulemaking on Recordkeeping for Custodial Accounts (the "proposal").[4] Motivated by the bankruptcy of Synapse Financial Technologies, Inc., a nonbank middleware provider, and the resultant inability of consumers to access their deposited funds due to Synapse's lack of adequate ledgering, the proposal seeks to impose new recordkeeping requirements on banks. While we agree

[1] The Bank Policy Institute is a nonpartisan public policy, research and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. BPI produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

[2] The American Bankers Association is the voice of the nation's $24.2 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $19.1 trillion in deposits and extend $12.6 trillion in loans.

[3] Established in 1996, the Association of Global Custodians is a group of 12 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure matters through comment letters, white papers and interaction with legislative and regulatory authorities and financial industry organizations. The member banks are competitors, and the Association does not involve itself in member commercial activities or take positions concerning how members should conduct their custody and related businesses. The Americas Focus Committee operates as an overarching full committee to address all Association matters involving regulatory/market structure issues arising in North or Latin America.

[4] 89 Fed. Reg. 80,135.

with the FDIC that the inability to access deposited funds due to recordkeeping failures by nonbank entities is a problem that must be addressed, we disagree with the approach taken in the proposal, which is overly broad in scope and which inappropriately seeks to make banks responsible for business deficiencies observed at nonbank entities. If finalized, the proposal would result in significant and adverse unintended consequences for banks' ability to serve their customers and, furthermore, would not optimally mitigate the risks the FDIC seeks to address through it. For the reasons discussed in greater detail herein, the proposal should therefore be withdrawn, and the FDIC and other relevant policymakers should refocus their efforts to prevent future harm, like that caused by Synapse's bankruptcy, on the nonbank entities that are most responsible for and best positioned to address the underlying causes of such harm. The FDIC should not continue to attempt to indirectly address concerns at nonbank entities by directly regulating all banks.

I. **Introduction**.

The FDIC acknowledges that the impetus for this proposal was the bankruptcy of a specific middleware provider, Synapse, and the resulting fallout, including consumer harm.[5] Synapse assisted its fintech customers by handling "the bookkeeping necessary to make sure customer accounts [were] credited and debited correctly" at the banks where Synapse helped place customer funds.[6] In the aftermath of Synapse's filing for Chapter 11 bankruptcy protection in April 2024, however, tens of thousands of bank accounts were frozen due to the inability to ascertain ownership.[7] The FDIC also notes that, "[i]n many cases, it was advertised that the funds were FDIC-insured, and consumers may have believed that their funds would remain safe and accessible due to representations made regarding placement of those funds in IDIs."[8]

Although we strongly support ensuring that beneficial owners can access their funds in a timely manner, the proposal suffers from numerous deficiencies. The proposal would not achieve this purpose and would create significant collateral consequences for banks and their customers. Indeed, the proposal would impose blanket requirements on all banks offering covered deposit accounts to address a specific incident involving a particular type of bank-fintech arrangement. The failure of Synapse, or any other similar nonbank entity, to maintain accurate ledgers should be addressed by imposing or strengthening requirements applicable to that type of entity. Any further actions the FDIC or other relevant policymakers propose to take to prevent future harm of the type caused by Synapse's failures must be appropriately targeted to address those specific risks.[9]

[5] 89 Fed. Reg, 80,135.

[6] Ken Sweet, *Abrupt shutdown of financial middleman Synapse has frozen thousands of Americans' deposits*, Associated Press (May 22, 2024) (link here).

[7] *Id.* Some customers could not access funds for "a number of months," and the FDIC asserts in the proposal that it has received more than 1000 complaints related to the failure. *See* 89 Fed. Reg, 80,135. A court-appointed trustee has found that "up to $96 million of customer funds were missing." Hugh Son*, 'I have no money': Thousands of Americans see their savings vanish in Synapse fintech crisis*, CNBC (Nov. 22, 2024) (link here).

[8] 89 Fed. Reg. 80,135.

[9] The fallout from Synapse's bankruptcy involved other factors the proposal does not address but that will be addressed by other recently updated rules. In particular, the FDIC notes that "it was advertised that the funds were FDIC-insured, and consumers may have believed that their funds would remain safe and accessible due to representations made regarding placement of those funds in IDIs." 89 Fed. Reg. 80,135. However, the proposal

Rather than imposing additional requirements on banks and making them serve as quasi-regulators for fintechs – only without the enforcement tools and oversight authorities possessed by the banking agencies – the FDIC should withdraw the proposal and work with the other banking regulators to use their examination authority under the Bank Service Company Act (BSCA) to require greater accountability of fintechs and other nonbanks engaging in the specific activities that gave rise to the concerns motivating this proposal.[10] The FDIC should also coordinate with the Consumer Financial Protection Bureau, which possesses broad authorities over nonbank providers of financial products and services.[11]

II. **<u>The FDIC should use its regulatory tools and authorities, including the Bank Service Company Act, in coordination with other policymakers, to impose greater accountability on fintechs to maintain accurate and complete ledgers</u>.**

We recognize and strongly support the FDIC's goal of enabling beneficial owners to obtain prompt access to their funds. However, the proposal would seek to achieve this goal by imposing broad requirements on banks to address compliance failures of nonbanks, and thus would impose regulatory burdens on all banks, in order to solve a problem ultimately created by nonbanks – which, unfortunately, has become a common practice of the FDIC and the other banking regulators, as demonstrated, for example, by numerous provisions in the recent brokered deposits proposal.[12] More importantly, this misplacement of responsibility would not effectively mitigate the issues the proposal seeks to address.

As noted, Synapse maintained ledgers of banks' customers, including the deposit amounts attributed to each individual customer, but Synapse failed to maintain them completely and accurately.[13] When Synapse filed for bankruptcy, "significant ledger irregularities were alleged by several partner banks indicating the account balances set forth in Synapse's ledger were 'materially

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does not address the issue of false advertising for good reason: the FDIC recently updated its rules regarding signs and advertising and misrepresentations of deposit insurance status to apply to digital and mobile platforms, meaning it has already taken relevant steps outside the proposal to achieve this purpose. 89 Fed. Reg. 3,504. Compliance with that rule's relevant sections was required by January 1, 2025. The FDIC should therefore assess the effectiveness of the final rule in addressing consumer confusion and reducing the risk of harm related to incidents similar to Synapse's bankruptcy. After a period of review, the results of such study will help the FDIC and other policymakers determine whether additional measures, including taking a more direct regulatory role with nonbanks, are needed to address further the causes of the harm that resulted from Synapse's bankruptcy.

[10] 12 U.S.C. 1861 *et seq.*

[11] *See, e.g.,* 12 U.S.C. 5514(e), 5515(d), 5516(e), 5563, 5564, and 5514(a)(1)(B)-(C).

[12] FDIC, *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions* (Aug. 23, 2024), 89 Fed. Reg. 68,244; *see also BPI Comments on the FDIC's Proposed Rulemaking on Brokered Deposits Regulatory Framework*, BANK POLICY INSTITUTE (Nov. 21, 2024), https://bpi.com/bpi-comments-on-the-fdics-proposed-rulemaking-on-brokered-deposits-regulatory-framework/.

[13] Alexandra Steinberg Barrage *et al.*, *Where the F(BO) is the Money? Part 2 — Adopting the Right Lessons from Synapse*, TROUTMAN PEPPER (Oct. 3, 2024) ("Synapse functioned as a middleware between banks and fintechs, opening demand deposit accounts on behalf of approximately 100 fintech companies (and their end users) at four different banks, and Synapse managed the account ledgers. This meant that the banks and the fintechs were all reliant on Synapse to determine how much each customer was owed.") (link here).

inaccurate' and, therefore, could not be used as the basis for distributing funds to end users."[14] Indeed, many banks encountered significant difficulties in obtaining, reviewing, and reconciling Synapse's records. Thus, the FDIC's motivating concern underlying the proposal stems from Synapse's failure to maintain complete and accurate ledgers in connection with bank-fintech relationships whereby fintechs provide customers products that use an insured bank account to provide a product or service.

Importantly, imposing the recordkeeping and other requirements contemplated in the proposal directly on fintechs and other nonbank entities would be more effective than imposing the requirements directly on banks. It would also be consistent with the principle of "same activity, same regulation." Where fintechs and other nonbank entities offer products and services that allow customers to hold and transfer funds, they should be expected to ensure the accuracy of their records. On Nov. 20, 2024, in response to questions from Rep. Bill Foster (D-IL) of the House Financial Services Committee on the lessons learned from the Synapse bankruptcy, the necessary steps "to better fintech customers in the future," and whether new legislation is needed, Acting Comptroller of the Currency Michael Hsu testified:

> I do think there is a gap for non-banks, in terms of the regulation of non-banks. Most non-bank fintechs are regulated as money services businesses by the states, and that regulation and oversight is highly uneven across the states. It's patchwork across the country. I do believe that a federal standard that levels up that regime would be helpful, and would have helped to prevent some of the problems that your constituents are having now.[15]

The proposal seeks to impose recordkeeping requirements on banking organizations offering what the agency labels "custodial deposit accounts with transactional features."[16] This term is defined as a deposit account that meets three requirements: (1) the account is established for the benefit of beneficial owner(s); (2) the account holds commingled deposits of multiple beneficial owners; and (3) a beneficial owner may authorize or direct a transfer through the account holder from the account to a party other than the account holder or beneficial owner. These accounts are common in certain bank-fintech arrangements, and the proposal aims to ensure these arrangements do not prevent the FDIC from making timely deposit insurance determinations or beneficial owners from receiving prompt access to their funds.[17] However, this definition will almost certainly capture numerous other types of accounts unrelated to bank-fintech arrangements and thus is unnecessarily broad to achieve the FDIC's goal.

Moreover, there are significant practical limitations to the overreliance on banks to police the activities of fintechs and other nonbanks. For instance, fintech companies often maintain relationships with multiple banks, and a particular bank may lack clear information from the fintech about which beneficial owners' funds it holds. Thus, it would be operationally challenging for a bank to accurately maintain the records contemplated by the proposal and reconcile them with the fintech's own records absent information from other banks that have similar relationships with the fintech. Unlike a bank in

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[14] *Id.*

[15] Bill Foster and Michael Hsu, *Hearing Entitled: Oversight of Prudential Regulators*, HOUSE FINANCIAL SERVICES COMMITTEE (Nov. 20, 2024), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409407.

[16] 89 Fed. Reg. 80,152.

[17] *See* 89 Fed. Reg. 80,136.

this instance, the fintech possesses a comprehensive view of how funds across different banks relate to individual customers and is therefore the logical party that should be responsible for ensuring the required recordkeeping. This informational disparity, along with other examples discussed in this letter, demonstrates why the proposed requirements are better suited for fintechs and other nonbank entities rather than banks. Imposing such recordkeeping requirements directly on nonbanks would also be a more efficient way of addressing the concerns motivating this proposal. Given that fintechs often have relationships with multiple banks, requiring each bank that has a relationship with a given fintech to comply with the recordkeeping requirements contemplated by this proposal would introduce unnecessary aggregate burden and complexity relative to applying the requirements only to that single fintech.[18]

Therefore, all nonbank intermediaries in the bank-fintech relationship chain, such as a middleware provider like Synapse, should be required to ensure the accuracy of their records. This recommendation is consistent with our response to the banking agencies' bank-fintech RFI, in which we recommended actions that the regulators should take to address the risks presented by certain bank-fintech relationships.[19] Specifically, we asserted that the banking agencies should use their regulatory tools and authorities to directly obtain information from, and exercise oversight of, fintechs to impose greater accountability on the fintechs. Further, we asserted that the agencies should use relevant examination authorities, such as the BSCA, to (i) directly examine fintechs in order to stay abreast of key developments and trends, especially in areas of minimal prudential oversight and that may be higher risk; (ii) leverage knowledge gained in conducting examinations of fintechs to eliminate needless duplication when examining applicable banks who have relationships with such fintechs; and (iii) issue a supervisory handbook for fintechs and other nonbank partners involved in 'as-a-service' arrangements.[20]

The BSCA "authorize[s]" the banking agencies to "issue such regulations and orders as necessary" to regulate and examine entities that perform services for a bank "*to the same extent* as if such services were being performed by" the bank.[21] Congress has provided the banking agencies the statutory authority to establish consistent regulation across banking services, whether those services are provided by a bank or fintech, and the banking agencies should therefore use that authority to address the deficiencies in recordkeeping practices by nonbanks that were revealed as a result of the Synapse bankruptcy. As Federal Reserve Board Governor Michelle Bowman recently observed:

> The Bank Service Company Act gives the federal banking agencies significant regulatory authority over outsourced banking services. In a world where third parties are providing far

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[18] Further, where banks do not have a direct relationship with a fintech's or other nonbank's customers, banks should be able to rely on these nonbanks to provide the services they represent they will provide (subject, of course, to banks' robust due diligence and third-party risk management procedures in the ordinary course).

[19] *See* BPI and TCH, *Comment on Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses* (Oct. 30, 2024).

[20] The recent interagency statement accompanying the RFI included useful references to resources that should helpfully promote education in this area. See OCC, FDIC, Federal Reserve, "Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services" (July 25, 2024) (link here).

[21] 12 U.S.C. 1867(d); 12 U.S.C. 1867(c) (emphasis added).

more of these services, it seems to me that these providers should bear more responsibility to ensure the outsourced activities are performed in a safe and sound manner.[22]

The deficient practices of nonbanks prompting the current proposal demonstrate the need for the banking agencies to exercise this "significant regulatory authority." The "structure of the [BSCA]" provides the agencies with multiple options for rulemaking, such as "the application of regulations that would otherwise be applicable to bank activities that have been outsourced" or "devising new regulatory requirements for the services provided, specifically designed for service providers."[23]

The regulators took a promising step in using the BSCA in the recent joint agency *Computer-Security Incident Notification Rule for Banking Organizations and Their Bank Service Providers*.[24] In the notice of proposed rulemaking for this regulation, "the bank regulators emphasized that they 'would enforce the bank service provider notification requirement directly against bank service providers.'"[25] Governor Bowman described this rule as "one example that makes appropriate use of" the BSCA authority when observing that regulators should consider "shifting the regulatory burden" from the banking industry to "more efficiently focus directly on service providers."[26]

As we have noted previously, the banking agencies should also work with the CFPB to support the supervision of fintech companies. The CFPB's broad authorities over nonbank providers of financial products and services include the authority to examine certain service providers to CFPB-supervised institutions, nonbanks that pose heightened risk to consumers or that are larger participants of defined markets for consumer products or services.[27] The CFPB should play a more active role in overseeing the nonbank providers over which they have authority, thereby complementing the more robust exercise of the banking agencies' authority under the BSCA. We strongly encourage the FDIC to collaborate with the CFPB to ensure that fintechs are sufficiently regulated and supervised to achieve the agency's purposes underlying this proposal.

III. <u>The current proposal is not appropriately tailored to address the concerns motivating its issuance</u>.

The definition of "custodial deposit accounts with transactional features" is significantly overbroad and would impose unnecessary costs and complexities on banks without mitigating the specific concerns that motivated the proposal. In addition to not appropriately targeting fintechs and other nonbanks responsible for maintaining accurate ledgers and records in connection with certain bank-fintech arrangements, the proposed definition of "custodial deposit accounts with transactional features" would capture large numbers of deposit accounts that are not true spending or transactional accounts. Many other types of accounts commonly offered by banks to service their customers' needs may allow funds to be sent to someone other than the beneficiary by entering additional bank account

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[22] Governor Michelle Bowman, *Welcoming Remarks at the Midwest Cyber Workshop* (Feb. 15, 2023) (link here).

[23] James Bergen and Paul Lim, *The Bank Service Company Act: The Curious Late Life of an Old Law*, Arnold & Porter (July 16, 2024) (link here).

[24] 86 Fed. Reg. 66,424 (Nov. 23, 2021).

[25] Jacob Cunningham, *The Limits of the Bank Service Company Act*, 74 Duke L.J. 227 (Oct. 2024) (link here).

[26] Bowman, supra note 22.

[27] 12 U.S.C. §§ 5514(a)(1)(B) and (C) and § 5514(e).

information. The proposal's broad coverage will increase operational complexity and the bank's cost burden in providing a broad range of existing products and services that customers require and value.

To illustrate the substantial overbreadth of the rule, we provide the following examples of changes that would be necessary, but not sufficient, to appropriately narrow the proposal's scope. These examples are by no means exhaustive and are intended to demonstrate the operational complexity of the proposed rule's approach. Furthermore, these examples highlight the need for the FDIC to withdraw the proposal and work with other policymakers on requirements that would directly apply to fintechs and other nonbanks that were the source of the issues motivating the proposal.

1. <u>The definition of "custodial deposit accounts with transactional features" should include a requirement that the product must purport to offer deposit insurance on a pass-through basis</u>. For an account to qualify under the definition of "custodial deposit accounts with transactional features" in proposed 12 C.F.R. 375.2, a fourth prong should require that the associated product must purport to offer deposit insurance on a pass-through basis. This additional prong would prevent omnibus accounts, wholesale accounts or accounts with limited ability to transact, and where there is no expectation by the beneficial owner of deposit insurance, from being unnecessarily governed by any final rule.

2. <u>The third prong of the definition of "custodial deposit account with transactional features" should be amended to include the requirement that the account be "established for the purpose of allowing the beneficial owner to authorize or direct a transfer through the account holder from the custodial deposit account to a party other than the account holder or beneficial owner."</u> The existing language captures a number of deposit account arrangements that, while not established for the purpose of sending funds to third parties other than the beneficial owner, currently have the capability to do so absent a contractual limitation being imposed by the bank. As currently drafted, banks would thus have to coordinate recordkeeping with a number of clients who never intended to provide third-party money movement to their underlying clients or, as an alternative, renegotiate their existing agreements with the client to specifically disclaim this transactional feature. By revising the definition as set forth above, the bank would be able to conduct a review of its client list and specifically target these new recordkeeping requirements to fintechs that are the focus of the rule.

3. <u>Banks subject to Part 370 should not be included in any final rule</u>. Besides adding significant new and incremental burdens, the proposal overlaps with certain existing requirements for banks subject to 12 C.F.R. 370, and thus, it is unnecessary for those banks to be subject to the proposal. The FDIC acknowledges that it already has issued regulations that include recordkeeping and data standard requirements to support timely determinations of deposit insurance coverage at banks, such as 12 C.F.R. 360.9, which includes data standards that apply to banks with at least 250,000 deposit accounts or $20 billion in assets, and 12 C.F.R. 370, which requires banks with more than 2 million deposit accounts to implement certain recordkeeping capabilities to calculate deposit insurance coverage in the event of the bank's failure. For example, 12 C.F.R. 370.5 already requires covered banks to take reasonably calculated steps to ensure that the account holder will provide the FDIC with the information needed to determine deposit insurance, and banks subject to Part 370 are required to certify compliance that a deposit insurance determination can be made. This requirement applies regardless of the type of account holder. Therefore, the FDIC should narrow the proposal to cover only those entities not already subject to 12 C.F.R. 370.

4. The FDIC should not apply any final rule to arrangements already subject to federal recordkeeping requirements and regulatory supervision. The FDIC states in the proposal's preamble that it "does not intend to impose any recordkeeping requirements through this proposal that directly conflict with other legal requirements," and several of the proposed exemptions are justified on the basis that the arrangement or account at issue is already subject to other recordkeeping mandates.[28] Accordingly, any final rule should explicitly state that if an entity is already subject to recordkeeping requirements and regulatory supervision under another federal framework, deposit accounts established by that entity are not subject to the rule. This revision would appropriately exempt several entities and account types.

   Among other entities, such an exemption would cover deposit accounts opened on behalf of a bank or other regulated financial institution, including those that support payment, clearing and settlement activities, such as deposit accounts for financial market infrastructures (e.g., International Central Securities Depositories, Central Securities Depositories, Central Counterparties); exchanges, derivatives clearing organizations, and other similarly regulated entities. Similarly, the rule should provide an exemption for Commodity Futures Trading Commission client money accounts and, relatedly, segregated customer accounts established for the purpose of complying with 17 C.F.R. 1.20(a) (governing the treatment of futures customer funds by futures commission merchants), 17 C.F.R. 1.20(g) (governing the treatment of futures customer funds by derivatives clearing organizations), 17 C.F.R. 30.7 (governing the treatment of customer funds used to margin, guarantee, or secure foreign futures and foreign options transactions) and 17 C.F.R. Part 22 (governing the treatment of cleared swaps customer collateral). This exemption would also ensure the rule remains flexible to account for future recordkeeping requirements that may be imposed on certain types of custodial accounts by other lawmakers or regulators.

5. The list of exemptions in the proposal is incomplete.

While the proposal contains a list of exemptions, this list will inevitably omit accounts that should be exempted simply because the FDIC has not worked with industry to conduct a comprehensive survey to catalogue every type of account that could potentially be in scope. Moreover, any finite list will necessarily leave out accounts with the features described in the proposal that banks may offer as they continue to innovate to meet customer demand. To once again illustrate the substantial overbreadth of the proposal and the need for the FDIC to rescind the rule, we provide examples of how the existing exemptions would need to be expanded, and we list examples of additional types of accounts that would have to be exempted. Once again, this list is by no means exhaustive.

a) *The FDIC would need to revise proposed 12 C.F.R. 375(d)(4) to provide a broad exemption that expressly covers circumstances in which a bank serves in an agency role to take in funds and provide those funds to the proper beneficiaries*. Examples include, but are not limited to, paying agents, disbursement agents, escrow agents, transfer agents, revocable and irrevocable trusts, and trust companies.

b) *The FDIC would need to revise proposed 12 C.F.R. 375(d)(5) to exempt additional kinds of employee benefit or retirement plans*. Any future rule would need to consider the following or similar revisions: "Accounts held in connection with an employee benefit plan or retirement

[28] 89 Fed. Reg. 80,141–142.

plan described in 12 CFR 330.14 **or accounts established in connection with employee benefit plans and retirements plans subject to, permitted by or as defined in ERISA or the Internal Revenue Code, including but not limited to health savings accounts, flexible spending accounts, and accounts related to deferred compensation plans and arrangements.**" In accordance with Sec. II(a)(4) of this comment, the FDIC would need to also exempt any other employee benefit or retirement plans where there is a recordkeeping requirement.

c) *The FDIC would need to revise proposed 12 C.F.R. 375(d)(10) to exempt real estate development and property management companies*. To do so, any future rule could revise the language as follows: "Accounts exclusively holding ~~security~~ deposits tied to property owners for a homeownership, condominium, housing association**s** governed by State law, neighborhood associations, or holding deposits tied to residential or commercial leasehold interests."

The following is a list of examples of additional types of accounts that should also be exempted from any proposal:

a) Custodial deposit accounts that a bank maintains for itself. These internal custodial deposit accounts are often used by a bank to integrate internal systems and consolidate records. This exemption would include accounts established by a bank (i) for internal consolidation and recordkeeping purposes; (ii) when the account's beneficial owners are customers of the bank and their balances are already reported by the bank as accountholder for another account at the bank[29]; or (iii) accounts maintained for recordkeeping purposes to record the aggregate liability balances for distributed ledger technology ("DLT") based bank deposits.[30]

b) Deposit accounts maintained by a corporate client that have a pooling structure, where the funds are held on behalf of multiple affiliates or subsidiaries of the corporate client.

c) Deposit accounts from charitable organizations where the charity maintains funds on behalf of underlying beneficiaries.

d) Commuter Benefit Accounts.

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[29] As an example, a bank may have a central general ledger account system (System A) on which it records all cash positions. As these systems may be older, the bank may implement newer cash deposit systems that may be nimbler and/or be dedicated to specific service, *e.g.,* collateral management, international payments, etc. (System B). System B records the deposit accounts for each of the bank's customers for that specific service (Customers X, Y, and Z). To integrate the cash positions on System B with the bank's general ledger, the bank opens an omnibus account on System A that is for the benefit of customers of System B. In the event Customer X transfers funds from its account from System B, the funds would be debited from both Customer X's account on System B and from the FBO account on System A. Such internal custodial deposit account should not be subject to additional reporting, as the bank would already report on Customer X, Y, and Z's accounts from System B, and an additional report from the FBO account on System A would result in double counting.

[30] Such an account may be used to evidence total deposit claims issued on DLT for the benefit of the depositors. The DLT-based bank deposits may either be account-based or non-account based. In all instances the bank would have access to both DLT and non-DLT based records to identify the depositors and comply with recordkeeping requirements such as Part 370.

e) Payroll and payment providers and processors. Payroll and payment providers and processors that hold funds in a non-fiduciary capacity would need to be added to the extent not otherwise covered by the current proposed exemptions.

f) Accounts established for the sole purpose of (i) the settlement of payment transactions from merchants submitted and processed through an electronic transaction processing network, such as a payment card network, or (ii) receiving settlement funding for outgoing client payments. These accounts are not meant to hold deposits, typically lack transactional features available to clients, and are used for settlement of incoming and outgoing funds.

g) Accounts for healthcare or medical practice administrators who manage payments to or from medical and dental practices, hospitals, and other similar arrangements.

h) Accounts for mortgage payment processors.

i) Accounts holding reserve assets.

j) Accounts holding reserve assets for stablecoins and other similar tokenized assets. Due to the nature of stablecoins and certain tokenized assets, neither the issuer of the stablecoin or tokenized asset nor the bank maintaining the account holding the reserve assets will know at every moment the identity of the beneficial owner of the reserve assets: the token will transfer between holder to holder, with each token holder having the right to redeem the token for the reserve asset. Thus, a requirement for banks to record and report the beneficial ownership at a regular interval would prevent banks from holding such reserve assets on behalf of their clients.

k) Non-reloadable pre-paid cards that do not purport to offer pass-through insurance. As currently drafted, the proposal would cover prepaid cards, such as gift cards and reward cards, that are not typically reloadable and that do not purport to offer pass-through insurance. The benefit of maintaining additional records on such cards is unclear. The current proposal could capture these common products, even though they are not necessarily offered in partnership with fintechs.

IV. **The proposed recordkeeping, internal control, and attestation requirements suffer from additional flaws.**

In addition to the foundational issues with the proposal, discussed earlier in this letter, which would result in significant practical difficulties for banks' compliance with the requirements it contemplates, there are multiple additional problems presented by the proposed recordkeeping and internal control requirements detailed in proposed 12 C.F.R. 375.3 and the attestation requirement in proposed 12 C.F.R. 375.4. These problems underscore once again the previously articulated need for the FDIC to withdraw the current proposal focused on banks and to instead work with other relevant regulators to hold fintechs and other nonbank entities accountable for maintaining accurate records. The following are illustrative examples of additional problematic aspects of these requirements.

Reconciliation

Proposed 12 C.F.R. 375.3(b)(2) would require daily reconciliation of account ownership. This provision would unnecessarily impose a substantial burden on banks. Banks would be subject to

increased costs and operational complexities relating to securing and storing data that would be received from the account holders on a daily basis. Additionally, banks would become the account holders' data repositories, an inappropriate expansion of their role in these arrangements. As payments move toward 24/7 operations, a daily reconciliation requirement would be even more burdensome and difficult for banks to manage.

Validation

Proposed 12 C.F.R. 375(c)(4)(iii) envisions an "independent validation of records held by third parties" to the extent records are maintained with that third party no less than annually. This would create either a significant cost for the third party that would likely be passed on to a bank and customers or a burden on the bank itself to conduct an audit on each and every counterparty to a custodial account that maintains transactional features. To the extent independent validation of records held by third parties is required, that requirement should apply to those third parties directly rather than to banks.

Attestation

Proposed 12 C.F.R. 375.4(b) would require annual attestation from a bank's "chief executive officer, chief operating officer, or the highest-ranking official of the institution, "after due inquiry," that the bank complies with the rule. The cited authority for the proposal is 12 U.S.C. 1821(f)(1) and 1831(g).[31] These statutory provisions do not provide the FDIC clear authority to impose an attestation requirement. Indeed, in contrast to other statutes, Congress has not imposed or authorized an attestation or certification requirement on executives in this context.[32] Also, the FDIC has failed to identify the benefits of the executive attestation requirement that could not readily be achieved through the exercise of its existing supervisory authorities with fewer negative consequences.

V. <u>The proposal could be misconstrued to inappropriately alter banks' existing BSA or sanctions obligations</u>.

In his statement in support of the proposal, Chairman Martin Gruenberg claimed, "the proposed rule will strengthen compliance with anti-money laundering and countering the financing of terrorism

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[31] 12 U.S.C. 1821(f)(1) states, "In case of the liquidation of, or other closing or winding up of the affairs of, any insured depository institution, payment of the insured deposits in such institution shall be made by the Corporation as soon as possible, subject to the provisions of subsection (g), either by cash or by making available to each depositor a transferred deposit in a new insured depository institution in the same community or in another insured depository institution in an amount equal to the insured deposit of such depositor." 12 U.S.C. 1831(g) states, "An insured depository institution may not enter into a written or oral contract with any person to provide goods, products, or services to or for the benefit of such depository institution if the performance of such contract would adversely affect the safety or soundness of the institution."

[32] For example, to take advantage of a specific exemption in the Volcker Rule to engage in prime brokerage transactions with a related covered fund, Congress required the banking entity's chief executive officer to certify in writing that the banking entity does not guarantee, assume, or otherwise insure the obligations or performance of fund. 12 U.S.C. § 1851(f)(3)(ii).

law."[33] This statement could imply that the FDIC views the proposal as expanding the BSA obligations of banks. Imposing such changes based on a single line in an otherwise unrelated recordkeeping proposal, without notice and comment and significant coordination with the Financial Crimes Enforcement Network and other banking regulators, would be highly imprudent. Moreover, the proposal does not consider the actual cost or burden of any such additional requirement, such as significantly expanded transaction monitoring and Know Your Customer responsibilities. The risk that the proposal could be so misconstrued reflects yet another reason why the FDIC should rescind it and work with other relevant regulators to hold fintechs and other nonbanks directly responsible for maintaining accurate records of their customers' accounts held with banks.

To further underscore the necessity of the proposal's rescission, it is critical to emphasize the FDIC's lack of essential coordination with key agencies, including the Financial Crimes Enforcement Network, the Federal Reserve, and the Office of the Comptroller of the Currency. Any rulemaking without such coordination warrants rescission, as it necessarily requires coordinated guidance, such as a statement similar to the *Answers to Frequently Asked Questions Regarding Suspicious Activity Reporting and Other Anti-Money Laundering Considerations* released in 2021,[34] clarifying that fintechs remain responsible for all accompanying obligations concerning their customers, including compliance with applicable law pertaining to KYC, AML/CFT, and fraud monitoring.[35] The proposal lacks a similar joint statement with the Office of Foreign Assets Control that it does not alter banks' sanctions compliance programs. The lack of critical interagency coordination provides additional justification for the FDIC to rescind the proposal.

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[33] Martin Gruenberg, *Statement on FDIC Notice of Proposed Rule: Requirements for Custodial Deposit Accounts with Transactional Features and Prompt Payment of Deposit Insurance to Depositors*, FDIC (Sep. 17, 2024) (link here).

[34] *See* FRB, FDIC, FinCEN, NCUA, and OCC, *Answers to Frequently Asked Questions Regarding Suspicious Activity Reporting and Other Anti-Money Laundering Considerations* (Jan. 19, 2021), https://www.fdic.gov/news/financial-institution-letters/2021/fil21005.html.

[35] This document should also clarify that fintechs that provide money transmission services – whether through currency, funds, or other value that substitutes for currency – are themselves financial institutions for purposes of the BSA and remain responsible for BSA obligations required of money services business for their customers, including compliance with applicable BSA rules.

The Bank Policy Institute, American Bankers Association, and Association of Global Custodians, Americas Focus Committee appreciate the opportunity to comment on this proposal. If you have any questions, please contact the undersigned.

Respectfully submitted,

Joshua Smith
Vice President, Assistant General Counsel
Bank Policy Institute
joshua.smith@bpi.com

Ryan T. Miller
Vice President & Senior Counsel, Innovation Policy
American Bankers Association
rmiller@aba.com

Walter Palmer
Chair, Americas Focus Committee
Association of Global Custodians
info@theagc.com