IBC
International Bancshares
Corporation

January 07, 2025

Via email: Comments@fdic.gov

Federal Deposit Insurance Corporation
James P. Sheesley, Assistant Executive Secretary
Attn: Comments – RIN 3064-AG07
550 17th Street, NW
Washington, DC 20429
Comments@fdic.gov

Re: Comments of International Bancshares Corporation on Proposed Rulemaking Regarding Recordkeeping for Custodial Accounts (RIN 3064-AG07).

Dear Mr. Sheesley:

The following comments are submitted by International Bancshares Corporation ("IBC"), a publicly traded, multi-bank financial holding company headquartered in Laredo, Texas. IBC maintains 166 facilities and 257 ATMs, serving 75 communities in Texas and Oklahoma through five separately state-chartered banks ("IBC Banks") ranging in size from approximately $479 million to $9.48 billion, with consolidated assets totaling over $15.5 billion. IBC is one of the largest independent commercial bank holding companies headquartered in Texas. The Federal Deposit Insurance Corporation ("FDIC") is the primary federal regulator of the IBC Banks, and the Federal Reserve Board ("FRB") is the primary federal regulator of IBC.

These comments respond to FDIC's notice of proposed rulemaking regarding recordkeeping for custodial deposit accounts with transactional features ("Notice"). The proposed rules are "intended to promote the FDIC's ability to promptly make deposit insurance determinations and, if necessary, pay deposit insurance claims 'as soon as possible' in the event of the failure of [a bank] holding custodial accounts with transactional features" as well as support "depositor and consumer protection benefits, such as promoting timely access by consumers to their funds, even in the absence of the failure of an IDI." [Notice at 80135]

IBC strongly disagrees with any regulatory action that would continue to allow the rampant abuse by fintechs of "banking as a service" ("BaaS") and functional "rent-a-charter" relationships with chartered and FDIC-insured banks. These relationships have skyrocketed in number and complexity, and have left more consumers harmed than all of the bank failures of 2023 and 2024. Many high-profile failures of these relationships have left regulators and consumers scrambling to find and/or re-create deposit records in order to provide restitution to consumers that relied on these fintechs for deposit products. Frustratingly, when these relationships fail, it is not the bank that fails and becomes

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subject to FDIC receivership. Rather, the fintech fails and is unable to provide sufficient deposit records for the partner bank to wind down the BaaS program and return customer funds correctly. Regulators are unable to step up in any meaningful way, because there is no bank failure and regulators have chosen to ignore their authority to oversee, audit, and regulate the fintechs at issue.

IBC believes that the use of omnibus custodial accounts for BaaS programs has stretched far outside the authority of both banks and fintechs. Custodial accounts were never meant to function as large pots of pooled money for which a non-bank third party maintains the ledger records and is the only means of communication and access between the end-user consumer depositor and the account holding bank. Non-banks were never supposed to have the authority to engage consumer depositors, manage the entire depositor relationship with the sponsor bank (from account opening, funding, and transaction access), and act as a complete shield between the consumer depositor and the bank. Moreover, custodial accounts and relationships were never meant to offer direct, full access to transactional deposit accounts. Rather, custodial accounts were meant to function as discrete, generally non-transactional tools that entities involved in money management, such as accountants and payroll processors, could use to assist their own clients. While IBC's position is not that banks cannot contract service providers to assist in customer onboarding, account and ledger maintenance, and other bank functions, IBC believes that this authority to engage bank service providers was never meant to, and should not have been allowed to, empower chartered and FDIC-insured banks to offload all bank functions to non-bank third party fintechs. This is especially true when banking regulators appear unwilling to use their authority to oversee, audit, and otherwise regulate fintechs that enter into BaaS programs with chartered banks. Even though many BaaS programs include terms between the program bank and fintech requiring the fintech to submit to bank regulator oversight, it is a rare case that the applicable regulator takes any interest in or action over the fintech until its overwhelmingly too late.

IBC is optimistic that the federal banking regulators are finally ready to address the elephant in the room: rampant use of BaaS programs and custodial authority to undermine this nation's banking industry. There was a reason that the FDIC was created and banks continue to be one of, if not the, most regulated entities in this country. Depositors, especially consumer depositors, need assurances that their money is appropriately secure and accessible. Unregulated fintechs are not subject to the same level of oversight and scrutiny that banks are, either through black letter law, contractual terms, or regulator practice. This has resulted in numerous bank/fintech BaaS program failures and increased regulator action. IBC was pleased to see the recent action the CFPB brought against Walmart, its fintech partner, and sponsor bank related to a BaaS program used to pay Walmart's contracted fleet delivery drivers. That case is a perfect microcosm of the issue with BaaS programs as they are currently allowed. IBC believes regulators should take a larger look at their regulations and authority and start to pare back the long leash they have given to fintechs and the banks that partner with them. While the Glass-Steagall Act prohibited "private banking" and reserved that authority to chartered banks, the regulators have failed to keep private banking by fintechs in check. Even though that prohibition has been amended and arguably relaxed over the years, there is no reason that federal regulators have to, or should, continue to allow non-banks to provide deposit accounts and banking services directly to consumers in the fintech's own name.

IBC appreciates the opportunity to comment on these proposed revisions.

Comments

1. The use of omnibus custodial accounts whose sub-account ledger is maintained solely by a non-bank fintech is inappropriate and must be addressed.

Custodial accounts, and custodial authority, were never meant to be used in the way fintechs are currently. Custodial accounts were traditionally a 1-to-1 relationship and even where their was an omnibus account, the bank set up appropriate sub-accounts for which it maintained the ledger. Moreover, custodial accounts were never meant to contain myriad sub-accounts that all had transaction features and were subject to thousands of transactions a day. The FDIC admits that these BaaS program accounts are subject to a higher volume of transactions than traditional custodial accounts, which accounts were never intended to be normal, day-to-day transactional accounts. [Notice at 80140] The volume of transactions that can run through a modern omnibus custodial account is simply too large to trust to a non-bank fintech. This is especially stark in the recent CFPB action against Walmart, as well as the Evolve Bank/Synapse fiasco. In those cases, consumers had planned on, and did (in some cases), using their fintech accounts for everyday activity and purchases. When those consumers lost access to their funds and/or accounts, or discovered that their accounts did not support everyday banking services, those consumers were left to figure out how to make rent payments, buy groceries, and make other necessary purchases and transactions. Obviously, many were unable to and faced dire consequences through no fault of their own. If any other person or entity took consumer funds and did not return them, it would correctly be called a crime.

Custodial accounts were also never meant to place a non-bank entity between the bank and its customer. It also is not the case that custodial account relationships were completely driven by the custodian – from presenting account opening documentation, completing know-your-customer due diligence, transaction instructions, and ledger recordkeeping. As currently implemented, most BaaS relationships are a bank simply ceding its complete authority and obligations to an unregulated, unchartered fintech. This cannot be allowed to continue or consumers will continue to be harmed by both nefarious or simply incompetent fintechs. Evolve Bank and its fintech partner Synapse had a BaaS program that disintegrated earlier this year when it was discovered that Synapse completely failed to adequately meet the obligations the bank had placed upon it – primarily sub-account ledger recordkeeping and customer due diligence. Consumers are still waiting for access to their deposits. One of the biggest reasons why the Evolve/Synapse failure continues to harm consumers is because Evolve Bank did not fail, and regulators seem to believe there is nothing that can be done until the bank fails, which is unlikely to happen and, more importantly, is false. These fintechs that offer deposit account access from a sponsor or program bank and are responsible for keeping deposit ledgers and records can absolutely be regulated and examined by federal and state banking regulators. In order to set up a BaaS program, most fintechs contractually submit to examination and oversight by the program bank's regulators. Moreover, a bank regulator has the authority to fully examine and oversee all parts of a bank's ledgering and recordkeeping processes, including those handled by a third party service provider. Bank regulators only need to exercise the authority they already have over these fintechs in order to prevent the catastrophic consumer harm that they are causing. While new and amended rules and regulations are welcome, it is more important to consider what existing tools are already immediately available to bank regulators.

FDIC states that its "mission is rooted in maintaining public confidence in the banking system, which heavily relies on the prompt and accurate payment of insured deposits. Any inaccuracies or discrepancies in the relevant records can delay a deposit insurance determination, leaving depositors in a state of uncertainty during a critical time." [Notice at 80136] IBC agrees, and that is why BaaS programs and the fintechs that offer them need to be restrained from acting as banks at all, and certainly without appropriate regulatory oversight. While banks should have the authority to contract with software and service providers that can assist the bank in maintaining its ledger and records, it is the bank's responsibility. Banks should not have the authority to completely delegate their legal obligations to non-bank, unregulated fintechs, and the appropriate regulator must examine banks and fintechs that are brokering these relationships.

2. <u>Regulators can address BaaS programs and fintechs without undermining a bank's authority to engage traditional bank service providers</u>.

There is a fundamental difference between a bank appropriately engaging a service provider to assist the bank in meeting its regulatory and business obligations and inappropriately subcontracting its obligations to a fintech. With a service provider, such as a bank core software provider or a technology provider, the depositor is under no delusion that they are engaged with anyone other than their bank. With BaaS programs offered by fintechs, consumers can be misled to think all accounts and services are being offered directly from the fintech, including FDIC-insured deposit accounts that may not have sufficient records from the fintech to support pass-through insurance. A customer could enter into a BaaS program with a fintech and have no idea who the program bank actually is, have no direct access to or means to communicate with the program bank, or have no way to ensure their consumer rights and protections are being fully observed. It is this misleading about the nature of the relationship that fundamentally differentiates a traditional bank service provider from a fintech and BaaS program.

IBC is concerned that FDIC does not appear to make a distinction between appropriate engagement of traditional bank service providers and newly minted BaaS programs offered by fintechs. FDIC states that "widespread use of digital channels, including websites and mobile applications [] created new opportunities and options to deliver financial products and services to consumers." [Notice at 80135] The internet and online banking are not wholly novel tools. Banks have offered these options for decades, and

BaaS programs and fintechs' use of them are decidedly *not* simply using technology to offer financial products and services. BaaS programs are expressly structured to confuse customers about who they are entering into a relationship with and who is holding their funds. BaaS programs are simply fintechs renting the charter of a bank to offer banking products and services without appropriate regulatory oversight and restrictions. Banks engaging software vendors and web developers to offer bank services and financial technology to customers is a far cry from a fintech surreptitiously renting a bank's charter to offer the exact same banking products and services to consumers without being subject to the same regulatory oversight and examination as banks. Banks are relying on fintechs to meet their regulatory compliance burdens, such as BSA/AML, consumer disclosures and error resolution, and Community Reinvestment Act compliance requirements, but regulators are failing to exercise their authority to oversee and regulate these fintechs in the same manner as chartered, FDIC-insured banks. It is these practices and failures that must be restrained, or consumers will continue to be harmed.

FDIC and other bank regulators must address this issue, and strictly limit and oversee the types of BaaS programs that it will allow to continue, if any.

3. <u>The federal banking regulators should actually exercise the power they have, via law and contractual terms, to oversee and regulate fintechs</u>.

If federal banking regulators will continue to allow BaaS programs, the regulators need to actually exercise their authority to regulate and audit fintech partners of banks. Most fintechs enter into BaaS relationships under authority that requires them to submit to state and federal bank regulators. Many, if not all, BaaS programs contain contractual terms requiring the same. The Notice states that the new rules will require certain additional, specific contractual requirements between banks and fintechs for BaaS programs. [Notice at 80143] However, it is IBC's understanding that these BaaS programs generally already have such contractual requirements. But, a contract is only as valuable as the amount of oversight expended to ensure each party complies with its terms and dutifully fulfills its obligations. For example, the Evolve/Synapse partnership contractually required Synapse to maintain sufficient deposit account and ledger records. But no one, not Evolve or the regulators to which Synapse agreed to be subject, took any interest in auditing or overseeing Synapse to ensure it was fulfilling its contractual obligations.

It does not seem that regulators use their power to do anything of use regarding these BaaS programs and simply let the fintechs run amok until the program publicly fails due to the fintechs' ineptitude. Regulators likely already have sufficient authority, via BaaS contractual terms between banks and fintechs, to regulate, oversee, and audit fintechs and the proposed rule is only lip service until regulators act on their already existing power. Regulators should make oversight of fintechs offering BaaS programs a regular part of their examination and supervisory functions. Regulators already have this authority and are not appropriately exercising it. Instead of trusting banks to do appropriate due diligence and exercise sufficient oversight of these programs and fintechs, regulators should be leading that charge.

IBC urges the FDIC to reconsider the proposed recordkeeping for custodial accounts. While IBC agrees that the increased enmeshment of banks and fintechs is a large cause for concern and increased oversight of non-banks offering access to financial products and services is necessary, the proposed rules are simply not sufficient to address the consumer harm that BaaS programs are causing. IBC recommends that the FDIC exercise its existing authority to greatly restrict the ability of non-banks to offer BaaS and related financial products and services, especially those that are inappropriately accepting and receiving consumer deposits without sufficient legal authority and regulatory oversight and examination.

Thank you for the opportunity to share IBCs views on these matters.

INTERNATIONAL BANCSHARES CORPORATION

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Dennis E. Nixon
President and CEO