[redacted]
Sioux Falls, SD 57103
[redacted]

Submitted Via E-Mail (comments@fdic.gov)

November 18, 2024

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments—RIN 3064—AF99
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: RIN 3064-AF99
Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

Dear Mr. Sheesley:

The Bancorp Bank, N.A. ("Bancorp") appreciates the opportunity to provide comments in response to the Federal Deposit Insurance Corporation's ("FDIC") Notice of Proposed Rulemaking ("NPR") regarding proposed revisions to the FDIC's brokered deposit regulation.[1]

The NPR proposes to essentially rescind the FDIC's 2020 Final Rule ("2020 Final Rule")[2], which established a modern and well-vetted framework adapting to today's banking marketplace where financial technology companies ("FinTechs") are increasingly assisting insured depository institutions ("IDIs") in developing stable deposit relationships with previously unbanked and underbanked customers. Under the 2020 Final Rule, such deposit relationships were properly classified as non-brokered deposits (subject to certain notice and application requirements).

The 2020 Final Rule recognized the potential benefits offered by modern FinTech-facilitated deposit programs to unbanked and underbanked customers, which include no- or low-fee checking accounts, fee-free overdrafts, and expedited direct deposit access. These features stand in stark contrast to the high fee bank accounts offered by traditional IDIs that all too often were the only banking options available to unbanked and underbanked customers, which also typically lacked the low-cost liquidity features of FinTech-facilitated deposit programs.

For the reasons stated below, Bancorp respectfully requests that the FDIC withdraw the NPR, and maintain the 2020 Final Rule's balanced approach of recognizing that such FinTech-facilitated deposit relationships are low-risk and align more closely with lower risk "core deposits," rather than an ill-fitting and "square peg, round hole" comparison to higher risk "brokered deposits."

[1] *Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions*, 89 Fed. Reg. 68244 (August 23, 2024).
[2] *Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions*, 86 Fed. Reg. 6742 (January 21, 2021).

Bancorp is a nationally chartered bank headquartered in Sioux Falls, South Dakota which provides nonbank financial companies with the people, processes and technology to meet their unique banking needs. Our business partners range from small business startups to companies on the Fortune 500 and those in between. For over 20 years, our goal has been to provide our partners with distinguished service and innovative solutions.

2020 Final Rule

Following a rigorous review process spanning nearly two years (which also included two separate public "notice and comment" periods[3]), the FDIC issued its 2020 Final Rule permitting IDIs to exclude the following (among other exclusions) from being considered a brokered deposit:

- Deposits facilitated by a third party, and such third party only facilitates the placement of deposits with one IDI ("Exclusive Deposit Placement Exception");[4]

- 100% of depositors' funds that the third party assists with placing at an IDI (with respect to a particular business line) are placed into transactional accounts that do not pay any fees, interest or other renumeration to the depositor (subject to FDIC notice requirements) ("Enabling Transaction Exception");[5] and

- In cases where depositors' funds (with respect to a particular business line) are placed with an IDI into transactional accounts, and such accounts do pay fees, interest or other renumeration to the depositor, the 2020 Final Rule created an application process for the FDIC to grant an exception for such funds being considered brokered deposits (the "Application Exception").[6]

In its preamble to the 2020 Final Rule, the FDIC noted the rapidly evolving banking environment brought by significant changes in technology, and that the 2020 Final Rule was necessary to modernize the FDIC's brokered deposit regulations to adapt to such marketplace changes:

> "Significant technological changes have affected many aspects of the banking industry, including the manner in which banks source deposits. For many banks, brokered deposits are an important source of funds, and the marketplace for brokered deposits has evolved in response to technological developments and new business relationships. ***The FDIC recognizes that its regulations governing brokered deposits are outdated and do not reflect current industry practices and the marketplace.*** As such, the FDIC initiated an extensive rulemaking process to seek input from stakeholders and to develop new regulations that take into consideration current industry practices and that allow for continued innovation.
>
> …

[3] *See* 84 Fed. Reg. 2366 (February 6, 2019) (Advance Notice of Proposed Rulemaking) and 85 Fed. Reg. 7453 (February 10, 2020) (Notice of Proposed Rulemaking).
[4] 12 CFR 337.6(a)(5)(ii)-(iii).
[5] 12 CFR 337.6(a)(5)(v)(I)(1)(ii). The notice requirement for the Enabling Transaction Exception is set forth in 12 CFR 303.243(b)(3).
[6] 12 CFR 337.6(a)(5)(v)(I)(2). The application requirement for the Application Exception is set forth in 12 CFR 303.243(b)(4)(i).

> Through this rulemaking process, the FDIC attempted to ensure that the brokered deposit regulations would continue to promote safe and sound practices ***while ensuring that the classification of a deposit as brokered appropriately reflects changes in the banking landscape***" (emphasis added).[7]

Furthermore, the 2020 Final Rule also acknowledged the strong consumer benefits of modernizing the FDIC's brokered deposit regulations to exclude low-risk deposits facilitated by FinTechs:

> "***The rule generates benefits to banks and consumers if deposit placement arrangements that do not present undue funding risk are not classified as brokered deposits.*** Changes and innovations in deposit placement activity are likely to continue, suggesting that demand for, and utilization of, certain types of deposit accounts currently classified as brokered are likely to grow in the years to come. These could include the use of technology services that help enable payments and online marketing channels that refer customers to certain banks. ***To the extent that the rule results in such deposits as being non-brokered, it could support ease of access to deposit placement services for U.S. consumers***" (emphasis added).[8]

NPR

The NPR would, in one fell stroke, entirely upend the carefully considered 2020 Final Rule by removing the exemptions noted above, and making virtually all IDI deposits facilitated by FinTechs considered brokered by default.

While the NPR would provide a mechanism for an IDI to apply for an exception for such deposits,[9] the IDI must prove that the primary purpose of the IDI's arrangement with the FinTech is for a substantial purpose other than to provide a deposit placement service or obtain FDIC deposit insurance.[10] This would be an exactingly high standard, and by the FDIC's own admission in the NPR, a standard that FinTech arrangements meeting the Enabling Transaction Exception would likely not meet.[11] As such, all such deposit arrangement would likely revert to being considered brokered under the NPR.

This reversion to the pre-2020 Final Rule regulation entirely dismisses the FDIC's reasoned analysis regarding the need for the brokered deposit regulation to keep pace with the evolving banking landscape brought by technology, and the banking benefits offered to consumers by such technological changes. Indeed, these marketplace changes have only accelerated since the issuance of the 2020 Final Rule, underscoring the need to maintain the 2020 Final Rule's flexibility.

The NPR is largely premised on the following viewpoints:

- IDI deposits facilitated by FinTechs pose safety and soundness risks due to their "precarious" and "highly unstable" nature, with the FinTech or underlying depositors able to move funds based on

[7] 86 Fed. Reg. 6742.
[8] 86 Fed. Reg. 6742, 6761.
[9] 89 Fed. Reg. 68244, 68254.
[10] 89 Fed. Reg. 68244, 68255.
[11] *Id*.

market conditions or other factors.[12] The NPR also cites recent developments regarding Synapse Financial Technologies, Inc. ("Synapse") as support for the need of the NPR;[13] and

- IDIs (particularly less than well-capitalized IDIs) may use FinTech deposit facilitation relationships to fund rapid growth without corresponding growth in risk management practices, which can expose IDIs to operational, liquidity and legal risks.[14]

Bancorp respectfully disagrees with the FDIC's viewpoints noted above for the following reasons:

(1) FinTech-Facilitated Deposits are Stable and Low-Risk: IDI deposit relationships facilitated by FinTechs represent stable and low-risk deposits that do not exhibit the characteristics of traditional, higher-risk brokered deposits, but rather are much more closely aligned to "core deposits."[15] Thus, considering such relationships as brokered will not meaningfully increase an IDI's safety and soundness;

(2) The IDI Supervisory Process is Best Suited to Manage FinTech Risk: The prudential banking regulators are far better suited through the supervisory process to address concerns related to an IDI's management of the operational, liquidity and legal risks posed by such FinTech-facilitated deposits, rather than the attempting to manage such risks through the FDIC's brokered deposit regulation. Indeed, the prudential banking regulators have recently initiated significant supervisory activity to address such risks; and

(3) The NPR May Reduce Access to Unbanked and Underbanked Consumers: Many FinTech-facilitated deposit programs provide banking services to unbanked and underbanked customers, including providing products and services specifically tailored to the needs of the unbanked and underbanked demographic. By classifying FinTech-facilitated deposits as brokered, the NPR may make such smaller-balance deposits much less attractive to IDIs, reducing the amount of such banking programs available to unbanked and underbanked customers.

FinTech-Facilitated IDI Deposit Relationships Are Stable and Difficult to Move

A key risk identified by the FDIC related to brokered deposits are their less stable nature – in other words, a brokered deposit might flee if the broker (or underlying depositor) moves funds to another IDI in the event that the IDI becomes troubled, or if interest rates are better elsewhere.

However, FinTech-facilitated deposits face substantial contractual, legal and operational obstacles encumbering their movement from an IDI, and thus do not pose the "flight risk" of a traditional brokered deposit.

[12] 89 Fed. Reg. 68244, 68250.
[13] *Id*.
[14] *Id*.
[15] As the FDIC noted in the NPR, "core deposits" are not defined by statute. Rather, core deposits are defined in the Uniform Bank Performance Report (UBPR) as the sum of all transaction accounts, money market deposit accounts (MMDAs), nontransaction other savings deposits (excluding MMDAs), and time deposits of $250,000 and below, less fully insured brokered deposits of $250,000 or less. 89 FR 68244, 68245 (fn 15). *See also* FDIC Study on Core Deposits and Brokered Deposits (July 8, 2011), pages 4-5, available at https://www.fdic.gov/regulations/reform/coredeposit-study.pdf.

Contractual Obstacles

As an initial matter, prior to launching any FinTech-facilitated deposit program, the IDI and FinTech will typically enter into a contractual agreement that will govern the IDI's offering, and the FinTech's servicing (on behalf of the IDI), of such deposit program ("Program Agreement"). A Program Agreement will frequently include a multi-year term, where the FinTech contractually commits to continually provide services to the deposit program during such multi-year term.

Additionally, a Program Agreement may contain significant financial disincentives for the FinTech to seek termination (and the accompanying transfer of deposits to another IDI) of the deposit program with the IDI. As such, a FinTech typically cannot simply move a deposit program facilitated by such FinTech to another IDI without running into strong contractual headwinds.

Legal Obstacles

Customers of a FinTech-facilitated deposit program usually enter into an account relationship directly with the IDI. The customer generally must enter into the IDI's deposit account agreement ("Account Agreement") when opening the account with the IDI, with the Account Agreement being directly between the IDI and the customer. The Account Agreement establishes the debtor-creditor account relationship between the IDI and the customer, with the IDI responsible for paying the deposit to the customer upon the customer's demand.

The FinTech usually is not a party to the account relationship between the IDI and customer, and thus has no contractual authority or control over the customer's deposits.

Additionally, the IDI will typically hold the customer's deposits in an IDI-owned and -controlled account at the IDI, meaning that only the IDI has custody and control of the customer's deposits. In this situation, the FinTech has no access to such IDI-controlled account or the customer deposits held in such account, and thus further lacks the legal and practical capability to move the customer deposits to another IDI.

As such, in FinTech-facilitated deposit programs, the FinTech generally lacks the legal or operational capability to unilaterally move a customer's deposit to another IDI.

Operational Obstacles

Movement of a FinTech-facilitated deposit program to another IDI is generally an exception case, given several operational stumbling blocks that must be cleared prior transfer to another IDI. Due to these significant operational hurdles, IDIs and FinTechs typically only seek to move such deposit programs in the event of a Program Agreement ending, or the IDI and FinTech mutually agreeing to wind-down the deposit program at the IDI.

The below summarizes the arduous operational processes required to transfer a FinTech-facilitated deposit program to another IDI:

- The FinTech likely would need to undergo rigorous due diligence by the new IDI, in addition to negotiating an extensive Program Agreement with the new IDI.

- The new IDI may be required under the Bank Merger Act to seek their federal prudential regulator's approval for the former IDI to assign, and for the new IDI to assume, the customer's deposits.[16]

- The FinTech may need to facilitate the customer's affirmative acceptance of the new IDI's Account Agreement.

- The FinTech may need to facilitate the issuance of new payment network-branded debit cards to customers that bear the new IDI's network-issued Bank Identification Number ("<u>BIN</u>"), in addition to identifying the new IDI as the debit card's issuer.

- Each IDI has a unique Routing Transit Number ("<u>RTN</u>") (also known as an ABA routing number), which is essential for the delivery of a customer's ACH direct deposit transactions (such as payroll). The customer would be required to update their direct deposit instructions to reflect the new IDI's RTN (in addition to potentially a new account number), which is a disruptive process for the customer.

- If the former IDI and new IDI utilize differing third-party processors, the transition to a new processor may require extensive technical development and testing.

While individual depositors may seek to move their FinTech-facilitated deposits to pursue a better interest rate or if the IDI experiences a material adverse event, in many cases such deposits are generally relatively small balance accounts, with a significant customer focus on transactions, rather than interest rates. Additionally, most customer individual balances in such programs are substantially below the FDIC deposit insurance maximum of $250,000, thus FDIC deposit insurance concerns are typically rare. Accordingly, deposit "flight risks" driven by individual depositors are likely low.

Given the above contractual, legal and operational obstacles impairing a FinTech from moving deposits from a FinTech-facilitated deposit program to another IDI, such deposits do not represent the "hot money" withdrawal risk of brokered deposits. Rather, FinTech-facilitated deposits much more closely resemble the characteristics of a "core deposit," which are identified by the FDIC as stable and lower cost.[17]

In fact, FinTech-facilitated deposit programs are the diametric opposite of traditional brokered deposits. Traditional brokered deposits are most often readily and quickly purchased by IDIs, typically in relatively large amounts. However, IDIs that are utilizing FinTech-facilitated deposit programs must make substantial investments in ant-money laundering, consumer compliance and risk management practices and personnel prior to collecting any such FinTech-facilitated deposits, and such deposit programs typically start small and only experience significant growth over time.

[16] 12 USC 1828(c)(2).
[17] *See* FDIC Study on Core Deposits and Brokered Deposits (July 8, 2011), page 5, available at https://www.fdic.gov/regulations/reform/coredeposit-study.pdf

Recent Bank Failures Did Not Involve FinTech-Facilitated Deposits

The NPR also looks to the recent failure of First Republic Bank ("FRB") as a basis for its proposal to remove the 2020 Final Rule's brokered deposit exclusions.[18] The NPR notes that FRB experienced a significant run on affiliated sweep deposits, and in particular uninsured affiliated sweep deposits.[19]

However, affiliated sweep deposits are starkly different from the stable and "hard to move" FinTech-facilitated deposits described above. Additionally, the vast majority of FinTech-facilitated deposits are well within the FDIC deposit insurance maximum of $250,000, further differentiating such deposits from uninsured affiliated sweep deposits.

Critically, Silicon Valley Bank ("SVB") also did not fail as a result of FinTech-facilitated deposit programs. Rather, SVB's failure was significantly due to SVB's concentration in venture capital and private equity customers, with such customers having substantial amounts of uninsured deposits, which led to such customers withdrawing their funds when they became concerned about SVB's financial condition.[20]

SVB's failure also clearly illustrates a much larger risk that is not addressed in the FDIC's brokered deposit regulations – large balance, non-brokered commercial accounts (with some funding from higher rate money market and certificates of deposit), which represent significant flight risks when IDIs experience troubled financial conditions. As noted above, FinTech-facilitated deposit programs are typically smaller balance deposits which are "sticky," and are typically significantly below the FDIC's deposit insurance $250,000 maximum.

The Bank Supervisory Process Better Positioned to Address FinTech-Facilitated Deposit Risks

The NPR cites recent events involving Synapse to demonstrate the volatile nature of FinTech-facilitated deposits.[21] However, these events were not caused by any volatility in the FinTech-facilitated deposits related to these programs, but rather due to operational issues unrelated to the nature of the deposits themselves.

In Synapse's case, Synapse was a FinTech "middleware" provider that facilitated deposits for multiple IDIs from various FinTech programs. These IDIs relied upon Synapse to maintain certain information necessary for the IDIs to reconcile customer accounts. Synapse filed bankruptcy in April 2024, and the affected IDIs were unable to obtain such reconcilement information from Synapse, which significantly impaired the affected IDIs from determining customer ownership interests in the IDIs' pooled custodial accounts holding customer funds.[22]

---

[18] 89 Fed. Reg. 68244, 68245.
[19] *Id*.
[20] *See Material Loss Review of Silicon Valley Bank*, Office of Inspector General, Board of Governors of the Federal Reserve System, Evaluation Report 2023-SR-B-013 (September 25, 2023), see pages 13 and 15, available at https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf.
[21] 89 Fed. Reg. 68244, 68250.
[22] *See* Chapter 11 Trustee's Second Status Report (June 13, 2024), In re Synapse Financial Technologies, Inc., Case No: 1:24-bk-10646-MB (Bankr. C.D. Cal. R. April 22, 2024), available at https://www.cravath.com/a/web/35oE6X3To78RBSqhCBM2t5/9bU16A/9890-268-06_13_2024-pacer268-main-document-012731-00001-central-district-of-california.pdf.

Such reconcilement issues were not caused by the fact that the IDIs' deposits themselves were facilitated by Synapse, but would appear to be caused by operational gaps in the custodial account reconcilement processes between the IDIs and Synapse.

The FDIC's brokered deposit regulation is not suited in any meaningful way to address operational risks between an IDI and FinTech. Rather, any remedial measures should be addressed by the prudential banking regulators either during the supervisory process, or in a separate rulemaking proceeding. Indeed, the FDIC has recently issued a Notice of Proposed Rulemaking that would create new IDI recordkeeping and reconcilement requirements that would potentially address the issues experienced by the IDIs in the Synapse instance.[23]

Similarly, the federal prudential banking regulators recently issued the "*Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services*" ("Joint Statement")[24]. The Joint Statement summarizes the prudential banking agencies' extensive guidance on third-party relationships, in addition to detailing effective IDI risk management practices that the agencies have observed in IDIs management of their third-party partnerships.

In conjunction with the Joint Statement, the prudential banking regulators also issued a Request for Information ("RFI") inviting comments on the nature of IDI-FinTech relationships, including the benefits and risks, effective risk management practices and the implications of such relationships, including whether enhancements to existing supervisory guidance may be helpful in addressing risks associated with such relationships.[25]

The prudential banking regulators also issued in 2023 new interagency guidance to IDIs related to risk management practices of third-party relationships ("Interagency Third-Party Guidance"), which recognized that IDIs were increasingly forming relationships with third-party FinTechs.[26] The Interagency Third-Party Guidance unified each banking agency's previous separately issued guidance on third-party risk management into one guidance document, in part to further assist IDIs in identifying and managing risks related to this increased use of FinTechs.

Additionally, the prudential banking regulators are already actively supervising IDIs that are offering FinTech-facilitated deposit programs, and have brought several recent public enforcement actions against IDIs related to their management of FinTech-related deposit programs.[27]

Accordingly, important and substantial work is already well underway by the prudential banking regulators (including the FDIC) to address the operational, liquidity and legal risks that FinTech-facilitated deposit programs may pose to IDIs. Attempting to address such operational, liquidity and legal risks via the brokered deposit regulation is a "square peg, round hole" use of the rule, whose purpose

---

[23] *Recordkeeping for Custodial Accounts*, 89 Fed. Reg. 80135 (October 2, 2024).

[24] *Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services* (July 25, 2024), available at https://www.occ.treas.gov/news-issuances/news-releases/2024/nr-ia-2024-85a.pdf.

[25] *Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses,* 89 Fed. Reg. 61577 (July 31, 2024).

[26] *Interagency Guidance on Third Party Relationships: Risk Management*, 88 Fed. Reg. 37920, 37923 (June 9, 2023).

[27] *See, e.g.,* Cease and Desist Order Issued Upon Consent, Evolve Bank & Trust, Docket Nos. 24-012-B-HC & 24-012-B-SM (June 11, 2024) (Federal Reserve Board); Consent Order, Blue Ridge Bank, N.A., AA-ENF-2023-68 (January 24, 2024) (Office of the Comptroller of the Currency); Consent Order, Thread Bank, FDIC 24-0022b (May 21, 2024)) (Federal Deposit Insurance Corporation).

rather is to manage the unrelated risks of rate-chasing deposits that are easily movable by a deposit broker.

Furthermore, attempting to address operational, liquidity and legal risks presented by FinTech-facilitated deposit programs may impede, and potentially even conflict with, the rapidly scaling efforts by the prudential banking regulators to separately address such IDI risks.

Small-Balance FinTech-Facilitated Deposits Programs May Become Less Attractive to IDIs

A primary benefit identified by the FDIC of the 2020 Final Rule was its potential to provide greater access to the financial system to unbanked and underbanked customers. The 2020 Final Rule's noted the following:

> "To the extent that the rule result in such deposits as being non-brokered, it could support ease of access to deposit placement services for U.S. consumers. ***Unbanked or underbanked customers, for example, may benefit from increased ease of access to deposit placement services because banks would be more willing to accept deposits that would be no longer considered brokered under the final rule"*** (emphasis added).[28]

Many FinTech-facilitated program deposit programs focus on providing banking services to both unbanked and underbanked consumers with relatively small balances, who may be unable to open bank accounts with larger IDIs. Such deposit programs may also offer lower customer fees than larger IDIs, while providing financial products and services specifically tailored to meet the specific needs of the unbanked and underbanked demographic.

Re-classifying FinTech-facilitated deposits as brokered would result in IDIs potentially paying higher FDIC deposit insurance assessments. Additionally, brokered deposits also often carry a negative stigma within the banking industry. As such, FinTech-facilitated, small balance deposits may become less attractive to IDIs, which could result in IDIs exiting FinTech-facilitated deposit programs, further excluding unbanked and underbanked customers from the banking system.

Grandfathering Request

In the event that the FDIC opts to finalize the NPR and remove the 2020 Final Rule's exemptions, Bancorp respectfully requests that the FDIC continue to allow the following to be considered non-brokered: (a) existing programs that presently qualify for the Exclusive Deposit Placement Exemption;[29] (b) existing programs where prior notice has been filed for the Enabling Transaction Exemption;[30] or (c) existing programs where the FDIC has already granted approval of an application for an Application Exemption.[31]

This grandfathering request is appropriate and necessary, as IDIs and FinTechs have structured deposit programs and accompanying financial terms on the critical assumption that such programs are non-brokered under the 2020 Final Rule. Reverting FinTech-facilitated deposits to being considered brokered

[28] 86 Fed. Reg. 6742, 6761-62.
[29] 12 CFR 337.6(a)(5)(ii)-(iii).
[30] 12 CFR 337.6(a)(5)(v)(I)(1)(ii).
[31] 12 CFR 337.6(a)(5)(v)(I)(2).

may require IDIs to redesign existing deposit programs already in the market (or remove them altogether), and revise financial terms with the FinTechs.

Conclusion

In sum, Bancorp strongly urges the FDIC to withdraw the NPR, and maintain the careful and thoughtful balance struck by the 2020 Final Rule. For the reasons noted above, the NPR would not lead to an increase in an IDI's safety and soundness, and prudential banking regulators are already moving to address IDIs' management of the operational, liquidity and legal risks raised by the NPR. Additionally, the NPR would unnecessarily reduce banking options to unbanked and underbanked customers, putting at risk the no- or low-cost features that such customers have come to rely upon, and which are not generally made available to them by traditional IDIs.

If the FDIC opts to move forward with the NPR, Bancorp respectfully requests the exemption of existing FinTech-facilitated deposit relationships from being considered brokered.

Thank you for the opportunity to comment. If you have any questions or wish to discuss this letter, please contact Brian Axell at baxell@thebancorp.com.

Sincerely,

[redacted]

Paul Frenkiel
Chief Financial Officer
The Bancorp Bank, N.A.