October 22, 2024

Via email and www.regulations.gov

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

Re: Notice of Proposed Rulemaking on Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, RIN 3064-AF99 (the "Proposed Rule")

Dear Mr. Sheesley,

This response is being submitted by Paxos Trust Company, LLC (Paxos). Paxos is a New York limited purpose trust company that is regulated by the New York State Department of Financial Services (NYDFS). Paxos provides a range of services associated with digital assets, including stablecoin issuance; custody and management of USD stablecoin reserves; and cryptocurrency services, such as providing the trading and liquidity services that enable Paxos' enterprise partners to provide their customers functionality to buy, hold, sell and transfer cryptocurrency. Paxos holds custodial assets, including bank deposits, U.S. Treasury bills, and repurchase agreements, under stringent fiduciary regulations. The Proposed Rule would disrupt a model that is already heavily regulated by state laws and introduce unnecessary burdens without a corresponding benefit to financial stability.

1. Impact on Fiduciary Institutions: Misapplication of PPE and Deposit Broker Classification

The Proposed Rule fundamentally alters the framework under which entities like Paxos operate by restricting the Primary Purpose Exception (PPE) to insured depository institutions (IDIs). This disqualification of non-IDI fiduciary institutions such as Paxos from applying for the PPE would automatically classify them as deposit brokers, despite the essential distinction between fiduciaries and deposit brokers.

Paxos, as a regulated NYDFS trust company, operates under New York Banking Law, which imposes strict obligations regarding the safekeeping and segregation of customer assets. The customer funds that Paxos holds "for the benefit of" its customers are legally segregated and are not available for speculative banking activities. The oversight provided by NYDFS ensures that Paxos's operations are subject to extensive reporting and compliance requirements aimed at protecting customer assets. This comprehensive state-level regulation makes Paxos's activities fundamentally different from the kind of risky growth behavior that brokered deposit regulations were originally designed to address under Section 29 of the Federal Deposit Insurance Act (FDIA).

By classifying Paxos as a deposit broker, the rule would impose unnecessary regulatory burdens, including redundant reporting obligations and compliance requirements, while also placing an unjustified regulatory burden on the receiving banks. These banks would face higher FDIC insurance premiums, increased liquidity coverage requirements, and stricter oversight, despite the fact that FBO customer funds do not contribute to systemic risk. Given the regulatory safeguards already provided by NYDFS and New York Banking Law, this additional federal oversight is unnecessary and redundant.

2. *Overextension of Section 29 of the FDIA*

The FDIC's Proposed Rule misapplies Section 29 of the FDIA, which was designed to restrict undercapitalized banks from relying on brokered deposits for rapid asset growth. Section 29 was enacted in the wake of the savings and loan crisis in response to the risky behavior of banks using brokered deposits to expand their balance sheets at an unsustainable pace. However, Paxos's fiduciary role as a custodian of segregated customer funds does not align with these concerns.

Paxos's customer funds are legally segregated under New York Banking Law, meaning they cannot be used by the receiving IDI to support any speculative growth. These funds are held for the exclusive benefit of Paxos's clients and remain protected from any risky activities the bank may engage in. The receiving bank cannot leverage these funds (Ex. 12 CFR 9.13) and they, therefore, do not contribute to the systemic risks that Section 29 of the FDIA was designed to mitigate.

Thus, applying brokered deposit regulations to Paxos's FBO customer funds creates an unnecessary regulatory mismatch. These funds are already protected by stringent state laws and fiduciary obligations, ensuring their safety and soundness. Given that neither Paxos nor the receiving bank can use these funds to speculate, the application of Section 29 brokered deposit regulations is not appropriate.

3. *Reliance on Outdated Data and Noncompliance with APA Standards*

The FDIC's justification for the Proposed Rule relies heavily on its 2011 study on brokered deposits, which fails to account for the significant evolution of fintech, fiduciary institutions, and digital banking services. The reliance on this outdated data raises serious concerns under the Administrative Procedure Act (APA), which requires agencies to base their rulemaking on up-to-date and accurate information.

Today's financial landscape is markedly different from what it was in 2011. Partnerships, such as those between Paxos and banks, play an increasingly important role in expanding access to financial services, particularly for underserved communities. The Proposed Rule fails to acknowledge these developments and, as such, risks stifling innovation without addressing any genuine risk to financial stability. To meet APA standards, the FDIC must reassess its reliance on outdated data and conduct a more thorough analysis of the current role of fintech and fiduciary institutions in the financial system.

4. *Dodd-Frank Provides Sufficient Systemic Risk Protections for Paxos's Bank Partners, Not Paxos*

The Dodd-Frank Wall Street Reform and Consumer Protection Act established extensive protections to address systemic risks, particularly for systemically important financial institutions (SIFIs). One of the key tools under Dodd-Frank is the Orderly Liquidation Authority (OLA), created under Title II of the act, which enables the FDIC to wind down failing SIFIs in a controlled manner to avoid broader financial instability.

As noted above, Paxos's customer funds are legally segregated under New York Banking Law and cannot be used by the receiving bank for speculative purposes or risky asset growth. These funds are not susceptible to the systemic risk concerns that Dodd-Frank is designed to mitigate.

The FDIC's Proposed Rule unnecessarily extends brokered deposit regulations to fiduciary institutions like Paxos, even though Paxos's role does not contribute to the systemic risks Dodd-Frank is trying to mitigate. Dodd-Frank's existing safeguards for SIFIs are sufficient to protect the financial system, especially as IDIs already fall under this oversight framework. The Proposed Rule's expansion of brokered deposit regulations to Paxos, which operates under strict fiduciary obligations, would impose duplicative and unnecessary burdens on both Paxos and its banking partners.

5. *Excessive Paperwork Burdens Violate the Paperwork Reduction Act*

The Proposed Rule introduces additional reporting requirements for firms like Paxos, despite the fact that Paxos is already subject to extensive compliance and reporting obligations under NYDFS oversight. The Paperwork Reduction Act (PRA) mandates that federal agencies minimize paperwork burdens by ensuring that any reporting requirements serve a clear regulatory purpose.

Paxos already provides comprehensive reports to the NYDFS, including financial audits, internal controls, and customer asset segregation reports. The FDIC's Proposed Rule would introduce redundant reporting requirements, creating an excessive administrative burden without improving financial stability. This violates the PRA's goal of reducing unnecessary paperwork and regulatory burdens.

6. *EGRRCPA's Deregulatory Intent and the FDIC's Proposed Rule*

The Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) was enacted to provide regulatory relief primarily to insured depository institutions, especially community banks that do not pose systemic risks. While Paxos, as a non-depository fiduciary, is not directly impacted by EGRRCPA, the Act's deregulatory intent benefits Paxos's banking partners, which may fall under its provisions. By easing regulatory burdens on community banks and encouraging innovation, EGRRCPA fosters greater financial inclusion through fintech partnerships, which are core to Paxos's business model.

The FDIC's Proposed Rule could undermine the spirit of EGRRCPA, particularly by imposing new regulatory burdens on these IDIs in their collaborations with fintech firms. Subjecting such partnerships, like those with prudentially regulated trusts like Paxos, to brokered deposit regulations could create additional compliance hurdles, counteracting the deregulatory objectives of EGRRCPA. By imposing stricter rules on the handling of custodial assets, the FDIC risks stifling innovation and limiting the ability of community banks to engage in safe, well-regulated partnerships that expand access to financial services.

Thus, we recommend that the FDIC revisit the Proposed Rule to ensure that it aligns with the deregulatory framework of EGRRCPA and avoids imposing unnecessary regulatory burdens on institutions that do not present systemic risks. A more tailored approach would allow for continued innovation and financial inclusion through fintech-bank partnerships, while still maintaining financial stability.

Conclusion and Recommendations:

- Retain the exclusive deposit arrangement exemption to avoid overregulating fiduciary institutions like Paxos that do not pose systemic risks;
- Allow exemptions for non-IDI fiduciary institutions in order to maintain a balanced and flexible regulatory framework;
- Limit the scope of Section 29 of the FDIA to focus on institutions that engage in speculative activities, rather than fiduciaries;
- Update the data and analysis used to support the rule to ensure that decisions are based on current fintech and fiduciary banking practices;
- Align the rule with EGRRCPA's deregulatory goals, and minimize redundant paperwork under the PRA.

Paxos believes that by adopting a more tailored approach, the FDIC can achieve its goals of enhancing safety and soundness while supporting innovation, financial inclusion, and responsible fiduciary practices. We thank you for the opportunity to comment.

Respectfully,

[redacted]

Charles Cascarilla
CEO & Co-Founder
Paxos