



Corporation
211 Main Street
San Francisco, CA 94105

June 4, 2020

Via Electronic Delivery

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: Brokered Deposits Restrictions (RIN 3064-AE94)

Ladies and Gentlemen:

In response to the request for comments by the Federal Deposit Insurance Corporation (FDIC) on a Notice of Proposed Rulemaking to revise its brokered deposit regulations (the Proposal),¹ The Charles Schwab Corporation (Schwab), a full service financial services company serving retail investors and depositors throughout the United States, is pleased to submit these comments. We applaud and greatly appreciate the efforts of the FDIC Board and staff to provide greater clarity in this complex area as product and technological developments have outpaced the agency's existing brokered deposits regulations and interpretations issued by the staff over the last 30 years.

Schwab strongly supports the provisions of the Proposal that recognize a primary purpose exception to the definition of a deposit broker for broker-dealer programs that "sweep" customer funds into deposit accounts at one or more banks and the proposed terms of such exception. We are requesting clarification of certain terminology utilized in the proposed primary purpose exception and are recommending modification of the proposed application process to eliminate the regulatory burdens that would be created by requiring every broker-dealer sweep program to be reviewed and approved by the FDIC, particularly sweep programs that deposit customer funds in affiliated banks. In addition, we urge the FDIC to utilize its

¹ 85 FR 7453 (Feb. 10, 2020).

brokered deposit regulations and other regulatory tools to differentiate between deposits that have stable characteristics and those that are less stable, whether or not such deposits are deemed to be “brokered”.

Schwab’s Business Model

Schwab is a savings and loan holding company that engages, through its subsidiaries, in wealth management, securities brokerage, banking, asset management, custody and financial advisory services. With over 12.9 million active brokerage accounts and client assets in custody of over \$3.8 trillion, we are one of the largest financial services firms in the United States.

Schwab offers securities brokerage and banking services through Charles Schwab & Co., Inc., a broker-dealer registered with the Securities and Exchange Commission (CS&Co.), and three wholly-owned FDIC-insured subsidiary banks - Charles Schwab Bank, SSB (Schwab Bank), Charles Schwab Premier Bank, SSB and Charles Schwab Trust Bank (collectively, the Banks). While each of these separate entities service clients directly, our “One Schwab” approach to client service focuses on a client’s specific financial needs, not which entity provides the product or service. Indeed, many deposit and lending products are offered to clients through programs at CS&Co., though Schwab Bank accepts deposits and make loans directly to clients.

The logical outcome of this approach is that our clients view our investment and banking services as offered collectively under the Schwab brand, not offered by a specific Schwab entity.

Schwab participates in the national deposit markets in three fundamental ways: (i) through the Bank Sweep program, a service CS&Co. provides to our brokerage clients to automatically deposit, or “sweep”, uninvested cash in their brokerage accounts into deposit accounts at one or more of our three Banks; (ii) our “High Yield Investor Checking” and “High Yield Investor Savings” deposit accounts that are offered by Schwab Bank, both directly to the public through Schwab Bank’s website and by referral from CS&Co.’s financial advisors; and (iii) offering the certificates of deposit (CDs) of unaffiliated banks to our brokerage customers. As brokered CDs are not the subject of the Proposal and will continue to constitute brokered deposits, we will not discuss that product in this letter except in the context of our business line comments below.

We note that our Bank Sweep program has been granted a “primary purpose” exception (PPE) to the definition of “deposit broker” set forth in Section 29(g)(2)(I) of the Federal Deposit Insurance Act (FDI Act)² as interpreted in FDIC Advisory Opinion 05-02 (Advisory Opinion).³ As a result, deposits placed with the Banks under the program are not deemed “brokered”

² 12 U.S.C. §1831f (2020).

³ FDIC Staff Advisory Opinion 05-02 (February 3, 2005), available at <https://www.fdic.gov/regulations/laws/rules/4000-10350.html>.

deposits. Schwab Bank currently reports the checking and savings accounts at Schwab Bank that are opened with the involvement of a CS&Co. financial advisor or at a CS&Co. branch office as “brokered” even though the clients establish such accounts directly with Schwab Bank.

Our experience over nearly two decades with deposits originating through both the Bank Sweep program and the checking and savings deposit account customers referred by our CS&Co. to Schwab Bank is that these deposits have the characteristics of “core” deposits: they are stable deposits with long durations that are not sensitive to movements in interest rates paid to customers.

Deposits at the Banks originated through the Bank Sweep program have had long durations, both through the last financial crisis and as interest rates on our sweep deposits have declined.⁴ In fact, during the recent financial markets turbulence, our sweep deposits have increased significantly, reflecting in part our customers’ collective de-risking of their investment portfolios.

The Proposal

If adopted, the Proposal would provide clarity on a number of brokered deposit issues, including, *inter alia*, the availability of the PPE to various third-party deposit arrangements. The PPE is included in both the FDI Act⁵ and FDIC regulations,⁶ and excepts a person from being a deposit broker if the person is: “An agent or nominee whose primary purpose is not the placement of funds with depository institutions.” As a result, deposits placed pursuant to this exception are not “brokered deposits.”

The FDIC staff has historically taken a narrow view of this exception. As noted above, in 2005 the staff did grant a brokerage firm a PPE for its sweep program on the basis that the funds deposited through the program with its affiliated bank were awaiting investment. The staff imposed certain conditions on the sweep program, including limiting the amount of the deposits that could be placed with the affiliated bank to 10 percent (the permissible ratio) of the customer assets held by the broker for the customers in the sweep program and a limit on fees paid by the bank to the broker. In addition, a report had to be provided to the FDIC each month demonstrating that the permissible ratio requirement had been met during the prior month.

⁴See Letter from Peter Morgan to Mr. Robert deV. Frierson et al. commenting on the Federal banking agencies proposed liquidity coverage ratio rule, Appendix A, (January 31, 2014), available at https://www.federalreserve.gov/SECRS/2014/February/20140226/R-1466/R-1466_013114_111947_335277918335_1.pdf

⁵ 12 U.S.C. §1831f.

⁶ 12 C.F.R. §337.6 (2020).

Despite the fact that this was staff guidance and not a regulation adopted by the FDIC, the conditions in the Advisory Opinion have operated as de facto regulatory requirements. In addition, although there is no application process provided for in Section 29 or the FDIC's implementing regulations, in order to obtain PPEs, banks and broker-dealers have been required to submit a written request to the staff describing how the conditions in the Advisory Opinion are being met and receive staff approval.

The Proposal would adopt a more expansive view of the PPE and would implement a formal application procedure for third parties or insured depository institutions to confirm the availability of the exception. The Proposal identifies two types of arrangements that would be deemed to meet the exception, subject to a streamlined application process. An application may be submitted in connection with any other arrangement, but it would be subjected to greater scrutiny by the FDIC.⁷

The first arrangement that would qualify for the exception is where less than 25 percent of the total assets an agent or nominee has under management for its customers in a particular business line is placed with depository institutions. The Proposal provides an example of how this new interpretation would be applied in the case of a broker-dealer's bank sweep program: A firm that offers brokerage accounts to various types of customers that allow customers to buy and sell securities and other financial products with a traditional bank sweep option would meet the PPE if the amount of customer funds it places in deposit accounts is less than a quarter of the total amount of customer assets it manages for its broker-dealer business.

Unlike the current PPE for brokerage firm bank sweep programs, this exception is not limited to programs with affiliated banks. In addition, the proposal would increase the permissible ratio from 10 percent to 25 percent and eliminates other restrictions in the Advisory Opinion.

The second arrangement deemed to qualify for the exception is for an agent or nominee that places customer funds into transactional accounts for the purpose of enabling payments. The exception is available only if no interest, fees or other remuneration is provided to the depositor.

Arrangements other than the two arrangements deemed to qualify for the exception may apply to the FDIC to receive the PPE. An applicant would be required to provide greater information to the FDIC in its application than an applicant offering one of the two arrangements deemed to be excepted, including information about marketing activities and fees. Further, the FDIC would not grant an exception if the agent or nominee promotes its deposit placement

⁷ 85 FR 7459-60.

service to “encourage savings”, “maximize yield”, “provide deposit insurance”, or any similar purpose.⁸

Comments on Specific Aspects of the Proposal

A. Considerations that Should Inform the FDIC’s Policies Concerning Deposit Funding

We agree that the definition of deposit broker is out of date and needs to be re-aligned with changes in technology and market practices. At the same time, we believe that there is merit to the FDIC differentiating between deposits that are less stable and those that are more stable, regardless of their characterization as “brokered” or “non-brokered” for purposes of Section 29 and the FDIC’s current and proposed brokered deposits regulations. In this regard, we note that the presence or absence of a third-party in either placing, or facilitating the placement of, deposits is, at most, only indirectly related to the underlying stability of those deposits. Additional factors such as any affiliation between the third party and the depository institution need to be taken into account in making this determination.

The legislative history of the restrictions on brokered deposits in the FDI Act does not provide any definitive guidance on what policies the FDIC should seek to promote in implementing the statute.⁹ However, Schwab respectfully submits that the FDIC’s brokered deposit regulations, along with any guidelines on what constitutes a core deposit, should be used to distinguish between more stable deposits resulting from placement arrangements offered by third parties and less stable deposits from arrangements where the third party is more likely to withdraw the deposits based on changes in the interest rates on the deposits or fees paid to the third party without reasonable notice to the bank. This should go hand in hand with identifying deposits that are not originated through third parties that are equally unstable due to the use of teaser or other interest rate inducements as “non-core” deposits. This would give the regulators the ability to accurately assess various types of deposit funding and implement consistent policies in their regulations and guidance that reflect the underlying nature of these various deposit funding sources.

We believe these policy considerations should be incorporated into the version of the final rule adopted by the FDIC. The Proposal offers a good starting point to develop a framework to better identify certain volatile funding sources, but needs refinement as we recommend below. We also believe that related policies, as reflected in the definition of core deposit, the liquidity coverage ratio regulations, and deposit insurance premium calculations

⁸ 85 FR 7460.

⁹ See Paul T. Clark, *Just Passing Through: A History and Critical Analysis of FDIC Insurance of Deposits Held by Brokers and Other Custodians*, 32 REV. BANKING & FIN. L. 99, 135-137 (2012), available at <https://www.bu.edu/rbfl/files/2013/09/Just-Passing-Through.pdf>.

should be reviewed in light of the goal of accurately identifying volatile deposit funding sources and practices to avoid misaligned incentives in other contexts.

B. Deposit Arrangements Deemed Qualified for the PPE Based on Line of Business and Assets under Management

We strongly support the FDIC's approach of granting certain deposit arrangements a presumption of qualification for the PPE and, specifically, sweep arrangements offered by broker-dealers that deposit customer funds in one or more affiliated banks. As demonstrated by the data provided by Schwab in its comment letter on the proposed liquidity coverage ratio rule, deposits directed by a broker to an affiliated bank have all the characteristics of core deposits. Furthermore, the funds of our customers that are swept to our Banks are funds that result from deposits used by customers to later purchase investments, interest payments, dividends and sales of securities. Those funds are awaiting investment in longer term investment products, as we fully disclose to our customers. Schwab's primary purpose in offering this service to its customers, and the primary purpose of many other broker-dealers in offering similar services, as recognized in the 2005 Advisory Opinion, is not the offering of a deposit placement service.

1. Affiliate Bank Sweep Programs Should Be Exempted from Any PPE Application Process

Schwab appreciates the FDIC's proposal to make the PPE permanently available for sweep programs offered by broker-dealers where the 25 percent permissible ratio test is met.¹⁰ In such instances, under the Proposal the FDIC would only require: (1) a description of the business line for which the applicant is filing an application; (2) the total amount of customer assets under management by the third party for that particular business line; and (3) the total amount of deposits placed by the third party on behalf of its customers, for that particular business line, at all depository institutions.¹¹

We believe, however, that the FDIC should go further than it has in the Proposal by (i) permitting affiliated bank sweep programs that have already received confirmation that they qualify for the PPE (Confirmed Sweep Programs) and are reporting deposit balances monthly to the FDIC to proceed under the new 25 percent permissible ratio test for bank sweep programs without submitting an application to the FDIC and (ii) providing that all other affiliated bank sweep programs that have not received confirmation (Unconfirmed Sweep Programs) may qualify for the PPE merely by notifying the FDIC that their sweep deposit program business

¹⁰ FDIC Staff Advisory Opinion 20-01 (March 19, 2020) [temporarily granting a 25 percent permissible ratio], available at <https://www.fdic.gov/regulations/laws/rules/4000-10420.html>.

¹¹ The FDIC also indicated that "An application would also need to include a description of the deposit placement arrangement(s) with the IDI or IDIs and the services provided by any other third parties involved." See 85 FR 7461.

lines meet the 25 percent test and thereafter providing periodic reports to the FDIC to confirm that they continue to comply with the test.

Exempting Confirmed Sweep Programs from the application requirement is both warranted and preferable for several reasons. First, the FDIC is very familiar with such programs, having already determined that these programs are for a primary purpose that is other than the placement of deposits with depository institutions. Further, these programs already provide monthly reports to the FDIC as a condition of the exception. Given the previous approvals and ongoing scrutiny these programs already receive from the FDIC, there is no need for the FDIC to further review these programs. Requiring an application for Confirmed Sweep Programs would impose unnecessary costs, delays and uncertainty for those required to file applications, especially in the event that, as many predict, the FDIC is inundated with a large number of PPE applications in a relatively short period of time following adoption of the final rule.

With respect to the Unconfirmed Sweep Programs, we believe that it also serves no useful purpose to require an application to confirm that these programs qualify for the PPE. A notification to the FDIC should be sufficient, as monthly reports will be filed concerning compliance with the 25 percent permissible ratio test. The FDIC could require that the notice contain relevant information concerning the program, such as a description of the operation of the program and the relevant line of business. However, the program should be deemed to have qualified upon filing of the notice, assuming that the program's business line description is consistent with the example provided by the FDIC in the Proposal, subject to the FDIC later objecting to some aspect of the program or business line described in the notice.

2. A Higher Standard for Non-Affiliated Bank Sweep Programs

Under the Proposal, a broker-dealer's sweep program with a non-affiliated bank or banks would be deemed to meet the PPE, subject to the streamlined application process. We believe that while such programs may be eligible for the PPE, they should be subject to more rigorous scrutiny than set forth in the Proposal due to the higher volatility of those deposits as reflected, among other ways, in their higher outflow treatment under the liquidity coverage ratio rule.¹² In our experience, some, though not all, of these programs: change banks in the program periodically without notice; move customer funds between banks to realize higher referral fees or other more favorable terms; or promote the program as a means to attract new customers by offering higher interest rates. Deposits at a bank in such a program may be withdrawn suddenly if the broker is offered a higher referral fee or other more favorable terms by another bank or if it has any concerns about the bank's financial condition. These concerns are greatly reduced in the

¹² Compare 12 C.F.R. §249.32(g)(7) (10 percent outflow rate for fully-insured affiliated bank sweep deposits) with 12 C.F.R. §249.32(g)(8) (25 percent outflow rate for fully-insured non-affiliated bank sweep deposits).

case of affiliated bank sweep programs, where a broker-dealer is not going to take any actions that would be adverse to its affiliated bank(s).

Consequently, we believe that the non-affiliated bank sweep programs should be subject to greater scrutiny and, among other things, should be required to respond to the following questions:

1. Are banks in the program not clearly identified to the depositors?
2. Can the banks in the program be changed or customers' funds be moved between banks without prior notice?
3. Are the fees paid to the broker by the banks higher than what a broker could charge an affiliated bank under Section 23A of the Federal Reserve Act and Regulation W?
4. Is the program marketed by comparing the interest paid to customers relative to what other programs are paying?

Affirmative answers to these and similar questions should weigh against these programs qualifying for PPE status.

3. Clarifying the Scope of the New PPE Test

A few of the terms used in the Proposal need further clarification in order to define the proper scope of the PPE test. The Proposal's description of the term "business line" appears very straightforward in the context of broker-dealer sweep programs, and in our view the example in the preamble of the Proposal should be codified in the final rule.¹³ In this regard, we request that the FDIC clarify that the term would encompass all accounts at a broker in which customers can buy and sell securities and other financial products and that offer a traditional bank sweep program.

In addition, the Proposal uses the term "assets under management" to describe the customer assets at a broker-dealer. That terminology has a specific meaning in the securities industry and refers to assets managed by a registered investment adviser that would typically

¹³ The only change we would recommend is the inclusion of brokered CDs with non-affiliated banks in the customer asset base used to determine compliance with the proposed 25 percent permissible ratio test. For our customers, brokered CDs are just another type of fixed-income investment, and there is no reason to exclude them from a sweep deposit program business line. Inclusion of brokered CDs as a part of customers' total assets would not result in those brokered CDs being treated as non-brokered deposits for the non-affiliated issuing banks.

have investment discretion over the assets.¹⁴ While many broker-dealers, including CS&Co., are dually registered with the SEC as brokers and investment advisers, not all clients avail themselves of advisory services. Utilizing the term in its accepted meaning, deposits swept from the accounts of the vast majority of brokerage clients who do not have managed accounts would not qualify for the PPE.

We believe a more appropriate term is “assets under custody”. The essential service that every broker provides to customers is the safe custody of the customers’ assets. Indeed, SEC regulations specifically address the obligations of a broker to maintain “possession or control” of a customer’s securities and other financial assets.¹⁵ Assets outside the broker’s control cannot be included on customer statements and, in our view, should be excluded from the scope of the assets used in the new PPE test.

C. Referrals from Affiliates

If adopted, the Proposal would permit the employees of certain separate legal entities to be treated as employees of the bank. Specifically, employees of a wholly-owned subsidiary of a bank would be deemed employees of the bank for purposes of the exception from the definition of deposit broker for deposits placed with a bank by its employees. The subsidiary may only engage in activities permissible for a bank.

The Proposal does not address deposits referred by employees of an affiliate of a bank where the affiliate does not satisfy the new wholly-owned subsidiary test. The existing staff guidance as set forth in the June 30, 2016 brokered deposits staff guidance, or “Frequently Asked Questions”, is ambiguous as to whether deposits resulting from referrals by employees of an affiliate are “brokered”.¹⁶ If they are considered brokered, the guidance would permit them to be re-classified as non-brokered after one year, assuming no on-going involvement of the affiliate or its employees. On-going involvement includes access to the depositor’s deposit account information in order to provide investment advice. Similarly, the Proposal would include within the definition of “facilitation” the ability of the third party to obtain deposit account information from the bank.

The deposits referred by CS&Co. are stable and long term. A deposit account opened on the Schwab Bank website or at a CS&Co. branch office as a result of a referral from a CS&Co.

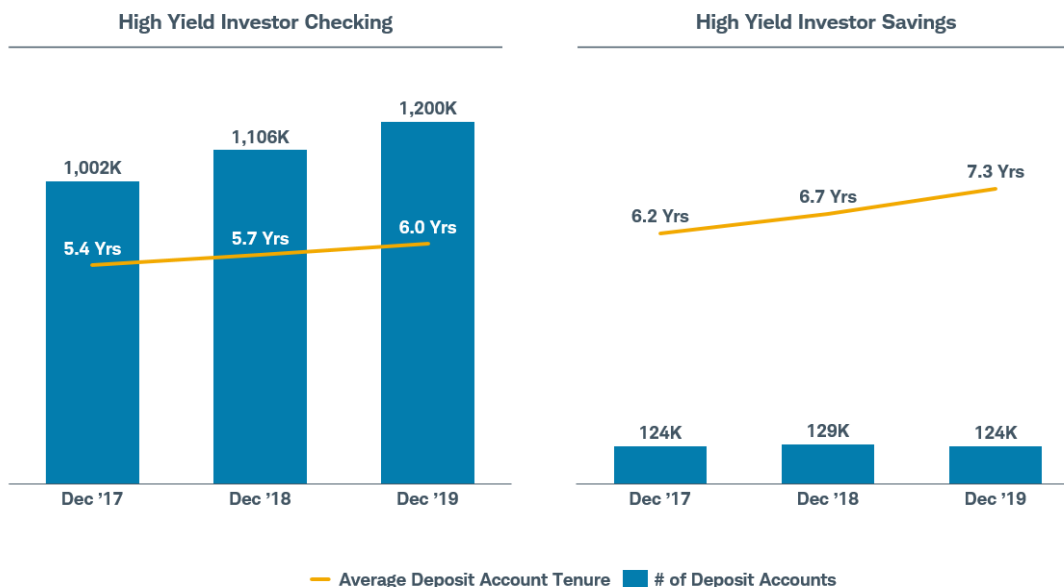
¹⁴ See, e.g. SEC Form ADV Instructions, at 6, “In determining the amount of your regulatory assets under management, include the securities portfolios for which you provide continuous and regular supervisory or management services as of the date of filing this Form ADV.” Available at <https://www.sec.gov/rules/final/2016/ia-4509-appendix-b.pdf>.

¹⁵ See 17 CFR 240.15c3-3(b) (2020).

¹⁶ FDIC “Identifying, Accepting and Reporting Brokered Deposits Frequently Asked Questions,” FAQ no. F-3 (June 30, 2016), available at <https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf>.

financial advisor is qualitatively no different than an account opened without such a referral. The stability of the deposit account relationships referred by CS&Co. to Schwab Bank have all the characteristics of core deposits. As demonstrated by the chart below, the number of deposit accounts and the duration of those deposits have increased over each time period reflected in the chart.

Schwab has a stable deposit account base, with steady growth in average account tenure



In light of the stability of deposit accounts referred by broker-dealers such as CS&Co. to affiliated banks, we respectfully request that the FDIC revise its position on such referrals. Specifically, we request that the sharing of customer information by affiliated banks and broker-dealers, and any resulting access that a broker may thereafter have to customer deposit information, in accordance with applicable law, (i) not be deemed “facilitation” for purposes of the definition of deposit broker in the Proposal and (ii) not preclude re-characterization of deposits from “brokered” to “non-brokered” after the account had been open for 12 months.

The privacy provisions of the Gramm Leach Bliley Act¹⁷ specifically permit affiliates to share customer information without approval of the customer, and a customer cannot opt out of this type of information sharing. This type of information sharing is intended to promote the design and marketing of financial products that meet the needs of customers of the two affiliates. The FDIC’s utilization of customer information sharing among affiliates as a factor in determining whether an affiliate is a deposit broker or has continuing involvement with a deposit

¹⁷ See 15 U.S.C. §§6801-6809.

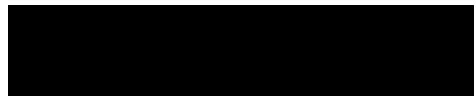
account conflicts with this public policy. Use of this factor also does not adequately account for modern business models such as Schwab's where banking and other financial services are offered in an integrated manner under a single brand.

It would also be helpful to the industry to clarify under what circumstances a mere referral of a customer to a bank from an affiliate would cause the deposits to be "brokered". We believe that, by itself, a referral of a customer by a broker to its affiliated bank in which the customer opens the deposit account directly with the bank should not be brokered.

* * * *

Schwab appreciates the Board's and its staff's efforts in the Proposal to provide much-needed clarity regarding the circumstances under which an entity may qualify for the PPE, particularly in the case of a broker-dealer offering an affiliated bank sweep program to its customers. Thank you, again, for the opportunity to comment on the Proposal. We are available to address any questions and welcome the opportunity for further dialogue to discuss or clarify the issues discussed herein.

Sincerely yours,

A solid black rectangular box used to redact the signature of Celeste Molleur.

Celeste Molleur
Vice President, Regulatory Liaison Office