Arnold & Porter

June 9, 2020

VIA ELECTRONIC MAIL [*comments@fdic.gov*]

Mr. Robert E. Feldman
Executive Secretary
Attn: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; RIN 3064-AE94

Dear Mr. Feldman:

This letter is being submitted in response to the Notice of Proposed Rulemaking published by the Federal Deposit Insurance Corporation (the "FDIC") in the *Federal Register* on February 10, 2020 regarding proposed revisions to the FDIC's regulations relating to the definition and regulation of brokered deposits (the "Proposed Rule").[1] We appreciate having this opportunity to present our views on the Proposed Rule.

I. Background

The stated objective of the Proposed Rule is to create a new framework for analyzing Section 29 of the Federal Deposit Insurance Act (the "FDI Act"), 12 U.S.C. § 1831f, and the FDIC's regulations thereunder, 12 C.F.R. § 337.6. Those regulations impose restrictions on the acceptance by insured depository institutions that are recently organized or not "well capitalized" (within the meaning given to that term under Section 38 of the FDI Act and the FDIC's regulatory capital rules)[2] of any deposit obtained, directly or indirectly, by or through any "deposit broker," and limits the amount of interest that such institutions may offer on brokered deposits. But the broader impact of the regulations is to define a "brokered deposit" in an expansive manner that is incorporated by reference into Call Reporting requirements, liquidity risk measurement

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[1] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7,453 (Feb. 10, 2020) (hereinafter the "Proposing Release"). On April 3, 2020, the FDIC announced a 60-day extension of the public comment period for the Proposed Rule.

[2] 12 U.S.C. § 1831o(b)(1)(A); 12 C.F.R. § 324.403(b)(1)(i).

requirements, and deposit insurance assessment calculations—all of which impose a chilling effect and a financial burden on all banks, including well-capitalized, well-managed banks that have operated successfully for many years, regarding the type and amount of deposit arrangements they are willing to accept.

In February 2019, the FDIC published an Advance Notice of Proposed Rulemaking seeking public comment on potential modifications to the FDIC's brokered deposits regulations (the "ANPR").[3] The ANPR was published in response to years of criticism from industry participants regarding the fragmented and opaque nature of the legal framework used to classify deposits as brokered, most of which was implemented in piecemeal through FDIC advisory opinions and interpretive guidance, and a large portion of which was not made available to the public.[4]

The Proposed Rule is designed to address these concerns, and to reflect technological advancements and innovations that have occurred in the banking and financial services sector since the enactment of the statute and the adoption of the FDIC's brokered deposits regulations, while preserving the underlying policy goals of those authorities.[5]

Our comments on the Proposed Rule are organized as follows: Part II of this letter contains our overarching comments and Part III of this letter contains our responses to the specific requests for comment posed by the FDIC in the release accompanying the Proposed Rule (the "Proposing Release").

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[3] Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2,366 (Feb. 6, 2019), *available at* https://www.fdic.gov/news/board/2018/2018-12-18-notice-sum-i-fr.pdf (hereinafter, the "ANPR"). We submitted comments to the FDIC on February 6, 2019 in response to the ANPR.

[4] *See* Remarks by FDIC Chairman Jelena McWilliams on "Brokered Deposits in the Fintech Age" at the Brookings Institution, Dec. 11, 2019, *available at* https://www.fdic.gov/news/news/speeches/spdec1119.pdf ("As the banking landscape has changed, and the permutations of how deposits are structured and offered have expanded, the FDIC's brokered deposits regime has struggled to keep up. For years, the FDIC faced difficult questions regarding whether different types of deposit arrangements should be reported as brokered. The FDIC responded to each of these questions on a one-off basis, typically through confidential letters or public or non-public staff advisory opinions. The result was the development of a fragmented, opaque legal regime that exists outside of the FDIC's public-facing regulations, understood by only a select few.").

[5] *See* Statement by FDIC Chairman Jelena McWilliams on the Notice of Proposed Rulemaking on Revisions to the Brokered Deposits Regulations; FDIC Board Meeting, Dec. 12, 2019, *available at* https://www.fdic.gov/news/news/speeches/spdec1219.pdf ("[The objectives of the Proposed Rule] are creating a more transparent and consistent process; minimizing risk to the Deposit Insurance Fund; ensuring consistency with the statute; and encouraging innovation in how banks offer services and products to customers . . . The [Proposed Rule] would establish a new, transparent framework for determining what qualifies as a brokered deposit. The framework reflects the transformative changes both in the banking industry and in how consumers interact with banks and access banking services while remaining faithful to the statute.").

II. Overview of Comments

The Proposed Rule seeks to provide long-awaited clarity for industry participants regarding a number of aspects of the existing brokered deposits regulations. We support the FDIC's efforts in this regard. There are, however, many issues presented by the Proposed Rule that will require further clarification and, in certain respects, may expand the categories of deposits presumptively treated as "brokered." This would, in turn, disrupt and restrict a number of types of deposit funding arrangements that we believe the FDIC, as a policy matter, does not wish to obstruct.

Summarized below are our general comments on the proposal:

- We believe the Proposed Rule suffers from certain defects in design and, if the Proposed Rule were to be adopted in its current form, the brokered deposits regulations would continue to be inconsistent in certain respects with the intended purposes of Section 29 of the FDI Act. For instance, the brokered deposits regulations would be more effective in carrying out these statutory purposes if those rules: (i) defined "deposit brokers" as third parties that have an agency relationship with and perform services for banks in respect of deposit funding arrangements that are initiated by the bank (thereby not capturing third parties that act on behalf of depositors), (ii) permitted bank affiliates to perform incidental activities on behalf of and for affiliated banks in respect of deposit funding arrangements without being viewed as "deposit brokers" under the "facilitation" prong of that definition, and (iii) did not establish a complicated administrative approval process for reliance upon the "primary purpose" exemption, but rather allowed that exemption to be self-executing as contemplated by the statute. These issues are discussed in greater detail in this summary and throughout our comments.

- Each of the statute and the existing brokered deposits regulations contains a general "primary purpose" exemption (as well as several similar more targeted exemptions, including for trusts) that by its terms is self-executing. By agency interpretation, the FDIC has penciled into the statute a requirement that each depository institution that receives sweep deposits from broker-dealers must separately seek and obtain its own determination from the FDIC to rely upon this exemption. The process for obtaining these determinations has historically been very slow and has imposed administrative burdens on banks, broker-dealers and the FDIC's own staff. The Proposed Rule would exacerbate this problem by branding a much broader range of deposit relationships as presumptively brokered, while also expanding the scope of the "primary purpose" exemption, and requiring each institution to seek and obtain its own FDIC determination that a particular arrangement is or is not a brokered deposit arrangement based on the overall context and purposes involved. Although the Proposing Release indicates that these determinations would be issued expeditiously, we are doubtful based on past experience that will be the case. The administrative burden this will place on the FDIC's own staff is large, as is the burden it will place on depository institutions and persons doing business with depository institutions. We anticipate that it will create a bottleneck to new deposit arrangements which, in turn, will create uncertainty and potentially inhibit banks from accepting categories of deposits that were not intended to fall within the scope of the brokered deposits regulations.

- In general, the framework set forth in the Proposed Rule continues to be designed to solve for a bank and thrift crisis from the 1980s that was addressed through much higher capital, liquidity and asset quality requirements. The proposed framework is not modeled to accommodate more recent marketplace innovations[6] or to address policy and risk management issues that have been identified by the FDIC in recent years, most notably those raised by the FDIC's 2011 study on core deposits and brokered deposits (the "FDIC Deposits Study").[7] The Proposing Release provides little insight as to what specific risks or policy issues various components of the Proposed Rule seek to address, in part because the FDIC has not provided citations to supporting material or references to the ANPR public comment record as support for the positions advanced by the Proposed Rule.

- The Proposed Rule's definition of the activities that would constitute "engagement in the business of facilitating the placement of deposits" within the FDI Act's definition of "deposit broker" would broaden the scope of that term and render a variety of deposit funding arrangements brokered without a clear rationale for doing so. The FDIC has over a number of years adopted a complicated web of advisory opinions and interpretive guidance on issues of "facilitation." We encourage the FDIC to adopt in any final rule a simpler, narrower and more functional approach to the "facilitation" prong of the "deposit broker" definition.

- The Proposed Rule's introduction of the "business line" concept within the proposed assets-under-management-based standard for reliance upon the "primary purpose" exemption from the definition of "deposit broker" does not align with how actual business lines and customer and product arrangements are structured in practice. Using deposit types to construct artificial "business line" parameters for this purpose generally will be a complicated and difficult

[6] For example, the increased use of automated systems and digital applications by a variety of public and private entities, many of which are linked to bank deposit accounts, to integrate cash management, payment and other systems in order to capture and analyze financial data in real-time.

[7] FDIC, Study on Core Deposits and Brokered Deposits, Submitted to Congress pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act at 54–56 (July 8, 2011) (hereinafter the "FDIC Deposits Study"), *available at* https://www.fdic.gov/regulations/reform/coredeposit-study.pdf.

task for industry participants. It will not map to how banks or their customers view the business lines of the bank.

- The Proposed Rule fails to address the status under the brokered deposits regulations of certain notable deposit types and funding arrangements (including, but not limited to, deposits of state and local governments and their investment pools, fiduciary accounts of investment advisers that are not bank trust departments, and deposits of externally-managed investment funds placed as principal), in certain cases by proposing rule provisions that are not entirely aligned with existing FDIC precedent.

III. Responses to Specific Requests for Comment

Set forth below are our responses to the specific questions presented in the Proposing Release regarding the Proposed Rule. Any question for which we have no specific response is omitted.

A. *Question 1—Is the FDIC's proposed definition of ''engaged in the business of placing deposits'' appropriate?*

We believe that the Proposed Rule's definition of "engaged in the business of placing deposits" continues the FDIC's expansion of the definition beyond what was envisioned by Congress. The legislative history of Section 29 of the FDI Act and its definition of "deposit broker" indicates that Congress intended for the restrictions set forth thereunder to apply only to the most "flagrant abusers" of the deposit insurance system that take excessive risks to the potential detriment of the Deposit Insurance Fund (the "DIF") and U.S. taxpayers, including by establishing interest rates and account terms that attract "hot money" deposits.[8] Congress never intended for Section 29 of the FDI Act to operate as broad prohibition on or regulation of banks' acceptance of deposits or as a clearinghouse for such deposits. Instead, the statute was meant to serve as a tool to limit the extent to which certain troubled institutions could, as a result of their deposit-taking activities, expose the DIF to undue risk. Congress acknowledged when enacting the statute that brokered deposits may serve as a useful source of funding for liquidity purposes, even for troubled institutions, and therefore intended for the statutory restriction to be applied selectively where the acceptance of brokered deposits by troubled institutions would be inconsistent with safe and sound banking practices.[9]

As commenters previously have communicated to the FDIC, deposits should be viewed as brokered under Section 29 of the FDI Act when the funding transaction is

[8] Testimony of Hon. Frank H. Murkowski, U.S. Senator from the State of Alaska, "Insured Brokered Deposits and Federal Depository Institutions," Hearing before the Subcommittee on General Oversight and Investigations of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 101st Congress, 1st Sess. (May 17, 1989); *see also* FDIC Deposits Study at 49–52.

[9] Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 1989, 402–403 (Aug. 4, 1989).

initiated by the bank, rather than by a prospective depositor with the assistance of a third party.[10] We agree with this view and recommend that any final rule includes as a key factor of the framework used to determine if a deposit is viewed as brokered whether the bank initiated the deposit process with the deposit broker acting as agent for the bank (by way of a fee agreement to "hire" their services) or, by contrast, whether the deposit broker is acting as an agent, representative or administrator of the depositor and/or providing services in respect of the funding arrangement generally.

In addition, as discussed further below, the application process set forth in the Proposed Rule for reliance on the "primary purpose" exemption of Section 29 of the FDI Act and the brokered deposits regulations[11] would create an enormous manual burden on depository institutions, third parties that provide various administrative services to depositors and depository institutions (but that may not be "agents" or "nominees" under the statute and regulations), as well as the FDIC staff. In order to limit the extent to which parties are required to rely on the "primary purpose" exemption, any final rule should, in the first instance, limit the parties that are captured by the definition of "deposit broker" in accordance with the original legislative intent behind the statute. Limiting the scope of the definition of "deposit broker" would also be consistent with the Proposed Rule's treatment of brokered certificates of deposit ("CDs") as such deposits are always initiated by the bank and the "deposit broker" in this context acts as the bank's agent in marketing and selling the CDs.

B. *Question 2—Is the FDIC's proposed definition of ''engaged in the business of facilitating the placement of deposits'' appropriate?*

The proposed definition of the "facilitation" prong of the "deposit broker" definition is not appropriate when applied in certain contexts. The Proposing Release states that "it is the FDIC's view that a level of control or influence indicates that the deposit relationship is between the depositor and the person rather than the depositor and the insured depository institution."[12] Although this is a logical policy objective, the following examples illustrate the inconsistent outcomes that can be produced under the "facilitation" definition as proposed:

- ***Example 1***: The Chief Financial Officer ("CFO") of a business contacts key banking relationships and asks for current rates on a money market savings account in response to a forecasted excess cash balance for a period of time.

[10] *See, e.g.*, Letter from Howard Headlee and Frank R. Pignanelli, Utah Bankers Association & National Association of Industrial Bankers, dated May 7, 2019, *available at* https://www.fdic.gov/regulations/laws/federal/2019/2019-unsafe-and-unsound-banking-practices-3064-ae94-c-096.pdf ("A true brokered deposit is initiated by the bank. Deposits are a commodity acquired from a broker whose business is to gather deposits in the same way a full service securities broker obtains stock for an investor or a commodities broker intermediates between buyers and sellers of raw materials.").

[11] 12 U.S.C. § 1831f(g)(2)(I); 12 C.F.R. § 337.6(a)(5)(ii)(I).

[12] Proposing Release at 7,457.

The CFO collects the rates and weights the choices against any applicable investment policy restrictions and selects the most appropriate deposit rate and counterparty. The CFO then wires funds from the business's operating account to a newly opened savings account at the selected depository institution.

- ***Example 2***: The CFO of a business hires a professional investment manager to handle in a separate account excess funds of the business and provide agreed upon investment guidelines. The investment manager contacts its key banking relationships in the same manner as described above and selects the same depository institution described in Example 1. The account is opened in the name of the business, but the investment manager possesses signing authority on the account and the right to access the account as a third party. The business pays a management fee to the investment manager, but the depository institution does not pay any fees or incentives to the investment manager.

In these examples, each of which is common in practice, the outcomes are the same for the depositor and depository institution, yet only the latter fact pattern would be captured by the "deposit broker" definition pursuant to the "facilitation" prong thereof, as amended by the Proposed Rule. Although the Proposing Release states the FDIC's view that when a person has a level of control or influence over the depositor, that person has the power to influence the movement of funds between institutions, thereby rendering the deposits over which the person has control or influence less stable, this view does not appear to be supported by any empirical evidence and was not addressed specifically in the FDIC's Deposits Study.[13] Accordingly, absent some form of compelling evidence to justify the above-described outcomes, we see no reason for the inconsistent treatment of the deposits placed under the arrangements described in our examples.

Further, the proposed "facilitation" definition is inconsistent with the FDIC's stated goal of prioritizing a general regulatory approach that encourages, and does not stifle, innovation in the banking sector.[14] The following examples illustrate how the Proposed Rule falls short of furthering this objective.

- The first prong of the proposed "facilitation" definition provides that a person who "directly or indirectly shares any third party information with [an] insured depository institution" in connection with the placement of deposits with that institution would be a "deposit broker." This prong of the definition would capture the core activities of essentially every financial technology ("<u>FinTech</u>") company or technology platform solutions provider performed for or on behalf of depository institutions. In our experience, banking

[13] *See* FDIC Deposits Study at 54–56.

[14] Remarks by FDIC Chairman Jelena McWilliams, *supra* note 4.

customers generally prefer to provide their personal information only once for ease of reuse in subsequent financial interactions. FinTech service providers that receive and store a consumer's credentials, for example, through a secure token identification process, and share verified consumer information with a depository institution in respect of a deposit transaction involving that consumer would become a "deposit broker" under the Proposed Rule.

- The second prong of the proposed "facilitation" definition provides that where a person "has legal authority, contractual or otherwise, to close [an] account or move [a] third party's funds to another insured depository institution" that person would be "facilitating" the placement of deposits. This prong of the definition would, for example, have a chilling effect on the use of certain efficient payment solutions, such as automated ACH payments between different accounts. To illustrate, consider a FinTech account management service that assists consumers in reducing their credit card debt or outstanding loan balances through automated debits to such accounts from excess funds supplied by accounts maintained with other institutions. Under the Proposed Rule, the use of such an automated service would render the underlying deposits brokered.

C. *Question 3—Is the FDIC's list of activities that would determine whether a person meets the ''facilitation'' prong of the ''deposit broker'' definition appropriate?*

In addition to the comments provided above, we believe that an essential factor underlying the activities that would meet the definition of "facilitation" is whether or not the person in question is acting on behalf of the bank or on behalf of the depositor. Where the person is acting as an agent of the depository institution, whether formally or informally, it would be appropriate for that person's activities to be considered potentially as "facilitation" activities. Where a person is acting on behalf of and at the direction of the depositor, that person's activities should not be viewed as "facilitation" activities because no services would be provided by an intermediary between a third party and a depository institution.

An FDIC staff memorandum to the public file for the Proposed Rule dated March 2, 2020 provides the staff's view that the "facilitation" prong of the "deposit broker" definition is not intended to capture activities by a third party that is interfacing directly with the depositor.[15] The FDIC should codify this position in any final rule and establish that activities carried out by a person in an agency capacity under the direction of the depositor are not "facilitation" activities.

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[15] Memorandum from Vivek Khare to Public File, Notice of Proposed Rulemaking, Brokered Deposits Restrictions (RIN 3064-AE94) (Mar. 2, 2020), *available at* https://www.fdic.gov/regulations/laws/federal/2020/2020-unsafe-unsound-banking-practices-brokered-deposits-3064-ae94-staff-001.pdf (hereinafter the "FDIC Staff Memorandum").

D. *Question 4—Has the FDIC provided sufficient clarity surrounding whether a third party intermediary would meet the ''facilitation'' prong of the "deposit broker" definition?*

The fourth "facilitation" activity discussed in the Proposed Rule—*i.e.*, acting as an "intermediary" between a third party that is placing deposits on behalf of a depositor and a bank—provides an exclusion for conduct performed in a "purely administrative capacity." The Proposing Release provides no explanation as to why this exclusion applies only to the fourth "facilitation" activity and not to any other such activity discussed in the Proposed Rule. The FDIC should clarify its intent with respect to the exclusion for "purely administrative" conduct. We believe that a third party's conducting of an "administrative function" incident to any activity viewed as a "facilitation" activity should be permissible.

With respect to the nature of an "administrative function" for purposes of the Proposed Rule, the Proposing Release states only that "reporting or bookkeeping assistance" provided to the person placing its customers' deposits with banks would constitute "administrative functions" and that "decision-making or steering persons" (including depositors) to banks would not be viewed as such.[16] Given the wide array of services provided by third parties as part of or incident to arrangements that involve the placement of deposits with banks, we believe that further clarity is needed. For instance, the FDIC should provide illustrative examples of the affirmative steps, if taken by a third party, that would constitute "decision-making or steering" of deposits to a bank. The FDIC should also provide guidance on what factors would be considered in determining whether a third party's conduct is "purely" administrative in nature.

E. *Question 5—Should the FDIC provide more clarity regarding whether any specific types of deposit placement arrangements would or would not meet the ''facilitation'' prong of the ''deposit broker'' definition? If so, please describe any such deposit placement arrangements.*

The Proposed Rule provides that a person's sharing, directly or indirectly, of third party information with an insured depository institution would constitute a "facilitation" activity. The Proposing Release does not make clear what would constitute "sharing" or "third party information" for purposes of this provision of the "facilitation" definition. Based on the text of the Proposed Rule, the provision of *any* information by a third party to a bank, even indirectly, would result in that third party being viewed as a "deposit broker." This would result in essentially every bank service provider that is involved, directly or indirectly, in a bank's deposit operations and that has access to "third party information" being captured by the definition of "deposit broker." This would produce an outcome inconsistent with the FDIC's historical approach to its treatment of a number of third party service arrangements under Section 29 of the FDI Act and its brokered

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[16] *See* Proposing Release at 7,457.

deposits regulations, including deposit listing services,[17] certain referrals by business professionals[18] and certain loan servicing, escrow and other operational functions.[19] The FDIC should either provide substantially greater clarity around the types of information sharing between third parties and banks that would be captured as a "facilitation" activity or consider removing this activity altogether from the definition.

In addition, the FDIC Staff Memorandum referenced above states the staff's position that certain marketing research or advertising functions and "general consulting and other advisory services" would not be covered by the "facilitation" definition "absent more involvement" by the person conducting the activity.[20] The FDIC should codify and expand upon the staff's position in any final rule and provide corresponding interpretive guidance on the substance and scope of these exclusions.

A variety of third-party intermediaries provide services in connection with the placement of deposits that could be, or presently are, viewed as "consulting" or "advisory" services. Consider the following examples:

- Investment advisers registered with the U.S. Securities and Exchange Commission ("SEC") are required to place their clients' assets in custody at a bank, trust company or securities' broker-dealer.[21] Such deposits are viewed as fiduciary deposits[22] and ordinarily are placed by the investment adviser under a broader advisory relationship, the "primary purpose" of which is not the placement of deposits with banks.

- Investment advisers, plan administrators, custodians and other third parties contract with local government investment pools ("LGIPs") to provide a variety of advisory, custodial and consulting services in respect of the management (typically by state treasurers or other state or local governmental officials) of the investments and cash balances of the LGIP.[23] LGIPs are not "deposit brokers"

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[17] *See* FDIC Adv. Op. 04-04 (July 28, 2004); FDIC Adv. Op. 92-54 (Aug. 3, 1992); FDIC, Identifying, Accepting and Reporting Brokered Deposits, Frequently Asked Questions, D2 (June 30, 2016) (hereinafter the "FAQs").

[18] *See* FDIC Adv. Op. 15-04 (Feb. 4, 2015); FAQs at B6.

[19] *See* FDIC Adv. Op. 17-02 (June 19, 2017).

[20] FDIC Staff Memorandum at 1.

[21] 17 C.F.R. § 275.206(4)-2.

[22] *See, e.g.*, 12 C.F.R. §§ 9.2 (defining a "fiduciary account" of a national bank to include investment adviser accounts) and 5.34(e)(5)(vii) (requiring that if a national bank wishes to accept fiduciary appointments for which fiduciary powers are required, then the national bank must have fiduciary powers its operating subsidiary also must have its own fiduciary powers under the law applicable to the subsidiary).

[23] LGIPs are exempt from registration as an "investment company" under the Investment Company Act of 1940. *See* 15 U.S.C. § 80a-2(b). The operations and investments of LGIPs are regulated under applicable state and local laws and regulations.

because they (i) invest their portfolio assets as principal, not as an agent, and (ii) operate diverse pools of assets that are not simply a means for third parties to invest in interests in insured bank deposits.[24]

- Forms of investment funds other than LGIPs, including SEC-registered investment companies and other investment funds that are exempt from registration, invest portions of their portfolios in insured bank deposits. Funds may be deposited as temporary cash balances awaiting investment or distribution, as collateral for other investments or transactions, or as bank CDs (potentially among other forms of deposits). These investment funds are legal entities that own the deposits for their own account as principal, and not as an agent. They are not "deposit brokers" for the same reasons as LGIPs as described above. These funds may be externally-managed and/or rely on services provided by third-party investment advisers, administrators and custodians.

In each of the above cases, a third party provides services that are, or could be, viewed as "advisory" or "consulting" services as an intermediary between a depositor and a depository institution in connection with the placement of deposits with that institution. We believe that the FDIC should confirm that the provision of such services would not be viewed as "facilitating" the placement of deposits. For additional discussion of these issues, please refer to our response to Question 11 below.

F. *Question 6—Is it appropriate for a separately incorporated operating subsidiary to be included in the IDI exception?*

We agree with the FDIC's decision to propose that bank operating subsidiaries be eligible for the IDI exception available under Section 29 of the FDI Act. Bank operating subsidiaries have long been viewed essentially as incorporated departments of their parent banks, rather than affiliates, and generally are subject to the same legal and regulatory requirements as their parent banks.[25] Accordingly, as acknowledged in the Proposing Release, deposit balances held with a depository institution that are owned by customers of an operating subsidiary of the bank should not be viewed any differently than deposits placed directly with the bank.[26]

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[24] *See* FDIC Adv. Op. No. 92-66 (Oct. 11, 1992) (without addressing LGIPs specifically, providing that the placement of deposits on behalf of other governmental entities by a third party administrator that operated alongside an LGIP was not viewed as deposit brokerage).

[25] *See* 12 C.F.R. §§ 250.141 & 5.34(e)(3); *see also* 12 U.S.C. §§ 371c & 371c; 12 C.F.R. §§ 223(k) & (w) (treating bank operating subsidiaries as being part of their parent banks for purposes of affiliate transaction restrictions) and 32.1(c)(2)(ii) (excluding loans by a bank to its majority-owned operating subsidiaries from loan-to-one-borrower limits).

[26] *See* Proposing Release at 7,458 ("There is little practical difference between deposits placed at an IDI by a division of the IDI versus deposits placed by a wholly-owned subsidiary of the IDI.").

G. *Question 7—Are the criteria for including an operating subsidiary in the IDI exception too broad or too narrow?*

The Proposed Rule would require that, for a bank subsidiary to be eligible for the IDI exception, the following criteria must be satisfied: (i) the subsidiary is an operating subsidiary that is 100% owned by the parent bank; (ii) the subsidiary places deposits of retail customers exclusively with the parent bank; and (iii) the subsidiary engages only in activities that are permissible for the parent bank. We offer the following comments on these requirements.

With respect to the first criterion described above, any operating subsidiary owned 50% or more by a bank should receive this treatment.

With respect to the second criterion described above, the FDIC should require that retail customer deposits be placed "primarily," rather than "exclusively," with the parent bank. As support for this modification, consider that bank CDs often are sold to registered investment advisers or securities broker-dealers. A bank's investment adviser or broker-dealer subsidiary that otherwise would qualify for the IDI exception should not be precluded from doing so based upon the fact that employees of the subsidiary, while acting in a fiduciary or agency capacity on behalf their clients, may purchase bank CDs from other banks in the names of their clients.[27] The exclusivity requirement set forth in the Proposed Rule is a standard that any investment adviser or broker-dealer subsidiary that invests in CDs or engages in insured deposit sweep arrangements on behalf of their clients would be incapable of satisfying. Accordingly, the requirement that a bank subsidiary "primarily" places its retail deposits with its parent bank would be a more functional standard. In addition, the Proposed Rule and Proposing Release do not provide any guidance on the meaning of the term "retail customer." To eliminate any potential confusion, the FDIC should clarify whether the term "retail customer" is intended to align with the definition of that term as set forth under the FDIC's liquidity risk measurement standards at 12 C.F.R. Part 329 and incorporated by reference to Part 329 in other FDIC regulations—or—if by referencing the deposits of "retail customers" in the second criterion the FDIC intended to exclude wholesale or commercial customer deposits altogether.

We believe the third criterion set forth in the Proposed Rule is unnecessary as bank operating subsidiaries generally are not permitted to engage in any activity that is not legally permissible for the parent bank and any activity that the subsidiary does conduct must be carried out in accordance with safe and sound banking principles so as

[27] The purchase of CDs in this fashion, especially in connection with the administration of a trust pursuant to which participants may elect to purchase CDs as part of an optional program distinct from the trust's primary investments or as a participation interest in a master CD, generally is viewed as engagement in the business of placing deposits under Section 29 of the FDI Act. *See*, *e.g.*, FAQs at E12.

to not endanger the safety and soundness of the parent bank.[28] Although a bank operating subsidiary may, under certain circumstances, engage in activities that the parent bank lacks the authority to conduct, these circumstances are somewhat limited and generally require regulatory approval. In any event, that a bank operating subsidiary may be permitted to engage in an activity that is not permissible for the parent bank does not alter the core legal status of the subsidiary as being treated as part of the bank and should have no bearing on the FDIC's determination to make available to bank operating subsidiaries the IDI exception established under Section 29 of the FDI Act.

H. *Question 8—Is it appropriate to interpret the primary purpose of a third party's business relationship with its customers as not placement of funds if the third party places less than 25 percent of customer assets under management for its customers, for a particular business line, at depository institutions? Is a bright line test appropriate? If so, is 25 percent an appropriate threshold?*

While we generally agree with the expansion of the "primary purpose" exemption and the implementation of a bright line test to determine its application, there are certain practical issues associated with the "business line" concept that has been embedded into the exemption language. For discussion of these issues, please refer to our response to Question 12 below.

With respect to the appropriateness of the 25% threshold, we are not aware of the statutory, regulatory or practical basis for this particular threshold.[29] Because there does not appear to be any clear statutory or other regulatory precedent for a 25% threshold, we would recommend that the FDIC establish in any final rule either a 50% threshold derived from the plain meaning of the word "primary," or demonstrate a legal basis for the establishment of a different, but comparable threshold.[30]

A 50% threshold would be consistent with the FDIC's approach to determining whether an agent or nominee may qualify for the "primary purpose" exemption. A key factor in that analysis is whether the agent or nominee receives a "majority" of its

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[28] *See* 12 C.F.R. § 5.34(e)(1)(i); Comptroller's Licensing Manual, Subsidiaries and Equity Investments at 9 (Jan. 2019).

[29] Statement by Martin J. Gruenberg, Member, FDIC Board of Directors on Notice of Proposed Rulemaking on Brokered Deposits (Dec. 12, 2019), *available at* https://www.fdic.gov/news/news/speeches/spdec1219c.html ("Furthermore, it is not clear how the 25% threshold was reached. There is no analysis provided to explain the basis for this change.").

[30] For instance, borrowing from the federal securities laws, the benchmark percentage of activity that constitutes the "primary" activity of an investment fund for purposes of registration as an "investment company" under the Investment Company Act of 1940 is defined at a 40% level measured in terms of the volume of the investment fund's assets that are invested in investment securities. *See* 15 U.S.C. § 80a-3(a)(1)(A).

revenue from deposit placement activity.[31] It is not clear based on this factor alone why a 25% threshold would be acceptable, but—for example—a 49% threshold would not. A 50% threshold would be a simple, reasonable standard that would limit the potential for overuse of the exemption, while also avoiding certain practical challenges associated with a lower threshold, such as where, as a result of marketplace activity outside of the control of the bank or third party, customer assets under management exceed, even temporarily, the 25% threshold.

To this end, the Proposing Release does not specify a methodology or frequency for the calculation of assets under management. The FDIC should clarify in any final rule the required approach to such calculation. Certain third parties, such as SEC-registered investment advisers, are subject to regulatory requirements for the calculation of assets under management, whereas as unregulated (or differently regulated) third parties may approach the calculation differently.[32] In any event, banks and third parties alike must be made aware of how frequently assets under management must be assessed, as well as the potential consequences of and remedies for exceeding the applicable threshold at any given time.

I. ***Question 9—Should the FDIC specifically provide more clarity regarding what is meant by customer assets under "management'' by a broker dealer or third party?***

Yes. While this concept works well for a traditional asset management arrangement (and/or in a broker-dealer scenario) we believe further clarity is required and highlight the following practical examples in in support of our view:

- Nearly all hedge funds and many private equity and venture capital funds use a third party for fund administration, which may perform certain "facilitation" activities as described in the Proposed Rule. We suggest clarifying in any final rule that "assets under administration" are viewed as "assets under management" so as to allow such third parties to avail themselves of the "primary purpose" exemption (whether as proposed under the Proposed Rule or pursuant to a broader standard as we suggest above).

- Broker-dealers and banks each may hold assets in custody for clients of which deposits may be a component; however, such assets generally are not viewed as being under the "management" of the broker-dealer or bank, as there is no

[31] *See* Proposing Release at 7,460.

[32] For Form ADV disclosure purposes, SEC-registered investment advisers are instructed to include in their regulatory assets under management securities portfolios for which they provide continuous and regular supervisory or management services as of the date of filing and must follow strict instructions regarding which assets may be treated as "securities" in connection with the valuation of their securities portfolios. *See* Form ADV, Item 5.F.

investment advisory relationship with the depositor. We suggest clarifying that "assets under custody" are viewed as "assets under management."

J. *Question 10—Is it appropriate to make available the primary purpose exception to third parties whose business purpose is to place funds in transactional accounts to enable transactions or make payments?*

Yes. However, to take advantage of the "transaction enabling" exemption, an agent or nominee would be required to place 100% of its customer funds into deposit accounts with banks and ensure that no fees, interest or other remuneration is provided to the depositor (while also submitting to an application process, which we address in greater detail below). We struggle to identify a practical business example where this standard would be satisfied.

The Proposed Rule's strict requirement that third parties receive no fees, interest or other remuneration is impractical. The ability to earn interest on funds placed in a deposit account (even if for only a single business day) or to receive fees for wire transfer processing or other related transaction services does not necessarily transform a third party's primary intent from processing ordinary business transactions (*e.g.*, for an operating account) into deposit placement activity. The Proposing Release states that where a third party or a bank provides any remuneration to a depositor, the FDIC would engage in a multi-factor analysis, including consideration of the volume of transactions in customer accounts and the nature of any fees, interest or other remuneration provided, to determine the applicability of the "primary purpose" exemption under the "transaction enabling" standard.[33] Although such an approach would need to be refined in a final rule and through interpretive guidance over time, its inherent flexibility would make the "transaction enabling" standard a more realistic standard to satisfy in practice.

We also note that the Proposed Rule is not clear on whether "earnings credits" (as allowed by the Board of Governors of the Federal Reserve System in its interpretation of Regulation Q on non-interest bearing transaction accounts) would be acceptable as the Proposed Rule would bar any "remuneration" on the account under the "transaction enabling" standard. In our experience, most business transaction accounts that do not earn interest would instead be eligible for "earnings credit."

K. *Question 11—Are there particular FDIC staff opinions of general applicability that should or should not be codified as part of the final rule? If so, which ones, and why?*

We encourage the FDIC to codify into the brokered deposits regulations the following FDIC advisory opinions and precedents:

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[33] *See* Proposing Release at 7,460.

- ***FDIC Advisory Opinion 94-39 (August 17, 1994)***. This opinion provides that funds deposited in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" or a "Special Reserve Bank Account for Broker-Dealers" ("Reserve Accounts") pursuant to SEC Rule 15c3-3(e)[34] are not deemed to be brokered deposits. SEC Rule 15c3-3(e) remains in force and this opinion is of continued utility to broker-dealers and banks. The FDIC should therefore codify this opinion into the brokered deposits regulations and establish that a broker-dealer's compliance with the requirements of SEC Rule 15c3-3(e) would be sufficient to rely upon the "primary purpose" exemption, without submitting an application for approval to do so or complying with ongoing reporting requirements.

- ***Unpublished Letter from Christopher L. Hencke to Jorge H. Coloma (November 13, 2013)***. This unpublished letter from the FDIC's legal staff provides that a mutual fund, acting through its employees or officers, that places its own funds with banks in insured deposit accounts is not viewed as a "deposit broker," and such funds are not viewed as brokered deposits. This letter supports our view that mutual funds, which are legal entities that own bank deposits for their own accounts and not as agent for their investors, are not "deposit brokers" because they act as principal and invest in bank deposits as part of a broad and diversified investment strategy and not simply for the purpose of investing in interests in insured deposits. The FDIC should publish its position set forth in the above unpublished letter and codify that position into the brokered deposits regulations in order to allow mutual funds that engage in the above-described conduct to be excluded from the definition of "deposit broker" without being required to rely upon the "primary purpose" exemption.

- ***FDIC Advisory Opinion 17-02 (June 19, 2017)***. This opinion provides that certain "middle market" companies with which banks maintain relationships and from which banks receive deposits are generally not viewed as "deposit brokers" under the "primary purpose" exemption, provided that such companies' relationships with banks are not "programmatic" and they are not compensated for their placement of deposits with banks. The FDIC should codify this opinion in the brokered deposits regulations and provide that any qualifying company that meets the criteria set forth in the opinion presumptively is covered by the "primary purpose" exemption and is not required to submit an application for approval to comply with ongoing reporting requirements.

- ***FDIC Advisory Opinion 16-01 (May 19, 2016)***. This opinion provides that the provision of clearing services by a bank for its customers that maintain deposit accounts with the bank's affiliates is covered by the "primary

[34] 17 C.F.R. § 240.15c3-3(e).

purpose" exemption where the reason for the establishment of a clearing account is to assist customers in making payments through the affiliated institution and not to gather deposits for the bank. The FDIC should codify this opinion in the brokered deposits regulations and provide that any clearing arrangement that meets the criteria set forth in the opinion presumptively is covered by the "primary purpose" exemption and any bank or bank affiliate that seeks to rely upon the opinion is not required to submit an application for approval to comply with ongoing reporting requirements.

- ***FDIC Advisory Opinion 92-51 (August 3, 1992)***. This opinion provides, with certain conditions, that a non-depository trust company that acts in a fiduciary capacity on behalf of its customers and administers certain traditional trusts is viewed as performing the function of a trust department of the bank and is not acting as a deposit broker in respect of any deposits placed with that bank. The FDIC's position on the application of the "primary purpose" exemption in this context is limited to the extent that a particular trust or fiduciary relationship is not formed for the "primary purpose" of placing funds with banks. The FDIC should codify this opinion in the brokered deposits regulations and provide that any qualifying arrangement that meets the criteria set forth in the opinion presumptively is covered by the "primary purpose" exemption and that an application for approval to rely on the exemption is not required, nor are the relevant parties required to comply with ongoing reporting requirements.

- ***FDIC Advisory Opinion 15-04 (February 4, 2015)***. This opinion provides that deposits placed with banks in connection with a referral by a lawyer, accountant, insurance agent or consultant are not viewed as brokered deposits, provided that the referral is not made pursuant to a formal, programmatic arrangement (such as a written agreement or under a referral fee arrangement). The FDIC should codify this opinion in the brokered deposits regulations and establish that any arrangement that meets the criteria set forth in the opinion is not viewed as a "facilitation" activity and therefore does not trigger the "deposit broker" definition.

- ***"Primary Purpose" Exemptions Granted Pursuant to FDIC Advisory Opinion 05-02 (February 3, 2005)***. The FDIC should provide in any final rule that any bank, investment adviser or broker-dealer that has received FDIC approval to rely upon the "primary purpose" exemption consistent with the standards established in FDIC Advisory Opinion 05-02 will be permitted to continue to rely upon the exemption in accordance with the parameters of the assets-under-management-based test set forth in any final rule without having to submit a new application for approval.

L. ***Question 12—Has the FDIC provided sufficient clarity regarding what will be considered a ''business line''? How can the FDIC provide more***

clarity? Are there other factors that should be considered in determining an agent's or nominee's business line(s)?

We believe that additional clarity regarding the "business line" concept and its purpose should be provided in any final rule. The Proposing Release indicates that the determination of what constitutes a "business line" will be dependent on the facts and circumstances of a particular business arrangement, and provides only one illustrative example of such a determination—*i.e.*, a company that offers brokerage accounts to various types of customers which include a traditional cash sweep option would be considered a "business line," whereas brokerage accounts that do not offer a cash sweep option would not be considered part of that "business line" because those customers are not part of the group of customers for whom the person is placing deposits, and any accounts in which customers are only able to place money in accounts at banks (and not invest in other types of assets) would also be considered a separate business line.[35] The final rule should clarify that a brokerage account customer's decision not to use a cash sweep option that is available to the customer would not render that account as being part of a separate "business line."

To illustrate the challenge of making a determination of what constitutes a "business line," consider a large asset management firm operating in a sizable market as an example—would the firm's "business line" be defined as (i) the funds overseen by one investment manager team within the firm, (ii) a product (*e.g.*, money market mutual funds) managed by the firm, (iii) the management division of the firm (*e.g.*, short-term investments), or (iv) the asset class division of the firm (*e.g.*, fixed income)?

We note that, as suggested above, if the definition of "deposit broker" were to be determined based on whether a person is acting on behalf of or paid directly by a bank, this would eliminate any need for the "business line" concept as the determination would be based on a person's legal role and source of compensation.

M. *Question 13—Are there scenarios where a nonbank third party, as part of the same business line, has different deposit placement arrangements with IDIs?*

Yes. This may occur where an individual bank does not view the nonbank third party as a "deposit broker" and thus deposits placed by the third party are not viewed as brokered deposits.

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[35] *See* Proposing Release at 7,461.

N. *Question 14—Is the application process proposed for the primary purpos e exception appropriate? Are there ways the application process could be modified to make it more efficient?*

As a threshold matter, we support the FDIC's proposal to adopt a more transparent process for obtaining a staff determination regarding the availability of the "primary purpose" exemption. However, we believe that the proposed application and process for FDIC staff review and approval thereof have the potential to be overly burdensome for industry and the FDIC staff alike. This dynamic will be magnified if the Proposed Rule's definition of the "facilitation" prong of the "deposit broker" definition is adopted as proposed, as numerous FinTech companies, financial institutions and other third parties may be required to rely upon the "primary purpose" exemption based on the conduct of activities that previously were not viewed as deposit brokerage. We anticipate that a deluge of applications will be submitted promptly after the effective date of any final rule and in the first several quarters thereafter. Without a substantial allocation of resources, we envision a processing backlog that will bring about a period of marketplace uncertain and will delay, if not derail, the structuring and operation of a variety of deposit funding arrangements.

In anticipation of these challenges, we suggest that the FDIC narrow the scope of the arrangements that would require individual determinations, and also adopt a more streamlined application process, including by (i) establishing a much shorter processing period for applications that are required to be filed of 30 days for the vast majority of applications and 60 days for only the most complex and novel applications,[36] (ii) adopting after-the-fact notice and non-objection procedures for qualifying banks and persons in connection with arrangements that are substantially similar to existing FDIC precedent (including FDIC advisory opinions and guidance that will be codified into the brokered deposits regulations by a final rule) and published orders on approved applications, (iii) limiting supporting documentation requirements only to the most complex and novel applications, and (iv) permitting qualifying banks and persons to self-certify on a quarterly basis the continued applicability of the exemption based on reasonable information provided that ongoing reports are filed not less than annually and in accordance with FDIC expectations for the reporting entity.

O. *Question 15—Is the application process for IDIs that apply on behalf of a third party workable? Are there ways to improve the process for IDIs that apply on behalf of third parties?*

We believe that, as proposed, the application process for third parties is not workable. Our primary concerns with this aspect of the Proposed Rule are as follows:

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[36] These processing periods would be consistent with the FDIC's general application processing periods for expedited and standard applications relating to banking activities set forth under 12 C.F.R. Part 303.

- For certain third parties, the question of whether a deposit is brokered is not of their concern or relevant to their business interests, and therefore those third parties will have no incentive to participate in the application process or assist with ongoing reporting obligations, such as with respect to assets under management where such information may not be publicly available.

- With respect to revenue-related information and "business line" determinations, required information often is non-public and subject to confidentiality agreements. Again, the third party likely will be unwilling to disclose this information to other parties and would not welcome the added exposure or liability associated with applying for or on behalf of a bank.

P. *Question 16—Are there additional ways that the FDIC could better ensure that the primary purpose exception is applied consistently, transparently, and in accordance with the statute?*

Before the application of the "primary purpose" exemption is necessary, we encourage the FDIC to adopt a clearer and less expansive definition of the "facilitation" prong of the "deposit broker" definition, which will, in turn, limit the extent to which a number of persons will be required to seek an exemption. In situations where the application of the exemption must be evaluated, we encourage the FDIC to permit more straightforward cases—which by the FDIC's own admission should constitute the vast majority[37]—to be processed under expedited application procedures or after-the-fact notice procedures. FDIC staff resources should be reserved for the processing of the most complex and novel cases and those that present legitimate potential risks to insured institutions, the financial system and the DIF. These steps would assist the FDIC in carrying out its objective to emphasize efficiency in application processing and reduce associated filing material in accordance with the Paperwork Reduction Act.[38]

Q. *Question 17—Should some or all FDIC decisions on applications for the primary purpose exception be publicly available? If so, in what format?*

Without limiting our above suggestions for streamlining and limiting the scope of the application process as proposed, we encourage the FDIC to publish and maintain a searchable database of all FDIC decisions on applications. Such decisions should include in each case—to the extent permitted within applicable confidentiality restrictions—copies of incoming application materials, which would enable industry participants that may seek to rely upon the "primary purpose" exemption in the future to understand the fact pattern underlying the application (including, but not limited to, the nature of the

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[37] *See* Proposing Release at 7,461 ("The FDIC expects such applications to generally be simple and straightforward, but recognizes there may be some cases, such as when defining the scope of the 'business line' is complicated, in which the FDIC may need more time to process the application.").

[38] *See* Remarks by FDIC Chairman Jelena McWilliams, *supra* note 4.

third party, the basic facts of the contemplated deposit funding arrangement, the details of any fees or other compensation arrangements, *etc.*) and the FDIC's application of Section 29 of the FDI Act and the brokered deposits regulations to that fact pattern. This will not only assist the FDIC in achieving its objectives to interpret the statute and regulations consistently and transparently, but over time will reduce the FDIC's processing burden as industry participants would be able to develop more refined and reliable expectations regarding the FDIC's potential interpretations.

R. *Question 18—Are there commonly known deposit placement arrangements not mentioned above that are sufficiently simple and straightforward that applications for such arrangements should receive expedited application processing, as described above?*

In situations in which the bank does not have any formal contractual relationship in place with the third party, there are no fee inducements or other incentives involved with the arrangement, and the third party is acting clearly as an agent for the underlying depositor—the presumption should be that the third party is not a "deposit broker" and no interpretation should be required—but to the extent there is any question, expedited processing or after-the-fact notice procedures would be appropriate, with the arrangement treated as not involving brokered deposits until the FDIC formally responds to the contrary, and then only in respect of the period after the response is received by the bank.

S. *Question 19—Are there other deposit placement arrangements with respect to which the FDIC should provide additional clarity as part of this rulemaking?*

Yes. For instance, the Proposing Release states in its discussion of deposit placements for the purpose of encouraging savings that "the FDIC would not grant a primary purpose exemption if the third party's primary purpose for its business relationship with its customers is to place (or assist in the placement of) funds into deposit accounts to "encourage savings," "maximize yield," "provide deposit insurance," or any similar purpose."[39]

The reference to deposits that are placed to "maximize yield" may penalize, perhaps unintentionally, third party asset managers who have a fiduciary duty to achieve the best result for their underlying clients and where they have no contractual agency relationship with the bank with which deposits would be placed. Here, as in other cases described above, to the extent that deposits placed by a third party that clearly is engaged as an agent of the depositor, and not the bank, were to be viewed as not being deposit brokerage, a better and more logical outcome would result. Where the third party is seeking to "maximize yield" as an agent of the depositor (and has a contractual relationship with and legal obligation with the depositor to do so), the bank cannot influence the outcome. By contrast, where there a third party provides a service through

[39] *See* Proposing Release at 7,460.

which it promotes, highlights or expresses a preference for a bank's deposit products over others—even if also acting as an agent of the depositor—the outcome can be influenced by the bank and therefore such an arrangement would warrant FDIC scrutiny.

T. *Question 20—Are the criteria for considering and approving primary purpose applications for third parties that seek a primary purpose exception based on placing less than 25 percent of customer assets under management at depository institutions appropriate?*

We believe, in certain respects, the proposed criteria are not appropriate. For instance, where a third party does not wish to apply directly for an exemption and therefore only the bank would be submitting an application, the bank will not necessarily have access to all of the third party's information, particularly with respect to assets under management and the total amount of deposits placed by the third party with any bank for the "business line" in question. Embedded within this challenge is the potential difficulty of reaching a "business line" determination with limited information being supplied by the third party.

As discussed above, another underlying challenge with the Proposed Rule in its current form is the calculation of the 25% assets under management threshold (*e.g.*, should this be viewed as a calendar-year end or every 12-month snapshot or measured more frequently?). The FDIC must clarify a calculation methodology and frequency in any final rule; however, we encourage the FDIC to adopt a framework that requires the calculation of assets under management not more frequently than annually and affords some measure of flexibility with respect to temporary or unexpected breaches of the applicable threshold.[40]

U. *Question 21—Are the criteria for considering and approving primary purpose applications based on enabling transactions appropriate?*

As discussed above, the "transaction enabling" standard for use of the "primary purpose" exemption category appears to be very difficult standard to satisfy. We are not aware of tangible, commercially-prevalent business practices and arrangements that clearly would satisfy this standard (perhaps outside of strict payment processing, which is not a depository activity).

[40] For example, SEC Rule 3a-2 establishes a temporary safe harbor from registration under the Investment Company Act of 1940 for so-called "transient investment companies," which are investment funds or operating companies that, as a result of unusual business activity (often in relation to the commencement and winding up of a company's operations), temporarily satisfy the definition of an "investment company" under the statute. In general, the Rule provides that a company is deemed not to be an "investment company" for a period not to exceed one year provided that the company has a bona fide intent to be engaged primarily in a business other than that of investing, reinvesting, owning, holding or trading in securities. *See* 17 C.F.R. § 270.3a-2.

With respect to the application information that third parties would be required to provide under the Proposed Rule if seeking to rely on the "primary purpose" exemption based on the "transaction enabling" standard, third parties may not have systems in place to measure the volume of transactions in customer accounts, particularly in relation to fees, interest or other compensation paid specifically for payment services. In addition, this information would be impossible to obtain for third parties that have new businesses or are launching new platforms or services as transaction volume data would not yet exist and pricing structures may be subject to modification. Accordingly, the FDIC should modify and make more flexible the application process for such third parties to allow for representations and pro forma transaction volume estimates that can be updated with actual data over time.

V. *Question 22—Are proposed requirements for the application process for business relationships, other than those described in paragraphs (C)(1) and (C)(2), appropriate?*

As discussed above in our response to Question 15, if a bank is submitting an application on behalf of a third party, that third party may not be inclined to share some or all of the information that would be required for the application. Specifically, the requirement to provide "revenue generated from the third party's activities related to the placement, or the facilitating of the placement, of deposits" and "revenue generated from the third party's activities not related to the placement, or the facilitating of the placement, of deposits" generally will not be known by or disclosed to the bank, and it is unreasonable to demand that the bank source this information from a third party with which it may have no contractual relationship (as the third party is only contractually bound to the underlying depositor).

We also note that the FDIC's ability to require "any other information that the FDIC requires to initiate its review and render the application complete" is overly broad and reflective of the unnecessarily bureaucratic design of the application process. While we appreciate the need for the FDIC to establish the flexibility to request additional materials as may be required, this provision may be used, as similar provisions have been by the FDIC and other regulatory agencies in various contexts, to delay processing of an application indefinitely and, in certain cases, without transparency. As noted above, we anticipate that a glut of applications will be filed promptly upon the effective date of any final rule. The above provision would allow the FDIC to delay decisions on applications indefinitely, rather than rendering a decision based on available information within the prescribed processing period. To the extent that the FDIC is intent on preserving the 120-day standard processing period for "primary purpose" exemption applications, as well as the extensive set of requirements for the contents of an application, we contend that the "catch-all" provision described under the Proposed Rule is superfluous and should be removed.

W. *Question 23—Is it appropriate to require reporting from nonbank entities that have received approval for a primary purpose exception?*

Should the FDIC require IDIs to report on behalf of such nonbank entities instead? Are there other ways the FDIC should consider to ensure that applicants that receive the primary purpose exception remain within the relevant standards?

Based on our understanding of our bank clients' existing relationships with nonbank entities, it is unlikely that third parties will submit applications for themselves and therefore will rely on banks to manage application and ongoing reporting obligations. With this scenario as context, the concept of quarterly reporting with daily average balances is overly burdensome and would not further the FDIC's stated objective of ensuring that the amendments to the brokered deposits regulations rules will foster innovation and safety in the banking system. We also note that bank Call Reports, in their current form, are not based on daily balances and therefore the proposed reporting standard would be inconsistent with existing standards for bank reporting.

X. ***Question 24—How frequently should the FDIC require reporting?***

As stated above, we believe annual reporting, perhaps supplemented by periodic self-certification, would be appropriate as business arrangements generally are unlikely to change dramatically within a calendar year or 12-month period. Annual reporting also would align with annual financial reporting and other balance sheet disclosures.

Y. ***Question 25—Is it appropriate for the FDIC to require IDIs to monitor third parties for eligibility for the primary purpose exception? Are there additional or better ways to ensure that third parties continue to remain eligible for the exception?***

The proposal for banks to monitor and self-report any commercial or contractual changes is reasonable, as that implies re-certification of the original approval request. However, a third party may experience material changes to its revenue structure, some of which may be temporary or periodic, without the specific and immediate knowledge of the bank. In these cases, it would be difficult, if not impossible, for the bank to monitor and report to the FDIC on the third party's behalf as contemplated in the Proposed Rule. This challenge would be more acute where the bank and the third party do not have a contractual relationship. For these reasons, we encourage the FDIC in any final rule to be more cognizant of the potential limitations of banks in fulfilling third-party monitoring obligations.

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We appreciate the opportunity to provide these comments in response to the Proposed Rule and we thank the FDIC for its consideration of the suggestions set forth herein. We would be pleased to provide additional information if it would be useful to the FDIC in this regard. To that end, please feel free to contact me by telephone at (202) 942-5745 or by email at David.Freeman@arnoldporter.com.

Sincerely,

[redacted]

David F. Freeman, Jr.

cc: Rae-Ann Miller
Vivek V. Khare
(Federal Deposit Insurance Corporation)