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July 27, 2015

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 – 17th Street, N.W.
Washington, D.C. 20429

Attention: Comments

**Re: RIN 3064-AE33**

Dear Mr. Feldman:

I am writing in response to the request of the Federal Deposit Insurance Corporation ("FDIC") for comment on an Advance Notice of Proposed Rulemaking concerning Large Bank Deposit Insurance Determination Modernization (the "ANPR")[1]. I appreciate the opportunity to provide comments on the ANPR on behalf of our clients.

Seward & Kissel represents a wide range of participants in the deposit markets, including broker-dealers, banks and service providers. Our clients underwrite and issue certificates of deposit ("CDs") and offer, support and participate in so-called deposit account "sweep" programs. Collectively, such deposit arrangements total in excess of $1.1 trillion, or approximately 11% of all domestic deposits.[2]

The FDIC is seeking comment on issues, and responses to questions, related to the resolution of large banks. These issues and questions center on the adequacy of bank records

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[1] Large Bank Deposit Insurance Determination Modernization, Advance Notice of Proposed Rulemaking, 80 Fed. Reg. 23,478 (April 28, 2015).

[2] Data are derived from brokered deposits reported on Call Reports ($856 billion as of March 31, 2015) and an estimate of broker-dealer "sweep" program deposits not reported by the banks as brokered pursuant to the "primary purpose" exception from the definition of "deposit broker" in FDIC regulations. This estimate is conservative. The amount of exempt sweep deposits is not readily available and we have assumed an amount at the low end of the estimate ($300-500 billion). Further, the amount of reported brokered deposits attributable to stored value card deposits, deposits referred from affiliates and other sources deemed "brokered" is not available. In excluding these deposits from our estimate, we may have over-estimated the amount of reported brokered deposits from these sources ($48 billion). It is very possible that the amount of deposits placed by regulated financial intermediaries is closer to $1.3 trillion.

to identify depositors, their insurable capacities and any beneficiaries or beneficial owners for which they may be acting in order to permit the FDIC to expeditiously determine insurance coverage in the event of a bank failure. This letter will solely address the options set forth in the ANPR concerning brokered deposits and similar arrangements that rely on "pass-through" deposit insurance.[3]

We commend the FDIC for soliciting public comment on how it can best fulfill its statutory obligation to pay deposit insurance "as soon as possible" following a bank failure.[4] As detailed below, the FDIC lacks the statutory authority to require banks to maintain the names and interests of the beneficial owners of deposit accounts held by financial intermediaries on a pass-through basis as proposed in one of the alternative solutions set forth in the ANPR. Furthermore, the FDIC has already developed policies and procedures to address insurance payment claims for brokered deposits and similar arrangements and the industry has addressed the possibility of insurance payment delays in standard customer disclosures provided in connection with deposit placements by financial intermediaries. While these policies and procedures would benefit from some improvement, they do not require wholesale revision.

**The ANPR.**

The ANPR establishes four goals for any regulatory action to accomplish the FDIC's statutory obligation:

1. Address any additional challenges to making deposit insurance determinations posed by certain large banks;

2. Enhance capabilities to make prompt insurance determinations in the event of the sudden failure of a large bank;

3. Safeguard the Deposit Insurance Fund by avoiding overpayment of insurance; and

4. Ensure that public confidence is maintained and depositors' expectations of prompt insurance payments are met.

In pursuit of these goals, the FDIC is seeking comment on the following two options with respect to pass-through deposit accounts[5]:

> Option 1: Require banks with a large number of deposit accounts to identify pass-through accounts, and place holds on these accounts as if the full balance were uninsured. If such a bank failed, brokers, agents and custodians would have to submit required information in a standard

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3 *See* 80 Fed. Reg. 23,482-23,483.

4 12 U.S.C. § 1821(f)(1).

5 80 Fed. Reg. 23,483.

format within a certain time. The standard format could expedite deposit insurance determinations.

Option 2: A bank with a large number of deposit accounts would have to maintain up-to-date records sufficient to allow immediate or prompt insurance determinations either for all pass-through accounts or for certain types of pass-through accounts where depositors need access to their funds immediately.

**Reliance on Pass-Through Insurance by Financial Intermediaries Placing Customer Deposits.**

As noted in the ANPR, a deposit account at a bank that is established by, and held through, a "fiduciary"[6] is insured by the FDIC on a "pass-through" basis to the beneficial owners of the deposit account if (i) the account records of the bank indicate that the fiduciary is acting for others and (ii) the fiduciary maintains records of the ownership of the deposit account in the "regular course of business".[7] If the bank fails, the FDIC will use the records of the fiduciary to determine deposit account ownership. Based on the fiduciary's records, which would be provided to the FDIC in the event of a bank failure, each beneficial owner will be insured as if the owner had established the deposit account directly with the bank and the deposit account will be aggregated with any other deposit accounts held by the owner in the same insurable capacity directly with the bank or through another fiduciary for purposes of the deposit insurance limits.

When offering a deposit placement service to its customers, a regulated financial institution, including banks and broker-dealers, typically establishes one or more deposit accounts with a bank in its name or the name of another agent[8] and relies on the availability of pass-through insurance in offering to place the customers' deposits. The products offered through such services include CDs, money market deposit accounts ("MMDAs"), a type of savings deposit, and transaction accounts (including both NOW accounts and demand deposit accounts). MMDAs, and MMDAs linked to transaction accounts, may be offered to customers as an automatic, or "sweep", deposit of uninvested customer funds or may be offered on a basis that requires the customer to specifically instruct a deposit or withdrawal of funds.

In most cases, the deposits placed by financial intermediaries with a bank are deemed "brokered deposits".[9] However, some sweep programs offered by broker-dealers that

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6 Fiduciary relationships include relationships involving a trustee, agent, nominee, guardian, executor or custodian. *See* 12 C.F.R. § 330.5(b)(1).

7 *See* 12 C.F.R. § 330.5(b)(2).

8 The Depository Trust Company acts as sub-custodian for many CD issuances. In addition, large custodial banks act as sub-custodians for both CDs and other types of deposit accounts.

9 *See* 12 C.F.R. §§ 337.6(a)(2) and 337.6(a)(5) for the definition of "brokered deposits."

deposit funds in an affiliated bank satisfy the "primary purpose" exception from the definition of "deposit broker"[10] and, therefore, are not reported on Call Reports as brokered deposits.

Over $1.1 trillion of deposits are placed by financial intermediaries with banks in reliance on pass-through deposit insurance.[11] These deposit accounts are owned by tens of millions of beneficial owners whose identities and deposit balances are maintained only on the books and records of the financial intermediary. Further, many of the customers of the financial intermediaries are trusts, employee benefits plans and other fiduciaries whose beneficiaries are themselves eligible for pass-through insurance coverage.[12]

Although the FDIC has suggested that any proposed rulemaking resulting from the ANPR would only affect approximately 37 banks,[13] these banks all accept deposits from financial intermediaries utilizing pass-through insurance. The magnitude of the operational burden on financial intermediaries to regularly transfer current ownership information to a bank, and on the bank to maintain such information, is readily apparent from the numbers cited above.

**Pass-Through Insurance Is Mandated by Statute.**

Pass-through insurance is mandated by the FDIC's enabling statute and is deeply embedded in the FDIC's history and jurisprudence. Requiring a bank to maintain on its books and records the identities and interests of the beneficial owners of deposit accounts established by a fiduciary, as suggested by Option 2 in the ANPR, is inconsistent with the FDIC's mandate and beyond the scope of the FDIC's authority.[14] As described below, the federal courts have ruled that previous attempts by the FDIC to limit pass-through insurance were beyond the scope of its authority, and Congress has rejected proposals to amend the Federal Deposit Insurance Act ("FDIA") to limit pass-through insurance. Even modest changes to the requirements for pass-through insurance must be made carefully in order to avoid disrupting deposit relationships that have been established in reliance on long-standing FDIC regulations and interpretations.

The FDIC's obligation to insure a deposit account owned by persons other than the person establishing the deposit account with the bank dates to the creation of the FDIC by the Banking Act of 1933, commonly known as the Glass-Steagall Act.[15] The FDIA states that the

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[10] *See* FDIC Advisory Opinion 05-02 (February 3, 2005).

[11] *See* FN2, *supra*.

[12] *See* 12 C.F.R. § 330.5(b)(3).

[13] *See* 80 Fed. Reg. 23,480.

[14] The FDIC's lack of statutory authority to limit pass-through insurance is not the sole legal obstacle to Option 2 in the ANPR. Among the other obstacles are the rights of customers of a regulated financial institution under the Gramm-Leach-Bliley Act's privacy provisions to withhold authority to have personal financial information released and the absence of authority by the FDIC to compel registered broker-dealers to transfer customer information to banks.

[15] The statutory provisions creating the FDIC in 1933 were codified as Section 12B of the Federal Reserve Act. Banking Act of 1933, Pub. L. No. 73-66, § 8, 48 Stat. 168. For a detailed account of the history of pass-through insurance, *see* Paul T. Clark, *Just Passing Through: A History and Critical Analysis of Insurance of Deposits Held by Brokers and Other Custodians*, 32 REV. BANKING & FIN. LAW (2012-2013).

FDIC shall "aggregate the amounts of all deposits in the insured depository institution which are maintained by a depositor in the same capacity and the same right for the benefit of the depositor **either in the name of the depositor or in the name of any other person**."[16]

Beginning in 1946, FDIC regulations provided for insurance of "any portion of a deposit . . . under a name other than that of the claimant, whose name or interest as such owner is not disclosed on the records of the closed bank . . . to the same extent as if his name and interest were disclosed on the records of the bank."[17] Regulations adopted by the FDIC in 1967 revised the agency's existing regulations and introduced the operational framework for pass-through insurance that exists today.[18] The regulations were restructured in 1990 after the Federal Savings and Loan Insurance Corporation was merged into the FDIC. The 1990 regulations incorporated provisions on multi-tiered fiduciary relationships (relationships in which one fiduciary is acting for another fiduciary), incorporated FDIC interpretations on the insurance of commingled funds in custody accounts and established the FDIC's policy to override state law where necessary in the interest of uniformity of insurance coverage.[19]

In 1984, the FDIC and the Federal Home Loan Bank Board ("FHLBB") adopted regulations that eliminated pass-through deposit insurance for deposit accounts established with the bank by a "deposit broker" as agent for its customers.[20] The regulations limited deposit insurance to $100,000, the then-current deposit insurance limit, for all deposit accounts of the deposit broker, effectively denying pass-through deposit insurance to the deposit broker's customers.

The final regulations were published on April 2, 1984, with an effective date of October 1, 1984. On June 2, 1984, the U.S. District Court for the District of Columbia ruled that the FDIC and FHLBB had exceeded their statutory authority in adopting the regulations and enjoined the agencies from implementing them.[21] On January 30, 1985, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the District Court's decision.[22]

In overturning the regulations, the Court of Appeals quoted the provisions of the FDIA stating that the amount due any depositor shall be determined by adding together all

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16 12 U.S.C. § 1821(a)(1)(C).

17 11 Fed. Reg. 177A-431, 177A-449 (Sept. 11, 1946) (codified at 12 C.F.R. § 330.4).

18 *See* Clarification and Definition of Deposit Insurance Coverage, 32 Fed. Reg. 10,408 (July 14, 1967).

19 *See* Deposit Insurance Coverage, Final Rule, 55 Fed. Reg. 20,111, 20,126 (May 15, 1990). The regulations were further amended in 1998 to provide the FDIC with greater flexibility in granting pass-through coverage when the existence of an agency or other relationship necessary for pass-through insurance is not clear from the bank's records. Where an account titling indicates the possibility of an agency relationship, the FDIC may grant pass-through insurance even though the account titling does not expressly state that such relationship exists.

20 *See* Brokered Deposits; Limitations on Deposit Insurance, Final Rule, 49 Fed. Reg. 13,003 (Apr. 2, 1984).

21 *FAIC Securities, Inc. v. United States*, 595 F. Supp. 73 (D.D.C. 1984), *aff'd.* 768 F.2d 352 (D.C. Cir. 1985).

22 *FAIC Securities, Inc. v. United States*, 768 F.2d 352.

deposits "maintained in the same capacity and the same right for his benefit either in his own name or in the names of others," and concluded:

> These provisions establish a clear and unequivocal mandate that the FDIC shall insure each depositor's deposits up to $100,000, determining the amount of those deposits by adding together all accounts maintained for the benefit of the depositor, whether or not in the depositor's name. There is no exception based upon the identity of the person opening, or responsible for opening, the account.[23]

The Court of Appeals also rejected the FDIC's claim that its authority to define terms in the statute provided authority for the regulations. The court held that "[a] general authority to define terms, and the extent of insurance coverage resulting from those terms, does not confer power to *redefine* those terms that the statute itself defines."[24]

In 1991, Congress rejected[25] a proposal by the U.S. Treasury Department to eliminate pass-through deposit insurance coverage on brokered deposits and certain employee benefit plans.[26] The proposal was part of a comprehensive review of federal deposit insurance that had been mandated by Congress in 1989.[27]

**Existing Policies and Procedures Address Concerns Set Forth in the ANPR.**

The FDIC has policies and procedures in place that address concerns set forth in the ANPR. These policies and procedures address the issues posed by Option 1 in the ANPR.

*Deposit Broker Processing Guide*

In July of 2001, the FDIC announced that it had launched a web page to "make it quicker and easier for deposit brokers to submit the information that enables the FDIC to make deposit insurance determinations...." [28] In December of 2001, the FDIC solicited public comment on a draft "Deposit Broker Processing Guide" (the "Guide"), which set forth the procedures for submission of customer information by a deposit broker in the event of the failure

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23 *Id.* at 361.

24 *Id.* at 362 (emphasis in original).

25 Compare the Federal Deposit Insurance Corporation Improvement Act of 1991 (P.L. 102-242) (December 19, 1991), with H.R. 1505, the Financial Institutions Safety and Consumer Choice Act of 1991 (§ 101), legislation introduced in the House of Representatives on March 20, 1991 to implement the Treasury Department's proposal. H.R. 1505 was considered by the House Banking Committee but no further action was taken.

26 *See* U.S. DEP'T OF THE TREASURY, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS iv-5 (1991).

27 *See* Financial Institutions Reform, Recovery and Enforcement Act of 1989, § 1001 (P.L. No. 101-73).

28 *See* PR-53-2001 (July 30, 2001).

of a bank in which funds have been deposited.[29] The proposed Guide also provided formatting instructions for submitting customer information as well as time frames for submission.

The Guide was adopted in early 2002 and has been utilized by deposit brokers for submission of customer information in all failed banks in which there has been a deposit insurance payment. Most intermediaries have incorporated the claims format into their operating procedures and can forward claims to the FDIC within a few business days after the failure of a bank in which the FDIC is making an insurance payment. This process has generally worked well for over a decade. Nevertheless, we believe that the Guide can be improved. For example, we recommend that the FDIC clarify that the Guide applies to all deposit accounts held by financial intermediaries on a pass-through basis, not just deposit accounts maintained by or for deposit brokers. This will eliminate any question as to whether broker-dealers that are offering sweep arrangements that are not brokered deposits can rely on the Guide if their affiliated bank fails.

*Access to Liquid Deposit Accounts*

When it proposed the current version of the Large Bank Deposit Insurance Determination Modernization regulations in 2008,[30] the FDIC received comments concerning the need of customers of broker-dealers and banks who have had funds swept to liquid deposit accounts, such as transaction accounts and MMDAs, to have immediate access to their funds. Commenters noted that these customers have a greater expectation of immediate access to their funds than customers holding CDs.

In response to these comments, the FDIC stated that an intermediary acting as a fiduciary could make withdrawals from MMDAs to satisfy withdrawal requests from its customers once a failed bank had re-opened, but the intermediary would be responsible for any payments to customers in excess of the insurance coverage for which the customer is eligible.[31] Intermediaries, particularly broker-dealers offering sweep programs, have incorporated this policy into their operating procedures.

The industry assumes that the FDIC would apply the same policy to transaction accounts and transaction accounts linked to MMDAs. However, it would be useful for the FDIC to clarify this point.

**Standard Industry Disclosures Manage Customer Expectations.**

Although the FDIA requires the FDIC to make insurance payments "as soon as possible" after a bank failure, the FDIC is not required to make payments within a specific time frame. Historically, the vast majority of failed banks are resolved through means other than by

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[29] *See* Agency Information Collection Activities: Proposed Collection; Comment Request, Notice and Request for Comment, 66 Fed. Reg. 65,964 (December 21, 2001).

[30] 73 Fed. Reg. 2364 (January 14, 2008).

[31] 73 Fed. Reg. 41,180, 41, 189 (July 17, 2008).

the FDIC making insurance payments.[32] In the relatively few instances where insurance payments have been made by the FDIC, payments have been made in a timely manner.

Nevertheless, it is standard practice for financial intermediaries placing deposits to provide customers with written disclosures concerning, *inter alia*, FDIC insurance coverage. While the level of detail included in the disclosures may vary from financial intermediary to financial intermediary, the disclosures routinely state that in the event of a bank failure there is no specific time frame in which the FDIC must make an insurance payment and the customer may not earn interest between the date of the failure and the receipt of an insurance payment.

A typical disclosure is set forth below.

> In the event that deposit insurance payments become necessary for your deposits, the FDIC is required to pay the original principal amount plus accrued interest to the date of the closing of the Insured Institution, subject to the limits on FDIC deposit insurance coverage. No interest is earned on deposits from the time an Insured Institution is closed until insurance payments are received. We will notify you if we receive any payments from the FDIC with respect to your deposit accounts.
>
> As an alternative to the direct deposit insurance payment from the FDIC, the FDIC may transfer the insured deposits of an insolvent institution to a healthy institution. Subject to insurance verification requirements and the limits on FDIC deposit insurance coverage, the healthy institution may assume your deposit accounts under their original terms or offer you a choice between either receiving payment of the deposit accounts or maintaining the deposits at a different rate. We will advise you of your options in the event of a deposit transfer.
>
> As with all federally insured deposits, if it becomes necessary for federal deposit insurance payments to be made on the deposit accounts, there is no specific time period during which the FDIC must make the insurance payments available. We will not be obligated to make any payments to you in satisfaction of a loss you might incur as a result of a delay in insurance payments applicable to your deposit accounts. Also, we will not be obligated to advance funds to you prior to payment from the FDIC.

For over 25 years, these disclosures have allowed financial intermediaries to manage customer expectations with respect to failed banks. There is no indication that

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[32] According to data made available by the FDIC on its website, between 1995 and 2015, out of a total of 570 failures, 31 have been resolved by FDIC insurance payments. *See also* Bert Ely, *FDIC Invents Costly Solution to Imaginary Problem,* AMERICAN BANKER, June 17, 2015.

the customers of financial intermediaries are demanding changes in the manner in which the FDIC handles insurance payments.

**Conclusion.**

The FDIC lacks the statutory authority to require that banks maintain the names of beneficial owners of deposit accounts held by financial intermediaries on a pass-through basis. Although this option may be superficially appealing in its seeming simplicity, it is not only *ultra vires*, it would impose substantial recordkeeping burdens and costs on banks and financial intermediaries and present insurmountable operational barriers.

During the last 15 years, the FDIC has adopted policies and procedures to address the issues raised in the ANPR. The FDIC's resources are most effectively expended on making some clarifying changes to the eminently workable existing policies and procedures rather than wholesale development of new policies and procedures.

I would be pleased to discuss with the FDIC staff any of the views set forth in this letter.

Very truly yours,

Paul T. Clark

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