May 13, 2020

By Email to comments@fdic.gov

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

Re: RIN 3064-AE94 – NPR for Comment re 12 C.F.R. Parts 303 and 337, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions

Ladies and Gentlemen:

Total Financial Solutions, LLC, d/b/a Total Bank Solutions ("**TBS**"), submits this comment letter in response to the FDIC's Notice of Public Rulemaking ("**NPR**")[1] to amend its regulations to create a new framework for analyzing certain provisions of the "deposit broker" definition and to establish an application and reporting process with respect to the primary purpose exception.

In its 2018 Advance Notice of Public Rulemaking ("**ANPR**"),[2] the FDIC recognized the need for a comprehensive review of its brokered deposit and interest rate regulations, because of, among other factors, significant changes, since adoption of the regulations, in: technology; business models; the economic environment; and products affected by these regulations. TBS's comments to the ANPR ("**TBS ANPR Comment Letter**") addressed the unnecessary restrictive impact the regulations have had on "deposit sweep programs" pursuant to which idle funds awaiting investment are transferred to deposit accounts at insured depository institutions ("**IDIs**") from accounts of customers ("**Customers**") at broker-dealers, trust companies, or other financial institutions ("**Source Institutions**") pursuant to an agreement governing the Customer's account at the Source Institution.[3] The FDIC has embraced TBS's position that the FDIC has the authority to address these outdated restrictions that fail to take into account advances in technology and products developed to meet evolving Customer needs. TBS believes that the FDIC can, and should, broaden the proposed amendments to better achieve its stated objective to "modernize its brokered deposit regulations to reflect recent technological changes and innovations" by allowing insured banks to "collaborate with third parties, including financial technology companies, for . . . access to deposits," consistent with

[1] Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020).
[2] Unsafe and Unsound Banking Practices (Brokered Deposits): Comprehensive Review of Regulatory Approach to Brokered Deposits, 84 Fed. Reg. 2366 (Feb. 6, 2019).
[3] Letter dated May 7, 2019, from Michael L. Kadish, Managing Director and Senior Counsel of TBS.

safe and sound practices.[4] Failure to recognize the important role third parties now play in rendering services to sweep program participants will result in the FDIC's failure to achieve its stated goals.

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[4] NPR, 85 Fed. Reg. at 7453.

I. ABOUT TBS

Founded in 2004, TBS is a privately held financial technology firm located in Hackensack, NJ. Leveraging proprietary technology, TBS sponsors and administers its Insured Deposit Sweep Program ("**IDS Program**"), by which idle funds awaiting investment in Customers' accounts at broker-dealers, trust companies, commercial bank trust departments and other Source Institutions are swept daily to deposit accounts IDIs that agree to accept deposits under the IDS Program ("**Sweep Banks**") in amounts such that each Customer's funds in the deposit accounts are fully insured by the FDIC. The IDS Program is designed to provide Customers with the benefit of full FDIC insurance for idle Customer funds awaiting investment, to provide Source Institutions with a safe and efficient means for managing such funds, and to provide Sweep Banks with a stable, diversified and cost-effective source of deposit funding.

TBS offers its *TBS Bank Monitor*® on-line subscription service to provide client Source Institutions the ability to conduct due diligence and ongoing surveillance of the safety and soundness of all IDIs. *TBS Bank Monitor*® provides analysis and support for risk surveillance, compliance testing and investment research. Subscribers to this service are not limited to TBS's IDS Program Source Institutions; other firms interested in monitoring the financial condition of IDIs also subscribe to the service. In addition, TBS utilizes TBS Bank Monitor® to perform credit risk analyses on all current IDIs, providing all clients with comprehensive quarterly risk assessment reporting.

II. OVERVIEW

A. Focus of TBS's Comments

Given the nature of its business, TBS's comments to the NPR relate to the impact of the proposed changes on cash sweeps arrangements by broker-dealers and other Source Institutions. The NPR recognizes the importance of Section 29 of the Federal Deposit Insurance Act ("**Section 29**")[5] to such sweep arrangements; the summary of issues raised by comments to the ANPR in Section II(B) of the Supplementary Information devotes a subsection to broker-dealer sweeps. Sweeps are a significant topic of discussion in the following paragraphs of Section III(B)(2) of the Supplementary Information: (c)(1) (Deposit Placements of Less Than 25 Percent of Customer Assets Under Management by the Third Party); by implication, (d) (Other Deposit Placements That May Meet the Primary Purpose Exception); and (g) (Evaluation of Business Lines).

While it appears that the FDIC is attempting, by its proposed changes to the regulation clarifying the applicability of the statutory primary purpose exception,[6] to expand the applicability of that exception, the overall impact of the revised regulation as proposed would in TBS's view have the opposite result.

[5] 12 U.S.C. § 1831f.

[6] There are nine exceptions from the definition of deposit broker provided in paragraph (g)(2) of Section 29 (12 U.S.C. § 1831f(g)(2)), the ninth of which, subparagraph (I), excludes from the definition, "an agent or nominee whose **primary purpose** is not the placement of funds with depository institutions." (Emphasis added.)

TBS's comments suggest changes the FDIC should make to achieve its intention to expand the applicability of the exception.

B. Summary of TBS's Comments

TBS summarizes its comments as follows:

1. The FDIC should more appropriately tailor the application of the brokered deposit regulations in proposed Section 337.6 to better accommodate cash sweep programs. As detailed in Part IV of this letter, such tailoring is consistent with the purposes of Section 29 and Section 337.6 of the FDIC regulations because deposits made in connection with cash sweep programs do not exhibit the attributes associated with traditional types of brokered deposits, and the institutions making the deposits and service providers that assist them do not share the attributes associated with traditional deposit brokers.

2. The FDIC should revise the Facilitation Prong of the "Deposit Broker" definition, which, as currently formulated, would likely prevent permitted holders of the primary purpose exception from appropriately using third-party service providers they currently use to administer their cash sweep programs. If the Source Institution is not a deposit broker, then a service provider that assists the Source Institution in connection with sweep arrangements with an IDI should be presumed also not to be a deposit broker.

3. In order to avoid discouraging a holder of the primary purpose exception from appropriately using a third-party service provider to administer cash sweeps, the FDIC should define expansively but explicitly and objectively the functions that can be performed by such a service provider in "an administrative capacity." TBS has provided a list of functions that should be considered administrative for this purpose in Section III.C.4 of this letter.

4. The FDIC should rescind Advisory Opinion 92-51 to the extent it requires deposits to be treated as brokered if a trust department or trust company accepts any fee in connection with the sweep.

5. The FDIC should extend the applicability of Advisory Opinion 93-47 to trust companies that are affiliates of an IDI, not just subsidiaries of IDIs.

TBS's comments expand upon the foregoing summary and also respond to some of the specific questions posed in the NPR.

III. DISCUSSION

A. Objectives of the NPR.

In a speech the day before the NPR was presented to the FDIC Board for approval, FDIC Chairman Jelena McWilliams noted the need to modernize the FDIC's brokered deposit regime for the following reasons:

> [S]ince [the adoption of Section 29 in 1989], the emergence of the internet and other technological innovations has fundamentally changed how banks interact with their customers. While some depositors still walk into a local branch, many customers now access banking services solely through the internet or smartphones, and today customers are increasingly utilizing channels such as prepaid cards and third-party fintech apps. Bank accounts are increasingly available to consumers through partners or affiliates of banks.
>
> A prime example is so-called "sweep accounts," which emerged around the early-to mid-2000s, in which broker dealers "sweep" cash balances that are not invested in stocks and bonds into FDIC-insured bank accounts or money market funds.[7]

Chairman McWilliams then described four objectives of the framework to be created by the NPR:

1. Encourage innovation within the industry;
2. Take a balanced approach to interpreting Section 29 that tracks the letter and spirit of the law;
3. Minimize risk to the Deposit Insurance Fund and address the core problems Congress sought to address in enacting Section 29 (and recognizing that brokered CDs were the specific products to which members of Congress referred in discussing the legislation); and
4. Establish an administrative process that emphasizes consistency and efficiency.[8]

The NPR includes a clearer, more expansive definition of the "primary purpose exception" to the definition of "deposit broker." For example, the FDIC Chairman's 12/11/19 Remarks referred to "unaffiliated sweeps that qualify for the primary purpose exception under the proposal," whereas only affiliated sweeps currently qualify for the exception. Expanding the primary purpose exception, absent other changes, would have the impact of reducing the scope of deposits treated as being brokered.

The Supplementary Information to the NPR confirms that the FDIC intended that "this proposed amendment to the primary purpose exception would expand the number of entities that meet the

[7] Keynote Remarks by FDIC Chairman Jelena McWilliams on "Brokered Deposits in the Fintech Age" at the Brookings Institutions, Washington, DC (Dec. 11, 2019), available at fdic.gov/news/news/speeches/spdec1119.html ("**FDIC Chairman's 12/11/19 Remarks")**.
[8] FDIC Chairman's 12/11/19 Remarks.

exception."[9] The FDIC eloquently summarized the benefits of reducing the range of deposits deemed to be brokered as follows:

> Changes and innovations in deposit placement activity are likely to continue, suggesting that demand for, and utilization of, certain types of deposit accounts currently classified as brokered are likely to grow in the years to come. These could include the use of technology services that help enable payments and online marketing channels that refer customers to certain banks. To the extent that the proposed rule would treat such deposits as nonbrokered, it could support ease of access to deposit placement services for U.S. consumers. . . . Additionally, to the extent that the proposed rule supports greater utilization of deposits currently classified as brokered deposits, but classified as non-brokered under the proposed rule, it could increase the funds available to insured depository institutions for lending to U.S. consumers. If the proposed rule does result in an increase in bank lending, some associated increase in measured U.S. economic output would be expected, in part because the imputed value of the credit services banks provide is a component of measured GDP.[10]

The FDIC has issued Advisory Opinions that currently permit (i) a broker-dealer to sweep Customers' funds to deposit accounts at an affiliated bank subject to specific conditions,[11] and (ii) a separately incorporated trust company affiliate of a bank to sweep deposits to affiliated and nonaffiliated banks to the same extent as the trust department of a bank[12] may pursuant to paragraph (g)(2)(C) of Section 29.[13] The primary purpose exception, as the FDIC has proposed to revise it in proposed Section 337.6(a)(5)(iii)(I) of its regulations, even with its attendant new application process, would in theory expand *the types of institutions* acting as the source for deposits deemed non-brokered; however, the proposed changes to the definition of "engaged in the business of facilitating the placement of deposits" in proposed Section 337.6(a)(5)(ii), or at least the application of the proposed revision as described in the Supplementary Information to the NPR, could defeat the FDIC's objectives in adopting the proposed rule by *narrowing* the scope of deposits deemed non-brokered under the primary purpose exception.

B. Description of Cash Sweep Programs.

Broker-dealers commonly use deposit sweep programs.[14] That is largely because broker-dealers are specifically authorized to place into such sweep programs otherwise uninvested cash in their

[9] NPR, 85 Fed. Reg. at 7459.
[10] *Id.* at 7464.
[11] FDIC Advisory Opinion No. 05-02, *Are Funds Held in "Cash Management Accounts" viewed as Brokered Deposits by the FDIC?* (Feb. 3, 2005 ("**Advisory Opinion 05-02**").
[12] FDIC Advisory Opinion No. 93-47, *Whether Independent Trust Company Which Conducts Activities On Behalf of Affiliated Bank Must Register as Deposit Broker* (July 21, 1993) ("**Advisory Opinion 93-47**").
[13] 12 U.S.C. § 1831f(g)(2)(C).
[14] "Sweep Program" is defined in 17 C.F.R. § 240.15c3-3(a)(17) as "a service provided by a broker or dealer where it offers to its customer the option to automatically transfer free credit balances in the securities account of the customer to either a money market mutual fund product . . . or an account at a bank whose deposits are insured by the Federal Deposit Insurance Corporation."

Customers' brokerage accounts.[15] There are several firms, including TBS, that sponsor and administer sweep programs used by broker-dealers and other Source Institutions, such as trust companies.

TBS provides the following services to Source Institutions as part of sponsoring and administering sweep programs:

1. Identifies Sweep Banks that are interested in taking sweep deposits. This includes:

    i. Recording target, maximum, and minimum balances desired by each Sweep Bank;

    ii. Making available to Source Institutions and prospective Source Institutions lists of potential Sweep Banks and the rates or range of rates such Sweep Banks have advised they are willing to pay for sweep deposits, subject to the Sweep Bank's negotiation with a particular Source Institution;

    iii. Recording reference rates used by Sweep Banks (e.g., Fed Funds daily or monthly).

2. Establishes operational parameters of the sweep program. This includes:

    i. Entering into agreements with Sweep Banks to assure consistency with operational parameters of the sweep program; and

    ii. Assisting Source Institutions in documenting contracts with Sweep Banks to assure consistency with operational parameters of the sweep program.

3. Administers the allocation of deposits of Customers to Sweep Banks by using one of two automated rules-based methodologies (described below) approved in advance by the Source Institution to calculate each day's allocation, subject to final decision by the Source Institution and actual movement of funds by the Source Institution's instructions to its own bank. This includes:

    i. Receiving daily transactional files from Source Institutions;

    ii. Identifying opt-outs (*i.e.*, Customers that have given instruction to not deposit funds in one or more specified Sweep Banks, frequently because the Customer already has deposits in that IDI outside the sweep program);

    iii. Calculating individual Customers' beneficial interests across Sweep Banks in a manner designed to achieve the level of FDIC insurance selected by the Source Institutions (*e.g.*, 4 banks to ensure $1 million of FDIC insurance) using one of the two following methodologies:

[15] 17 C.F.R. § 240.15c3-3(j)(2)(ii).

a. Distance From Target -- Use algorithm implementing **rules established by the Source Institution**, consistent with the target maximum and minimum balances set by each Sweep Bank; or
b. Waterfall – Prioritize Sweep Banks in order **selected by the Source Institution**, filling each Sweep Bank up to its selected target balance before allocating deposits to the next Program Bank;

iv. Tracking withdrawals each day within a given month by the Source Institution and/or each Customer of each Source Institution from Money Market Deposit Accounts ("**MMDAs**") at each Sweep Bank for the compliance with restrictions on automatic withdrawals pursuant to Section 204.2(d)(2) of the Federal Reserve Board's Regulation D ("**Regulation D")**;[16]

v. Sending reports to Sweep Banks about the deposits to be received by, withdrawals to be made from, or transfers between accounts to be processed by, each Sweep Bank each day;

vi. Maintaining records on behalf of the Source Institution regarding each day's deposits, withdrawals, and interest accruals, and the end-of-day balance, of each Customer as a beneficial interest in the omnibus account to facilitate the Source Institution's compliance with its obligations to facilitate the Sweep Bank's compliance with the FDIC's recordkeeping rules in 12 C.F.R. Parts 360 and 370;

vii. Providing end-of-day balances to the Source Institution to facilitate its reconciliation with each Sweep Bank (as required by FINRA for broker-dealers);

viii. Maintaining records of interest accruing to each Customer holding a beneficial interest in the Source Institution's custodial account at the Sweep Bank, based on instructions received from the Source Institution, and of interest paid out upon a Customer's withdrawal of all funds at a Sweep Bank;

ix. Maintaining records of fees accruing to each of the Source Institution (both clearing and introducing brokers) and to TBS as administrator; and

x. Preparing necessary fee invoices; providing reports to the Sweep Banks and Source Institutions regarding invoicing and fees.

C. <u>Facilitation Prong of the "Deposit Broker" Definition</u>.

The NPR would amend the definition of "deposit broker" in proposed Section 337.6(a)(5) by adding a new definition of "engaged in the business of facilitating the placement of deposits of third parties

[16] 12 C.F.R. § 204.2(d)(2)

with insured depository institutions" to mean a person engaged in one or more of the following activities ("**Proposed Facilitation Activities**"):

(A) Directly or indirectly sharing any third party information with the IDI ("**Information Sharing Restriction**");
(B) Having legal authority, contractual or otherwise, to close a third party's deposit account or move the third party's funds to another IDI ("**Account Authority Restriction**");
(C) Providing assistance or being involved in setting rates, fees, terms or conditions for the deposit account ("**Contract Assistance Restriction**"); or
(D) Acting directly or indirectly with respect to the placement of deposits, as an intermediary between a third party that is placing deposits on behalf of a depositor and an IDI, other than in a purely administrative capacity ("**Intermediary Restriction**").

The remainder of this Section III.C addresses the following four questions raised by the FDIC in the NPR:

> Question 2: Is the FDIC's proposed definition of "engaged in the business of facilitating the placement of deposits" appropriate?
>
> 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?
>
> Question 4: Has the FDIC provided sufficient clarity surrounding whether a third-party intermediary would meet the "facilitation" prong of the "deposit broker" definition?
>
> 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 FDIC's proposed definition of "engaged in the business of facilitating the placement of deposits," including the list of Proposed Facilitation Activities that would determine whether a person meets the facilitation prong of the "deposit broker" definition, is ambiguous, overbroad, and not sufficiently tailored to the extent that it applies to deposit sweep programs. In particular, the factors proposed for determining when a third-party service provider would be viewed as a deposit broker under the "facilitation" prong of the "deposit broker" definition at best lack clarity and specificity, and at worst inappropriately interfere with the ability of a holder of a primary purpose exception to use the services of a third party to administer a sweep program.

The Supplementary Information to the NPR states: "For example, if an agent or nominee that meets the primary purpose exception uses an intermediary (in a manner that is not purely administrative) in placing, or facilitating the placement of, deposits, then the intermediary would be a deposit broker, and the resulting deposits would be brokered."[17] We believe this should not be the standard the FDIC adopts with regard to sweep programs. If the Source Institution is not regarded as a deposit broker

[17] NPR, 85 Fed. Reg. at 7457.

because it meets the FDIC's exemption qualifications, then a service provider that only assists the Source Institution in connection with the deposits should not be a deposit broker.

Advisory Opinion 05-02 imposed some restrictions on the fees to be paid by the Sweep Bank to its affiliated broker-dealer, and included the assumption that, "the fees represent payment for recordkeeping and administrative services and not payment for the placement of deposits." Nothing in the Advisory Opinion, however, imposed restrictions on the broker-dealer's use of a third-party service provider to administer the arrangement.

For participants in sweep programs, it is crucial to know with precision what functions performed by the service provider that administers the program for a Source Institution which qualifies for the primary purpose exception would result in the deposits swept by the Source Institution to be treated as brokered. Otherwise, a service provider would have to guess whether performing a particular function comes within the scope of "administrative functions." Failure to address this issue with greater specificity than the rule as proposed in the NPR will undoubtedly complicate and confuse the process created by the NPR to obtain approval of the use of the primary purpose exception. The examples of administrative functions set forth in the NPR[18] (reporting and bookkeeping assistance provided to the person placing its Customers' deposits) are <u>not</u> sufficiently comprehensive. Moreover, the examples of functions that are not administrative (assisting in decision-making or steering persons to particular institutions) create significant uncertainty as to what activities beyond ministerial reporting and bookkeeping assistance would be regarded as within the scope of administrative functions.

As noted above, the proposed rule includes four Proposed Facilitation Activities that cause a person to be deemed to be engaged in the business of facilitating the placement of Source Institutions' deposits with IDIs. Each of those four Proposed Facilitation Activities are so overbroad that we believe few, if any, sweep administrators could avoid deposit broker status. The NPR, as drafted, would virtually preclude the use of a third-party administrator by any Source Institution approved to use the primary purpose exception (at least without losing all of the benefit of that exception). If the FDIC decides to require applications for the primary purpose exception, despite TBS's recommendation below to the contrary, the lack of clarity regarding when a third party service provider would be regarded as acting in an administrative capacity would make the application process cumbersome and lengthy.

1. <u>Information Sharing Restriction</u>

The Facilitation Prong reads, in relevant part, "A person is engaged in the business of facilitating the placement of deposits of third parties with insured depository institutions, by . . . (A) The person [sic] directly or indirectly shares any third party information with the insured depository institution." Absent some revision, this provision would appear to treat a sweep program administrator as the "person" and the Source Institution and its Customers as "third parties."

[18] NPR, 85 Fed. Reg. at 7457.

Although a sweep administrator generally does not share the identities of the Source Institution's underlying Customers with the Sweep Bank, a sweep administrator providing services to the holder of a primary purpose exception cannot avoid sharing other Source Institution information with the Sweep Bank. The NPR's current formulation would prevent the administrator from providing services relating to providing records to the Sweep Bank necessary (i) under the FDIC's recordkeeping rules in 12 C.F.R. Parts 360 and 370 and (ii) to the Sweep Bank's compliance with the MMDA rules in Regulation D (12 C.F.R. § 204.2(d)(2)). A sweep administrator should be able to share third-party information with an IDI to the extent consistent with the definition of "administrative capacity"; we suggest a definition of that term in Section III.C.4 below. Such permitted shared information should, at a minimum, include:

i. Tracking withdrawals each day within month by the Source Institution and/or each Customer of each Source Institution MMDAs from each Sweep Bank for the compliance with restrictions on automated withdrawals pursuant to Section 204.2(d)(2) of Regulation D;

ii. Sending reports to Sweep Banks about deposits to be received by, withdrawals to be made from, or transfers between accounts to be processed by, each Sweep Bank each day.

iii. Maintaining records of the end-of-day balance of each Customer as a beneficial interest in the omnibus account; while performed by the administrator as an agent of the Source Institution, technically the information is subject to the FDIC's recordkeeping rules in 12 C.F.R. Parts 360 and 370;

iv. Providing assistance to facilitate the Source Institution's reconciliation of end-of-day balances with each Sweep Bank (as required by FINRA for broker-dealers);

v. Forwarding invoices to Program Banks on behalf of the Source Institutions to pay fees to the custodian and administrator pursuant to the sweep program documentation (but the administrator does not itself move any funds); and

vi. Providing necessary reports and information to the Sweep Banks about any of the administrative services listed in Section III.C.4 below.

Section 337.6(a)(5)(ii)(A) should be revised to permit the foregoing categories of information to be shared with the IDI by an administrator of a deposit sweep program without causing that administrator to be treated as a deposit broker. In this regard, the FDIC's requirements permit a listing service to serve as a communications link between the depositor and the IDI. See FDIC Advisory Opinion No. 04-04 (July 28, 2004). [19] If an entity that otherwise was not a deposit broker could serve as a communications link for purposes of the listing service exemption, TBS believes the FDIC should similarly permit other service providers to perform the same function.

[19] FDIC Advisory Opinion No. 04-04, *Question Regarding FDIC's Criteria for Determining When a "Listing Service" Is a "Deposit Broker"* (July 28, 2004) ("**Advisory Opinion 04-04**").

2. Account Authority Restriction

The Account Authority Restriction causes a person to be a deposit broker if "[t]he person has legal authority, contractual or otherwise, to close the account or move the third party's funds to another insured depository institution."

Administrators of sweep programs using the Distance-From-Target allocation methodology run nondiscretionary algorithms using criteria approved in advance by Source Institutions to generate allocations of deposits among Sweep Banks, which may be subject to final approval by the Source Institution. The Sweep Bank establishes an aggregate target amount of deposits that it will accept from the sweep program, and the administrator tracks the target balances of all Sweep Banks across deposits made by different Source Institutions. Each business day the administrator generates a tentative allocation based on the amount by which the actual balances are short of the aggregate target amount, until all Sweep Banks have achieved their targets or are equally short of those targets. The Distance-From-Target methodology may produce fewer day-to-day variances in funding among Sweep Banks than the Waterfall methodology.

Administrators using the Waterfall allocation methodology allocate deposits to each Sweep Bank in the order specified by the Source Institution. Deposits are allocated to a Sweep Bank until it receives its target balance, then to each successive IDI until it receives its target balance.

Under either the Distance-From-Target or the Waterfall methodology, a tentative allocation is presented to the Source Institution, and the final decision regarding the allocation of deposits is made by the Source Institutions. Source Institutions are able to require changes to the recommended allocations. Funds are moved only by the Source Institution instructing its bank. Under either methodology, deposits of individual Customers' funds are allocated in a way that maximizes FDIC insurance to the Customers. In either case, **only the Source Institution – never the administrator** – actually moves funds through instructions to its bank.

Therefore, the FDIC should clarify, in the text of the rule or at least in guidance, that a sweep program administrator is not a deposit broker by virtue of the fact that it calculates an allocation of the deposits of a Source Institution and its underlying Customers among Sweep Banks participating in the Source Institution's sweep program in accordance with rules-based non-discretionary criteria established by Source Institutions, and communicates those allocations for final approval of and implementation by the Source Institutions.

3. Contract Assistance Restriction

Proposed Section 337.6(a)(5)(ii)(C) is overbroad to the extent it prevents the sweep program administrator from having **any** ability to assist either the Source Institution or the Sweep Bank, or to have any involvement, in setting rates, fees, terms, or conditions for the deposit accounts at the Sweep Banks. This could be read to prevent a sweep program administrator from performing, at a minimum, any of the following ordinary sweep administration services:

i. Recording rates to be paid by each Sweep Bank and making that data available to prospective Source Institutions;

ii. Entering into agreements with Sweep Banks to document consistency with operational parameters of the sweep program, such as cut-off time for receipt of deposits for same-day credit, instructions for withdrawals for same-day processing, procedures for compliance with Federal Reserve Regulation D, and procedures by which Sweep Banks and Source Institutions reconcile end-of-day balances; or

iii. Assisting Source Institutions in documenting contracts with Sweep Banks to assure consistency with operational parameters of the sweep program similar to those described immediately above for the agreements between Sweep Banks and the administrator, plus processes relating to payment of interest and fees and compliance with FDIC rules relating to pass-through insurance, with anti-money laundering and OFAC rules, and in the case of Source Institutions that are broker-dealers, guidance of the Financial Industry Regulatory Authority ("**FINRA**").

If a sweep program administrator cannot perform the first two of the foregoing three activities, then for all intents and purposes the FDIC will have limited the availability of the primary purpose exception to Source Institutions that are affiliated with the Sweep Banks. This would be inconsistent with the FDIC's statement that it will eliminate specific reference to affiliation as a prerequisite for eligibility for the primary purpose exception, and not limit eligibility for the primary purpose exception to Source Institutions that are affiliated with the Sweep Banks.[20] Without a third party administrator to record rates offered by Sweep Banks, it would be cumbersome for each Source Institution to identify a network of potential Sweep Banks sufficient to provide the desired level of FDIC deposit insurance. Without the ability of the third party administrator to enter into agreements with Sweep Banks detailing the operational parameters of the sweep program described above, it would be difficult for any network to achieve the requisite operational efficiency.

The fact that an administrator assists Source Institutions in identifying IDIs that may be willing to act as Sweep Banks and makes available to Source Institutions information about a rate or range of rates that a Sweep Bank would be willing to pay for sweep program deposits should not, in and of itself, cause the subsequent deposits to be treated as brokered. Indeed, these are precisely the types of information a listing service makes available to its clients, and FDIC Advisory Opinion 04-04 and Section D of the FAQs issued about brokered deposits in June 2016,[21] generally exempted listing services from the definition of deposit broker. That treatment is appropriate in the case of a sweep program administrator because the administrator is not separately compensated for making the information available, and restricting the service provider to functions performed in an administrative capacity is consistent with the other conditions generally applicable to listing services exempt from

[20] FDIC Chairman's 12/11/19 Remarks (referring to "unaffiliated sweeps that qualify for the primary purpose exception under the proposal").
[21] FDIC Financial Institution Letter 42-2016, "*Identifying, Accepting and Reporting Brokered Deposits Frequently Asked Questions*" (June 30, 2016), available at https://www.fdic.gov/news/news/financial/2016/fil16042b.pdf.

classification as a deposit broker. **The Contract Assistance Restriction should be revised so that a sweep administrator would not be treated as a deposit broker as a result of performing the services listed above.**

4. Intermediary Restriction

As noted above, the Intermediary Restriction in proposed Section 337.6(a)(5)(ii)(D) would treat as a deposit broker an intermediary between a Sweep Bank and a Source Institution placing deposits in that Sweep Bank if the intermediary acts in other than a purely administrative capacity. The description of the Intermediary Restriction in the NPR Supplementary Information states, "Administrative functions would include, for example, any reporting or bookkeeping assistance provided" to the Source Institution, but "would not include, for example, assisting in decision-making or steering persons (including the underlying depositors) to particular insured depository institutions."[22] This goes beyond the conditions imposed in Advisory Opinion 05-02, which allows payment of fees "for recordkeeping **AND** administrative services" (emphasis added). Thus, it was contemplated that administrative services constitute services **in addition to** recordkeeping.

The Intermediary Restriction should be revised to clarify that a person will not be treated as a deposit broker as a result of providing services for a sweep program in an administrative capacity. The FDIC should provide that a service provider will be acting in an "administrative capacity" if it engages in one or more of the following functions:

i. Identifying Sweep Banks that are interested in taking sweep deposits;
ii. Establishing and documenting operational parameters of the sweep program;
iii. Administering the allocation of deposits of Customers to Sweep Banks by using a methodology approved in advance by the Source Institution to calculate each day's allocation, subject to final decision and actual movement of funds by the Source Institution or its bank
iv. Tracking withdrawals each day within a given month by the Source Institution and/or each Customer of each Source Institution from MMDAs at each Sweep Bank for the compliance with restrictions on automated withdrawals pursuant to Section 204.2(d)(2) of Regulation D;
v. Maintaining records of the end-of-day balance of each Customer as a beneficial interest in the omnibus account; while performed by the administrator as an agent of the Source Institution, technically the information is subject to the FDIC's recordkeeping rules in 12 C.F.R. Parts 360 and 370;
vi. Providing assistance to facilitate the Source Institution's reconciliation of end-of-day balances with each Sweep Bank (as required by FINRA for broker-dealers); and
vii. Preparing, maintaining and distributing reports to Sweep Banks and Source Institutions regarding the foregoing.

[22] FDIC Chairman's 12/11/19 Remarks.

The current proposal's inclusion of the word "purely" before "administrative capacity" adds confusion, not clarity, and "purely" should be deleted. The FDIC should just define "administrative capacity" objectively, as suggested above, in which case "purely" would be superfluous.

D. Need to Exclude Sweep Program Administrators from the Facilitation Prong of the "Deposit Broker" Definition.

Deposit sweep programs are dramatically different from the forms of brokered deposits that caused Congress to adopt Section 29, and deposit sweep administrators are dramatically different from deposit brokers whose activities are deemed to justify the regulation of deposits as brokered under Section 29.

1. Deposit Sweep Programs vs. Traditional Brokered CDs

In her remarks before the FDIC Board on December 12, 2019, FDIC Chairman McWilliams recognized that, "Today, the term 'brokered deposits' encompasses a diverse range of deposit placement arrangements, including traditional brokered CDs" plus "various types of brokerage sweep accounts, certain prepaid card programs and health savings accounts, and a range of other types of deposit products that involve online or mobile third parties. When Congress enacted brokered deposits restrictions thirty years ago, most of these types of deposit placement arrangements did not exist, and today they exhibit meaningfully different characteristics from the traditional brokered deposits Congress sought to address. . . . [Brokered CDs are] the specific products Congress targeted when it enacted brokered deposits restrictions in 1989 . . . ."[23]

The following table from last year's TBS ANPR Comment Letter summarizes the distribution of banks that are "well capitalized", "adequately capitalized" and less than "adequately capitalized" under the Prompt Corrective Action ("**PCA**") capital regime[24] among Sweep Banks[25] and Non-Sweep Banks.[26]

[23] 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.html.

[24] See 12 C.F.R. § 324.403(b).

[25] Sweep Banks in the table include IDIs that participate in TBS's IDS Program and those identified from nine websites listed in the TBS ANPR Comment Letter as participating in other insured deposit sweep programs.

[26] Total number of banks and data regarding prompt corrective action capital categories derived from banks' Reports of Condition available on the FFIEC Central Data Repository's Public Data Distribution website.

Sweep Banks vs Non-Sweep Banks

	2006 - 2018			2011 - 2018		
PCA Category of Sweep Banks	# of banks	% of total		# of banks	% of total	
Well Capitalized	209	91.7%		222	97.4%	
Adequately Capitalized	14	6.1%	**8.3%**	3	1.3%	**2.6%**
< Adequately Capitalized	5	2.2%		3	1.3%	
Total	228	100.0%		228	100.0%	
PCA Category of Non-Sweep Banks With No Brokered Deposits						
Well Capitalized	3079	92.6%		2974	94.0%	
Adequately Capitalized	119	3.6%	**7.4%**	62	2.0%	**6.0%**
< Adequately Capitalized	125	3.8%		126	4.0%	
Total	3323	100.0%		3162	100.0%	
PCA category of Non-Sweep Banks With Brokered Deposits						
Well Capitalized	4534	79.1%		3808	90.6%	
Adequately Capitalized	506	8.8%	**20.9%**	149	3.6%	**9.4%**
< Adequately Capitalized	695	12.1%		245	5.8%	
Total	5735	100.0%		4202	100.0%	

To summarize the more detailed analysis that was included in the TBS ANPR Comment Letter, the percentage of IDIs that accepted sweep deposits and became less than adequately capitalized or even adequately capitalized during the period from 2006 to 2018 was on par with IDIs that took no brokered deposits during that period and much lower than the percentage of IDIs that took brokered deposits and incurred a PCA category reduction.

Since the 2018 study, five banks have failed and 12 banks experienced a decline in PCA category. All failures were from Non-Sweep Banks, of which two had non-sweep brokered deposit balances. Non-Sweep banks accounted for 11 of the 12 PCA downgrades, of which six had non-sweep brokered deposit balances. The stronger performance of Sweep Banks in 2019 - no failures and only one with a PCA decline - further supports the assertion that Sweep Banks undergo rigorous selection and monitoring by sweep programs and their deposits are materially less risky than other forms of deposits regarded as brokered.

TBS is unaware of any data demonstrating that sweep deposits have contributed to high rates of IDI asset growth. The statistical data presented above supports TBS's position that the FDIC has unfairly restricted sweep deposits by categorizing them automatically as brokered deposits without having done sufficient analysis to justify such restrictions.

2. Sweep Administrators vs. Deposit Brokers

The third concern identified in the ANPR was that, "Brokered and high rate deposits [lumped together] were sometimes volatile because deposit brokers (on behalf of customers), or the customers

themselves, were often drawn to high rates and were prone to leave the bank when they found a better rate or they became aware of problems at the bank."[27]

Source Institutions sweep Customers' funds to deposit accounts as a temporary placement of funds awaiting investment; they are not intended to be long-term investments, and Source Institutions have a duty of care to their Customers whose funds are in their custody. Therefore, the Source Institutions must be concerned with the soundness of the Sweep Banks. Source Institutions – whether they are broker-dealers, trust companies, or other financial institutions – do not want their Customers' funds to get tied up in a bank receivership. They typically establish eligibility criteria for IDIs to which they will sweep deposits and along with sweep plan administrators, such as TBS, monitor for continued conformance with those criteria, with a view to identifying trends that might predict when a Sweep Bank would cease to be well capitalized.[28] IDIs that utilize sweep deposits as part of their funding strategy are aware of these expectations. Moreover, neither Source Institutions nor sweep administrators have any incentive to precipitously withdraw deposits from a Sweep Bank, as that reduces capacity for the sweep program to provide insured deposits for the Source Institutions' Customers. Rather, the Source Institutions and the sweep program administrators have an identity of interest with the FDIC to identify negative trends and consult with a Sweep Bank to correct those trends well before the IDI's financial condition deteriorates to the point where a Source Institution determines that withdrawal of its deposits are necessary to protect the Source Institutions' Customers. While TBS provides information through its TBS Bank Monitor® data system that allows users, including but not limited to Source Institutions, to analyze the condition of discrete IDIs, TBS, and to its knowledge, any other sweep administrator, does not have authority to close a Source Institution's account at a Sweep Bank and would not risk incurring liability by recommending that a Source Institution withdraw its Customers' funds from or close an account at a Sweep Bank.

Deposit sweep programs were of enormous benefit to the banking system to satisfy IDIs' need for liquidity during the market disruptions in March 2020. The precipitous drop in the stock market resulted in sell-offs that caused investors to hold greater-than-normal levels of cash in their brokerage accounts; and the reduction of interest rates resulting from the Federal Reserve Board's reduction to zero of the Federal Funds rate resulted in a spike of demand for loans. Broker-dealers and IDIs turned to the sweep programs to allocate the otherwise uninvested cash to IDIs that were experiencing a need for liquidity. TBS believes IDIs sought incremental balances to accommodate the sharp increase in draws on lines of credit including, but not limited to, commercial lines and retail credit cards. The incremental liquidity provided by sweep programs, in conjunction with FHLB advances, Federal

[27] *Id.* (Emphasis added.)

[28] While only TBS has access to its proprietary *Bank Monitor* tool to meet these expectations, other sweep administrators also have procedures to meet these expectations. For example, another sweep administrator firm, StoneCastle Cash Management, states that it "reviews each bank in its network and monitors those banks on a quarterly basis. Management is keenly aware that headline risk to a failed bank could cause stress on the franchise and ultimately FICA's future viability." Kroll Bond Rating Agency, *StoneCastle Federally Insured Cash Account*, (Feb. 21, 2018), p. 9, available at https://www.krollbondratings.com/show_report/8823.

Reserve discount window advances, repurchase agreements, and other short-term funding sources, represented prudential utilization of well-diversified contingency wholesale funding strategies.

Even if the FDIC believes that the statutory definition of deposit broker includes intermediaries performing certain functions in connection with sweep programs, it has the authority to exempt them. The statutory exclusions are a floor – the FDIC must implement at least those exclusions, but nothing in the FDI Act precludes the FDIC from creating additional exceptions by regulation. Indeed, the Core Principles and related case law discussed in Section IV of this letter support the concept that **the FDIC should tailor the final rule to exclude from the definition of deposit broker persons performing administrative functions, as defined in Section III.C.4 above** (pp. 13-14)**, for sweep programs.**

3. Alternative Proposal to Remove Stigma from Sweep Deposits

TBS noted in its ANPR Comment Letter that Sweep Banks may have remained well capitalized more consistently than IDIs that do not accept sweep deposits because they must stay well capitalized to be able to accept sweep deposits as long as they are classified as brokered deposits. **If the FDIC agrees with that conclusion, it could, in cases where the holder of a primary purpose exception uses an administrator to perform functions beyond recordkeeping and bookkeeping, impose a requirement that any participating Sweep Bank remain well capitalized at all times that it treats the sweep deposits as nonbrokered.** At any time that a Sweep Bank were to then become less than well capitalized, the deposits would be classified as "brokered" and the Sweep Bank would need to file an application to continue to accept the brokered deposits. While this would effectively give the same regulatory treatment to the deposits as if they were brokered, it is TBS's experience that examiners and analysts still impose an undeserved stigma on IDIs that accept any kind of brokered deposits, and the treatment suggested by TBS would alleviate this concern with respect to sweep deposits without compromising the FDIC's prudential concerns.[29]

E. Responses to Specific Questions Posed in the NPR

1. Questions 6 and 7:

Question 6: Is it appropriate for a separately incorporated operating subsidiary to be included in the IDI exception?

Question 7: Are the criteria for including an operating subsidiary in the IDI exception too broad or too narrow?

[29] The TBS ANPR Comment Letter suggested other actions, such as revisions to the FDIC's Assessments Rule in 12 C.F.R. Part 327, the federal bank agencies' Liquidity Coverage Ratio: Liquidity Risk Measurement Standards (Part 329 of the FDIC's regulations), and the UBPR classifications of core deposits, to address the problem of unwarranted stigmatization of brokered deposits by examiners and analysts. That discussion is beyond the scope of this letter.

In its comments to the ANPR, TBS urged the FDIC to Amend the FDIC Brokered Deposit Rule to incorporate the provisions of Advisory Opinion 93-47 ("**Advisory Opinion 93-47**"),[30] which allows a separately incorporated trust company affiliate of a bank to sweep deposits to affiliated and nonaffiliated banks to the same extent as the trust department of a bank, with such sweeps being excluded from being considered brokered under the Primary Purpose Exclusion, and rescind Advisory Opinion 92-51 ("**Advisory Opinion 92-51**")[31] to the extent it causes a sweep deposit to be a brokered deposit if a trust department or trust company takes any fee in connection with the sweep.

Unless the FDIC proposes to eliminate Advisory Opinion 93-47, proposed new Section 337.6(a)(5)(iii)(A)(1) of the FDIC Brokered Deposit Rule would be unnecessary. That provision of the proposed rule would extend the exception in Section 29 for deposits placed by employees of the IDI to a wholly owned operating subsidiary of an IDI that engages only in activities permissible for the IDI. The proposed rule, however, would unnecessarily narrow the exception by (i) requiring that the trust company be a wholly owned subsidiary of the IDI; and (ii) that the trust company place deposits of retail customers exclusively with its parent insured IDI.

Paragraph (g)(2)(C) of Section 29 exempts from the definition of "deposit broker" a trust department of an IDI, if the trust in question has not been established for the primary purpose of placing funds with IDIs. It does not require that the funds be deposited by the trust department in the same IDI; there is no reason that Section 337.6(a)(5)(iii)(A)(1) should require that, either. That is, there is no reason to place additional restrictions on an operating subsidiary than those that apply to the parent IDI itself. Moreover, by requiring that all retail deposits be placed with the parent bank, the trust company subsidiary could be forced with a Hobson's choice of whether to place uninsured funds in the parent bank (which might breach its fiduciary duty or possibly even state law), or to lose the exemption from deposit broker status. Such a requirement also has the effect of denying beneficiaries from obtaining full deposit insurance of their funds in the event their interests were to exceed deposit insurance limits.

Finally, if the FDIC decides to provide an exception to trust companies that are subsidiaries of IDIs, it should not be limited to "wholly owned subsidiaries." TBS suggests that, instead, a trust company be eligible if it would qualify as an "operating subsidiary" under Section 5.34(e)(2) of the OCC's

[30] FDIC Advisory Opinion No. 93-47, *Whether Independent Trust Company Which Conducts Activities On Behalf of Affiliated Bank Must Register as Deposit Broker* (July 21, 1993).
[31] FDIC Advisory Opinion No. 92-51, *Extent to Which Trust Department of Bank Is Subject to Registration Requirements Imposed by New Brokered Deposit Prohibitions* (Aug. 3, 1992).

regulations.[32]

2. Question 8:

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?

TBS commends the FDIC for establishing a bright-line test, which is effectively a presumption to be used when a Source Institution applies for the primary purpose exception. The bright-line test provides clarity that will benefit Source Institutions that file the applications, and the FDIC staff that processes them. In this regard, TBS recommends the FDIC establish additional bright lines for other elements of the proposal, especially with regard to permissible administrative functions.

3. Question 11:

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?

TBS makes the following recommendations:

i. The FDIC should clarify the status of any approvals it has given to date in accordance with Advisory Opinion 05-02;
ii. The FDIC should incorporate the provisions of Advisory Opinion 93-47 to allow a separately incorporated trust company affiliate of an IDI to sweep deposits to affiliated and nonaffiliated IDIs to the same extent as the trust department of an IDI, with such sweeps being excluded from being considered brokered under the Primary Purpose Exclusion, and without requiring that all retail deposits be placed with the parent IDI; and
iii. The FDIC should rescind Advisory Opinion 92-51 to the extent it causes a sweep deposit to be a brokered deposit if a trust department or trust company takes any fee in connection with the sweep. TBS believes the provisions of Paragraph (g)(2)(C) of Section 29 can be self-effectuating, and do not need further clarification by the FDIC.

[32] A subsidiary would be an "operating subsidiary" of an IDI under the OCC rule (12 C.F.R. § 5.34(e)(2)) if:
(i) The IDI has the ability to control the management and operations of the subsidiary, and no other person or entity exercises effective operating control over the subsidiary or has the ability to influence the subsidiary's operations to an extent equal to or greater than that of the IDI;
(ii) The IDI owns and controls more than 50% of the voting (or similar type of controlling) interest of the operating subsidiary, or the parent IDI otherwise controls the operating subsidiary and no other party controls a percentage of the voting (or similar type of controlling) interest of the operating subsidiary greater than the IDI's interest; and
(iii) The operating subsidiary is consolidated with the IDI under generally accepted accounting principles (GAAP).

TBS viewed its comment regarding Advisory Opinion 92-51 as relating to the Trust Management Exception in subparagraph (C) of paragraph (g)(2) of Section 29. The NPR did not address subparagraph (C), only the bank employee exemption of subparagraph (B). The Trust Management exclusion from the definition of "deposit broker" exempts deposits placed by a trust department of an IDI, if the trust in question has not been established for the primary purpose of placing funds with IDIs.[33]

The issue here is that independent trust companies need to prudentially invest the funds of their trust Customers subject to the same duties as trust departments of IDIs, and, in any event, the funds must be deposited by the trust companies in IDIs until they are invested more permanently.

In Advisory Opinion 93-47, the FDIC acknowledged that "a trust company affiliated with a bank and serving essentially the same function as a trust department for that bank would be excluded from the definition of deposit broker . . . so long as the trust or other fiduciary relationship in question has not been established for the primary purpose of placing funds with insured depository institutions." Advisory Opinion 93-47 should be incorporated into Section 337.6(a)(5)(iii)(C) (as renumbered in the proposed FDIC Brokered Deposit Rule).

FDIC Advisory Opinion 92-51, applicable to trust departments of banks under the Trust Management Exclusion, sets out three tests for determining whether the fiduciary relationship was created for the "primary purpose of placing funds with depository institutions," and, therefore, causes any funds deposited from a trust account resulting from that relationship to be treated as brokered:

1. *Fees received.* If the depository institution receives a fee for its account from the IDI with which its trust department places the funds of a trust, the trust department [or affiliated trust company] is a deposit broker as to that trust.

2. *"But for" test.* If the trust would not have been established but for the purpose of placing funds in an IDI, the trust department [or affiliated trust company] is a deposit broker as to that trust.

3. *Substantial purpose test.* If there is no substantial purpose for the trust other than the placement of funds in IDIs, the trust department [or affiliated trust company] is a deposit broker as to that trust.

While TBS understands the imposition of the "but for" and "substantial purpose" tests, even the primary purpose exception has not been read by the FDIC to require that a broker-dealer receive **no** fees, as is clear from Advisory Opinion 05-02 and from the proposed rule. **Therefore, there is no rationale for an absolute prohibition on a bank or trust company receiving some fee in connection with sweeping deposits to a bank,** if for no other reason than that the trust company will be required to assist the bank in complying with the FDIC's Part 370 regulations (Recordkeeping for

[33] 12 U.S.C. § 1831f(g)(2)(C).

Timely Deposit Insurance Determination),[34] which become effective this year. A bank or trust company would, of course, need to make its own determination that the fee is consistent with its fiduciary obligations under applicable law.

4. Question 14:

Question 14. Is the application process proposed for the primary purpose exception appropriate? Are there ways the application process could be modified to make it more effective or efficient?

While TBS recognizes that the FDIC attempted to limit the length of the application processing period by specifically providing in proposed Section 303.243(b)(7) that an applicant for the primary purpose exception should receive a written determination within 120 days of the FDIC's receipt of a complete application, TBS does not believe that will create a fair process. In Section VI(A) of the NPR – the Paperwork Reduction Act section – the FDIC "estimated that 1,203 firms will apply for an exception based on placing less than 25 percent of customer assets under management on average each year over three years."[35] If even a modest percentage of those firms were to apply shortly after the rule becomes effective, the FDIC would be unable to process the applications within the 120-day timeframe. Firms whose applications are processed early would be given an unfair competitive advantage over firms whose applications are processed later. Moreover, this unfairness is exacerbated when the FDIC seeks additional information from applicants whose applications are deemed incomplete, which has the effect of further extending the processing timeframe for such applicants.

The NPR does not explain the reasons that the FDIC has chosen to propose an application process for the primary purpose exception. As noted above, paragraph (g)(2) of Section 29 lists nine exceptions from the definition of "deposit broker." The primary purpose exception in subparagraph (I) is merely one of the nine exceptions. There is nothing in paragraph (g)(2) to suggest that the exceptions are not self-effectuating. The "approval" process used for banks to claim the primary purpose exception to date appears, in the absence of prior rulemaking, to have been a no-action letter process. In fact, the FDIC issued its FAQs because it believed that banks were asserting the exception in situations where the FDIC believed it did not apply. The FDIC has never suggested the need for an application process for any of the other eight exceptions in Section 29(g)(2). It appears that the reason the FDIC wants to create an application process for the primary purpose exception is to be able to impose, as a condition of approval, ongoing reporting requirements in proposed Section 303.243(b)(9). Nothing would prevent the FDIC from adopting ongoing reporting requirements by regulation in the absence of an application process, and nothing would prevent the FDIC from requiring an IDI to provide notice to the FDIC that it had commenced accepting deposits in reliance on the primary purpose exception so that the FDIC would know to expect future reports from that IDI.

Rather than mandate an application process, TBS proposes that the FDIC include specific and detailed requirements in the final rule for the primary purpose exception, as we have recommended in this letter

[34] 12 C.F.R. Part 370.
[35] 85 Fed. Reg. at 7465.

for the primary purpose exception for deposit sweep programs. IDIs and third parties should be able to rely upon these rule requirements, perhaps based on a reasoned opinion of experienced counsel that they satisfy the rule requirements. The FDIC could of course subsequently make a different determination in the case of a specific IDI or program. If an IDI or third party desires greater certainty, it could at its option utilize the current no-action process, or the application process proposed in the NPR if it is finally adopted. Even if the FDIC determines to mandate the application process in all cases, TBS recommends that the FDIC nevertheless include specific and detailed requirements for the primary purpose exception in the final rule. This will provide important guidance for IDIs and third parties about how to structure their relationships and their FDIC applications, as well as easing the burden on FDIC staff and Board in processing and deciding on the applications.

5. Question 17:

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

The NPR anticipates that Source Institutions will apply for the primary purpose exception. It will be the Sweep Banks, however, that rely on the approval to report the deposits as non-brokered. Therefore, if despite TBS's response to Question 14 above the FDIC proceeds in adopting the application process, the Source Institutions will need to be able to provide evidence of the FDIC's approval, so there must be some form of public order under Section 309.4(a)(2)(i) of the FDIC's rules evidencing the approval. That order would need to include any conditions that affect the activities of Sweep Banks or intermediaries. Source Institutions can request confidential treatment of information that constitutes a trade secret or privileged or confidential commercial or financial information pursuant to Section 309.4(g)(4) of the FDIC's rules.

Even if confidential information is omitted from such a public order, it would still be helpful if each order were to include the reasons the FDIC approved or disapproved the application.

6. Question 20:

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?

If despite TBS's response to Question 14 above the FDIC proceeds in adopting the application process, then, in order to make the 120-day processing period realistic, the FDIC should consider adding additional detail to provisions that require "a description," such as in proposed Section 303.243(b)(4)(i)(A) and (D). As noted in Section III.C above, a broader, clearer definition of the administrative capacity permitted a sweep program administrator is critical for the orderly administration of the regulation.

7. Question 23:

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?

Proposed Section 303.243(b)(9) merely states that third parties, or IDIs that apply on behalf of the third party, that receive a written approval from the FDIC "shall provide reporting . . . ." There is no description of the nature of the reporting. TBS believes that the FDIC has sufficient experience from the approvals it has granted to date to specify some generally applicable reporting requirements so that they do not vary too much from applicant to applicant. Of course the FDIC would have the flexibility to add or alter reporting requirements as required to address specific circumstances.

IV. STANDARDS THE FDIC SHOULD APPLY TO THE NPR.

The TBS ANPR Comment Letter detailed reasons that the FDIC should tailor its regulations regarding brokered deposits consistent with standards established by recent federal case law[36] and seven principles for the regulation of the financial system (the "**Core Principles**") established by Presidential Executive Order 13772 ("**E.O. 13772**").[37]. In the context of the regulation of brokered deposits, we summarize the relevant Core Principles as follows:

> The FDIC is required to conduct a rigorous regulatory analysis and appropriately tailor the regulations to impose only those restrictions necessary to preserve safety and soundness of insured institutions and the banking system, without unnecessarily restricting customers' financial decisions, or the ability of institutions to manage their own liquidity.

The Core Principles, particularly the expectation that agencies will conduct rigorous regulatory impact analyses and will appropriately tailor regulations, effectively incorporate the requirement that agencies engage in reasoned decision-making established by the U.S. Supreme Court in *Michigan v. EPA*, 135 S. Ct. 2699, 192 L.Ed.2d 674 (2015). In that case, the Court stated:

> Federal administrative agencies are required to engage in "reasoned decision making."[38] . . . "Not only must an agency's decreed result be within the scope of its lawful authority, but the process by which it reaches that result must be logical and rational." *Ibid.* It follows that agency action is lawful only if it rests "on a consideration of the relevant factors."[39]

[36] *Michigan v. EPA*, 135 S. Ct. 2699, 192 L.Ed.2d 674 (2015); *MetLife, Inc. v. FSOC*, 177 F. Supp. 3d 219 (D.C.D.C. 2016).

[38] Citing *Allentown Mack Sales & Service, Inc. v. NLRB*, 522 U.S. 359, 374 (1998).
[39] *Michigan v. EPA*, 135 S. Ct. at 2706, citing *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 43 (1983).

The Court went on to say:

> One does not need to open up a dictionary in order to realize the capaciousness of [the phrase "appropriate and necessary"]. In particular, "appropriate" is "the classic broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant factors."[40] Although this term leaves agencies with flexibility, an agency may not "entirely fail[l] to consider an important aspect of the problem" when deciding whether regulation is appropriate.[41]

While *Michigan v. EPA* addressed rules issued by the Environmental Protection Agency over power plants, a federal court has had the opportunity to apply the case to financial system regulation. In *MetLife, Inc. v. FSOC*, 177 F. Supp. 3d 219 (D.C.D.C. 2016), the United States District Court for the District of Columbia relied on *Michigan v. EPA* in overturning the decision by the Financial Stability Oversight Council ("**FSOC**") to designate MetLife, Inc., pursuant to the Dodd–Frank Act, as a nonbank financial company subject to enhanced supervision by the Federal Reserve Board under enhanced prudential standards, on the grounds that MetLife's material financial distress could pose a threat to financial stability of the United States. The District Court ruled that the FSOC was arbitrary and capricious in "purposefully" omitting consideration of arguments made by MetLife, finding that "FSOC assumed the upside benefits of designation . . . but not the downside costs of its decision." 177 F. Supp. 3d at 220. The court concluded that the failure to quantify the impact of factors the agency assumed in rebutting factual analyses submitted by MetLife was an intentional refusal to engage that rendered FSOC's decision arbitrary and capricious. 177 F. Supp. 3d at 237-238.[42]

V. CONCLUSION

Based on the foregoing, TBS urges the FDIC to take the following actions to appropriately tailor its proposed rule as follows:

1. The FDIC should more appropriately tailor the application of the brokered deposit regulations in proposed Section 337.6 to better accommodate cash sweep programs. Such tailoring is consistent with the purposes of Section 29 and Section 337.6 of the FDIC regulations because deposits made in connection with cash sweep programs do not exhibit the attributes associated with traditional types of brokered deposits, and the institutions making the deposits and service providers that assist them do not share the attributes associated with traditional deposit brokers.

2. The FDIC should revise the Facilitation Prong of the "Deposit Broker" definition in Section 337.6(a)(5)(ii) of the rule as proposed to permit holders of the primary purpose exception to use third party administrators of cash sweep programs. Specifically, the FDIC should:

[40] Citing *White Stallion Energy Center, LLC v. EPA*, 748 F.3d 1222, 1266 (D.C. Cir. 2014, opinion of Kavanaugh, J.)
[41] Citing *State Farm*, 463 U.S. at 43.
[42] FSOC and MetLife's joint motion to vacate the court's determination that FSOC is required to consider direct and indirect costs was denied by the court. See Order of February 28, 2018 (Civ. Action No.15-cv-45 (RMC)).

a. Tailor the Facilitation Prong to exclude from inclusion as a deposit broker a sweep program administrator providing cash sweep programs to Source Institutions holding the primary purpose exception.
b. Tailor the Facilitation Prong to include as "administrative" services the following services provided by a sweep program administrator:
    i. Identifying Sweep Banks that are interested in taking sweep deposits;
    ii. Establishing and documenting operational parameters of the sweep program;
    iii. Administering the allocation of deposits of Customers to Sweep Banks by using a methodology approved in advance by the Source Institution to calculate each day's allocation, subject to final decision and actual movement of funds by the Source Institution or its bank;
    iv. Tracking withdrawals each day within a month by the Source Institution and/or each Customer of each Source Institution from MMDAs at each Sweep Bank for the compliance with restrictions on automated withdrawals pursuant to Section 204.2(d)(2) of Regulation D;
    v. Maintaining records of the end-of-day balance of each Customer as a beneficial interest in the omnibus account (although performed by the administrator as an agent of the Source Institution, technically the information is subject to the FDIC's recordkeeping rules in 12 C.F.R. Parts 360 and 370);
    vi. Providing assistance to facilitate the Source Institution's reconciliation of end-of-day balances with each Sweep Bank (as required by FINRA for broker-dealers; and
    vii. Preparing, maintaining and distributing reports to Sweep Banks and Source Institutions regarding the foregoing.

c. Revise Section 337.6(a)(5)(ii)(A) to permit at least the following information to be shared by a sweep administrator with the IDI:
    i. Sending information to Sweep Banks confirming deposits to be received by, withdrawals to be made from, or transfers between accounts to be processed by, each Sweep Bank each day.
    ii. Forwarding invoices and payment instructions to Program Banks on behalf of the Source Institutions to pay fees to the custodian and administrator pursuant to the sweep program documentation (while preserving the condition that the administrator does not itself move any funds); and
    iii. Providing necessary reports and information to the Sweep Banks about any of the above listed administrative services.

d. Clarify that the Contract Assistance Restriction of proposed Section 337.6(a)(5)(ii)(C) does not cause a sweep administrator to be treated as a deposit broker because it provides services in an administrative capacity, including:

i. Recording rates to be paid by each Sweep Bank and making that data available to prospective Source Institutions;
ii. Entering into agreements with Sweep Banks to document consistency with operational parameters of the sweep program; or
iii. Assisting Source Institutions in documenting contracts with Sweep Banks to assure consistency with operational parameters of the sweep program.

e. Eliminate the mandatory application process for the primary purpose exception, or replace it with notice and reporting requirements. Include specific and detailed requirements in the final rule for the primary purpose exception, and allow IDIs and third parties to rely upon these rule requirements, perhaps based on a reasoned opinion of experienced counsel. Make the application process available on an optional basis to IDIs and third parties desiring a greater degree of certainty about the brokered deposit status of their program.

3. Amend proposed Section 337.6(a)(5)(ii)(C) to incorporate the provisions of Advisory Opinion 93-47, which allows a separately incorporated sister trust company affiliate of a bank to sweep deposits to affiliated and nonaffiliated banks to the same extent as the trust department of a bank, with such sweeps being excluded from being considered brokered under the Primary Purpose Exclusion, but rescind Advisory Opinion 92-51 to the extent it causes a sweep to be a brokered deposit if a trust department or trust company takes any fee in connection with the sweep.

TBS thanks the FDIC for its consideration of these comments, and would be delighted to respond to any request to provide further information about the matters discussed in this letter to assist the FDIC as it performs the rigorous analysis appropriate for these issues. If you have questions about these comments, please direct them to the undersigned by email to mkadish@totalbanksolutions.com.

Sincerely,

[redacted]

Michael L. Kadish
Managing Director and Senior Counsel

cc: Eric A. Pierce
CEO, Total Bank Solutions