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June 27, 2016

Mr. Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street NW  
Washington, DC 20429  
Attention: Comments

RE: Notice of Proposed Rulemaking regarding Recordkeeping for Timely Deposit Insurance Determination (12 CFR §370); RIN 3064–AE33<sup>1</sup>

Dear Mr. Feldman:

The American Bankers Association, The Clearing House Association, the Consumer Bankers Association, and the Securities Industry and Financial Markets Association (collectively, the Associations)<sup>2</sup> appreciate the opportunity to respond to the notice of proposed rulemaking (NPR) from the Federal Deposit Insurance Corporation (FDIC) on “recordkeeping for timely deposit insurance determination.” Comments in this letter are drawn from discussions with representatives from all of the banks that would be subject to the NPR as proposed (covered banks).<sup>3</sup>

The NPR seeks to ensure that, should a bank with a large number of deposit accounts fail, depositors would have prompt access to their funds post-failure. The Associations support this goal as a means to reinforce public confidence in the FDIC, bank deposits, and the U.S. banking system, and are committed to working with the FDIC to design and implement cost-effective solutions to achieve these ends.

We recognize the potentially significant operational challenge to find a least costly method to resolve a bank with a large number of deposit accounts, per the FDIC’s statutory obligation.<sup>4</sup> However, we believe that the NPR does not appropriately balance the burdens and costs it would

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<sup>1</sup> 81 Federal Register 10026, February 26, 2016, [www.gpo.gov/fdsys/pkg/FR-2016-02-26/pdf/2016-03658.pdf](http://www.gpo.gov/fdsys/pkg/FR-2016-02-26/pdf/2016-03658.pdf).

<sup>2</sup> Descriptions of the Associations are provided in Appendix B.

<sup>3</sup> The proposed requirements would apply to banks with at least two million deposit accounts.

<sup>4</sup> 12 USC §1823(c)(4).

impose on covered banks and their customers on the one hand, and the limited improvements for resolving such a bank and expediting payments to its depositors on the other. Put more simply, we do not believe that the potential benefits justify the costs. In particular, the Associations believe that the FDIC has not considered the inconvenience and cost to both financial intermediaries (through which some deposits are placed in covered banks) and the ultimate beneficial owners themselves if daily reporting of individual depositor/beneficiary information were required. Furthermore, we believe that the proposed 12 CFR §370 rule would cause substantial disruption in the deposit markets and increase the risk of breaches of security of depositors' personal identification information.

Moreover, the Associations respectfully question whether the problem identified in the NPR requires a solution as complex and costly as the proposed rule. First, the NPR asserts that current FDIC regulations and procedures are insufficient to "mitigate the complexities of the largest institution failures" and notes weaknesses in "covered institutions' deposit data (often finding inaccurate or incomplete data), deposit recordkeeping systems, and capabilities for imposing provisional holds," among other deficiencies.<sup>5</sup> The FDIC does not need another rule to close these deficiencies, as it already has supervisory authority to compel covered banks to comply in full with 12 CFR §360.9.<sup>6</sup> The requirements outlined in the NPR would not enhance the FDIC's enforcement authority to address these deficiencies.

Second, the NPR observes that the FDIC's current systems would be strained to handle failure of a covered bank.<sup>7</sup> As an alternative to requiring a set of banks to upgrade their deposit account systems to compensate for the FDIC's systems limitations, the FDIC could upgrade its own systems to be prepared to resolve a bank with a large number of deposit accounts. Such an upgrade would also support resolution of any bank – not just a covered bank – and so would provide numerous potential benefits to FDIC operations.

Changes to narrow the cost-benefit imbalance are offered below, as well as the Association's perspective on the success of a covered bank resolution if FDIC adopts these changes. The Associations would be pleased to facilitate discussions between bankers and FDIC staff to discuss the details of these suggestions.

## **I. Cost-Benefit Imbalance for the Proposed 12 CFR §370 Rule**

The Associations recommend that the FDIC perform full diligence to quantify and validate the benefits presumed to be achieved, considering the full implications for depositors, deposit intermediaries, the deposit markets broadly, and covered banks over time. Before covered banks are required to incur the significant expense to seek out extensive deposit account holder and beneficial owner information (or adapt to customer refusals to provide it), overhaul their IT systems, and absorb the attendant market disruption, and before depositors and third-party beneficial account holders have to manage the disruptions of these banks implementing a

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<sup>5</sup> NPR at 10028

<sup>6</sup> This section requires, among other things, that covered banks maintain specified data on depositors in a specified format for FDIC's use in the event of a failure.

<sup>7</sup> NPR at 10027.

12 CFR §370 rule, the FDIC has a responsibility to provide concrete evidence to support the purported benefits of such a rule and conduct a full benefit-versus-cost analysis. The Associations offer to assist in development of an investigation of the costs and benefits in coordination with covered banks.

The FDIC is to be applauded for engaging an independent analyst, and the Associations and covered banks appreciate that the FDIC has made public detailed results from that study.<sup>8</sup> We note, however, that the analysis does not consider or quantify the potential impact on depositors, depositors' agents and custodians, and other financial intermediaries that place deposit funds in covered banks, as well as to deposit and funding markets generally.

Even the benefits to depositors of the proposed rule are unclear, in that the proposed systems would be put into action only should a covered bank fail. The NPR does not propose any change in insurance coverage for deposits and, with or without the proposed changes, the FDIC will continue to provide prompt access to depositors' insured funds in case of failure of a covered bank. For deposit accounts where the ultimate beneficial owners cannot be determined immediately, the FDIC can continue to follow its current practices to make determinations in short order. This has been the practice in hundreds of bank failures over the last decade with no detrimental effect on public confidence in bank deposits or the FDIC.

The NPR would require covered banks to obtain, record on their deposit account information systems, and continuously update all the data needed for FDIC deposit insurance calculations. For certain types of accounts (discussed below), information regarding account beneficiaries would need to be obtained from named intermediary accountholders on a daily basis. Given that the FDIC lacks authority over these entities, the accountholders likely would be incentivized to seek out alternative banking relationships rather than accede to this ongoing nuisance, resulting in disruption to these accountholders (and to other aspects of their banking relationship) and to the deposit markets.

Another important element overlooked in the analysis is the added security risk for depositors' personal information. The extra collection, movement, and transfer of identification information poses additional risks to depositors, third parties that open accounts on behalf of depositors (e.g., trustees, brokers, and employee benefit plan fiduciaries), and covered banks. Movement of these data is of no current benefit to depositors, beneficial owners, or covered banks.

As for the impact of 12 CFR §370 as proposed on covered banks, while the independent analyst's study recognizes that the proposed account recordkeeping and system overhaul requirements would involve major expense for covered banks, representatives from these institutions report that the burden estimates cited significantly understate the actual implementation cost – and *fail to address the ongoing costs*. It is worth noting that, *while the NPR proposes to reduce the possible cost to the FDIC were a covered bank to fail – and only in the one-time case of failure of that bank – having to collect regularly and maintain current*

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<sup>8</sup> Some covered institutions have expressed interest in seeing the calculations that pertain to them in the cost study. We suggest that the FDIC provide this information to these banks individually.

*account information for FDIC insurance determinations, maintain IT systems to be capable of performing such determinations, and comply with periodic examination and testing requirements for these processes, would impose substantial ongoing costs on covered banks.*

Further, the analysis does not consider anti-competitive effects. The FDIC expects that “[c]overed institutions could pass at least some of the costs of the proposed rule to their stakeholders (customers, creditors, shareholders).”<sup>9</sup> In competitive financial markets, it is more likely that these stakeholders would take their funds and financial business to other institutions.

In sum, the Associations are deeply concerned that the limited benefits of the proposed rule would not justify the customer impact, business disruption, operational complexity, implementation costs, and ongoing expense. If the requirements were modified to include exemptions for certain classes of deposits and to incorporate other recommendations, as discussed below, we believe that the FDIC’s objective could be achieved with much less disruption of the deposit markets and more manageable cost to covered banks.

## **II. Overview of the Industry Recommendations**

The Associations propose the following changes for any final 12 CFR §370 rule to achieve the stated objective with less disruption to the deposit markets and cost to covered banks:

- **Exemptions for classes of deposit accounts.** For some types of deposit account, it is not feasible, practical, or even possible – not least because of burdens on customers – for covered banks to collect the depositor information required in the NPR. Rather than inviting petitions for exceptions from the proposed recordkeeping requirements for such accounts, class exemptions should be provided in any final rule.
- **Ownership right and capacity codes (12 CFR §330).** Any final rule should permit covered banks to classify accounts for FDIC insurance determination as recorded on their internal systems, in line with the FDIC’s current practice in bank failures, rather than requiring ongoing searches for and repeated updates of information that covered banks do not have and are unlikely to be able to obtain.
- **Exception process.** While the starting point for any final rule should be class exemptions from the proposed recordkeeping requirements for certain classes of deposit accounts, individual covered banks are likely to have idiosyncratic accounts for which obtaining the requisite depositor information would be impossible or cost-prohibitive. Therefore, even with deposit class exemptions, any final rule should include a process to petition for exceptions from the proposed recordkeeping requirements, as proposed. However, details of the exception process are needed, so the process itself should be subject to public notice and comment.

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<sup>9</sup> NPR at 10045.

- **Board attestation.** Attestation to compliance with a final rule should not be required from a covered bank's board of directors. Examination reviews and annual reporting, as proposed, will suffice to demonstrate compliance.
- **Implementation timeline.** Covered banks would need at least four years, with potential extensions depending on their progress, to develop processes and systems necessary to implement the requirements of any final rule.
- **Continued flexibility.** The FDIC should work with covered banks on an individual basis and be flexible where application of the proposed requirements is not practical without modification.

These key recommendations and other suggested changes to the NPR are discussed below. Some technical questions on the proposed processes are posed in Appendix A.

Implementation of a 12 CFR §370 rule would involve major technical resources, investment, and operational challenges to develop systems and obtain additional information from many customers. Knowing the final scope of exemptions and exceptions is critical. Otherwise, covered banks would be forced to devote significant time and resources seeking unobtainable information and designing systems that would ultimately have to be altered to fit revised requirements. These efforts would needlessly delay implementation. Therefore, *the Associations urge the FDIC to give due consideration to our recommendations and, after any final rule is adopted, devote sufficient staff resources to respond expeditiously to requests from covered banks for exceptions well in advance of required implementation.*

### III. Recommended Substantive Modifications

#### A. Exemptions for Classes of Deposit Accounts

In working with banks to assess implementation of 12 CFR §360.9, the FDIC identified classes of deposits for which full depositor identification information could not reasonably or practically be obtained.<sup>10</sup> The deposit recordkeeping requirements under any final 12 CFR §370 rule should reflect this experience and, as a starting point, exempt certain classes of deposit.

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<sup>10</sup> The FDIC exempted seven classes of deposit account from the 12 CFR §360.9 requirements: (1) those where beneficial owner data are not maintained by the bank (*e.g.*, brokerage customer deposit sweeps, brokered CDs where the CD is registered with the Depository Trust and Clearing Corp., and deposit exchanges between banks (*e.g.*, CDARS); (2) gift and payroll cards where cardholder data are maintained by an unaffiliated entity; (3) omnibus deposit accounts through another institution or non-bank customer on a pass-through basis so that the bank has no direct relationship with the individual account beneficiaries (*e.g.*, escrow accounts, safekeeping balances and employee deductions accounts); (4) accounts that reside on external systems with only summary posting of totals to the bank's general ledger (*e.g.*, card and loan overpayments, prepaid loan expenses and loan proceeds in process, clearing accounts, unclaimed property accounts, general ledger suspense accounts, and Health Savings Accounts); (5) deposits in process for settlement or transfer, where the account holder information resides temporarily in an internal account; (6) balances for government benefits payable (*e.g.*, food

As proposed, a covered bank could apply for exceptions from the NPR's requirements, if it:

- cannot obtain the information on beneficial owners from the account holder after requests for such information,
- provides a reasoned legal opinion on why such information is protected from disclosure by law, or
- provides an explanation of why the information necessary to obtain would change so frequently it would be impracticable and too costly to obtain.

While we support a process to petition for exceptions, the proposed process poses several challenges (discussed below). More to the point, a number of broad classes of accounts will clearly meet one, if not all, of the criteria above. Requiring each covered bank to submit petitions for exceptions for a range of these accounts would be senselessly cumbersome and grossly inefficient – including for the FDIC itself – considering that all or most covered banks would be expected to seek exceptions for certain classes of accounts. The time and effort required by the covered banks to develop numerous lengthy petitions, and for FDIC staff to review and rule on those petitions, would impede implementation of any final rule and unproductively consume FDIC resources.

Therefore, *instead of asking individual covered banks to petition for exceptions for all accounts where the proposed recordkeeping requirements would be impractical or infeasible, substantial efficiencies for the banks and the FDIC can be achieved by recognizing in advance the classes of accounts for which many covered banks will need exceptions and exempting them in any final 12 CFR 370 rule.* Deposit account categories that warrant block exemptions as a starting point include:

- deposits of trusts, including bank-maintained collective investment funds, and other fiduciary relationships,
- deposits of employee benefit plans,
- brokered deposit accounts,
- cashier's, teller's, and certified checks, personal money orders, and foreign drafts,
- Lawyer Trust Accounts and Real Estate Trust Accounts,
- prepaid government benefits, payroll and "general purpose reloadable" cards, and
- foreign office deposits.

A common feature of these account types is that the information required to determine the identity – and, in some cases, the number – of beneficial owners is not part of the bank's deposit recordkeeping system. In cases where the information needed is maintained in the ordinary course of business by customers, agents, fiduciaries or third parties, FDIC regulations have for years permitted use of such information to establish the amount of deposit insurance coverage

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stamps and child support, and health benefits payable to employees); and (7) U.S. Treasury Tax and Loan Accounts. See [www.fdic.gov/regulations/resources/largebankdim/modernization.html](http://www.fdic.gov/regulations/resources/largebankdim/modernization.html).

and covered banks have made major long-term investments in systems based on those rules.<sup>11</sup> The NPR, however, would require that all such information be imported into the covered banks' deposit account records and maintained on a current basis at all times, unless individual covered banks apply for and receives exceptions.<sup>12</sup>

The following subsections discuss in detail classes of accounts for which exemptions from the proposed recordkeeping requirements are appropriate and necessary. While these accounts are identified here as examples of accounts for which compliance with the proposed recordkeeping requirements would be difficult or impossible, the Associations encourage the FDIC to consider whether there are other accounts with similar characteristics that warrant class exemption in any final rule, to forestall a further need for individual covered banks to submit separate exception petitions.

### **1. Deposits of Trusts and Other Fiduciary Relationships**

The covered banks offer depository services to trusts and other fiduciary relationships while acting in many capacities, including as trustee, custodian, investment manager/agent, and simply as a depository institution. In all of these situations, the depositor information obtained by the covered institution is limited by a number of factors that warrant the need for a class exception from the proposed rule. In the various account scenarios described below, the covered bank, regardless of its client base, would satisfy at least one, if not all three, of criteria identified as warranting an exception,<sup>13</sup> and as demonstrated below, FDIC should acknowledge these circumstances without requiring individual exception petitions.

Furthermore, there is no advantage to the FDIC in requiring the covered banks to obtain information about trust beneficiaries at account opening and periodically thereafter. Under state law, the trustee, as legal owner of the assets held in trust, has a fiduciary obligation to manage those assets for the sole benefit of the trust beneficiaries. Although entitled to make reasonable inquiries of a trustee and hold the trustee accountable for fiduciary breaches, the beneficiary does not have any direct right or authority to receive, distribute or otherwise manage assets on behalf of a trust. In other words, in the event of a bank failure, only the trustee has the legal authority to request and receive any FDIC insurance proceeds on behalf of the trust. And the trustee, owing to its fiduciary duty to the beneficiaries, has great incentive to submit the requisite information as soon as possible to the FDIC to obtain any insured deposit to which the trust is entitled.

#### *Third-Party Individual Trustees*

A trustee opening an account on behalf of a trust would be bound by common law and statutory fiduciary duties to keep confidential certain information about the trust, including personally identifiable information such as the names and Social Security numbers (SSNs) of the trust

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<sup>11</sup> 12 CFR §330.

<sup>12</sup> Proposed 12 CFR §370.4(c). The Associations note that there are questions regarding the frequency with which covered banks would be required to collect account data for particular deposit classes.

<sup>13</sup> See III.A above.

beneficiaries.<sup>14</sup> It was for that very reason the Uniform Trust Code (UTC) was amended to include §1013, allowing for the use of a Certification of Trust containing limited information (which does not include the names of beneficiaries) to show the trustee's authority to transact business on behalf of the trust. The purpose of the Certification is "to protect the privacy of a trust instrument by discouraging requests from persons other than beneficiaries for complete copies of the instrument in order to verify a trustee's authority." In addition, many state statutes contain a provision similar to UTC §1013(h), which imposes potential liability on third parties demanding the entire trust document.

Given the importance of the duty of confidentiality, trustees would be wary of providing beneficiary information upon the bank's request at account opening, let alone periodically thereafter to meet the proposed requirement. The non-contingent trust interests of a particular trust deposit could vary periodically as beneficiaries die, are born, or turn a certain age, or when other conditions are triggered that would make a contingent beneficiary become a non-contingent beneficiary. Although arguably in the best position to know this information, even the trustee may not know the current status of all beneficiaries *every single day*, as required in the NPR. In some larger, older trusts, after the third generation, there may be dozens of beneficiaries with non-contingent interest. Maintaining this information on a daily basis may sometimes be difficult even for the trustee.

Anecdotally, the Associations have heard that trustees would consider opening an account at another institution to avoid having to respond to this unwanted inquiry. This result is not helpful to covered banks, nor to trust depositors, because there may be very good business and practical reasons for a trustee to open an account at a particular institution.

#### *Third-Party Institutional Trustees*

Nondepository trust companies often establish deposit accounts with third-party banks to facilitate transactions and investments for their clients. For example, a trust company will use these deposit accounts for purposes of accepting client contributions into their respective fiduciary accounts before wiring the money to settle purchases of appropriate investments for those accounts. Hence a busy trust company could be depositing dozens of checks a day in varying amounts on behalf of trusts with multiple non-contingent beneficiaries, as well as other fiduciary clients. This information would change every day as new contributions are made and shortly thereafter placed into investments for the fiduciary account. As is true for individual trustees, institutional trust companies would also be wary of, and may be contractually or otherwise prohibited from, violating the confidentiality of their trust beneficiaries by disclosing to the depository bank their names and government identification numbers. Moreover, these trust companies would have great concerns about sharing customer information with potential wealth management and trust competitors that are very likely much larger financial institutions.

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<sup>14</sup> See generally, Restatement (Third) of Trusts §170, Duty of Loyalty. Some state statutes, such as California Financial Code §1602, impose a general prohibition on disclosure except under limited circumstances. One could argue that none of the exceptions is met in the situation in which a covered bank requests, but does not require, disclosure of trust beneficiary information, and the lack of disclosure does not ultimately affect the FDIC insurance afforded the deposit.



### *Collective Investment Funds, Including Common Trust Funds*

Third-party trust companies and trust departments of covered banks that maintain and manage certain collective investment funds, including common trust funds, sometimes invest the assets of those funds in deposit products for the purpose of meeting the funds' investment objectives.<sup>15</sup> For example, short-term investment funds (STIFs)<sup>16</sup> are funds similar to money market mutual funds, but made available only to fiduciary accounts of the trust company, including qualified employee benefit plans. STIFs sometimes invest in CDs or other types of deposits either for investment purposes or to maintain appropriate levels of liquidity for redemption purposes. Because these funds are established as trusts, they are entitled to pass-through FDIC insurance for their investors. The investors in the STIFs may include employee benefit plan trusts with their own plan participants and beneficiaries, personal trusts with their own trust beneficiaries, or other collective investment funds (*e.g.*, a fund of funds arrangement).

In the case of the employee benefit plan investor, the bank sponsor of the STIF generally does not know the identity of the underlying plan participants and beneficiaries. The relevant information is kept by the plan recordkeeper, which would not be willing to disclose the information unless directed to do so by the plan's named fiduciary or other authorized plan representative. For reasons outlined below with respect to Employee Benefit Plans, even if the recordkeeper were able and willing to transmit daily information to the bank STIF sponsor, the bank STIF sponsor may not be willing to take on the legal responsibility and expense of maintaining the data security of this personally identifiable information and for transferring it in a secure fashion to the covered bank.

The immense complexity of collecting and maintaining this voluminous and constantly changing data is exemplified in the common investment arrangement whereby a collective investment fund invests in other collective investment funds, with the top level fund known as a "fund of funds." In these situations, one or more employee benefit plans will have invested in the top level fund that has invested in other funds and so forth. Therefore, there can be multiple layers of pass-through depositors, each holding a portion of the information necessary to determine the specific position of the ultimate underlying beneficial owners at any given time. To require this disparate set of parties to report *daily* to the covered bank or to an intermediary that would report to the covered bank would be an expensive and impractical solution to an information gathering problem that can be solved in a less cumbersome and expensive way during resolution of a bank.

### *Corporate Trustees for Bond Indentures or Similar Documents*

In the case of a bank serving as trustee (or in a related capacity, such as paying agent) pursuant to a bond indenture, pooling and servicing agreement or similar document, the bank does not know the identity of the beneficiaries. Unless the issuer of the bonds provides physical certificates to evidence an investor's ownership – which is rarely done – the bonds are held in book entry form at the Depository Trust Company (DTC). When paying interest on a bond, the trustee (or paying

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<sup>15</sup> Collective investment funds are established as trusts to allow for the collective investment of fiduciary accounts, which may include qualified plans. See Internal Revenue Code §584(a); Investment Company Act §§3(c)(3) and 3(c)(11); 12 CFR 9.18; 29 U.S.C. 18 (from Employee Retirement Income Security Act of 1974 (PL 93-406) §408(b)(8)), and related guidance.

<sup>16</sup> 12 CFR 9.18(b)(4)(iii).

agent) makes a single payment to the DTC to cover amounts due to bondholders. The DTC, in turn, makes appropriate proportionate payments to its members (typically banks and broker-dealers) who, in turn, make proportionate payments to their clients. This process proceeds until the interest payments reach the actual bondholders. All buying and selling activity (including resales) of the bonds occurs at the lowest level of this chain, for which information is not provided to the indenture trustee. When indenture trustees must try to reach individual bondholders, for example with respect to bankruptcy of the issuer, the trustee must ask the DTC to work through its participants to provide a list of the bondholders, a process that is quite time-consuming and expensive. Thus, indenture trustees have no knowledge of the actual bondholders (with the rare exception noted above with respect to holders of physical certificates). Moreover, even if this information could be obtained, it would only reflect a point in time as bondholders may change frequently. Consequently, it is entirely infeasible for covered banks to meet a requirement to have beneficiary information on an ongoing basis.

#### *Fiduciary Self-Deposits Made by Covered Banks*

For deposits made by the trust department of a covered bank into the commercial side of the institution,<sup>17</sup> the same duties of loyalty and confidentiality generally limit the sharing information about beneficiaries prior to resolution of the bank. Indeed, the guidance of the Office of the Comptroller of the Currency (OCC) in its Conflicts of Interest Handbook notes:

Bank policies should require an information barrier, sometimes referred to as a “Chinese wall,” that prevents the passage of material inside information between a bank’s fiduciary department and areas of the bank or its affiliates that perform activities such as commercial lending and investment banking. The passage of such information would be in violation of securities laws and regulations, as well as fiduciary standards. A total separation of fiduciary and commercial functions within a bank is not required, and joint marketing to and servicing of customers is not prohibited. Rather, the required information barrier should isolate fiduciary personnel making investment decisions from material nonpublic information that might influence those decisions. Similarly, the barrier should prevent individuals in other areas of the bank or an affiliate from using information obtained by the bank in its fiduciary capacity, including when the bank acts as indenture trustee, to influence credit decisions or actions unrelated to the bank’s fiduciary role.<sup>18</sup>

Therefore, although not prohibited outright, there is a bias toward not sharing information between the fiduciary and commercial sides of the bank if not in the interests of the client and not properly protected to avoid breaches of fiduciary duties and securities laws. In addition, at least some states impose duties of confidentiality on bank trustees with limited exceptions.<sup>19</sup>

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<sup>17</sup> These deposits are also known as “fiduciary self-deposits.”

<sup>18</sup> Office of the Comptroller of the Currency, *Comptroller’s Handbook: Conflict of Interest*, January 2015, p. 51 ([www.occ.gov/publications/publications-by-type/comptrollers-handbook/conflictinterest.pdf](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/conflictinterest.pdf)).

<sup>19</sup> See California Financial Code §1602; Illinois 205 ILCS 620/5-10.5.

Furthermore, due to requirements under federal regulations and state statutes, fiduciary self-deposits that are awaiting investment must be collateralized above the insured amount.<sup>20</sup> It is the Associations' understanding that the FDIC, when resolving a failed institution, addresses the collateralized deposits first without detailed inquiry into the particularities of the underlying beneficial ownership interests in the deposit. ***The Associations, therefore, ask that the FDIC provide a class exemption for fiduciary deposits to avoid unnecessary and costly information sharing.***

Such a class exemption would not diminish the FDIC's prompt access to the necessary information in the event of a failure, while preserving important "information barriers" between the fiduciary and commercial sides of the bank. If required to maintain in their deposit or other recordkeeping systems current trust or pass-through beneficiary information, the covered banks would be significantly disadvantaged in offering deposit services to trusts and other pass-through accounts. The trust departments would need to inquire much more frequently than they currently do with third-party trustees for whom they provide fiduciary services, as well as with other direct clients to revise and maintain changes in beneficiary information due to births, deaths, and other changes in status. These clients, wanting to avoid being pestered with unnecessary requests for information, would clearly have cause to take their business elsewhere.

## 2. Deposits for Employee Benefit Plans

With respect to employee benefit plans, FDIC regulations provide that:<sup>21</sup>

- (a) "Pass-through" insurance. Any deposits of an employee benefit plan in an insured depository institution shall be insured on a "pass-through" basis, in the amount of up to the [standard maximum deposit insurance amount] for the *non-contingent interest* of each plan participant [Emphasis added]....
- (c) Determination of interests—
  - (1) Defined contribution plans. The value of an employee's non-contingent interest in a defined contribution plan shall be deemed to be the employee's account balance as of the date of default of the insured depository institution, regardless of whether said amount was derived, in whole or in part, from contributions of the employee and/or the employer to the account.
  - (2) Defined benefit plans. The value of an employee's non-contingent interest in a defined benefit plan shall be deemed to be the present value of the employee's interest in the plan, evaluated in accordance with the method of calculation ordinarily used under such plan, as of the date of default of the insured depository institution.

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<sup>20</sup> 12 CFR §9.10 for national banks, 12 CFR §150.290, §150.300, §150.310, and §150.320 for federal savings associations. Various state statutes for state-chartered institutions, *e.g.*, Alabama Code 1975 §5-5A-28, Florida Statute 660.37, Illinois 205 ILCS 620/2-8, Missouri 20 CSR 1140-27.010, Nebraska 8-162.02, Tennessee 45-2-601, Texas FI. Code Ann. §184.301, and Washington 11.100.037.

<sup>21</sup> 12 CFR §330.14.

The NPR contemplates that the covered bank, acting as an employee benefit plan trustee or custodian for an employee benefit plan trustee, would have access to and maintain in its own records information concerning the value of each beneficiary's non-contingent interest, as well as perhaps having the capability to calculate, in accordance with the plan's own detailed terms, the value of those interests. A defined benefit plan, or other employee benefit plan (collectively, plans) commonly has tens, and sometimes hundreds, of thousands of participants and beneficiaries, which does not represent a static pool of participants or balances. In the case of a defined employee benefit plan, by law and practice, responsibilities for identifying beneficiaries and their entitlement to account assets belong to the plan administrator. The values of beneficiaries' interests are generally calculated by an actuary maintained by the plan administrator based on the participant information kept by a third-party recordkeeper. Defined contribution plans typically transmit their orders to purchase or redeem shares or interests in investment menu options through an omnibus deposit/custodial account, *i.e.*, an account that would be in the name of the intermediary responsible for transmitting an aggregated order to the sponsor of a given investment menu option.<sup>22</sup> The relative interests of the participants whose orders are transmitted through an omnibus deposit/custodial account change daily, as new employees are hired, as others leave the plan, or as participants allocate their funds among the various investment options, as allowed in certain defined contribution plans.

The recordkeepers generally will not disclose this information to third parties, such as covered banks, unless instructed to do so by the plan sponsor. Requests for plan sponsors to provide these data, as envisioned under the NPR, would upset industry expectations about the bank-trustee's limited roles and responsibilities, impose significant costs on the bank-trustee, lead to a duplicate beneficiary-level recordkeeping regime, interfere with the allocation of responsibility under applicable fiduciary law to decide entitlement to plan assets, and invite beneficiary and consumer claims against the bank-trustee. With respect to a bank-custodian of benefit-plan-trust assets, the bank is even further removed from the trust's beneficiaries, so the bank should have even fewer (if any) obligations with respect to identifying such beneficiaries and their entitlements. Furthermore, the expense and difficulty imposed on the recordkeeper and plan of providing this information on a daily basis to a covered bank would likely dissuade the plan from offering a deposit-type product in the case of a participant-directed defined contribution plan.<sup>23</sup>

Instead of imposing the expense and difficulty of transmitting large volumes of data each day to covered banks,<sup>24</sup> it would be far more efficient to allow the plan recordkeepers, which have the most current beneficiary information at any given point in time, to provide this information to the

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<sup>22</sup> In the case of a deposit-type product that is offered on the plan's menu, the "sponsor" would be the depository bank.

<sup>23</sup> Recordkeepers and plans were similarly dissuaded from offering certain investment options to their plan participants after the Securities and Exchange Commission amended the money market fund rules to impose fees and gates on Prime Money Market Funds. A recent SPARK Institute survey found that none of its member recordkeepers plans to adapt its systems to allow plan investments in Prime Money Market Mutual Funds, and instead were recommending that plans switch to Governmental Money Market Funds. See press release at [www.benefitslink.com/pr/detail.php?id=50432](http://www.benefitslink.com/pr/detail.php?id=50432).

<sup>24</sup> Note that not all recordkeepers use the same data formats, thereby making it very difficult for a covered bank to implement a recordkeeping system that can accept and standardize heterogeneous information.

FDIC quickly after a resolution. Internal Revenue Service rules already require the plan and its service providers to allocate *all* the funds of the plan among the participants as the information changes.<sup>25</sup> The recordkeeper, at the request of the plan, would quickly work with the FDIC in a resolution situation to provide the needed information.

Even if covered banks had the values of each beneficiary's non-contingent interest, they could not independently confirm that the valuations are correct under the terms of the plan, as the NPR would require. The complexities of maintaining such voluminous and varying information demonstrate the impracticality of including deposits made by employee benefit plans in the scope of any final rule. The effort and expense of forcing plans and their service providers to provide and revise the required calculations for such accounts clearly outweigh any benefits to the FDIC of having the proposed capability for that proportion of a covered bank's deposits. ***The Associations, therefore, ask that the FDIC provide a class exemption for benefit plan deposits because the required information collection and calculations are inconsistent with benefit plan administration practices that are outside covered banks' control.***

### 3. Brokered CDs and Sweep Accounts

The brokered deposit market maintained by broker-dealers registered with the Securities and Exchange Commission (SEC), and in some cases banks,<sup>26</sup> relies on the pass-through deposit insurance coverage available to deposit account owners pursuant to 12 CFR §330.5. The brokers act as custodians in holding the deposit accounts for their customers and maintain records of ownership of the accounts as agent for their customers in compliance with SEC regulations,<sup>27</sup> as well as to satisfy FDIC requirements that records be maintained by a fiduciary in the regular course of its business.<sup>28</sup> As a result, a bank that has entered into a contract with a broker to have its deposit accounts offered to the broker's customers in this market – whether through the brokered certificate of deposit (CD) market or a broker's "sweep" program – does not know or have access to the identities of the brokers' customers.

In determining the feasibility of the proposed rule, and in evaluating the Associations' request for class exemptions, it is important at the outset for the FDIC to understand both the nature of client relationships in the securities industry, the regulatory requirements imposed on brokers to protect customer information, and the various means by which customer assets are held. This will help the FDIC understand the complex array of operational, cost, competitive and regulatory impediments that will, in many cases, preclude brokers from providing customer information to covered banks if 12 CFR §370 is adopted as proposed.

As with the banking industry, competition for customers in the securities industry is significant, because customers are a broker's source of revenues and profits. Brokers compete with each

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<sup>25</sup> Revenue Ruling 80-155.

<sup>26</sup> Banks primarily participate in the market as deposit brokers through programs such as Promontory Interfinancial Network's CDARS<sup>®</sup> and ICS<sup>®</sup>, which permit banks to place customer funds in deposit accounts at other banks and in some cases to receive deposits in return.

<sup>27</sup> 17 CFR §240.17f-4.

<sup>28</sup> 12 CFR §330.5(b).

other, as well as with banks, to provide quality services at competitive prices. Customer information is a valuable, proprietary asset that is not shared with competitors.

Like banks, brokers serve not only individuals and corporations, but trusts, employee benefit plans, and other entities eligible for pass-through insurance. Also, like banks, brokers do not typically acquire and maintain records of the beneficiaries or beneficial owners in these arrangements. Any determination of the deposit insurance coverage available to beneficiaries or beneficial owners would require a broker to request from the fiduciary that is its customer the names of each beneficiary and beneficial owner and the non-contingent interests in the particular arrangement. Obtaining and maintaining *current* information on beneficiaries or beneficial owners, if in fact each fiduciary would be willing to provide this information, would pose significant operational and cost issues to a broker.

In addition to competitive and practical considerations, customer information is subject to security and privacy considerations. Brokers are regularly examined by the SEC and the Financial Industry Regulatory Authority (FINRA) for compliance with applicable regulations and guidance. Transferring customer information to a third party without the direction of the customer is inconsistent with the protections provided to customers and the obligations imposed on brokers by applicable regulations.<sup>29</sup> Any request from a third party, particularly from a third party that is a competitor, for a broker's customer information would face significant and, in many cases, virtually insurmountable barriers.

Another significant factor in evaluating the feasibility of the proposed rule is the manner in which assets are held in the securities industry. There are over 4,000 registered broker-dealers in the U.S.<sup>30</sup> While a number of larger brokerage firms hold their customers' assets and maintain customer records themselves (referred to as "self-clearing" brokers), the vast majority of brokers utilize another broker-dealer to custody their customers' assets and maintain customer records. In these arrangements, one broker-dealer, referred to as a "clearing broker," holds the customer assets of other so-called "introducing brokers." While these arrangements can differ in certain respects, in general the clearing broker holds the assets of the introducing broker's customers and maintains the customer records. However, the customers remain customers of the introducing broker for many regulatory purposes,<sup>31</sup> as well as for customer relationship purposes.

Based on the most recently available data, there are over 450 clearing brokers. The two largest clearing brokers, Pershing LLC and National Financial Services, LLC, act on behalf of over 1,000 introducing brokers.<sup>32</sup>

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<sup>29</sup> See 17 CFR Part 248.

<sup>30</sup> See the SEC's Fiscal Year 2017 Congressional Budget Justification, p. 73, available at [www.sec.gov](http://www.sec.gov).

<sup>31</sup> For example, the clearing broker typically delegates to the introducing broker its responsibilities pursuant to the Customer Identification Program (CIP) regulations (31 CFR §1023.100(d)(2)(i)).

<sup>32</sup> See *Select SEC and Market Data*, Fiscal 2015, at Tables 8 and 9, available at [www.sec.gov](http://www.sec.gov). The data concerning Pershing LLC and National Financial Services LLC are derived from the 2014 and 2015 annual rankings of clearing brokers published by *Investment News*, available at [www.investmentnews.com](http://www.investmentnews.com).

The sheer number of brokers and clearing brokers in the industry, as well as the clearing broker arrangement itself, complicates the possible transfer of customer information to a covered bank. Although a clearing broker may maintain customer records for hundreds of introducing brokers, as both a practical and contractual matter it would need authorization from the introducing brokers to transfer customer information to a covered bank.

To provide a sense of scale to the amount of customer information that would have to be transferred from brokerage firms to covered banks if the NPR is adopted as proposed, as of March 31, 2016 there were \$813 billion of brokered deposits reported on bank Call Reports. Of this amount, approximately \$350 billion were brokered CDs.<sup>33</sup> The Associations also estimate that \$350 billion of the \$813 billion reported brokered deposits are in sweep programs. In addition, some sweep programs have qualified for exemption from classification as “brokered deposit”<sup>34</sup> and thus are not reported as such on the Call Reports of those banks. Like sweep programs in which deposits are deemed “brokered,” these programs utilize pass-through insurance. We estimate that between \$600 billion and \$700 billion are on deposit at banks through these exempted programs.<sup>35</sup> Therefore, almost 13 percent of all domestic deposits are held on a pass-through basis through broker-dealers or other banks through these various deposit programs.<sup>36</sup> While the business models of the covered banks vary significantly, we believe it is reasonable for the FDIC to assume that in the aggregate the deposit composition of covered banks reflect this overall industry percentage. If the proposed rule is adopted without a provision for class exemption, covered banks would continuously have to obtain from the brokerage industry and other banks customer information on almost 13 percent of the total deposits at covered banks.

As discussed below, average sweep deposit balances and purchases of brokered CDs are substantially below the \$250,000 FDIC insurance limit. Therefore, the brokers could be transferring information on millions of customers for any one covered bank. The burden of implementing such a data transfer and maintenance program would fall not just on the covered banks, but on brokers, who would not be subject to the rule.

Set forth below is a description of CD and sweep programs offered by brokers and some banks.<sup>37</sup> While each product relies on pass-through insurance, there are some differences in the manner in

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<sup>33</sup> This includes CDs held at the Depository Trust Company and those held through The Bank of New York Mellon and other banks acting as sub-custodian for CDARS and similar programs. We estimate that approximately \$50 billion are “institutional” CDs owned by institutional investors in amounts substantially in excess of the FDIC insurance limit.

<sup>34</sup> FDIC Advisory Opinion 05-02, February 3, 2005.

<sup>35</sup> Data are derived from a survey of broker-dealer sweep programs.

<sup>36</sup> This number was calculated by summing the estimated amount of brokered CDs (\$350 billion), the estimated amount of reported brokered sweep deposits (\$350 billion), and the estimated amount of unreported brokered sweep deposits (\$700 billion). The total (\$1.4 trillion) was divided by the amount of domestic deposits (\$11.1 trillion) as of March 31, 2016, to arrive at the result.

<sup>37</sup> For a history of the development of these products and discussion of relevant legal issues, see Paul T. Clark, *Just Passing Through: A History and Critical Analysis of FDIC Insurance of Deposits Held by*

which the deposit account products are offered and held by the brokers, and in the ability of the deposit accounts to move freely in the market. However, as described below, each deposit account product would present formidable, and in some cases insurmountable, operational and competitive issues to covered banks to obtain this information if the rule is adopted as proposed.

### *CD Programs*

CDs are issued through a broker pursuant to an agreement between the bank and the broker in which the broker agrees to offer the CDs to its customers. In many cases, the broker may also offer the CDs through a syndicate of other brokers that have entered into agreements with the originating broker. A typical syndicate includes between 100 and 200 brokers. Most banks active in this market have agreements with several originating brokers in order to negotiate the most favorable pricing and access the greatest possible number of potential depositors.

CDs are typically issued in denominations of \$1,000 and evidenced by a Master Certificate of Deposit that represents the total number of CDs issued on the same date and on the same terms. For example, a bank issuing \$1 million of CDs maturing on May 1, 2017, would issue 1,000 CDs evidenced by a single Master Certificate.

Master Certificates are issued in the name of “Cede & Co., as a nominee for The Depository Trust Company” and held by DTC on behalf of the brokers and banks that maintain accounts at DTC.<sup>38</sup> As noted above, these account holders are referred to as participants. DTC is a clearing corporation registered with, and regulated by, the SEC. Its primary function is holding securities and other financial assets in order to permit ownership of these assets on a book-entry basis (*i.e.*, investor ownership is evidenced by records maintained by the participants acting as agents for their customers, not by the issuing banks or DTC). DTC maintains information solely about the holdings of its participants; it does not maintain, and has no access to, information about the underlying owners of the assets it holds.<sup>39</sup>

A broker offering the CDs of a bank to its customers and to customers of other brokers directs DTC at the settlement of the issuance to allocate the appropriate number of CDs it sold to its customers to its participant account at DTC and the appropriate number of CDs sold by the other brokers to the participant accounts of the brokers, or the participant accounts of a broker's clearing broker. If a customer who purchased CDs from one broker moves his or her account to another broker, the requisite number of CDs are added to the transferee broker's participant account at DTC and deducted from the transferor broker's participant account. The transferee broker would maintain the records concerning its new customer's CD ownership.

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*Brokers and Other Custodians*, 32 *Review of Banking and Financial Law* 99 (2012), available at [www.bu.edu/rbfl/files/2013/09/Just-Passing-Through.pdf](http://www.bu.edu/rbfl/files/2013/09/Just-Passing-Through.pdf).

<sup>38</sup> CDARS and similar programs utilize The Bank of New York Mellon and other banks as a sub-custodian in the same manner as brokers utilize DTC.

<sup>39</sup> See FAQs: How Issuers Work with DTC, available at [www.DTC.com](http://www.DTC.com), and Paul T. Clark, *Just Passing Through: A History and Critical Analysis of FDIC Insurance of Deposits Held by Brokers and Other Custodians*, 32 *Review of Banking and Financial Law* 99 (2012), at page 152, *et seq.*



This book-entry method of evidencing CD ownership permits CDs to move freely in the market. Many brokers maintain a secondary market in CDs for their own customers wishing to sell their CDs prior to maturity. CDs also trade between brokers and over a number of electronic trading platforms, such as BondDesk, Knight BondPoint, and the Bloomberg Trade Order Management System. Such trading provides liquidity to CD holders whose early withdrawal rights are very limited.<sup>40</sup>

Because CDs can easily move between customers of a single broker and between brokers, the transfer of customer information to a covered bank with respect to any single Master Certificate could require a transfer of such information from numerous brokers to the covered bank and would necessitate frequent updating to reflect changes in ownership. DTC does not maintain this information and cannot facilitate the transfer of this information.

Based on information provided by DTC, as of April 30, 2016, nearly \$250 billion of retail CDs are held at DTC. Average purchases in this market range from \$35,000 to \$50,000, depending on the profile of a broker's customer base. Utilizing an average purchase of \$45,000, there are approximately 5.5 million customer accounts in the securities industry holding brokered CDs through DTC.

#### *Sweep Programs*

Brokers offer their customers various options to invest automatically, or “sweep,” available cash in the customer's brokerage account into a liquid investment so that the customer can earn interest until the customer decides how to invest the funds for a longer term. Over the last 15 years, brokers have increasingly offered deposit accounts at one or more banks as an alternative to money market mutual funds.

The sweep programs utilize a money market deposit account (MMDA)<sup>41</sup> or an MMDA linked to a transaction account.<sup>42</sup> A bank establishes a single MMDA, or a single MMDA and a single transaction account, in the name of the broker at the bank pursuant to an agreement specifying the broker's role as agent and custodian for its customers. The agreement contains provisions required by the SEC to ensure that the broker is securely maintaining the deposit accounts as agent and custodian for its customers.<sup>43</sup>

The structure of sweep programs can vary depending on whether the broker is affiliated with one or more banks; and, if so, the capacity of the bank or banks to accept all the deposits of the broker's customers. If a broker is not affiliated with a bank, it will typically enter into

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<sup>40</sup> Early withdrawal is permitted only upon the death or adjudication of incompetence of a CD holder.

<sup>41</sup> An MMDA is an account in which (i) no more than six (6) transfers and withdrawals can be made per month and (ii) the depository institution reserves the right to take up to seven (7) days to satisfy a request for withdrawal. See 12 C.F.R. §204.2(d)(1) and §204.2(d)(2).

<sup>42</sup> A transaction account is an account that generally does not have withdrawal restrictions. Transaction accounts include negotiable order of withdrawal, or NOW, accounts. See 12 C.F.R. §204.2(e).

<sup>43</sup> See Sweep Guidelines (Draft), which were developed in 2006 by the staffs of the SEC (Trading and Markets Division) and FINRA (Financial Operations Department), and provided in draft form to select FINRA members, but never published (“Sweep Guidelines”); see also 17 C.F.R. §240.15c3-3.

agreements with a number of unaffiliated banks to accept customer deposits in order to increase the amount of FDIC coverage potentially available to its customers. The programs may be structured as sweeps to (1) an affiliated bank or banks, (2) an affiliated bank and one or more unaffiliated banks, or (3) unaffiliated banks.

Based on a review of industry data, average deposit balances in customer accounts participating in a broker's bank sweep program range from \$7,000 to nearly \$30,000. The primary factor affecting the difference in average balances appears to be the nature of the customers the broker serves. A broker serving higher net worth customers with greater amounts of assets at the broker will, understandably, have higher customer average balances.

The total deposit balances maintained through a broker's sweep program can be substantial. Total balances in the largest sweep programs exceed \$100 billion. Although the average customer balance may be relatively small, the large number of customers participating in the program can produce a large total balance.

For example, assuming a \$20 billion program and average customer balances of \$15,000, then over 1.3 million customer accounts have deposit balances. Furthermore, customer balances can change daily as a result of a customer's purchase and sale of securities and the receipt of interest and dividend payments on securities held in the customer's account. Assuming a broker would be willing to transfer and regularly update this amount of customer information, engaging in such information transfers would impose a substantial operational burden on the broker, as well as on the covered bank, to securely receive, maintain and regularly update the records.

#### *Customer Disclosures*

Under both specific guidance issued by the federal securities regulators and general principles of full disclosure under the federal securities laws, it is industry practice in the securities industry to provide customers purchasing CDs and participating in a bank deposit sweep program with a written disclosure document.<sup>44</sup> In addition to describing the features of the deposit product being offered, the document covers FDIC insurance coverage limits and the various ownership capacities eligible for separate insurance coverage. This is not only good practice, it also reflects that fact that these deposit products are intended to be sold on a fully-insured basis.

In addition to providing disclosures about FDIC insurance coverage, brokers provide customers with an overview of how the FDIC would resolve a failed bank at which the customer has a deposit. A typical disclosure document would include the following:

In the event that federal deposit insurance payments become necessary, payments of principal plus unpaid and accrued interest will be made to you. There is no specific time period during which the FDIC must make insurance payments available, and [broker] is under no obligation to credit your Account with funds in advance of payments received from the FDIC.

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<sup>44</sup> See NASD Notice to Members 02-69 (Clarification of Member Obligations Regarding Brokered Certificates of Deposit) (October 2002); *see also* the Sweep Guidelines, *supra* note 43.

Furthermore, you may be required to provide certain documentation to the FDIC before insurance payments are made. For example, if you hold deposits as trustee for the benefit of trust participants, you may be required to furnish affidavits and provide indemnities regarding an insurance payment.

Customers are, therefore, already informed under existing FDIC guidance that there could be a delay in receiving funds in a bank failure, and purchase CDs or participate in sweep programs with this understanding. In the few instances where there have been delays in insurance payments at a failed bank, this disclosure has assisted brokers in managing customer expectations.

#### *Deposit Broker Processing Guide*

The FDIC already has in place policies and procedures to address the concerns set forth in the NPR about payment of insured deposits held by a failed covered bank through a broker or other intermediary. In July 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....”<sup>45</sup> In December 2001, the FDIC solicited public comment on a draft *Deposit Broker Processing Guide*, which sets forth the procedures for submission of customer information by a deposit broker in the event of the failure of a bank in which funds have been deposited.<sup>46</sup> The proposed *Guide* also provided formatting instructions for submitting customer information as well as timeframes for submission.

The *Guide* was adopted in early 2002 and, since then, has been utilized by deposit brokers for submission of customer information in all failed banks in which there has been a deposit insurance payment.<sup>47</sup> 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 worked well for nearly 15 years.

#### *Access to Liquid Deposit Accounts*

When it proposed the current version of the Large Bank Deposit Insurance Determination Modernization regulations in 2008, 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 do customers holding CDs.

In response to these comments, the FDIC stated that, once depositor funds become available following appointment of a receiver of a failed bank, an intermediary acting as a fiduciary could make withdrawals from MMDAs to satisfy withdrawal requests; the intermediary would, however, be responsible for any payments to a customer in excess of the insurance coverage for

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<sup>45</sup> FDIC Press Release 53-2001 (July 30, 2001).

<sup>46</sup> Notice and Request for Comment, 66 Federal Register 65,964 (December 21, 2001).

<sup>47</sup> See FDIC, *Deposit Broker's Processing Guide*, posted to [www.fdic.gov/deposit/deposits/brokers/](http://www.fdic.gov/deposit/deposits/brokers/)

which the customer is eligible.<sup>48</sup> Intermediaries, particularly broker-dealers offering sweep programs, have incorporated this policy into their operating procedures.

#### *Class Exemptions for Brokered CDs and Sweep Deposits*

Under the proposed exception procedures, a covered bank may request exception from the recordkeeping requirements if it provides a written statement from each depositor that is acting for unnamed beneficiaries or beneficial owners stating that the depositor will not or cannot provide identification information on the beneficiaries or beneficial owners. As discussed below, accountholders for brokered CDs and sweep deposits held by broker-dealers would not be willing or able to provide these data daily. Accordingly, ***the Associations respectfully request class exemptions for brokered CDs and sweep deposits held by broker-dealers or other banks on behalf of customers.***

#### *Brokered CDs*

To apply for an exception under the NPR, a covered bank would need to request beneficial owner names from DTC, which would respond by stating that it does not have the names of its participants' customers. The covered bank could request that DTC provide the names of the participants holding its CDs. This would result in the covered bank obtaining the names of hundreds of brokers, many of them clearing brokers acting for introducing brokers. Even if the covered bank were to contact all of these brokers, we believe the vast majority would decline to provide customer information or simply not respond to the request.

The Associations believe that transferring customer information to the covered banks is not necessary to achieve the purposes of the NPR. Holders of CDs do not have an expectation of immediate access to their funds. Past experience indicates that brokers provide the FDIC with customer information within a few business days of a bank's failure. Payment has been made within a one to two week time frame. Because of the nature of time deposits and the disclosures provided by brokers concerning potential delays in payment, we do not believe that delays in payment would affect depositor confidence.

Additionally, retail brokered CDs, the vast majority of brokered CDs, are sold on the basis of the availability of full FDIC insurance, and average transactions are substantially below the \$250,000 insurance limit.<sup>49</sup> While it is possible that a *de minimis* amount of any covered bank's retail brokered CDs is in excess of the coverage limit available to a particular depositor, we believe the FDIC can assume for resolution planning purposes that a covered bank's retail brokered CDs are fully insured.

Therefore, the Associations request that the FDIC include in any final rule a class exemption for a covered bank's CDs held in the name of DTC or another sub-custodian that is acting on behalf of multiple custodians.

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<sup>48</sup> FDIC, "Large-Bank Deposit Insurance Determination Modernization," 73 Federal Register 41, 180, 41,189 (July 17, 2008), available at [www.fdic.gov/regulations/resources/largebankdim/08Final717.pdf](http://www.fdic.gov/regulations/resources/largebankdim/08Final717.pdf). This rule that led to 12 CFR §360.9

<sup>49</sup> A covered bank can readily identify for the FDIC their CDs sold in the institutional CD market. The FDIC can assume these CDs are substantially uninsured.

### *Sweep Deposits*

As with brokered CDs, a covered bank utilizing the proposed exception process would need to request beneficial owner identification data from each broker holding deposit accounts on behalf of customers in its sweep program. The vast majority of brokers would decline based on competitive considerations, cybersecurity risk, and cost.

With respect to brokers that are affiliated with a covered bank, the FDIC should not assume that the considerations applicable to non-affiliated arrangements do not apply to affiliated arrangements. In particular, the FDIC should not assume that brokers and affiliated covered banks share recordkeeping systems or even use compatible systems. The cost to a broker of providing the beneficial owner information to its covered bank affiliate on a regular basis may, in some cases, be as great as the cost to a broker that is not affiliated with a covered bank. For example, one broker that shares a compatible system with its covered bank affiliate estimates that it will cost \$3 million to \$5 million to modify the existing system to provide beneficial owner information to the bank on a regular basis. Cybersecurity risk and, in some cases, competitive considerations, would also make brokers reluctant to provide customer information to affiliated covered banks.<sup>50</sup>

Whether the broker is affiliated with the bank or not, the broker would need to request from many of its customers the names of beneficiaries or beneficial owners for whom the customer is acting and information concerning the balances attributable to each beneficiary or beneficial owner for insurance purposes. Obtaining such information is time-consuming, expensive, and potentially disruptive of customer relationships. Further, many customers will decline to provide this information.

The Associations believe that gathering, transferring, and updating customer information is unnecessary to achieve the purpose of the NPR. As with CDs, brokerage customers maintain deposit balances in sweep programs that are, in many cases, substantially below the FDIC insurance limit. As with CDs, these programs are offered to customers in a manner designed to keep customers under the insurance limit. We believe that the FDIC can reasonably assume that only a *de minimis* amount of sweep deposits at a covered bank is uninsured.

The policy adopted by the FDIC in 2008 addresses the issue of customer demands for liquidity if a covered bank in a broker's sweep program fails.<sup>51</sup> A broker can manage its exposure to a customer whose deposits at a bank (that might someday fail), including those placed through the broker, exceed \$250,000 by obtaining affidavits and indemnifications before permitting withdrawals.

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<sup>50</sup> A broker may be an affiliate of a covered bank for purposes of certain banking regulations, such as the Bank Holding Company Act and Regulation Y, but not be a consolidated subsidiary of the covered bank (or *vice versa*) or a consolidated subsidiary of a common parent. In cases where no actual control exists (*i.e.*, there is less than a 50 percent controlling equity interest), the broker and covered bank are no more likely to share customer information or systems than between unaffiliated brokers and covered banks. As a practical matter, the bank's ability to obtain the required information from the broker will be impeded by the bank's (or its parent company's) lack of operational control over the broker.

<sup>51</sup> See footnote 48.

We request that any final rule contain a class exemption from the recordkeeping requirements for sweep programs where a broker agrees to provide to a covered bank, at the end of each calendar quarter or upon reasonable notice, the number of customers participating in the broker's sweep program, the average customer balances in the sweep program and, based solely on the broker's records, the number of customers with uninsured deposits and amount of such deposits.

#### **4. Deposit Instruments: Cashier's Checks, Teller's Checks, Certified Checks, Personal Money Orders, and Foreign Drafts**

The proposed recordkeeping requirement is not limited solely to conventional deposit accounts; it would capture other products offered or issued by a bank eligible for FDIC insurance coverage. At proposed 12 CFR §370.2(b), the term "deposit" is defined broadly, incorporating by reference the following definition from 12 USC §1813(l) (emphasis added):<sup>52</sup>

- (l) DEPOSIT. – The term "deposit" means –
- (1) the unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a ***check or draft drawn against a deposit account and certified by the bank or savings association***, or a letter of credit or a traveler's check on which the bank or savings association is primarily liable: Provided, That, without limiting the generality of the term "money or its equivalent," any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank or savings association for collection, ...
  - (4) outstanding draft (including advice or authorization to charge a bank's or a savings association's balance in another bank or savings association), ***cashier's check, money order***, or other officer's check issued in the usual course of business for any purpose, including without being limited to those issued in payment for services, dividends, or purchases,...

This definition captures cashier's checks, teller's checks, certified checks, personal money orders, and foreign drafts within the scope of the proposed rule. All of these instruments that qualify as deposits warrant class exemptions from the proposed recordkeeping requirements. As discussed below, by the nature of these deposits, it would not be possible for a covered bank to determine on the spot the final beneficiary for FDIC insurance determination.

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<sup>52</sup> 12 CFR §370.2(b) defining the term "deposit." Emphasis added.

### *Cashier's checks*

A cashier's check is defined at UCC §3104(g)<sup>53</sup> as "a draft with respect to which the drawer and drawee are the same bank or branches of the same bank."

An accountholder or non-acountholder can generally purchase a cashier's check from a bank's retail location. In the event of a sale to an existing accountholder, presumably that accountholder has provided to the bank a taxpayer identification number (TIN).<sup>54</sup> Therefore, the bank should have on its books and records the accountholder's TIN as a unique identifier.

However, in the event a non-acountholder is a purchaser of a cashier's check, a bank would not normally capture a TIN. That non-acountholder would not be establishing an account, *i.e.*, a "formal banking relationship" triggering the requirement to secure a TIN under the Bank Secrecy Act (BSA).<sup>55,56</sup>

Moreover, in the event a bank issues a cashier's check to satisfy an accounts payable obligation, such as paying a vendor or a service provider, the bank may not in many cases capture a TIN, unless the annual payment exceeds \$600.<sup>57</sup>

Further, an "owner" of a cashier's check is initially a purchaser or remitter<sup>58</sup> of the instrument. That purchaser/remitter may tender the instrument back to the issuing bank and seek reimbursement for the purchase price or cause the issuance of a replacement instrument. That bank would deface the instrument "NOT USED FOR PURPOSES INTENDED" and reimburse

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<sup>53</sup> All references to the UCC are from the California Commercial Code.

<sup>54</sup> 31 CFR §1020.220(a)(2)(i)(4)(i).

<sup>55</sup> See 31 CFR §1020.100(a)(2)(i): a "sale of a check" does not establish a banking relationship for purposes of a customer identification program triggering the requirement to obtain a TIN.

<sup>56</sup> One exception: If the purchaser of a cashier's check in the amount of \$3,000 or more is an individual using currency in amounts of \$3,000-to-\$10,000 inclusive to purchase the instrument, a bank is required to secure that individual's Social Security number. (31 CFR §1010.415(a)(2)(i)(B)).

<sup>57</sup> Internal Revenue Code Instructions for Form 099-MISC, p. 1, and Form 1099-MISC.

<sup>58</sup> See UCC §3103(a)(11): (11) "Remitter" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser. Also see UCC §3201, official comment 2, with emphasis: In most cases negotiation occurs by a transfer of possession by a holder or remitter. Remitter transactions usually involve a cashier's or teller's check. For example, Buyer buys goods from Seller and pays for them with a cashier's check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3-105(a). If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the "remitter." Section 3-103(a)(11). ***The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery.*** This transfer is a negotiation because Seller becomes the holder of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3-306 against Seller or a subsequent transferee of the check. Section 3-202(b) provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by a holder.

the purchaser/remitter or issue a replacement instrument. As the purchaser/remitter acquires the original instrument, that party is deemed the owner thereof.

Upon delivery of the instrument to its intended payee, however, that payee becomes the holder and owner of the instrument, able to enforce it in accordance with its terms.<sup>59</sup> The issuing bank would not have captured the TIN of the payee generally upon issuance. Even if it captured that information, it does not have knowledge regarding the delivery of the instrument. Thus, the bank can only speculate about the identity of the cashier's check's owner; that owner could be the purchaser/remitter, the payee upon delivery, or a transferee.<sup>60</sup>

In short, securing a TIN in connection with a cashier's check is highly challenging, if not impossible, in many cases, particularly in case of a non-accountholder or a payee (or transferee). Further, no federal regulation appears currently to require a bank to secure such information as to a payee. Even if a bank could capture this information, it would not have knowledge of the holder of the instrument, as delivery may or may not have occurred to a payee or transferee.

#### *Teller's checks*

A "teller's check" is a draft drawn by a bank on another bank, or payable at or through a bank.<sup>61</sup> While a teller's check may be less common than a cashier's check, it involves the same issues as a cashier's check, particularly as to a payee or transferee of the instrument.

#### *Certified checks*

A "certified check" is defined in UCC §3409(d) as:

- "Certified check" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated below or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.
- "Acceptance" means the drawee's signed agreement to pay a draft as presented. It shall be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.
- A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.
- If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

A bank faces similar questions regarding the payee or transferee. The payee's TIN is not normally captured and the bank has no actual knowledge regarding the delivery or further transfer of the instrument.

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<sup>59</sup> UCC §3201 and §3301.

<sup>60</sup> UCC §3201.

<sup>61</sup> UCC §3104(h).



### *Personal money orders*

A personal money order is similar to a checking account subject to a single draft, the money order itself.<sup>62</sup> A bank normally sells these instruments in amounts of \$500 to \$1,000. The bank does not normally obtain the purchaser's TIN, and the institution would not have that information if the purchaser is not an accountholder.<sup>63</sup> Unlike a cashier's check, teller's check, or certified check, the bank is not directly liable under a personal money order; the drawer<sup>64</sup> field is completed by the purchaser, not the institution, resulting in the drawer having direct liability under the instrument.<sup>65</sup> Therefore, the accountholder would be the purchaser of the personal money order for purposes of the proposed rule.

### *Foreign drafts*

A foreign draft is issued by a domestic bank against its *nostro* account<sup>66</sup> maintained with a foreign bank. As the domestic bank is the issuer, it is directly liable under the instrument. The analysis above as to a teller's check is applicable to a foreign draft.

***For these reasons, the Associations request that all of the above instruments that qualify as deposits be exempt from the proposed recordkeeping requirements.***

## **5. Lawyer Trust Accounts and Real Estate Trust Accounts**

### *Lawyer Trust Accounts*

Lawyers and law firms frequently establish depository Interest on Lawyer Trust Accounts (IOLTAs) for the purpose of managing client funds, as required under American Bar Association Model Rule of Professional Conduct 1.15 and ethics rules adopted by all state court systems. Lawyers may also establish escrow accounts to manage the proceeds of class action judgements and settlements.<sup>67</sup> In the creation and management of these accounts, the lawyers are subject to a fiduciary duty to their clients, which, similar to trustees, includes a duty of client confidentiality.<sup>68</sup> Therefore, similar to trustees, lawyers and law firms will be wary of providing sensitive client information requested by a covered bank, especially if the lack of disclosure *does not* ultimately affect the FDIC insurance afforded the account.

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<sup>62</sup> 5 *Quinn's UCC Commentary & Law Digest* §4-403[B][4] (Rev. 2d ed); *United Apparel Distributors, Inc. v. Chase Manhattan Bank, N.A.*, 548 F. Supp. 672 (S.D.N.Y. 1982).

<sup>63</sup> See 31 CFR §1020.100(a)(2)(i): a "sale of a check or money order" does not establish a banking relationship for purposes of a customer identification program triggering the requirement to secure a taxpayer identification number.

<sup>64</sup> UCC §3103(a)(3).

<sup>65</sup> UCC §3414(b).

<sup>66</sup> An account maintained by a domestic bank with a foreign bank denominated in the currency of that country. *Nostro* accounts are used to facilitate settlement of foreign exchange and trade transactions. A *nostro* account is an account maintained by a foreign bank with a domestic bank.

<sup>67</sup> Courts overseeing class action judgements and settlements often require that the proceeds, before distribution, be invested in either U.S. securities or a fully insured deposit.

<sup>68</sup> American Bar Association Model Rule 1.6, Confidentiality of Information.

In addition, these accounts are established to facilitate transactions on behalf of clients, such as paying for court and legal expenses, as well as receiving proceeds from law suit judgements and settlements. They, therefore, have frequent, if not daily, withdrawals and deposits made on behalf of various clients. Providing up-to-date information, as per the NPR, would be administratively difficult and costly for accountholders.

Under American Bar Association Model Rule 1.15, lawyers must keep adequate records on IOLTAs and other client accounts for up to five years. Therefore, information on the relative beneficial ownership interests in an IOLTA would be made available promptly to the FDIC in the event of a resolution.

Indeed, for these very reasons, the Financial Crimes Enforcement Network (FinCEN) recently provided an exception to its customer due diligence final rule for IOLTAs and lawyer escrow accounts:

FinCEN understands that many attorneys maintain client trust or escrow accounts containing funds from multiple clients and other third parties in a single account. Funds flow in and out of these accounts during the normal course of business, and while these movements may not be as frequent as those found in, for example, pooled accounts in the securities and futures industries, they nevertheless create significant operational challenges to collecting this information with reference to the relevant clients and third parties. As in the case of non-excluded pooled investment vehicles, FinCEN believes that it would be unreasonable to impose such collection obligations for information that would likely be accurate only for a limited period of time. FinCEN also understands that State bar associations impose extensive recordkeeping requirements upon attorneys with respect to such accounts, generally including, among other things, records tracking each deposit and withdrawal, including the source of funds, recipient of funds, and purpose of payment; copies of statements to clients or other persons showing disbursements to them or on their behalf; and bank statements and deposit receipts. For these reasons, FinCEN believes that attorney escrow and client trust accounts should be treated like other intermediated accounts described above, and we accordingly deem such escrow accounts intermediated accounts for purposes of the beneficial ownership requirement.<sup>69</sup>

***The Associations urge the FDIC to take an approach similar to FinCEN and acknowledge the significant obstacles to obtaining and maintaining beneficial ownership information on IOLTAs and lawyer escrow accounts by providing a class exemption from the proposed recordkeeping requirements for these accounts.***

#### *Real Estate Trust Accounts (RETAs)*

Similar in structure and concept to IOLTAs, many states require real estate brokers/agents and title companies to establish pooled interest-bearing real estate trust accounts (RETAs), also known as real estate brokers trust accounts, in which a title/escrow agent deposits funds from multiple clients and the funds are held for a short period of time until the real estate transaction is

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<sup>69</sup> 81 Federal Register (91), May 11, 2016, 29398 at 29416.

complete. The states mandate that the interest earned be paid to a third party, often state programs that support low-income housing and other state housing goals (similar to state mandates for IOLTA interest to be used for free or low-cost legal services programs). The state provides a taxpayer identification number (TIN), which is used when establishing a pooled RETA, and this number is used by a bank for all pooled RETAs in a state.

These funds are associated with specific, point-in-time real estate transactions, and banks often do not charge fees or else charge reduced fees for such accounts. Therefore, the burden and cost of collecting, maintaining, and synthesizing underlying beneficiary information on an ongoing basis would outweigh any benefit. Significantly increased operational requirements regarding these accounts may have unintended consequences on their availability.

*As with IOLTAs, the Associations urge the FDIC to acknowledge the significant obstacles to obtaining and maintaining beneficial ownership information of RETAs by providing a class exemption from the proposed recordkeeping requirements.*

## **6. Government Benefits, Payroll, and General Purpose Reloadable Cards**

The FDIC's general practices recognize two major types of prepaid cards: (1) closed-loop cards that generally are sold to individuals (such as gift cards and prepaid telephone cards) or provided to individuals (rewards cards) that permit the cardholder to obtain goods or services from a specific merchant or group of merchants (collectively, "non-reloadable cards"), and (2) open-loop cards that provide broader access to stored funds placed on deposit at banks by cardholders or other parties (such as general purpose reloadable cards, payroll cards, and government benefits cards).<sup>70</sup> That proposal indicates that, while all prepaid card deposits would be subject to a final rule, the focus was on "making prompt deposit insurance determinations on 'open-loop' prepaid cards."<sup>71</sup>

*The Associations believe a class exemption from the record-keeping requirements is warranted in any final 12 CFR §370 rule for closed-loop cards and other non-reloadable cards.* Serious consideration should be also given to a class exemption for other open-loop cards (e.g., payroll cards and government benefit cards) in light of the observed reluctance of employers and governments to share customer-level information, and improbability – impossibility in some cases – for balances on open-loop cards to exceed \$250,000. The FDIC should note that rules from other federal agencies exempt certain prepaid cards.<sup>72</sup>

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<sup>70</sup> NPR at 10035.

<sup>71</sup> NPR at 10035.

<sup>72</sup> The Bureau of Consumer Financial Protection's proposed prepaid card rule would provide a carve-out for "(1) a gift certificate as defined in §1005.20(a)(1) and (b); (2) a store gift card as defined in §1005.20(a)(2) and (b); (3) a loyalty, award, or promotional gift card as defined in §1005.20(a)(4) and (b); or (4) a general-use prepaid card as defined in §1005.20(a)(3)." (See [http://files.consumerfinance.gov/f/201411\\_cfpb\\_regulations\\_prepaid-nprm.pdf](http://files.consumerfinance.gov/f/201411_cfpb_regulations_prepaid-nprm.pdf), page 10.)

### *Class Exemption for Closed-Loop Cards and Non-Reloadable Cards*

Closed-loop and non-reloadable cards have certain features that support exemption as classes from the scope of a final rule. As acknowledged in the NPR, funds paid in exchange for many of these types of card are not FDIC-insured on a pass-through basis.<sup>73</sup> Furthermore, whether or not FDIC-insured, bank collection of information on the owner of a closed-loop card (or similar open-loop card) is limited at best, commensurate with the nature and use of these cards. Under the Bank Secrecy Act, only limited identifying data are required to be collected at the time of sale for many of these cards, with additional ownership data collected only later at the cardholder's election. Moreover, these cards are often easily transferrable (e.g., given to friends or relatives), so the issuing bank may have no idea of the current owner. Thus, maintaining ownership data would be extremely difficult and reliant on retail customers expending time to provide personal identification information for a limited benefit. The information is subject to constant or near-constant change and could not reasonably be relied on at the point of failure.

The difference in data collection requirements for covered and non-covered institutions would be significant, giving non-covered institutions a significant advantage in the marketplace. It is highly likely that these cards would have increasingly diminished value to retail customers if they would be required to provide such information on an ongoing basis. The result would be that covered institutions would consider that the investment in data aggregation and reporting for unreliable information regarding funds ownership would not be warranted. For these reasons, ***closed-loop cards and similar open-loop cards (e.g., single-load gift and reward) should be exempted from the scope of a final rule.***

### *Class Exemptions for Other Open-Loop Cards*

With the exception of non-reloadable cards, the Associations recognize the FDIC's concerns with the availability of funds to open-loop cardholders in the event of a bank failure. Covered institutions have and continue to invest significant sums and staff time to payments systems and operations that ensure funds due to employees or government beneficiaries are delivered not only in a timely manner but also to the correct beneficiary. However, the FDIC should recognize the practical limitations of obtaining beneficiary-level information, given customers' very real concern for data security and privacy. ***The Associations, therefore, request a class exemption for open-loop cards from the scope of any final rule;*** alternatively, we ask the FDIC to maintain a flexible stance towards approval of bank-specific exception petitions citing customer refusal to provide personal identification information on an ongoing basis.

### *Unwillingness to Provide Personal Identification Numbers*

The FDIC should appreciate the sensitivity of employers and government agencies to daily transmittal of SSNs, TINs, and other government-issued identification numbers of their employees and beneficiaries in connection with open-loop cards. Regulated financial institutions are at the forefront of data protection and are used to maintaining and protecting the confidentiality of large amounts of highly sensitive data. Nonetheless, employers and government agencies are alerted to the added exposure involved with additional transmission of personal identification information and would prefer to maintain such information on their own

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<sup>73</sup> NPR at 10035.

systems. In fact, many of the customers of covered banks choose these institutions because the employee or beneficiary data transmitted is limited to only what is necessary to ensure prompt and accurate payment and does not include this information.

#### *FDIC Exposure to Deposit Insurance Overpayment Risk*

It is highly unlikely that an individual would be beneficiary of an open-loop payroll card or government benefits card in excess of \$250,000. These types of cards are subject to the internal limits of the specific program, which generally (if not always) constrain the maximum amount of funds on the relevant card to some \$10,000s, certainly well below \$250,000. Covered banks maintain sufficient data to determine the amount of funds connected to a specific card and therefore can determine an aggregate FDIC insurance exposure. In the very rare case that an individual or entity has a prepaid card with a balance over \$250,000, the bank would maintain information on the individual (or could easily do so if required) to facilitate deposit insurance determination.

#### *Cost to Covered Insured Depository Institutions*

While prepaid card balances may be reflected on the main deposit system(s) of a covered bank in omnibus accounts, beneficiary-level information, to the extent available, is often reflected on other systems that are product or product-type specific. This architecture has been developed, in part, based on many years of rules and practices surrounding pass-through deposit insurance. Implementing changes in order to obtain, standardize, and synthesize the data needed to determine which prepaid accounts are to be aggregated with others for insurance determination purposes would require significant time and cost for affiliates and/or third-party processors. For payroll cards and government beneficiary cards in particular, the modifications envisioned in the NPR may be particularly difficult and costly.

The challenge would be complicated by the fact that the account identifiers used by prepaid and government card systems may differ from those on other deposit systems, as many underlying beneficiaries may not have readily verifiable SSNs or TINs. The bank would need to undertake additional or separate aggregation efforts to address this unique problem, aggregation efforts that could not be executed through a SSN or TIN match.

#### *Other Competing Government Mandates Affecting Prepaid Cards*

A proposed rule on prepaid cards from the Bureau of Consumer Financial Protection is expected to be finalized during the FDIC's consideration of this NPR. While the aims and data requirements of the Bureau rule differ from those of the NPR, the technology and operational staff involved in prepaid card systems would be addressing the Bureau's rule at the same time as the FDIC's final rule. Furthermore, intensified focus on the BSA/Anti-Money Laundering customer identification requirements and limited federal agency flexibility in meeting those requirements have necessitated development of additional systems that may or may not complement the FDIC's efforts.

#### *Systems Modifications*

The Associations share the FDIC's desire to ensure that employees and government beneficiaries receive their appropriate amount of federally insured deposits. To that end, covered banks are

willing to modify their deposit systems to be able to receive underlying employee/beneficiary information requisite for FDIC insurance determination. This (in addition to the other systems enhancements and required data aggregation and insurance calculation architecture) would allow employers or governments to maintain the currency and integrity of employee/beneficiary data on their own systems for accurate deposit insurance determination. Importantly, this framework also would ensure timely deposit insurance determinations for underlying employees/beneficiaries of these cards, as covered banks' systems would have the capability of receiving sensitive personal identification information from employers and government agencies at the specific point in time of a bank resolution.

## **7. Foreign Office Deposits**

The proposed treatment of foreign office deposits is unnecessary to achieve the intent of the proposed rule. Under 12 USC §1813(l), deposits in foreign branches of U.S. banks generally do not count as "deposits" under the Federal Deposit Insurance Act, and therefore are not protected by FDIC insurance in the event of a bank failure. Individual depositor information is not needed to make FDIC insurance determinations, since these deposits are specifically uninsured.

However, under 12 USC §1813(l)(A)(5), foreign office deposits are classified as deposits for the FDIC's purposes if they are explicitly dually payable in both a foreign and a U.S. office of the bank. This provision does not override the ban on FDIC insurance protection for such deposits, but it does give them status as (uninsured) deposits. The distinction is relevant in that, under 12 USC §1821(d)(11), uninsured deposits have priority claims in a bank failure over non-deposit liabilities. Thus, dually payable deposits enjoy a prior claim over other foreign office deposits, which count simply as general liabilities. Therefore, to determine the appropriate liabilities to transfer to an assuming bank, the FDIC might need to be able to identify the aggregate balances of foreign office deposits that are dually payable *versus* those that are not.

Depositor files prepared under 12 CFR §360.9, and similar files that could be prepared under 12 CFR §370, provide information on foreign office deposits to support resolution of a covered bank. If the FDIC sees a need for more information to support a bank resolution where the distinction between uninsured deposits and general liabilities is relevant, any final rule could provide that these files be supplemented with the aggregate balance of dually payable foreign office deposits. The Associations note, however, that the issue of dually payable deposits is recent, and covered banks advise that they do not have any such deposits at present.

***Therefore, the Associations recommend that deposits in covered banks' foreign offices should be exempt from the proposed recordkeeping requirements, as this information is not needed for FDIC deposit insurance determinations.***

## **B. Petitioning for Exceptions**

As proposed, a covered institution may apply for an exception from the proposed recordkeeping requirements for a deposit account if it "(i) ... has requested such information from the account holder and certifies that the account holder has refused to provide such information or has not

responded to the covered institution's request for information; (ii) [p]rovides a reasoned legal opinion that the information needed to complete the requirements ... for accounts of a certain type is protected from disclosure by law; or (iii) [p]rovides an explanation of how the information needed to complete the requirements ... changes frequently and updating the information on a continual basis is neither cost effective nor technologically practicable."<sup>74</sup> The Associations support the flexibility to seek exceptions. While we feel strongly that certain classes of deposit account should be exempted from the proposed recordkeeping requirements, individual covered banks are likely to have other idiosyncratic accounts for which obtaining the requisite depositor information would be impossible or cost-prohibitive. Therefore, an exception process is needed to make the proposed recordkeeping requirements workable.

Several clarifications are needed with respect to the exception process, including:

- Could a petition for an exception cover a class of accounts for a type of deposit?<sup>75</sup>
- How should a petition demonstrate that a deposit account holder has refused or been unresponsive to a covered bank's request for information?
- If a petition can pertain to a type of account, must it demonstrate that every account holder in that group has refused or been unresponsive to requests for information? How would this apply for accounts initiated after the petition is submitted?
- How should a petition demonstrate that information for an account or type of accounts changes frequently and the limits on durability of account information?
- If a petition can pertain to a group of deposit accounts, how should it demonstrate that, while changes in information for individual accounts may be infrequent, there are apt to be frequent changes within that subset of accounts collectively, making daily updates cost-ineffective?
- While awaiting a ruling from the FDIC, must a covered bank continue to attempt to gather information on accounts for which a petition for an exception has been submitted?<sup>76</sup>
- What process will there be to appeal an FDIC ruling on a petition?
- Does the FDIC contemplate a general sunset period for approved exceptions? If so, will there be a flexible process for renewals?

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<sup>74</sup> Proposed 12 CFR §370.4(c).

<sup>75</sup> Proposed 12 CFR §370.4(e) provides that "[t]he covered institution's application shall provide a copy of the information request letter sent to the account holder(s) and a summarized description of the accounts affected that includes, at a minimum, the number of accounts affected, the amounts on deposit in affected accounts, and any other information needed to justify the request." We seek clarification that a petition would not have to list a group of individually identified accounts, but instead could describe a type of account, including accounts of this type to be initiated after the petition is submitted.

<sup>76</sup> Proposed 12 CFR §370.4(c)(2) provides that "a covered institution will not be in violation of this part during the pendency of an application for an extension, exception or exemption submitted pursuant to this section." At issue is whether a covered bank would be allowed reasonable time to achieve compliance should an exception petition be denied.

A key point is that ***covered banks must be allowed reasonable time to implement the results of exception determinations.*** The FDIC must be prepared to respond expeditiously to petitions for exceptions and allow time for banks to come into compliance after receiving rulings. In particular, if an exception were denied, the FDIC could not require immediate compliance. The NPR includes no assurance that the process would provide time for implementation in a rational manner that avoids this problem.

Without answers to the above questions, it is difficult for covered banks to evaluate the overall proposal or to determine the cost or difficulty of its implementation. ***The Associations feel strongly that the exception petition process is so critical that input from covered institutions would be needed to assure a workable scheme. Accordingly, we recommend that this process be further clarified then repropose for public review and comment.***

After the exception petition process has been developed with public input, some ambiguity may remain as to how it will work in practice. To alleviate this uncertainty and support competitive equity among covered institutions, ***we recommend that the FDIC provide public notice of all exceptions granted or denied on a timely and ongoing basis – without naming the petitioners or specific deposit account holders – with explanations of the bases for those rulings.*** Provision of an exception for one covered bank without notice to others could create competitive inequalities among the banks, especially given the prohibition on sharing confidential supervisory information. ***The FDIC should also consider granting industry-wide class exemptions where justified by one covered bank so that others do not have to trouble those same deposit customers and commit time and effort to query them.***

#### *Misleading and Confusing Disclosures*

The Associations strongly object to the NPR's disclosure requirement when exceptions are granted. The NPR would require covered banks to, "[i]n the case of an exception, disclose to the account holder reported with the application that in the event of the covered institution's failure, payment of deposit insurance may be delayed and items may be returned unpaid until all of the information required to make a deposit insurance determination has been provided to the FDIC."<sup>77</sup> The notifications could raise concerns among notified parties and lead them to rethink their account relationships.

Moreover, many bank intermediaries offer accounts for which covered banks would submit exception petitions. In case of failure of a non-covered bank, as for a covered bank, it is standard practice for deposit insurance to be delayed and items returned unpaid for the types of account for which exception petitions will likely be submitted. The NPR offers no evidence that FDIC payouts would be delayed longer in case of a failure of a covered bank *versus* any other bank. Therefore, ***to single out covered banks for special disclosure requirements would be unjustified, likely drive deposits away from excepted accounts, create competitive disadvantages, and be categorically unfair.*** To help depositors understand the treatment of such accounts in the event of the failure of any bank, the Associations recommend that the FDIC

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<sup>77</sup> Proposed 12 CFR 370.5(f)(4).



augment the information it disseminates and posts to its website under “Understanding Deposit Insurance.”<sup>78</sup>

### C. Ownership Right and Capacity Codes under 12 CFR §330

In order to comply with the proposed rule, covered banks would have to apply the Ownership Rights and Capacity Codes in accordance with the definitions and requirements of 12 CFR §330.<sup>79</sup> However, these banks do not currently have in their records all the data needed to assign the correct capacity codes certain accounts in exact alignment with 12 CFR §330. Acquiring this information for existing accounts and updating systems and processes to be able to get and record it for new accounts would be an overwhelming task. Accordingly, *the Associations ask that any final 12 CFR §370 rule should permit covered banks to classify accounts for FDIC insurance determination as recorded on their internal systems, in line with FDIC's current practice in bank failures.*

As an example of the problem, a bank's records must note whether a deposit account in the name of two or more persons has signatures for all account parties in order to count as a “qualified joint account” under 12 CFR §330.9 and therefore receive separate FDIC protection up to \$250,000 for each party. However, there is no current requirement for banks to (1) ensure that all signature cards are complete and on file for joint accounts, or (2) record in deposit recordkeeping systems which joint accounts have complete signature cards.<sup>80</sup> Consequently, covered banks advise that they cannot certify that their deposit recordkeeping systems have complete signature cards and thus are “qualifying” joint accounts, because they have never been required to maintain such records. Even banks that have tried to do so may have incomplete records for deposits acquired in mergers and acquisitions.

For another example, revocable and irrevocable trust capacity code definitions reference other federal regulations as a basis for account classification or proper beneficiary designation. Many banks' recordkeeping systems do not distinguish between revocable and irrevocable trusts or comply with the detailed and nuanced trust classification and beneficiary parameters under 12 CFR §330.10–13.

Accounts of corporations, partnerships and unincorporated associations present similar challenges. Determination of appropriate insurance coverage requires understanding as to whether such entities are “engaged in independent activity” to receive separate insurance as

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<sup>78</sup> [www.fdic.gov/deposit/deposits](http://www.fdic.gov/deposit/deposits)

<sup>79</sup> NPR at 10032.

<sup>80</sup> Every bank is required to maintain for a period of five years “either the original or a microfilm or other copy or reproduction of ... [e]ach document granting signature authority over each deposit or share account, including any notations, if such are normally made, of specific identifying information verifying the identity of the signer (such as a driver's license number or credit card number) (31 CFR §1010.430(d) and 31 CFR §1020.410(c)(1)). This record retention requirement does not stipulate that a grant of signature authority over a deposit account be evidenced in writing; it merely means that when signature authority is granted in writing, the document evidencing that authority must be retained for a five-year period.

business accounts.<sup>81</sup> To permit certification of insurance calculations, “independent activity” would need to be explicitly verified on an account-by-account basis, requiring time-consuming, manual review of existing business accounts.

A covered bank could go through all of its deposit accounts records to verify accounts as per 12 CFR §330, but this would be a momentous undertaking. Going forward, keeping these records accurate and up-to-date would be a continuing and likely insurmountable challenge. For joint accounts, an individual will frequently open an account and take the signature card for a joint co-owner to sign, but then take considerable time – if ever – to return it with all signatures.

To ensure appropriate classification, covered banks would need to update onboarding procedures, rechannel systems of record to reclassify accounts properly, retrain employees to classify existing accounts and accounts at opening, and develop plans to update existing accounts. This effort would exist outside the scope of systems projects and would be daunting to the point that covered banks would likely have to reassess the business case for certain account types. For example, covered banks would have to reconsider offering trust products through branches where staff are not trust specialists and not equipped to review trust documentation to ensure correct classification under 12 CFR §330.10–.13.

This effort would also require customer participation to classify existing accounts properly. Any requirement that necessitates customer participation must be granted ample time and allow for reasonable tolerance of errors. Many deposit customers would likely move accounts out of covered banks or forego opening accounts there to avoid the complications forced by more stringent application of rules.

More to the point, the Associations note that certain information needed to classify accounts accurately under 12 CFR §330, such as complete signature cards for many joint accounts, likely is missing in most, if not all, bank failures, regardless of size. When the FDIC has sought to expedite account resolutions in the past, it is not clear that it has held to these requirements. In this case, it would be inequitable to treat accounts and account owners differently depending on whether the account is in a covered *versus* another bank.

***The Associations simply request equivalent treatment for covered banks. To treat a small set of banks and their deposit customers differently from all other banks would present an onerous burden with anti-competitive effects on the covered banks and no demonstrable benefit to the public.***

The NPR states that “the FDIC is not proposing to amend the insurance coverage rules in 12 CFR §330. Assuming that the FDIC does decide to amend part 330, it would do so through a separate rulemaking so that all consequences of doing so could be thoughtfully considered.”<sup>82</sup>

***The Associations believe this issue is critical to the cost-versus-benefit value of the proposed***

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<sup>81</sup> 12 CFR §330.11(a).

<sup>82</sup> NPR at 10032.

***rule and to the competitive balance between covered and other banks, and recommend that it be addressed before any final 12 CFR §370 rule is adopted.***

In point of fact, review of 12 CFR §330 is needed in recognition of the proliferation of digital technology. The outmoded specifications are out of step with access to accounts through electronic security credentials.

#### **D. Attestation Process**

The NPR sets forth a two-part approach for compliance testing that includes an annual board attestation requirement and FDIC supervisory review. Presumably, the intent in proposing board attestation is to ensure compliance. However, covered banks would implement a 12 CFR §370 rule like any other, with review by Audit and subject to examiner oversight. Annual reporting would also apply (as proposed). Therefore, the Associations see no justification for the FDIC to prescribe a different degree of assurance of compliance for this rule than for any other.

While the Associations appreciate the objective to emphasize the importance of adherence to the proposed recordkeeping requirements, we believe that board attestation would not be necessary to assure that a covered bank's 12 CFR §370 systems are effective and that compliance with this regulation would remain an institutional priority. Furthermore, we believe that board attestation would unnecessarily and inappropriately expand the role of a board area beyond its traditional and critical oversight role. ***Rather than a board attestation requirement, any final regulation should provide that the board of directors would oversee the covered bank's establishment and implementation of a compliance framework that meets the standards described in the rule.***

A critical starting point for good governance is recognition that the proper role of a bank's board of directors is oversight. As discussed in a recent industry report issued by The Clearing House (TCH Report),<sup>83</sup> board oversight of control and compliance frameworks is one of the core functions of a board. Foundationally, this involves the board and/or a board committee overseeing that the institution has established appropriate risk management and control programs and oversight of management implementation of those programs.<sup>84</sup> Accordingly, the Associations believe that board and/or board committee oversight of the *process* instituted to comply with the proposed requirements would be appropriate. Oversight in this regard can be expected to include periodic review of relevant management and control function reports (such as IT), as well as audit assessments and examination reports. The board oversight process is

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<sup>83</sup> The Clearing House, "The Role of the Board of Directors in Promoting Effective Governance and Safety and Soundness for Large U.S. Banking Organizations," May 2016, available at [www.theclearinghouse.org/issues/articles](http://www.theclearinghouse.org/issues/articles).

<sup>84</sup> The precise structure through which a particular board determines to carry out core board functions will appropriately differ. For example, boards may opt to utilize board committees, such as the audit or risk committees, in different ways or for different purposes, although in all cases these committees are accountable to and routinely report to the full board, which determines where to vet particular matters. The ability of a board of directors to delegate functions to a board committee is a fundamental concept of corporate law and recognized by the U.S. federal banking authorities. See, e.g., Delaware General Corporation Law §141(c); Model Business Corporation Act §8.25(d).

intended to assure that compliance remains a priority and that management is implementing board direction and adhering to legal requirements.

The Associations have concerns over the proposed introduction of annual board attestation, which implies a heightened level of scrutiny or assurance and greater board-level involvement in the IT and compliance processes. Several factors underlie these concerns:

- U.S. regulators are placing growing responsibilities and emphasis on banking organizations' boards of directors. The TCH Report identifies many of the hundreds of existing requirements directed at these boards under federal banking laws, regulations, and agency interpretive guidance statements, including examination guidance. Several senior U.S. financial agencies recently expressed concerns relating to the increasing regulatory compliance-related obligations of directors that may divert attention from critical core board functions, including focusing on emerging risks and strategy.<sup>85</sup> The core oversight function of the board should be the starting point for all policies, laws, regulations, guidance, and supervision in order to foster sound board governance that is critical to promoting bank safety and soundness.
- The proposed attestation requirement appears to trespass the important boundary between a board of director's traditional and statutorily mandated oversight responsibility and operational and compliance responsibilities that are appropriately the ambit of senior management. Requiring the board to certify "that the covered institution has implemented and successfully tested its information technology system for compliance"<sup>86</sup> and describe "the effects of all approved or pending applications for exception or extension on the ability to determine deposit insurance coverage using the covered institution's information technology system"<sup>87</sup> could be understood to imply that boards should become involved in the IT and compliance activities of the bank, thereby transforming a board's core oversight function into a management function. The requirement also connotes a guarantee of results, in this case a guarantee that the covered bank has an effective IT framework that complies with the legally enforceable regulations. That, in turn, would imply that directors could be held liable for management actions even where

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<sup>85</sup> As Federal Reserve Governor Daniel Tarullo recently noted, "There are many important regulatory requirements applicable to large financial firms. Boards must of course be aware of those requirements and must help ensure that good corporate compliance systems are in place. But it has perhaps become a little too reflexive a reaction on the part of regulators to jump from the observation that a regulation is important to the conclusion that the board must certify compliance through its own processes. [Regulators] should probably be somewhat more selective in creating the regulatory checklist for board compliance and regular consideration." See Federal Reserve Governor Daniel Tarullo, talk at the Association of American Law Schools 2014 Midyear Meeting, Washington, D.C., June 9, 2014 and page 7 of the TCH Report citing recent remarks from Securities and Exchange Commission Chair Mary Jo White and Comptroller of the Currency Thomas Curry.

<sup>86</sup> NPR at page 10049 and 10052.

<sup>87</sup> NPR at page 10052.

the directors' oversight has been reasonable.<sup>88</sup> Determinations such as those required in the proposed regulation should be made, and appropriately reported, by senior management to the board. Senior management and control function executives, given their role as the accountable executives for implementing such requirements, are best positioned to have first-hand knowledge of the IT and testing systems sought by the FDIC.

- Requiring members of the board of directors to attest to successful implementation and testing of the technology system could potentially compromise a board's ability to provide an independent view and oversight relating to management and IT compliance efforts. As FDIC Chairman Gruenberg noted last year, "... a director's responsibility to oversee the conduct of the bank's business necessitates that directors exercise independent judgment in monitoring and evaluating management's actions."<sup>89</sup> Note also that the FDIC's *Pocket Guide for Directors* states that "[t]he first step both the board and individual directors should take is to establish and maintain the board's independence... [A] director's duty to oversee the conduct of the institution's business necessitates that each director exercise independent judgment in evaluating management's actions and competence."<sup>90</sup>
- The proposed attestation would represent a deviation from standard practice. Based on review of hundreds of board requirements outlined in the TCH Report, the proposed requirement appears to be unique in calling for attestation by the board of directors for compliance with the technical terms of a regulation. The closest analogue is perhaps Call Report attestations by members of the board of a bank as required under 12 USC §161 and 12 USC §1817(a)(3).<sup>91</sup> That attestation, however, is considerably different in scope and mandated by statute. In contrast, the proposed requirement is not statutorily mandated. If other regulatory agencies were to follow the FDIC's lead and require board certification of compliance with the many regulations applicable to covered banks, it would simply become impossible for the board to function in an effective manner.

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<sup>88</sup> By way of comparison, the certifications promulgated under the Sarbanes-Oxley Act of 2002 (PL 107-204) are generally limited by a "materiality" standard; a company's officers are required to certify that they have designed or caused to be designed systems of controls. In contrast, the proposed attestation would require the board to certify not merely that those risk-based programs are reasonably designed to comply with the requirement, but to attest to implementation and successful testing (*i.e.*, actual compliance) with the proposed requirements. As such, it appears that a board that, in good faith, submits an attestation later deemed "incorrect or false" may nonetheless be found to be in violation.

<sup>89</sup> See Remarks by Martin Gruenberg, Chairman, Federal Deposit Insurance Corporation, to the American Association of Bank Directors, Washington, D.C. on May 12, 2015.

<sup>90</sup> FDIC, *Pocket Guide for Directors*, [www.fdic.gov/regulations/resources/director/pocket/#Independence](http://www.fdic.gov/regulations/resources/director/pocket/#Independence)

<sup>91</sup> See, *e.g.*, 12 USC §161 ("The correctness of the report of condition shall be attested by the signatures of at least three of the directors of the bank other than the officer making such declaration, with the declaration that the report has been examined by them and to the best of their knowledge and belief is true and correct.")

In sum, rather than attestation, any final 12 CFR §370 rule should provide that the board of directors or a board committee oversee the compliance process. This approach would reflect the oversight function that is the core of directors' duties. FDIC examination for compliance, board of directors oversight, internal monitoring and testing, and the reporting process would assure that compliance with the proposed regulation would remain an institutional priority.

### **E. Implementation Timetable**

Covered banks would need considerable time to implement the processes envisioned in the NPR. The proposed two years are virtually certain to be inadequate, especially if the FDIC contemplates significant reliance on the individualized exception application process. The proposed IT system changes would be highly complex and require major changes. Covered banks advise that *implementation after any final 12 CFR §370 rule is issued would require at least four years with potential for extensions, as set forth in the NPR.*

The FDIC is asking covered banks to undertake major systems development projects at a time when key resources in all of the banks are under pressure to enhance data security systems. In addition, all are occupied with major initiatives, most driven by new compliance demands, and some of which involve categorization of deposits for other regulatory purposes. *The Associations urge the FDIC to recognize that covered banks would have to queue 12 CFR §370 system enhancements with already planned-for efforts to meet other regulatory requirements.*<sup>92</sup> Each of these initiatives require planning for systems design, development, testing, validation, and production – steps that cannot be compressed without sacrificing the quality and accuracy of the data – and all have deadlines and milestone requirements that are beyond the institutions' control. To add a deposit insurance determination project to this extensive list would require careful consideration and rebalanced allocation of resources, including incorporation into multi-year budget and human resource planning. Covered banks indicate that the system enhancements to meet the expectations of the NPR would not interplay with these other processes, so its implementation could not be integrated with any of them. The timetable in any final rule will need to take this queuing into account.

Representatives from the covered institutions indicate the most laborious element in the proposed requirements would be asking deposit accountholders for depositors' and beneficial owners' personal identification information, applying for exceptions, waiting for the FDIC to respond, then seeking full accountholder information after determining for which accounts this must be obtained. Exemptions from the recordkeeping requirements for classes of accounts, as outlined above, would therefore be critical to meeting any deadline.

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<sup>92</sup> Covered banks are currently incorporating systems enhancements for Federal Reserve reporting to support stress testing, capital planning and risk assessments (forms FR Y-14A and FR Y-15); the Liquidity Coverage Ratio rule and form FR 2052A; resolution planning; BSA/Anti-Money Laundering Know Your Customer and Transaction Monitoring; Service Members' Civil Relief Act; Foreign Account Tax Compliance Act; Language of preference (Spanish language letters, notices, statements); Volcker Rule compliance; and TILA-RESPA Integrated Disclosures.

Some of the technical expertise required to implement this rule, particularly in the area of deposit insurance calculation, is found only within the FDIC. Covered banks cannot fully begin to design systems until this expertise is made available after a rule is finalized, which places additional pressure on the implementation timeframe.

Any final 12 CFR §370 rule would be less costly and disruptive if sufficient time is permitted for covered banks to coordinate their requests for accountholders'/depositors' personal identification information with cyclical "Know Your Customer" reviews, because this is when banks refresh due diligence reviews. Such coordination would also lessen the inconvenience to customers.

## **F. Testing Compliance**

Proposed 12 CFR §370.6 outlines standards for an annual "deposit insurance coverage summary report." *The Associations request that any final 12 CFR §370 rule confirm that covered banks would not be required to run end-to-end tests on final FDIC-insured deposit determinations on an annual basis.* Such tests would be an excessive commitment of time and personnel.

An end-to-end test would involve extensive employee resources in a dedicated trial environment. For each deposit system, this would mean (1) establishment of a sample data set, (2) coordination among multiple systems and corresponding staff, (3) quantitative analysis of the data, and (3) validation of results through verification of customer-level insurance calculations, Owner Right and Capacity Code assignment, and holds and debit functions. Given the complexity of multi-deposit systems and FDIC insurance determination calculations, the systems and data analysis could easily run a month or more.

Covered institutions would thoroughly test the full functionality of their 12 CFR §370 systems before launch. In addition, Audit and supervisors would review periodically and the NPR proposes on-site FDIC trials. Therefore, testing would be unnecessary in years with no significant system changes or events. The Associations propose that testing be required only if the bank has undergone a major change (*e.g.*, an acquisition or merger) or there has been a major systems change (*e.g.*, adding or replacing a deposit system). Should the FDIC see a need for any additional tests, we recommend that these be infrequent, certainly no more often than once every three years.

## **G. Flexible Implementation**

Enhancing recordkeeping systems so that FDIC insurance determinations can be made on covered banks' systems at the close of any business day presents major challenges. Covered banks would be required to create management information systems to implement complex legal determinations and assume responsibility for them, rather than FDIC retaining that responsibility. Although all banks have operational familiarity with these rules, none today takes responsibility for the legal determination of insurance coverage beyond the extent required to address customer inquiries and assure accuracy in advertising. As proposed, highly complex systems programming according to detailed business rules would be essential to achieve the contemplated calculations of FDIC insurance coverage in the compressed timeframe of a

resolution. This requirement clearly transcends banks' compliance responsibilities and represents a core part of FDIC's statutory responsibilities. Therefore, *the Associations recommend that the FDIC provide customized programming and allocate staff time to work closely with covered banks on its integration into their systems.* Direct involvement between bank and FDIC staff over many months would be essential, recognizing that information systems vary among institutions, so that any operationally effective solution would involve details that are unique to each covered bank.

The NPR offers that "materials available on the FDIC's web site which describe deposit insurance coverage as well as the periodic deposit insurance coverage seminars offered by the FDIC should assist the covered institutions to develop their systems and to assess the cost to comply with the proposed rule's requirements."<sup>93</sup> Systems staff from covered institutions indicate that significant, detailed dialogue between the FDIC and each covered bank would be needed to assure precise systems operations. The FDIC has unique experience in translating its insurance rules into operating and analytical systems to assess deposit account status. The bank staff request that the FDIC turn over its procedures on handling different types of accounts so that covered banks can begin programming on their internal systems. The level of accuracy and certainty inherent in the FDIC's objectives make this cooperation essential.

Considering the complexity of the systems and processes envisioned in the NPR and challenges in implementation, the Associations urge the FDIC to apply the same level of flexibility as for 12 CFR §360.9 in assessing, on an individual basis, each covered bank's capabilities to comply with any final 12 CFR §370 rule, and granting class exemptions and exceptions where application of the requirements is not feasible or practical.

#### **H. Exemption for Banks that Would Qualify as Covered Banks due to Credit Balances on Open-End Credit Accounts**

Under proposed 12 CFR §370.2(b), the term "deposit" incorporates by reference the definition from 12 USC §1813, which includes credit balances on open-end credit accounts. These deposits typically have low balances and are transitory in nature. This is because a credit card credit balance may exist for only a few days after an overpayment and be gone shortly thereafter with subsequent use of the credit card account, or else the banks is required under the Truth in Lending Act to refund a credit balance to the customer. Thus, these deposits do not materially impact deposit insurance determination.

Accordingly, the FDIC should be open to a petition for exemption from any final 12 CFR §370 rule if a bank would not qualify as a covered bank if open-end credit accounts were not counted as deposit accounts. Holding such an institution to the rule's requirements would not serve the FDIC's objective and would be a waste of resources for both the FDIC and the bank. From the FDIC's perspective, the burden of having to process requests for exceptions and extensions and conduct periodic testing would not be worth the effort for a bank with a large number of deposit accounts that that do not impede deposit insurance determination.

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<sup>93</sup> NPR at 10038.



## **I. Exemption from 12 CFR §360.9 Requirements**

The NPR proposes that, under 12 CFR §370.4, “[a] covered institution may apply to the FDIC for a release from the provisional hold and standard data format requirements of §360.9 of this chapter. The FDIC’s grant of such a release will be based upon the covered institution’s particular facts and circumstances as well as its ability to demonstrate compliance with the requirements set forth in §370.3.”<sup>94</sup>

Any final 12 CFR §370 rule will go far beyond 12 CFR §360.9, even with the changes proposed here. Accordingly, there is no reason for a covered bank to be required to apply for release from the provisions of 12 CFR §360.9 *Therefore, the Associations request that, upon the compliance date of 12 CFR §370, 12 CFR §360.9 should cease to apply for covered banks.*

## **J. Achievement of the FDIC’s Overall Objectives: Effective Resolution of a Covered Bank**

The changes recommended above would permit the FDIC to make the insurance determinations required to resolve a covered bank. With these changes, the information in a covered bank’s systems would permit the FDIC to calculate, using the bank’s systems, to a reasonable and fully sufficient degree of precision insurance coverage for beneficial owners for deposit accounts for which class exemptions are proposed. The information that covered banks would maintain, together with information maintained by other agents, trustees, and similar parties in the ordinary course of business, would comply with 12 CFR §330.

The Associations recognize that it is critically important for the FDIC to be able to determine aggregate deposit insurance in a covered bank’s deposits in order to meet the least-cost resolution requirements of 12 USC §1823(c)(4)(A). To the extent that the insurance obligation for particular types of accounts depends on knowing the ultimate beneficiaries of the accounts (for example, because of pass-through insurance under 12 CFR §330), FDIC regulations already establish specific requirements for the information that the insured bank’s deposit account records must reflect to establish the basis for pass-through insurance coverage. Importantly, for certain types of accounts (*e.g.*, trust accounts, mortgage servicing accounts, and retirement and other employee benefit accounts), FDIC’s regulations in 12 CFR §330 do not require identification of specific beneficial owners directly from the bank’s records.<sup>95</sup> Moreover, these requirements implicitly acknowledge that a continuous update of that information directly in the bank’s records would be entirely impractical.

In using the well-established principles and procedures of 12 CFR §330, the FDIC would avoid imposing additional information collection requirements on insured banks, including covered banks, and the attendant burdens on their deposit customers. Critically, however, allowing banks to operate with the information that is reasonably and efficiently available, rather than the excessive and customer-intrusive information as proposed, would not impede the FDIC in making least-cost determinations should a covered bank fail.

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<sup>94</sup> Proposed 12 CFR §370.4(h).

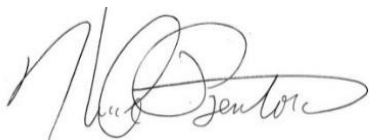
<sup>95</sup> See, *e.g.*, 12 CFR §330.5(b)(3).

Nor have the FDIC's resolution procedures delayed access to the funds for depositors and beneficial owners for whom agents, trustees, and similar intermediaries act. In fact, when the FDIC uses a purchase and assumption transaction, access to funds in the transferred accounts is virtually immediate for almost all depositors. Once FDIC acknowledges that the information covered banks propose to maintain (generally consistent with 12 CFR §330) would permit a reliable estimate of the aggregate deposit insurance amount to support a least-cost determination, the transfer of the affected deposits, which is not dependent on immediate identification of each ultimate beneficial owner, would likewise expeditiously provide depositors access to the funds to which they are entitled. To the extent that the presence or level of certain types of accounts may raise a risk of inadvertent excess coverage of uninsured deposits for a beneficial owner, the holds procedure under 12 CFR §370.3(f) and used by the FDIC in purchase-and-assumption resolutions would provide assurance of a successful transaction without risk of excessive costs.

#### IV. Conclusion

The Associations and covered banks appreciate that FDIC staff have engaged in open discussions concerning the NPR. We look forward to continuing to work together to achieve the ends that the NPR seeks. The Associations believe that continued conversations will facilitate those achievements.

Sincerely,



Hu Benton  
Vice President for Banking Policy  
American Bankers Association



David Pommerehn  
Vice President and Senior Counsel  
Consumer Bankers Association



John Court  
Managing Director and Deputy General Counsel  
The Clearing House Association



Robert W. Strand  
Senior Economist  
American Bankers Association



Carter McDowell  
Managing Director and Associate General Counsel  
Securities Industry and Financial Markets Association

Cc: Marc Steckel, Deputy Director, Division of Resolutions and Receiverships, FDIC  
Teresa J. Franks, Assistant Director, Division of Resolutions and Receiverships, FDIC  
R. Penfield Starke, Assistant General Counsel, Legal Division, FDIC  
Karen L. Main, Counsel, Legal Division, FDIC

## Appendix A – Technical Questions on the Proposed Processes

1. Will the four proposed output files replace the files used under 12 CFR §360.9 to create provisional holds on accounts or will the new data elements be appended to the 12 CFR §360.9 files?
2. Is a CS\_Unique\_ID to be assigned to each person/entity with an account ownership role? For example, if a customer account has a “primary account holder” or is a joint account, does this identifier have to be assigned for each of those persons? (The Preamble says “as the unique identifier for each individual or entity involved in the deposit relationship...”)<sup>96</sup>
3. In Table A1, are all the customer file data elements mandatory? For example, must a “permanent legal address” be supplied? The bank may not have this information or have any way to determine it.
4. In table A1, how should “address of record” be recorded when a customer has multiple telephone numbers and addresses on record?
5. In Table A2, what type of hold will be required in the Account File?
6. In Table A4, what type of hold will be required in the Pending File?
7. In Table A4, will it be sufficient to provide only the first title for DP\_Account\_Title? In some cases, there are multiple lines yet the Pending File leaves room for only one?
8. The NPR would require that a covered bank’s IT systems be capable of preparing specific output files “in successive iterations as the covered institution receives additional data from external sources necessary to complete any pending deposit insurance calculations.”<sup>97</sup> Does this provision contemplate separate interfaces to consume each file type per system/source or must all deposit type sources be aggregated into a single interface for all four files?

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<sup>96</sup> NPR at 10039, C, last paragraph.

<sup>97</sup> NPR at 10053.

## **Appendix B – Descriptions of the Cosigning Associations**

### **American Bankers Association**

The American Bankers Association is the voice of the nation's \$16 trillion banking industry, which is composed of small, regional and large banks that together employ more than two million people, safeguard \$12 trillion in deposits and extend more than \$8 trillion in loans.

### **The Clearing House**

The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

### **Consumer Bankers Association**

The Consumer Bankers Association is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

### **Securities Industry and Financial Markets Association**

SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$20 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit [www.sifma.org](http://www.sifma.org).