November 21, 2024

*Via Email (comments@fdic.gov)*

James P. Sheesley
Assistant Executive Secretary
Attention: Comments—RIN 3064-AF99
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

**RE: Notice of Proposed Rulemaking on Unsafe and Unsound Banking Practices: Brokered Deposit Restrictions**

Dear Mr. Sheesley:

Apex Clearing Corporation ("Apex") timely submits this comment letter to the Federal Deposit Insurance Corporation ("FDIC") in response to the notice of proposed rulemaking to amend the FDIC's regulations relating to brokered deposits ("NPRM").[1] Apex appreciates the opportunity to provide comments on the NPRM.

## I. Background on Apex

Apex is a U.S.-based broker-dealer registered with the United States Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Agency ("FINRA"). Apex acts as a clearing broker. Introducing brokers, who have a direct client relationship with investors, engage Apex to provide services for their investors, including custodial services, handling the investor's brokerage account, clearing and settling trades on behalf of the investor, and providing recordkeeping services to the introducing brokers and their investors.

Brokerage accounts at Apex often have cash balances, known as "free credit balances," resulting from the sale of securities, dividends, or cash placed in the accounts pending the purchase of securities. Free credit balances are not insured by the FDIC, and may or may not earn interest for investors. Consequently, Apex offers sweep programs whereby such free credit balances are swept to FDIC-insured depository institutions ("IDIs"), where the funds are eligible for FDIC insurance coverage and the investors may earn interest on those funds. Apex has entered into agreements with individual IDIs to accept deposits of its customers' free credit balances.[2]

[1] 89 Fed. Reg. 68,244 (Aug. 23, 2024).

[2] Apex also has an agreement with Reich & Tang (as a successor to Total Bank Solutions) to provide administrative and recordkeeping services to Apex in connection with sweep programs.

The Apex bank deposit sweep programs are designed so that no more than $250,000 of an individual investor's cash is deposited at any one bank—the current standard maximum deposit insurance amount ("SMDIA") eligible for FDIC insurance.[3]

In 2020, the FDIC published a final rule amending its brokered-deposit regulations (the "2020 Rule").[4] Among other things, the 2020 Rule codified a designated business exception ("DBE") to the definition of a deposit broker for entities where, with respect to a particular line of business, "[l]ess than 25 percent of the total assets of the agent or nominee has under administration for its customers is placed at depository institutions [(the "25% Test")]."[5] Entities meeting the 25% Test are deemed to have a primary purpose other than the placement of deposits, and thus are not considered deposit brokers under the FDIC's primary purpose exception ("PPE").[6]

To qualify for the 25% Test under the 2020 Rule, a third party, or an IDI acting on behalf of a third party, must provide the FDIC with written notice that the third party will rely on the 25% Test.[7] The notice must include information regarding the third party's customer assets under administration and the total amount of deposits placed on behalf of its customers, and the person filing the notice must provide updates to such information on a quarterly basis.[8] In other words, a broker-dealer (i.e., a third party under the 2020 Rule) could file a notice that it is relying on the 25% Test, and the individual IDIs working with the broker-dealer could rely on the broker-dealer's filing without having to submit their own individual notices.

In April 2021 Apex filed a notice with the FDIC that Apex would rely on the 25% Test.[9] Apex provided the information required under the FDIC's rules with its notice, and has provided quarterly updates to that information thereafter. The information provided by Apex shows that, as of September 30, 2024, less than one percent of Apex's assets under administration for the quarter ending on that date were placed for deposit at IDIs pursuant to Apex's sweep programs. Although the exact percentage fluctuates to some extent in the ordinary course of business, the percentage consistently remains in compliance with the 25% Test. Because Apex qualifies for the 25% Test under the FDIC's current regulations, each IDI to which Apex sweeps customer funds may rely on Apex's DBE, meaning that the IDIs can deem Apex not to be a deposit broker without having to make any independent filings with the FDIC.

---

[3] In rare circumstances, where an investor's total free credit balances exceed $250,000 multiplied by the number of banks that accept sweep deposits, a portion of the investor's total credit balances may be placed at an individual bank in excess of the SMDIA, a possibility that Apex clearly discloses to customers. However, the overwhelming majority of deposits are less than or equal to the SMDIA, so that the investors are eligible for full FDIC insurance coverage on these deposits when aggregated with any other deposits they hold in the same capacity at the same IDI.

[4] See 86 Fed. Reg. 6,742 (Jan. 22, 2021).

[5] 12 C.F.R. § 337.6(a)(5)(v)(I)(1)(*i*).

[6] Id.

[7] 12 C.F.R. §§ 303.243(b)(3).

[8] Id. §§ 303.243(b)(3)(i), (iv).

[9] See FDIC Public Report of Entities Submitting Notices for a Primary Purpose Exception as of 3/15/2024, available at https://www.fdic.gov/resources/bankers/brokered-deposits/public-report-ppes-notices.pdf.

## II. Comments

### A. Background: Changes to Primary Purpose Exception and Replacement of the 25% Test

Under the PPE in the FDIC's current brokered deposit rules, a deposit broker does not include "[a]n agent or nominee whose primary purposes is not the placement of funds with depository institutions[.]"[10] Broker-dealer sweep programs, like those offered by Apex, that sweep free credit balances to IDIs are intended to provide a significant benefit to investors—FDIC insurance coverage for such free credit balances and earning interest on the cash that is swept. These benefits are the hallmark of broker-dealer bank deposit sweep programs that have operated safely and soundly for decades, and which have been acknowledged to have a purpose other than the placement of deposits, i.e., to hold free credit balances in a safe, liquid, FDIC-insured account pending investment or distribution. In the NPRM, however, the FDIC for the first time has taken the position that "the purpose of providing FDIC insurance coverage is indistinguishable from the placement of deposits,"[11] and therefore does not qualify for a PPE.

The NPRM also proposes significant changes to the 25% Test. First, the NPRM proposes to change the threshold for meeting this DBE from 25% of assets under administration to 10% of assets under management (the "Broker-Dealer Sweep Exception" or "BDSE").[12] Assets under administration is defined as "securities portfolios and cash balances with respect to which an investment adviser or broker-dealer provides continuous and regular supervisory or management services."[13] Second, under the NPRM each IDI must separately submit the required notice to the FDIC that the IDI will rely on the BDSE,[14] and may only rely on the BDSE if "no additional third parties" are involved in the sweep program."[15] And third, under the NPRM, if any third party is involved in the deposit placement arrangement, regardless of whether the third party itself is a deposit broker, the broker-dealer will not meet the BDSE.[16]

The NPRM's proposed replacement of the 25% Test with the BDSE and related changes would substantially reverse the changes made by the 2020 Rule. The 2020 Rule was adopted after a lengthy, multi-year process that included an advance notice of proposed rulemaking, the FDIC soliciting information from industry, a notice of proposed rulemaking, and the receipt and

---

[10] 12 C.F.R. § 337.6(a)(5)(v)(I).

[11] 89 Fed. Reg. at 68,253 n.80.

[12] Id. at 68,271 (proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(1)(*i*)). The NPRM also limits the availability of the BDSE to broker-dealers and investment advisors, id., which, while not an issue for Apex, represents a narrowing of entities who might qualify for this DBE.

[13] Id. at 68,272 (proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(11)).

[14] Id. at 68.269 (proposed 12 C.F.R. § 303.243(b)(3)).

[15] Id. at 68,271 (proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(1)(*i*)).

[16] Id. at 68,271 (proposed 12 C.F.R. § 337.6(a)(iv)((I)(1)(*i*)). Further, each IDI that submits a notice must certify that no additional third parties are involved in the deposit placement arrangement. Id. at 68,269 (proposed 12 C.F.R. § 303.243(b)(3)(i)(E)).

consideration by the FDIC of a large number of comments from industry participants.[17] Only after that extensive process did the FDIC issue its final rule, explaining that "its regulations governing brokered deposits are outdated and do not reflect current industry practices` and the marketplace."[18]

Just over three years later, however, the FDIC now proposes to replace the 25% Test with the BDSE and make other related changes without any data showing that the revisions in the 2020 Rule no longer serve the purposes for which they were adopted. As discussed below, the NPRM will unnecessarily complicate the process for relying on this DBE and increase the number of deposits at IDIs that are characterized as brokered, without a sufficient basis to conclude that the deposits that will be affected have the attributes of risk that the FDIC associates with brokered deposits.[19]

B. The Proposed Replacement of the 25% Test With the BDSE Is Not Warranted

1. Assets Under Administration vs. Assets Under Management

As noted above, the NPRM would change the denominator for determining whether the BDSE is met from assets under administration to assets under management. The FDIC explained that this change was made because the FDIC is now limiting this DBE to broker-dealers and investment advisers:

> From the FDIC's experience with the 2020 Final Rule, ''customer assets under administration'' is a more appropriate measure when including a broader group of business relationships and business lines, whereas ''assets under management'' would be appropriate under the proposed rule to accurately reflect the scope of the types of services provided by broker dealers and investment advisers.[20]

However, the actual definition of assets under management in the NPRM, which refers to "securities portfolios and cash balances with respect to which an investment adviser or broker-dealer provides continuous and regular supervisory or management services,"[21] is too limiting and does not accurately describe the services that may be provided by a broker-dealer. In particular, a clearing broker (like Apex) typically would not provide supervisory or management services; those services generally would be provided to customers by their introducing broker or

---

[17] See,, e.g., 84 Fed. Reg. 2,366 (Feb. 6, 2019) (advance notice of proposed rulemaking); 85 Fed. Reg. 7,453 (Feb. 10, 2020) (notice of proposed rulemaking); 86 Fed. Reg. 6,742 (Jan. 22, 2021) (final rule).`

[18] 86 Fed. Reg. at 6,742.

[19] As the NPRM notes, brokered deposits historically raised concerns by regulators and Congress because "(1) such deposits could facilitate a bank's rapid growth in risk assets without adequate controls; (2) once problems arose, a problem bank could use such deposits to fund additional risk assets . . . : and (3) brokered and high-rate deposits were sometimes considered less stable because at the time, deposit brokers (on behalf of customers), or the customers themselves, were often drawn to high rates and prone to leave the bank quickly to obtain a better rate or if they became aware of problems at the bank." Id. 89 Fed. Reg. at 68,245.

[20] 89 Fed. Reg. at 68,256.

[21] Id. at 68,272 (proposed 12 C.F.R. § 337.6(a)(5)(iv)(I)(11)).

investment adviser, which in this context is typically a third party unaffiliated with the clearing broker. Indeed, "continuous and regular supervisory or management services" typically describes services provided by investment advisers, not by broker-dealers. Many of the introducing brokers on Apex's platform provide services to self-directed investors, and would be excluded from this definition. Yet, clearing brokers like Apex clearly are providing services relating to their role as a broker-dealer with respect to securities portfolios and cash balances in brokerage accounts.

Based on the FDIC's explanation for this change, it is not clear whether the FDIC intends to exclude clearing brokers from being able to qualify for the BDSE. If so, Apex strongly requests that the FDIC reconsider this position. Clearing brokers, like Apex, play an important and significant role in the securities industry, including acting as a custodian, holding accounts for clients of introducing brokers, and executing trades for clients of introducing brokers. Moreover, by their nature, clearing brokers act for many introducing brokers, and the introducing brokers have the direct client relationship with individual investors. Clearing brokers do not have the ability to unilaterally withdraw deposits placed with IDIs on a large scale that is the hallmark of a brokered deposit. Thus, the deposits placed by clearing brokers do not have the risk attributes that the FDIC associates with brokered deposits; preventing clearing brokers from relying on the BDSE would significantly increase the amount of deposits that would be characterized as brokered while having little or no discernable impact on the risks that are associated with "true" brokered deposits.

Further, we urge the FDIC to rethink the "continuous and regular supervisory or management services" standard as it applies to broker-dealers (whether introducing brokers or clearing brokers) who offer self-directed trading accounts. If anything, self-directed brokerage customers are <u>less</u> likely to act in unison to withdraw deposits than customers who are all receiving (presumably consistent) advice from their investment advisers or broker-dealers. The effect of the "continuous and regular supervisory or management services" standard would be to lower the availability of FDIC-insured bank deposits, and lower the interest paid on those deposits, to smaller individual investors most in need of those deposits.

For these reasons, to the extent the FDIC intended to prevent clearing brokers or brokers offering self-directed trading accounts from being able to rely on the BDSE, Apex urges the FDIC to reconsider its position. If, however, that is not the FDIC's intent, then we urge the FDIC either to modify the BDSE to refer to assets under administration, or revise the definition of assets under management to read as follows: "*Assets under management* means securities portfolios and cash balances with respect to which an investment adviser or broker-dealer provides supervisory, management, or other services."

2. <u>25% versus 10%</u>

Apex further requests that the FDIC reconsider the change in this DBE from 25% to 10%. The NPRM offers little support or explanation for this change, other than the conclusory statements that "because a third party that places less than 25 percent of its customer's assets under administration in a bank account does not, by itself, demonstrate that the deposit-placement activity is for a goal other than to provide deposit insurance or a deposit placement

service",[22] and that placing less than 10 percent of customer funds at IDS "would be more indicative that the primary purpose for broker dealers and investment advisors . . . is to temporarily safe-keep customer free cash balances . . . awaiting investment."[23] But the NPRM ignores the long history of bank sweep programs in which broker dealers have, in a safe and sound manner, placed up to 25% of assets under administration with IDIs in order to provide a safe, liquid, FDIC-insured account for free credit balances pending investment or distribution and allow their customers to earn interest on such free credit balances, with such deposits being considered core deposits and exhibiting none of the risks that the FDIC associates with brokered deposits. In short, the NPRM offers no data or support for its conclusion that the higher 25% threshold has created an inordinate risk that deposits placed by broker-dealers or investment advisors are less stable or otherwise more susceptible to being quickly moved from one IDI to another.[24] For these reasons, we request that the FDIC not make this change.

3. Treating The Fact That Free Credit Balances Are Eligible for FDIC Insurance as Equivalent to Having the Purpose of Placing Deposits

To the extent that the change from 25% to 10% or any of the other changes proposed in the NPRM is influenced by the FDIC's newly announced position that the purpose of obtaining FDIC insurance coverage for free credit balances is the same as the purpose of placing deposits, we believe the FDIC's position is flawed. When investor free credit balances are swept to IDIs, the primary purpose is to provide a safe and liquid repository of funds that are held pending investment or distribution. The fact that protection for those free credit balances is provided in the form of FDIC insurance, and that interest may be earned for investors is all ancillary to the fact that the cash is generated in the pursuit of a separate securities brokerage business. Indeed, benefiting from FDIC insurance is a "purpose" of virtually all retail deposit activity, so it can hardly be said that this is a factor that differentiates sweep deposits from any other retail deposit activity. The fact that broker-dealers seek to protect the customer funds they hold pending investment or disbursement simply does not support the conclusion that their purpose is to provide deposits and funding for the IDIs. In any event, the NPRM offers no support for its change in position, as FDIC Director Jonathan McKernan noted: "For example, in proposing to eliminate the enabling transactions test, the proposal offers no discussion of the risks of these deposits. The proposal flatly and simply asserts '[t]he FDIC believes that there is no relevant

[22] Id. at 68,256.

[23] Id.

[24] FDIC Director Jonathan McKernan apparently shares this view, stating that "in proposing to narrow the 25 percent test, the proposal simply asserts 'lowering the threshold to 10 percent may reduce potential risks to safety and soundness and to the [Deposit Insurance Fund] by providing more transparency regarding the characteristics of the deposits so placed.'" Statement by Jonathan McKernan, Director, FDIC, Board of Directors, on the Proposed Brokered Deposit Restrictions (July 30, 2024) ("McKernan Statement") (emphasis added), available at https://www.fdic.gov/news/speeches/2024/statement-jonathan-mckernan-director-fdic-board-directors-proposed-brokered#:~:text=The%20proposal%20flatly%20and%20simply,relates%20to%20skepticism%20of%20banks'. Moreover, as the U.S. Supreme Court has noted, "[u]nexplained inconsistency is . . . a reason for holding an interpretation to be an arbitrary and capricious change from agency practice under the Administrative Procedure Act." National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967, 981 (2005).

difference between an agent or nominee's purpose in placing deposits to enable transactions and placing deposits to access a deposit account and deposit insurance.'"[25]

4. Requiring IDIs to Submit the Notice Relating to the BDSE and to Certify That No Additional Third Parties Are Involved

As noted above, under the 2020 Rule a third party, or an IDI acting on behalf of a third party, could submit a notice to the FDIC that the third party would rely on the 25% Test.[26] Thus, under the current regulations, a broker-dealer could submit a notice to the FDIC that it qualifies for the 25% Test, and all IDIs to which the broker-dealer sweeps funds could rely on the broker-dealer's notice. That would not mean that the deposits at an IDI would be considered core deposits; if another third party that meets the definition of a deposit broker is involved in the placement of the deposits, then the deposits would be considered brokered even though the broker-dealer itself is not a deposit broker.

Under the NPRM, the FDIC would now require each IDI to submit a separate notice that it would rely on the BDSE.[27] As part of that notice, the IDI must certify that no additional third parties are involved in the deposit placement arrangement.[28] As a result, every IDI that receives funds from a broker-dealer in a sweep program would now be required to submit a separate notice of reliance on the BDSE, in each case providing information about the broker-dealer's assets and deposits, and each IDI will have to provide quarterly updates of that information. The NPRM suggests that this will result in more accurate and uniform reporting.[29] We respectfully disagree. The proposed notice process will result in substantial number of duplicate filings on behalf of each broker-dealer. For example, Apex currently works with more than 25 IDIs with respect to its sweep program, each of which would need to separately file a notice under the proposed rule even though the information provided would be substantially similar with respect to Apex. This duplicative process will increase the risk of errors in providing information (because the relevant information will be that of the broker-dealer, not the IDI), thus making it less likely that the notices and reporting will be accurate, and creating an unnecessary, burdensome and complicated process.

Moreover, the inclusion in the definition of the BDSE that, in addition to placing less than 10% of assets under management for deposit, "no additional third parties are involved in the deposit placement arrangement[,]"[30] and the related requirement that the IDI certify that no additional third parties are involved,[31] is misplaced and will create further complications. The

---

[25] See McKernan Statement.

[26] 12 C.F.R. §§ 303.243(b)(3).

[27] 89 Fed. Reg. at 68,269 (proposed 12 C.F.R. § 303.243(b)(3)).

[28] Id. (proposed 12 C.F.R. § 303.243(b)(3)(i)(E)).

[29] Id. at 68,256 ("In order to ensure accurate and uniform reporting by the depository institutions receiving sweep deposits from broker-dealers, the proposed rule would allow an IDI to file a designated exception notice for the BDSE on behalf of broker-dealers[.]")

[30] Id. at 68,271 (proposed 12 C.F.R. § 337.6(a)(iv)((I)(1)(*i*)).

[31] Id. at 68,279 (proposed 12 C.F.R. § 303.243(b)(3)(i)(E)).

NPRM added these requirements not because of any concern that broker-dealers were improperly relying on the 25% Test under the current regulations, but because the FDIC believes that IDIs are failing to consider the involvement of other third parties (i.e., not the broker-dealers relying on the 25% Test) that meet the definition of a deposit broker.[32] While this may be a valid concern, the proposed solution is not appropriate, because whether or not an IDI properly reports deposits as brokered based on the involvement of a party other than the broker-dealer should not have any bearing on whether the broker-dealer itself qualifies for the BDSE. If a broker-dealer places less than 10% of assets under management for deposit, and thus is deemed to have a primary purpose other than placing deposits (i.e., holding investors' free credit balances in a safe, liquid, FDIC-insured account pending investment or distribution), whether another third party involved in the deposit process is a deposit broker does not alter the fact that the broker-dealer is not a deposit broker.

Moreover, the fact that a third party may be involved in a deposit placement arrangement does not necessarily mean that the deposits should be treated as brokered; if the third party also qualifies for a PPE, then the deposits could be treated as core. The definition of BDSE thus would exclude arrangements that would, even under the NPRM, qualify as core deposits.

Finally, requiring an IDI to certify that no third party is involved will impose additional burdens by requiring IDIs to certify to information to which they may not have access (e.g., if the IDI does not itself have an agreement with the third party). This will result in a more complicated process, require IDIs to rely more on information that is not within their control, and likely lead to additional errors and inaccuracies.

For these reasons, we urge the FDIC to revert to requiring broker-dealers and investment advisers (or third parties acting on their behalf) to submit the notice of reliance on the BDSE, eliminate from the BDSE definition the requirement that no third parties are involved in the deposit placement arrangement, and eliminate the requirement for the notice to certify that no such third parties are involved.

### C. The FDIC Should Wait Until It Has a Chance To Review Responses to its Request for Information Before Proposing Any Changes to the Brokered Deposit Regulations

The FDIC has essentially conceded that it does not have sufficient information to determine the impact, if any, of the deposits that ceased to be brokered deposits as a result of the 2020 Rule. In this regard, concurrent with the NPRM, the FDIC has issued a request for information from industry participants regarding deposits.[33] Because the NPRM is intended to

[32] For example, in the introductory material to the NPRM the FDIC states that it anticipated that, under the 2020 Rule, most unaffiliated sweep deposits would be classified as brokered "because of the understanding that most broker-dealers, even those with valid primary purpose exceptions, outsourced their deposit allocation functions to an intervening third party providing 'matchmaking activities' and these additional third parties would thus meet the 'deposit broker' definition." Id. at 68,255 (emphasis added). However, the FDIC apparently believes that many IDIs failed to consider the involvement of such intervening third parties, resulting in "a large number of unaffiliated sweep deposits being misreported as nonbrokered." Id.

[33] See FDIC Request for Information on Deposits (July 30, 2024), available at https://www.fdic.gov/system/files/2024-07/bc-request-for-information-on-deposits.pdf.

reverse many of the changes made by the 2020 Rule, we urge the FDIC to delay any changes to the brokered deposit regulations until the FDIC has an opportunity to review and consider the responses to its request for information.

## III. Conclusion

The FDIC has proposed to replace the 25% Test with the BDSE and to require every IDI to submit a notice and quarterly information with respect to each broker-dealer that qualifies for the BDSE. The FDIC also has announced a fundamental change by stating that the purpose of obtaining deposit insurance coverage is indistinguishable from the purpose of placing deposits. These changes will result in millions of dollars of deposits being considered brokered deposits, rather than core deposits, without any support or rationale suggesting that the deposits exhibit any of the risk attributes of brokered deposits. These changes will also create a burdensome, duplicative, and unnecessary process for relying on the BDSE, increasing the risk of inaccurate filings. For these reasons, we urge the FDIC to: (i) revert to using assets under administration as the basis for calculating whether a broker-dealer qualifies for this DBE, or clarify the definition of assets under management to ensure that clearing brokers and brokers providing self-directed accounts to investors will qualify; (ii) continue to use 25%, rather than 10%, as the threshold for whether a broker-dealer qualifies for this DBE; (iii) permit third parties, and particularly broker-dealers, to submit a notice of reliance on the BDSE rather than require every IDI to which funds are swept to do so; (iv) delete from the BDSE definition the requirement that no third parties are involved in the deposit placement arrangement and delete the requirement for a certification to that effect from the notice of reliance on the BDSE; and (v) acknowledge that the purpose of obtaining FDIC insurance coverage for free credit balances is not the same as the purpose of placing deposits.

* * *

Apex appreciates the opportunity to provide comments to the NPRM. If there are any questions regarding our comments, please do not hesitate to contact the undersigned at [redacted] or [redacted].

Sincerely,

[redacted]

Rajeev Khurana
Chief Legal Officer and Secretary