November 21, 2024

Peter J. Morgan, III
Managing Director - General Counsel &
Corporate Secretary

Via Electronic Delivery

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Attention: James P. Sheesley, Assistant Executive Secretary

Re: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions (FDIC RIN 3064–AF99)

Ladies and Gentlemen:

The Charles Schwab Corporation ("CSC" and together with its affiliates "Schwab"),[1] Westlake, Texas, submits this comment letter in response to the proposed rule *Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions* (the "Proposal") published in the Federal Register on August 23, 2024, by the Federal Deposit Insurance Corporation ("FDIC").[2] We appreciate the opportunity to comment on the Proposal.

The Proposal effectively overturns a final rule adopted by the FDIC a few years ago (the "2021 Final Rule") that established a new framework for analyzing whether certain deposit arrangements qualify as brokered deposits.[3] The 2021 Final Rule followed an advance notice of proposed rulemaking in 2019 ("2019 ANPR"), a proposal in 2020 ("2020 Proposal"), and a thoughtful and appropriate multi-year process of gathering public input and data.[4]

The FDIC suggests that it is issuing the Proposal due to a "significant decline in reported brokered deposits," as a result of the 2021 Final Rule due, in part, "to some IDIs misunderstanding and misreporting deposits," under the 2021 Final Rule, particularly when a third party is involved.[5] The FDIC generally provides no rationale nor data to demonstrate why the Proposal is needed nor how it would address the FDIC's concerns.

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[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody and financial advisory services to individual investors and independent investment advisors. More information is available at https://www.aboutschwab.com.

[2] 89 Fed. Reg. 68,244 (Aug. 23, 2024) (Proposal).

[3] 86 Fed. Reg. 6742 (Jan. 22, 2021).

[4] 84 Fed. Reg. 2366 (Feb. 6, 2019); 85 Fed. Reg. 7453 (Feb. 10, 2020).

[5] *See* 89 Fed. Reg. 68,244 and 68,245. IDI refers to insured depository institution.

We believe the Proposal, if finalized as proposed, would be vulnerable to challenge under the Administrative Procedure Act ("APA")[6] for at least three reasons: (1) the FDIC has exceeded its statutory authority by narrowing an unambiguous primary purpose exception ("PPE") legislated by Congress; (2) Congress did not delegate power to the FDIC to determine what constitutes a brokered deposit; and (3) the Proposal is arbitrary and capricious because the FDIC has not adequately explained why changing the PPE's threshold from 25 percent of assets under administration to 10 percent of assets under management would solve any of the problems identified in the Proposal. Below, we address each of these in turn after providing some relevant background.

We also explain why the proposed changes do not work as a matter of policy as demonstrated, for example, during the coronavirus pandemic when the 10 percent threshold proved unworkable due to its procyclicality. At a minimum, should the FDIC go forward with the Proposal despite lacking clear statutory authority, we recommend the FDIC maintain the 25 percent of assets under administration PPE in the 2021 Final Rule.

We agree with FDIC Vice Chairman Travis Hill that it is "a mistake for the FDIC to substantively reopen the brokered deposits rule. Doubling down on the pre-2020 brokered deposits regime in 2024 is like doubling down on stone castles after the invention of cannons."[7] We respectfully ask the FDIC that the Proposal be withdrawn, and the 2021 Final Rule be maintained.[8]

We also question the motivation and timing of the Proposal. The ink is barely dry on the 2021 Final Rule, which has been effective for less than three years. The Proposal has no data nor analysis. It comes amid a report on FDIC workplace misconduct and culture and reflects the agenda of a FDIC Chairman who has effectively resigned.[9]

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[6] 5 U.S.C. §§ 551–559.

[7] Travis Hill, Vice Chairman, FDIC, Remarks by Vice Chairman Travis Hill at the American Enterprise Institute "Reflections on Bank Regulatory and Resolution Issues," (July 24, 2024), https://www.fdic.gov/news/speeches/2024/remarks-vice-chairman-travis-hill-american-enterprise-institute-reflections-bank (footnotes omitted).

[8] The Bank Policy Institute et al., Re: Notice of Proposed Rulemaking, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions; Request for Extension of Comment Period (FDIC RIN 3064–AF99) (Aug. 21, 2024), https://bpi.com/bpi-and-a-coalition-of-trades-ask-fdic-to-withdraw-brokered-deposit-proposal/ (requesting the FDIC withdraw the Proposal).

[9] Michael Stratford, "Embattled FDIC Chair Gruenberg says he will resign Jan. 19," Politico (Nov. 19, 2024), https://www.politico.com/news/2024/11/19/fdics-gruenberg-says-he-will-resign-jan-19-00190373; Martin J. Gruenberg, Chairman, FDIC, "Statement by FDIC Chairman Martin J. Gruenberg" (May 20, 2024), https://www.fdic.gov/news/press-releases/2024/statement-fdic-chairman-martin-j-gruenberg; *see also* Press Release, FDIC, FDIC Special Review Committee Releases Independent Report on Workplace Misconduct and Culture (May 7, 2024),

I. Background

CSC is a savings and loan holding company headquartered in Texas that engages, through its subsidiaries, in wealth management, securities brokerage, banking, asset management, custody and financial advisory services. Schwab offers securities brokerage and banking services through Charles Schwab & Co., Inc. ("CS&Co."), a broker-dealer registered with the Securities and Exchange Commission ("SEC"), and three wholly owned FDIC-insured subsidiary banks, Charles Schwab Bank, SSB, Charles Schwab Premier Bank, SSB, and Charles Schwab Trust Bank (collectively, the "Banks"). CSC and the Banks' primary Federal regulator is the Federal Reserve. Schwab's business model is primarily to serve retail customers and provide retail customers with affordable access to equity markets.

Registered broker-dealers maintain programs in which customer funds are automatically deposited, or "swept," into deposit accounts at insured deposit institutions ("IDIs") ("Sweep Programs."). Full-service broker-dealers have offered deposit accounts through Sweep Programs to customers dating back to at least 2000.[10] This occurred after the Gramm-Leach-Bliley Act of 1999 repealed certain portions of the Glass-Steagall Act to allow broker-dealers to be under common control with IDIs.[11]

Sweep Programs offer customers the opportunity to earn interest on funds awaiting investment that reflects prevailing short-term interest rates associated with transactional accounts, withdraw the funds on demand, and, unlike other financial products, enjoy principal stability. The combination of principal stability, liquidity, and the ability to earn interest on deposits, and the administrative convenience of having this occur within the customer's brokerage account, has contributed to the popularity of these programs. Notably, Sweep Programs, which also are structured to comply with SEC rules,[12] offer the benefit of safe banking options to customers and serve an important role for customers in the U.S. financial markets.

Schwab's Sweep Program has a primary purpose exception under the FDIC's 2021 Final Rule implementing section 29(g)(2)(I) of the Federal Deposit Insurance Act ("FDI Act"). The

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https://www.fdic.gov/news/press-releases/2024/fdic-special-review-committee-releases-independent-report-workplace.

[10] *See* The Charles Schwab Corporation, Comment Letter Re: Brokered Deposits and Interest Rate Restrictions (FDIC RIN 3064-AE94) at 2 (May 7, 2019), 2019-unsafe-and-unsound-banking-practices-3064-ae94-c-074.pdf (fdic.gov) (hereinafter "Schwab 2019 ANPR Comment Letter"); *see also* 84 Fed. Reg. 2372.

[11] Seward & Kissel, Re: Brokered Deposit Restrictions (FDIC RIN 3064-AE94) at 11 (June 9, 2020), https://www.fdic.gov/system/files/2024-06/2020-unsafe-unsound-banking-practices-brokered-deposits-3064-ae94-c-111.pdf.

[12] Schwab 2019 ANPR Comment Letter at 3 (citing 17 C.F.R. 240.15c3-3(j)(2)(ii)). SEC rules require, among other things, written disclosure, and affirmative written customer consent prior to participation in such programs.

statute provides that the term "deposit broker" does not include "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."[13] A form of this primary purpose exception dates to FDIC guidance that is nearly 20 years old.

In 2005, the FDIC had confirmed that certain deposits placed through a Sweep Program involving an affiliated bank and broker-dealer were eligible for an exception from classification as brokered deposits in FDIC Staff Advisory Opinion 05-02 ("2005 Advisory Opinion").[14] Schwab's Sweep Program had been granted a PPE to the definition of deposit broker as set forth in section 29(g)(2)(I) of the FDI Act as interpreted in the 2005 Advisory Opinion. We would note, especially since the FDIC has sought comment on an alternative to eliminate this PPE in the Proposal, that this PPE dates back nearly two decades. The 2005 Advisory Opinion had certain "qualifications," which we have previously argued did not have the force and effect of law,[15] and most of which were not codified in the 2021 Final Rule.

As implemented in the 2021 Final Rule, there are certain designated business exceptions that meet the primary purpose exception. Business relationships are designated as meeting the primary purpose exception where, with respect to a particular business line: Less than 25 percent of the total assets that the agent or nominee has under administration for its customers is placed at depository institutions ("25 percent of assets under administration exception") (referred to generally as the "Permissible Ratio").[16] In adopting the 2021 Final Rule, the FDIC recognized that "'…customer assets under administration'. . . more accurately reflects the FDIC's intention that this test cover both customer assets managed by the agent or nominee and those customer assets for which the agent or nominee provides certain other services but may not exercise deposit placement or investment discretion."[17]

The Proposal seeks comment on revising the 25 percent of assets under administration exception, referred to as the "25 percent test," which it would rename as the "Broker-Dealer Sweep Exception" ("BDSE"). The BDSE would be available only to a broker-dealer or investment adviser registered with the SEC and "only if less than 10 percent of the total assets that the broker-dealer or investment adviser, as agent or nominee, has under management for its

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[13] 12 U.S.C. § 1831f(g)(2)(I).

[14] FDIC Staff Advisory Opinion 05–02, 2005 WL 1276372 (Feb. 3, 2005, repealed on Apr. 1, 2021, by the 2021 Final Rule) (hereinafter 2005 Advisory Opinion).

[15] We have previously argued that as guidance, these qualifications did not have the force and effect of law. *See* Schwab 2019 ANPR Comment Letter at 7-8; *see also* Role of Supervisory Guidance, 86 Fed. Reg. 12,079 (Mar. 2, 2021), https://www.fdic.gov/news/press-releases/2021/pr21005.html.

[16] 12 CFR 337.6(a)(5)(v)(I)(1)(i). In the Proposal, the FDIC refers to the 25 percent of assets under administration exception as the "25 percent test."

[17] 86 Fed. Reg. 6751.

customers, in a particular business line, is placed into non-maturity accounts at one or more IDIs, without regard to whether the broker-dealer or investment adviser and depository institutions are affiliated."[18] The FDIC maintains that "placing less than 10 percent of customer funds at IDIs would be more indicative that the primary purpose … is to temporarily safe-keep customer free cash balances (e.g., uninvested funds) that are awaiting reinvestment," and that "[t]he FDIC views the 10 percent threshold as evidence that a de-minimis amount of customer funds are placed into deposit accounts for the primary purpose of re-investment rather than to provide a deposit placement service or deposit insurance."[19] As we explain below, the FDIC's rationale for these changes is not grounded in the statute.

For the reasons described herein, we respectfully request that the 2021 Final Rule be maintained, and the Proposal be withdrawn, including because the Proposal if finalized as proposed would be vulnerable to APA challenge. At a minimum, should the FDIC go forward with the Proposal despite lacking clear statutory authority, we recommend the FDIC maintain the 25 percent of assets under administration exception in the 2021 Final Rule without modification. Our request to maintain the 2021 Final Rule should not be viewed as acknowledgement that the 2021 Final Rule complies with the statute; rather it reflects a judgment by Schwab that the 2021 Final Rule reflects a reasonably workable compromise for the reasons described herein.

II. The Proposal if finalized would be vulnerable to an APA challenge.

We believe the Proposal, if finalized, would be vulnerable to an APA challenge for at least three reasons: (1) The FDIC has exceeded its statutory authority by narrowing an unambiguous PPE legislated by Congress; (2) Congress did not delegate power to the FDIC to determine what constitutes a brokered deposit; and (3) The Proposal is arbitrary and capricious, as the FDIC has not adequately explained why changing the PPE's threshold from 25 percent of assets under administration to 10 percent of assets under management would solve any of the problems identified in the Proposal. We describe each of these in turn in more detail below.

a. The FDIC lacks authority to impose qualifications on the PPE.

The FDIC has exceeded its statutory authority by narrowing an unambiguous PPE legislated by Congress. The FDI Act does not define the term "brokered deposits" but instead defines the term "deposit broker."[20] The FDI Act provides the term "deposit broker" does not include "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."[21] Congress did not legislate any qualifications on the PPE.

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[18] 89 Fed. Reg. at 68,255-56; *see also* 12 CFR 337.6(a)(5)(iv)(I)(1)(i) (proposed).

[19] 89 Fed. Reg. at 68,256.

[20] 12 U.S.C. § 1831f(g)(1).

[21] 12 U.S.C. § 1831f(g)(2)(I).

There is nothing ambiguous about the meaning of "primary purpose" or determining an entity's primary purpose in placing deposits. In the Proposal, the FDIC states: "The FDIC views the 10 percent threshold as evidence that a de-minimis amount of customer funds are placed into deposit accounts for the primary purpose of re-investment rather than to provide a deposit placement service or deposit insurance."[22] But the statutory test is not whether the amount is de minimis; rather it is whether the primary purpose of the deposit broker is the placement of funds with depository institutions.

Schwab qualifies for the PPE under the plain language of the statute. As a retail broker-dealer that sweeps customer funds awaiting investment to a deposit account at IDIs,[23] Schwab does not have as its primary purpose "the placement of funds with depository institutions."[24] There is no way a court would determine that CS&Co.'s primary purpose is to be a deposit broker—which is what would be required by statute.

A numeric PPE threshold is not dispositive of whether the primary purpose of a Sweep Program is to place deposits with an IDI, and a 25 percent threshold can correspond with the PPE just as easily as a 10 percent threshold because both relate to funds held for investment.

As FDIC Vice Chairman Travis Hill explained in his statement on the Proposal, which he voted against:

> "To start, I strongly disagree with the revised approach to the primary purpose exception. The statute is quite clear: if a person's primary purpose is something other than the placement of deposits, the person is not a deposit broker.… I also disagree with replacing the '25 percent test.' I do not think it is accurate to conclude that the primary purpose of a company that collects funds from customers and, for example, places 12 percent of those funds at banks is the placement of deposits, given that 88 percent of those funds are placed elsewhere."[25]

The FDIC does not have statutory authority to narrow or modify the statutory PPE.[26] Two current Supreme Court Justices, Brett Kavanaugh and Samuel Alito, recently observed in a

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[22] 89 Fed. Reg. 68,256.

[23] Whether or not the funds are swept to an *affiliated* bank has no bearing on whether the primary purpose exception applies (among other possible qualifications on this PPE suggested in alternatives in the Proposal).

[24] 12 U.S.C. § 1831f(g)(2)(I).

[25] Travis Hill, Vice Chairman, FDIC, "Statement by Vice Chairman Travis Hill on the Notice of Proposed Rulemaking on Brokered Deposit Restrictions," (July 30, 2024), https://www.fdic.gov/news/speeches/2024/statement-vice-chairman-travis-hill-notice-proposed-rulemaking-brokered-deposit (footnotes omitted).

[26] Although Schwab did not raise this argument in its comment letter on the 2020 Proposal, it likely would not be time-barred from raising it now. *See* 28 U.S.C. § 2401 (six-year statute of

dissenting opinion concerning the Fair Labor Standard Act's exception for paying overtime if an employee worked in a "bona fide executive . . . capacity" that "[t]he Act focuses on whether the employee performs executive duties, not how much an employee is paid. So it is questionable whether the Department's regulations—which look not only at an employee's duties but also at how much an employee is paid…will survive if and when the regulations are challenged as inconsistent with the Act."[27]

After the Court's decision in *Loper Bright Enters. v. Raimando*, which overturned *Chevron* and requires courts to "exercise their independent judgment in deciding whether an agency has acted within its statutory authority," courts will not defer to the FDIC's interpretation of the statutory PPE.[28]

b. Congress did not delegate power to the FDIC to determine what constitutes a brokered deposit.

"The nondelegation doctrine bars Congress from transferring its legislative power to another branch of Government."[29] "The interpretation of the meaning of statutes, as applied to justiciable controversies," is meant to be "exclusively a judicial function."[30] The FDI Act cannot be read so broadly as to delegate authority that Congress did not confer, particularly in light of the Supreme Court's holding in *Loper* which requires a clear delegation that is absent from the FDI Act.

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limitations for APA claims). *See Cigar Assn. of Am. v. U.S. Food and Drug Admin.*, 480 F. Supp. 3d 256, 268 (D.D.C. 2020) (citing Nicopure Labs, LLC v. FDA, 266 F. Supp. 3d 360, 399 (D.D.C. 2017), aff'd, 944 F.3d 267 (D.C. Cir. 2019)) (holding that FDA correctly concluded that it lacked authority to change the grandfather date in a statute because when "the statute is clear" an agency has "no power to change it").

[27] *Helix Energy Solutions Group, Inc. v. Hewitt*, 598 U.S. 39, 67 (2023) (Kavanaugh, J., *dissenting*). Department refers to the Department of Labor.

[28] 144 S. Ct. 2244, 2273 (2024).

[29] *Gundy v. United States*, 588 U.S. 128, 132 (2019).

[30] *Loper Bright Enterprises*, 144 S.Ct. at 2258 (quoting *U.S. v. Am. Trucking Assns., Inc.*, 310 U.S. 534, 544 (1940)) (also citing *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358, 369 (1946); *Medo Photo Supply Corp. v. NLRB*, 321 U.S. 678, 681–682, n. 1 (1944)).

Congress did not delegate the power to the FDIC to decide what constitutes a brokered deposit nor to circumscribe the PPE in the FDI Act. Congress only delegated to the FDIC the power to regulate brokered deposits.[31]

Congress did not delegate the power to determine the antecedent question—namely, what constitutes a brokered deposit. Congress legislated clearly on that point by defining "deposit broker"[32] and establishing various "exclusions" including the PPE.[33] Any attempt to use section 1831f(f) to limit the scope of the PPE assumes the conclusion about whether the deposit is brokered and will not survive judicial review.

Regardless, this provision does not establish a limiting or guiding principle for the FDIC and thereby violates the nondelegation doctrine. As commenters have noted in response to the Basel III Endgame proposal, "[i]f it is indeed the [A]gencies' view that there are no meaningful limits to what they can do, and no standards to guide them, then their governing statutes cannot be reconciled with the non-delegation doctrine."[34] The nondelegation doctrine has long distinguished between "important" policy issues, "which must be entirely regulated by the legislature itself," and subjects "of less interest, in which a general provision may be made, and power given to those who are to act under such general provisions to fill up the details."[35] By utilizing rulemaking authority to narrow a statutory PPE, the FDIC clearly crosses the line into important policy issues that cannot be delegated by Congress. Attempting to do so risks a ruling that the statute itself is unconstitutional.

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[31] *See* 12 U.S.C. § 1831f(f) ("The Corporation may impose, by regulation or order, such additional restrictions on the acceptance of brokered deposits by any institution as the Corporation may determine to be appropriate.").

[32] 12 U.S.C. § 1831f(g)(1).

[33] 12 U.S.C. § 1831f(g)(2).

[34] Bank Policy Institute, Financial Services Forum, Securities Industry and Financial Markets Association, and U.S. Chamber of Commerce, Comment Letter Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity (Federal Reserve Docket No. R-1813, RIN 7100-AG64; FDIC RIN 3064-AF29; Docket ID OCC-2023-0008) at 52 (Jan. 12, 2024), https://bpi.com/wp-content/uploads/2024/01/Joint-Trades-Legal-Comment-on-Basel-III-Endgame-Proposal-FINAL.pdf; *Indus. Union Dep't, AFL-CIO v. Am. Petroleum Inst.*, 448 U.S. 607, 646 (1980) (plurality) ("If the Government was correct in arguing that neither § 3(8) nor § 6(b)(5) requires that the risk from a toxic substance be quantified sufficiently to enable the Secretary to characterize it as significant in an understandable way, the statute would make such a 'sweeping delegation of legislative power' that it might be unconstitutional." (quoting *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 539 (1935))).

[35] *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 43 (1825).

c. The Proposal is arbitrary and capricious because the FDIC has not provided an adequate explanation to justify its changes.

The FDIC has not adequately explained why changing the PPE's threshold from 25 percent of assets under administration to 10 percent of assets under management would solve any of the problems identified in the Proposal. The FDIC has not proffered an adequate explanation to justify the reversal from its existing 25 percent assets under administration threshold for the PPE.

The FDIC calls the existing 25 percent of assets under administration exception "overly broad" and asserts that the primary purpose of these arrangements in placing customer deposits at IDIs is "often not [] for a substantial purpose other than to provide a deposit-placement service or FDIC deposit insurance,"[36] but provides no evidence to support this assertion and adds on a purpose related to FDIC deposit insurance that is absent from the statute.

The FDIC does not provide any data nor rational explanation for a 10 percent threshold.[37] The FDIC simply asserts that a 10 percent threshold "would be more indicative that the primary purpose for broker dealers and investment advisors…is to temporarily safe-keep customer free cash balances (e.g., uninvested funds) that are awaiting reinvestment."[38] As Schwab noted when the 2019 ANPR to the 2021 Final Rule was issued, a 10 percent threshold is "uncorrelated with [the] primary purpose exception."[39]

As Director Jonathan McKernan pointed out in his statement expressing his opposition, the Proposal only asserts that "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."[40] More broadly, Director McKernan points out:

> "This proposal does a good job of marshalling evidence of the risks posed by brokered deposits. The proposal does not, however, offer any evidence that some

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[36] 89 Fed. Reg. 68,255.

[37] The lack of data for the Proposal generally is underscored by the fact that on the same day as the Proposal, the FDIC approved a request for information seeking "information on the characteristics that affect the stability and franchise value of different types of deposits." *See* Request for Information on Deposits, 89 Fed. Reg. 63,946 (Aug. 6, 2024).

[38] 89 Fed. Reg. 68,256

[39] Schwab 2019 ANPR Comment Letter at 7.

[40] Jonathan McKernan, Director, FDIC, "Statement by Jonathan McKernan, Director, FDIC, Board of Directors, on the Proposed Brokered Deposit Restrictions," (July 30, 2024), https://www.fdic.gov/news/speeches/2024/statement-jonathan-mckernan-director-fdic-board-directors-proposed-brokered (hereinafter McKernan Statement) (footnotes omitted).

> of the deposits that this proposal would re-classify as brokered deposits actually present the same or similar risks. That evidence should inform whether a particular type of deposit falls within the newly proposed framework for the primary purpose exception."[41]

The FDIC also has not proffered an adequate explanation for considering "assets under management," which would require an investment adviser or broker-dealer to provide "continuous and regular supervisory or management services," instead of "assets under administration."[42]

The 2021 Final Rule applied the 25 percent PPE threshold to assets under administration; the Proposal would apply a 10 percent PPE threshold to assets under management. The FDIC points to its "experience" with the 2021 Final Rule and asserts that "'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."[43]

First, there is no statutory basis in the PPE for differentiating between assets under management versus assets under administration. Second, the FDIC's rationale is conclusory and thus not entitled to deference. Third, the FDIC's rationale also is incorrect as a matter of practice for retail broker-dealers like Schwab as discussed below.

Additionally, the proposed alternatives to the 10 percent PPE threshold for assets under management are arbitrary and capricious. The proposed alternatives include eliminating the designated exception for sweep deposits altogether or restoring the pre-2020 conditions (affiliated IDIs and "flat fees").[44] Like the Proposal itself, neither of these alternatives has a statutory basis.

Where the FDIC proposes an alternative to rescind the PPE for broker-dealers, it states that "an IDI would be required to submit the required information listed under the general primary purpose exception application process as described in the proposed rule to demonstrate that the deposit-placement activity of the sweep arrangement, including those with an additional third party, is for a substantial purpose other than to provide deposit insurance or a deposit placement service."[45] This is new language the FDIC is using to redefine the PPE is devoid of a

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[41] McKernan Statement.

[42] 89 Fed. Reg. 68,256.

[43] 89 Fed. Reg. 68,256.

[44] 89 Fed. Reg. 68,258.

[45] 89 Fed. Reg. 68,258.

statutory basis. The FDIC cannot eliminate the PPE for broker-dealers or require the IDI to "demonstrate" a particular purpose to qualify for an exception provided by statute.

The FDIC contends that the Proposal is necessary because there has been a decline in reported brokered deposits for several reasons, none of which is adequate to justify this Proposal. First, the FDIC blames this decline on the 2021 Final Rule "expand[ing] the scope of the primary purpose exception to the deposit broker definition."[46] A regulation cannot expand or modify a legislated exception.

Second, the FDIC contends that "the decline in reported brokered deposits is also due, in part, to some IDIs misunderstanding and misreporting deposits" under the 2021 Final Rule.[47] Moving to a 10 percent threshold where no third party is involved would not solve that misunderstanding or misreporting of third parties; clarifying the reporting requirements does not require changing the threshold.

Third, pointing to the failure of Silicon Valley Bank ("SVB") and First Republic Bank and the failure of crypto company Voyager and fintech Synapse (a deposit broker for fintechs), the FDIC contends that "experiences" since the 2021 Final Rule "have shown that some of the underlying reasons to narrow the coverage of the rule have proved to be problematic."[48] But the FDIC does not explain how the Proposal would have changed any of those outcomes or reduced the cost to the Deposit Insurance Fund. And the Material Loss Reviews by the Federal Reserve and FDIC Office of Inspector Generals ("OIGs") for SVB and First Republic Bank, respectively, do not mention brokered deposits in connection with the institutions' failures.[49] In each of these cases, other causes of failure are described, including runs on uninsured deposits.[50]

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[46] 89 Fed. Reg. 68,244-45.

[47] 89 Fed. Reg. 68,245.

[48] 89 Fed. Reg. 68,245.

[49] Off. of Inspector Gen., Board of Governors of the Federal Reserve System, Material Loss Review of Silicon Valley Bank, Evaluation Report 2023-SR-B-013 (Sept. 25, 2023), https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf (hereinafter SVB Material Loss Review); Off. of Inspector Gen., FDIC, Material Loss Review of First Republic Bank, Report No. EVAL–24–03 (Nov. 28, 2023), https://www.fdicoig.gov/news/summary-announcements/material-loss-review-first-republic-bank (hereinafter First Republic Bank Material Loss Review). Nor does the material loss review for Signature Bank. Off. of Inspector Gen., FDIC, Material Loss Review of Signature Bank, Report No. EVAL–24–02 (Oct. 23, 2023), https://www.fdicoig.gov/sites/default/files/reports/2023-10/EVAL-24-02.pdf (hereinafter Signature Bank Material Loss Review).

[50] *See, e.g.*, SVB Material Loss Review at 13, and 28-29; First Republic Bank Material Loss Review at 8-10, 13, 21-22, and 29-3; *see also* Signature Bank Material Loss Review at 9-10, 11-13, 25, 26, 34-35, and 38.

It is widely appreciated that run risk from uninsured deposits played a pivotal role in the failures of Silicon Valley Bank and Signature Bank.[51] BPI's Pat Parkinson, former Division Director of Supervision and Regulation at the Federal Reserve, for example, has pointed out: "Recent disorderly failures of certain regional banks, notably SVB and Signature Bank, were caused largely by very rapid runoffs of uninsured deposits," noting "[t]hose two banks were unusually dependent on such deposits," with SVB's uninsured deposits nearly 94 percent of its total deposits, while Signature Bank's was nearly 90 percent.[52] Parkinson calls for an approach whereby regulators "focus their attention on banks that heavily dependent on uninsured deposits," stating that "[s]uch a targeted approach could improve safety and soundness while avoiding potential adverse effects on credit availability from implementing unnecessarily broad measures based on limited information."[53] The Proposal does not address this evidence. To the extent the Proposal is a response to spring 2023 events, we believe it is the wrong tool. The FDIC should work with the other banking agencies, and the focus should be on the stability of deposits,[54] which must operate within a sound liquidity risk management framework that includes but is not limited to: (1) a concentration framework and (2) other factors that distinguish the stability of deposit types such as insured versus uninsured deposits.

Finally, the FDIC says that moving to a 10 percent threshold when no additional third parties are involved "would be more operationally workable than the current 25 percent test notice process as the required information would be tailored to specific information to which the receiving IDI should have access or be able to obtain . . . ."[55] The FDIC never explains why the current test is not operationally workable especially when no third parties are involved.

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[51] *See, e.g.*, Martin J. Gruenberg, Chairman, FDIC, "Statement of Martin J. Gruenberg, Chairman Federal Deposit Insurance Corporation Request for Information on Deposits," (July 30, 2024), https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corporation-2 ("Runs of uninsured deposits directly contributed to the failures of Silicon Valley Bank and Signature Bank in March 2023 and the subsequent failure of First Republic Bank, all large regional banks. These runs were exacerbated by each bank's heavy reliance on uninsured deposit funding and concentrations in the depositor base, among other factors.")

[52] Pat Parkinson, "What to do about Uninsured Deposits?," The Bank Policy Institute (Oct. 5, 2023), https://bpi.com/what-to-do-about-uninsured-deposits/ (hereinafter Parkinson Uninsured Deposits) (citing call report data) (also describing how First Republic was vulnerable to runs on uninsured deposits).

[53] Parkinson Uninsured Deposits.

[54] *See, e.g.*, Michael J. Hsu, Acting Comptroller of the Currency, "Statement at the FDIC Board Meeting NPR on Brokered Deposits Restrictions and RFI on Deposits," (July 30, 2024), available at https://www.occ.gov/news-issuances/news-releases/2024/nr-occ-2024-86a.pdf.

[55] 89 Fed. Reg. 68,256.

The "primary purpose" exception is expressly provided by statute, which does not, on its face, give the FDIC any authority to impose requirements limiting its application. The flip-flop between 10 percent and 25 percent would create a strong record that the courts should in a post-Chevron world fashion a judicial solution rather than accept a rule from the FDIC.

III. The Proposal should be withdrawn, and the 2021 Final Rule maintained because, among other reasons, the 10 percent threshold is procyclical and proved unworkable during the coronavirus pandemic.

Below we explain why the 25 percent of assets under administration exception under the 2021 Final Rule should be maintained, and the Proposal should be withdrawn, including because a 10 percent threshold proved unworkable during the coronavirus event. We also explain why assets under administration in the 2021 Final Rule should be maintained and why assets under management in the Proposal is an inappropriate concept for retail broker-dealers like Schwab. As a final matter, we also respectfully request maintaining the notice provisions of the 2021 Final Rule related to the exception for the 25 percent of assets under administration exception, which allow a broker-dealer (as opposed to the IDI) to provide the notice to the FDIC.

a. The 25 percent of assets under administration exception under the 2021 Final Rule should be maintained; the 10 percent threshold is procyclical and proved unworkable, including during the coronavirus pandemic.

The 10 percent threshold is uncorrelated with the Primary Purpose Exception. It is not determinative of whether a broker-dealer's "primary purpose is the placement of funds with depository institutions."[56] Sweep Programs operated by retail broker-dealers like CS&Co. involve continuing customer relationships that are based on the customer's desire to purchase and sell securities through the customer's brokerage account. Customers do not open brokerage accounts at a retail broker-dealer, such as CS&Co. for the Sweep Program. The 2005 Advisory Opinion recognizes this fact in finding that the primary purpose of full-service brokerage accounts is to facilitate securities transactions, not deposit placements.[57] The FDIC provides no evidence nor supporting rationale in the Proposal to refute this fact or its basic rationale for this PPE dating back nearly two decades.

As we have explained in earlier comment letters,[58] the Permissible Ratio has no bearing on whether the primary purpose of a Sweep Program is to place deposits with an IDI. The Permissible Ratio is, by definition, sensitive to market volatility and procyclical. During periods

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[56] 12 U.S.C. § 1831f(g)(2)(I). We made many of these same comments in our 2019 ANPR Comment Letter. *See generally* Schwab 2019 ANPR Comment Letter.

[57] 2005 Advisory Opinion (stating that "the 'primary purpose'" of a Sweep Program "is to facilitate the customers' purchase and sale of securities."). The FDIC also explains how historically dating back to 1990 "the FDIC has taken the position that 'primary purpose' means 'primary intent.'" *See id.*

[58] Schwab 2019 ANPR Comment Letter.

of market declines, retail customers tend to reduce their risk exposure by selling their securities and holding more cash. The result is to increase the swept funds numerator and decrease the brokerage account assets denominator, which can create significant swings in the Permissible Ratio. A broker-dealer has little, if any, control over this customer-driven activity, which by its very nature is entirely unrelated to the broker-dealer's primary purpose.

In the event of prolonged or precipitous market decline, strict application of the 10 percent threshold has proven unworkable in practice. It may require a broker-dealer to unenroll certain customers from the Sweep Program in order to reduce the Permissible Ratio. In such a case, the broker-dealer's primary purpose in establishing the Sweep Program would not have changed. The converse is also true: if the ratio were above the 10 percent threshold and positive market forces resulted in a movement of the ratio below 10 percent, the broker-dealer's primary purpose would not have shifted from placing deposits with an IDI to not placing deposits with an IDI. As the FDIC is aware, a good example of how market events influence the Permissible Ratio occurred during the recent coronavirus pandemic.

In March 2020, Schwab requested that the FDIC suspend the applicability of the 10 percent threshold during the economic and market dislocations caused by the coronavirus. As we explained to the FDIC, a national emergency was declared as a result of the coronavirus pandemic. At the time, Schwab witnessed a combination of a significant decline in the total value of its customer assets, and a related marked increase in the amount of deposits swept to its banks pursuant to the Sweep Program, as net customer sales of securities increased, and customers looked to avoid losses. As a result, the total amount of assets of CS&Co. customers who elected to participate in the Sweep Program (the Permissible Ratio denominator) had decreased; total bank sweep deposits (the Permissible Ratio numerator) had increased.

Schwab explained to the FDIC that suspension was essential to ensuring that Schwab could assist its customers in a stressful period. At the time, Schwab projected that if current stock market trends and customer behavior had continued, the Permissible Ratio would have exceeded the 10 percent threshold, potentially disqualifying its program from the PPE and causing the Sweep Program deposits to lose their non-brokered status unless CS&Co. and Schwab's Banks took certain actions to reduce the amount of the Sweep Program, which likely would have had very negative and unintended consequences for the company and its customers in the midst of the coronavirus pandemic and national emergency. Schwab also noted that these were the types of exigent circumstances contemplated by the 2005 Advisory Opinion.[59]

Schwab would have been in the position of taking immediate steps to reduce the amount of deposits in the Sweep Program to ensure the Permissible Ratio remained below 10 percent. Such actions could have included, with at least 30 days' prior notice to millions of customers, establishing a deposit threshold above which any funds in excess of that threshold were swept to a money market mutual fund instead of an FDIC-insured bank. Alternatively, entire categories of

[59] The 2005 Advisory Opinion recognized: "In the event of a catastrophic event, *** may contact the FDIC to request that the primary purpose exception continue to apply."

CS&Co. customers could have been declared ineligible for the Sweep Program, thereby forcing these customers to switch to either free credit balances held by CS&Co. or money market mutual funds. In either case, this would have forced customers' funds out of banks and reduced FDIC insurance protection available to customers[60] and potentially could have created uncertainty and had negative signaling impacts for investors, markets and customers.

In recognition of these circumstances, the FDIC staff temporarily viewed CS&Co. as meeting the primary purpose exception if funds swept to the Banks and any other bank did not exceed 25 percent of the *total amount of assets* handled by CS&Co. for those clients who participate in the Program.[61] We believe this action by the FDIC reflected an acknowledgement of the inappropriateness of the 10 percent threshold given its real world consequences, unnecessarily exacerbating stress and disruption in financial markets and potentially compromising the safety and soundness of the banking system.

Even before these events, in February 2020, the FDIC already had proposed: "the primary purpose of an agent's or nominee's business relationship with its customers will not be considered to be the placement of funds, subject to an application process, if less than 25 percent of the total assets that the agent or nominee has under management for its customers, in a particular business line, is placed at depository institutions."[62] The FDIC explained:

> "It is the FDIC's view that the primary purpose of a third party's business relationship with its customers is not the placement of funds with depository institutions if the third party places less than 25 percent of customer assets under management for its customers, for a particular business line, at insured depository institutions. The FDIC believes that if 75 percent or more of the customer assets under management of the third party is not being placed at depository institutions, for a particular business line, the third party has demonstrated that the primary purpose of that business line is not the placement of funds at depository institutions. The FDIC also believes that establishing a transparent, bright line test is beneficial for all parties."[63]

[60] These funds would have potentially still been subject to Securities Investor Protection Corporation or SIPC coverage.

[61] *See* The Charles Schwab Corporation, Re: Brokered Deposits Restrictions (FDIC RIN 3064-AE94) at 6, note 10 (June 4, 2020), https://www.fdic.gov/system/files/2024-06/2020-unsafe-unsound-banking-practices-brokered-deposits-3064-ae94-c-065.pdf (Schwab 2020 Proposal Comment Letter) (citing FDIC Staff Advisory Opinion 20–01 (Mar. 19, 2020) (temporarily providing a 25 percent permissible ratio, subject to certain other representations)).

[62] 85 Fed. Reg. 7459.

[63] *See id.*

The 25 percent of assets under administration exception was ultimately codified in the 2021 Final Rule, with assets under management changing to assets under administration, as explained below, as a result of public comment on the 2020 Proposal.[64] Fundamentally, this higher threshold recognized, especially in the aftermath of the coronavirus, the need to have a buffer to account for these types of market fluctuations.[65] We also believe that it is not prudent to rely on one-off exceptions in times of stress when the need for the higher threshold had been demonstrated in recent and predictable circumstances.

One of the apparent rationales provided to modify the 25 percent of assets under administration exception has to do with the involvement of an additional third party. For example, the FDIC says, "…[T]he FDIC has observed that some IDIs receiving deposits through a sweep arrangement have incorrectly relied upon a third party's 25 percent primary purpose exception notice to not report certain deposits as brokered, without conducting analyses, or without having access to the appropriate documentation to conduct analyses, and despite the involvement of an additional third party that meets the 'deposit broker' definition."[66] Changing 25 percent of assets under administration to 10 percent of assets under management does nothing to address purported concerns about third parties, and the FDIC provides no rationale to justify the changes.

In terms of the alternatives on which the FDIC seeks comment: Alternative A to eliminate this designated business exception would not comport with the statute and would overturn nearly two decades of FDIC precedent. When a retail broker-dealer whose primary purpose is providing access to equity markets offers a Sweep Program to its customers, the broker-dealer is acting as an agent or nominee whose primary purpose is not the placement of funds with depository institutions. This has been recognized by the FDIC for nearly two decades.[67] Alternative B of the Proposal would restore additional qualifications related to fees and affiliated

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[64] 86 Fed. Reg. 6751.

[65] It also is worth noting that several other rules including standardized liquidity rules and deposit insurance assessment rules penalize a firm's holding of brokered deposits. Thus, there are many other regulatory constraints on brokered deposits, beyond the Permissible Ratio.

[66] 89 Fed. Reg. 68,245; *see also* Martin J. Gruenberg, "Statement of Martin J. Gruenberg, Chairman Federal Deposit Insurance Corpoation [SIC] on the Notice of Proposed Rulemaking on Brokered Deposits," (July 30, 2024), https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-federal-deposit-insurance-corpoation ("For example, under the current rule any third party may immediately invoke a primary purpose exception from being considered a "deposit broker" by submitting a notice indicating that it places less than 25 percent of customer assets under administration, for a particular business line, at more than one bank ('25 percent test'). The FDIC has observed that some banks receiving deposits through a sweep arrangement have incorrectly relied upon a notice submission for the 25 percent test, despite the involvement of an additional third party that meets the 'deposit broker' definition.")

[67] *See* 2005 Advisory Opinion.

status of the IDI and broker-dealer. These conditions have nothing to do with the broker-dealer's primary purpose in placing the deposits under the statute.[68]

As a final note, our request to maintain the 25 percent assets under administration exception in the 2021 Final Rule should not be viewed as acknowledgment that the 2021 Final Rule complies with the statute; rather it reflects a judgment by Schwab that the 2021 Final Rule reflects a reasonably workable compromise for the reasons described herein.

b. Assets under administration under the 2021 Final Rule should be maintained; assets under management under the Proposal is an inappropriate and unworkable concept for retail broker-dealers.

The Proposal also proposes to modify the 25 percent of assets under administration to 10 percent of assets under management. The Proposal explains: "From the FDIC's experience" with the 2021 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."[69] By contrast, in the 2021 Final Rule, in adopting assets under administration, the FDIC explained: "[t]he revised phrase more accurately reflects the FDIC's intention that this test cover both customer assets managed by the agent or nominee and those customer assets for which the agent or nominee provides certain other services but may not exercise deposit placement or investment discretion."[70] The rationale of the 2021 Final Rule is correct.

We support maintaining the exception for 25 percent of assets under administration as adopted in the 2021 Final Rule for the reasons explained by the FDIC, and similarly the reasons provided in our 2020 Comment Letter.[71] The terminology "assets under management" has a specific meaning in the securities industry and refers to assets managed by a registered investment adviser that would typically have investment discretion over the assets.[72]

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[68] *See* 89 Fed. Reg. 68,258; *see also* Schwab 2019 ANPR Comment Letter.

[69] 89 Fed. Reg. 68,256.

[70] 86 Fed. Reg. 6751. The 2021 Final Rule explained: "As part of the final rule, in determining the amount of customer assets under administration by an agent or nominee, for a particular business line, the agent or nominee must measure the total market value of all the financial assets (including cash balances) that the agent or nominee administers on behalf of its customers that participate in a particular business line." *See id.*

[71] Schwab 2020 Proposal Comment Letter at 8-9.

[72] *See* Schwab 2020 Proposal Comment Letter at 9, note 14 (citing SEC Form ADV Instructions); SEC, Form ADV: General Instructions at 19, https://www.sec.gov/files/formadv-instructions.pdf ("In determining the amount of your regulatory assets under management, include the securities portfolios for which you provide continuous and regular supervisory or

CS&Co. like other broker-dealers offers sweep features in connection with self-directed brokerage or investment accounts in which the individual investor retains all investment discretion. While many broker-dealers, including CS&Co., are dually registered with the SEC as brokers and investment advisers, not all clients avail themselves of advisory services. Utilizing the term in its accepted meaning, deposits swept from the accounts of the vast majority of brokerage clients who do not have managed accounts would not qualify for the PPE. Moreover, whether or not the broker-dealer manages the client's assets is irrelevant to the question of whether the broker-dealer has a primary purpose of placing funds with an IDI. The FDIC fails to justify these changes. For these reasons, any final rule should maintain assets under administration.

c. The notice provisions of the 2021 Final Rule should be maintained.

We also respectfully request maintaining the notice provisions of the 2021 Final Rule related to the 25 percent test. The existing notice provisions provide that: "A third party, or an insured depository institution on behalf of a third party, must notify the FDIC through a written notice…"[73] The Proposal would require the IDI to provide this notice.[74] It is not clear what goal this achieves other than placing additional burden on IDIs, especially since the third party (e.g., a broker-dealer) is likely the one with the information required by the notice.

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The Proposal, if finalized, will be vulnerable to an APA legal challenge for the reasons described herein. The FDIC lacks authority to impose qualifications on the PPE. Congress did not delegate power to the FDIC to determine what constitutes a brokered deposit. The Proposal is arbitrary and capricious because the FDIC did not provide adequate explanation to justify its changes. Schwab respectfully requests the FDIC withdraw the Proposal and maintain the 2021 Final Rule for the reasons explained herein. At a minimum, should the FDIC go forward with the Proposal despite lacking clear statutory authority, we recommend the FDIC maintain the 25 percent of assets under administration exception in 2021 Final Rule. More broadly, it would provide helpful clarity for Congress or the FDIC to recognize that broker-dealers who operate Sweep Programs act as an agent or nominee whose primary purpose is not the placement of funds with depository institutions.

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management services as of the date of filing this Form ADV."); *see also* Federal Reserve, FR Y-15 Instructions (June 2021) at GL-1, https://www.federalreserve.gov/apps/reportingforms/Report/Index/FR_Y-15 ("Assets under administration are securities or other assets for which a banking organization or subsidiary of the banking organization is contractually obligated to provide an administration service (e.g., back office administration and recordkeeping services).").

[73] 12 CFR 303.243(b)(3).

[74] 89 Fed. Reg. 68,256 and 68,269, 12 CFR 303.243(b)(3) (proposed).

Schwab greatly appreciates the opportunity to submit this comment letter on the Proposal. If you have any questions or require additional information, please contact the undersigned at [redacted] or [redacted].

Very truly yours,

Peter J. Morgan, III
Managing Director, General Counsel & Corporate Secretary

Cc: The Honorable Travis Hill, Vice Chairman
The Honorable Jonathan McKernan, Director
(Federal Deposit Insurance Corporation)

The Honorable Michael J. Hsu, Acting Comptroller
(Office of the Comptroller of the Currency)

Rick Wurster, Managing Director, President
Mike Verdeschi, Managing Director, Chief Financial Officer
Paul V. Woolway, Managing Director, Chief Banking Officer
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