MAG
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January 16, 2025

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Sent via electronic mail to comments@fdic.gov.

Re: Proposed Rulemaking on Recordkeeping for Custodial Accounts, 12 CFR Part 375 RIN 3064-AG07

Dear Chairman Gruenberg:

The Merchant Advisory Group (MAG) respectfully submits these comments in response to the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking (NPRM) on recordkeeping for custodial accounts.

The MAG plays a vital role in helping merchants shape innovative approaches to payments. Providing unparalleled collaboration, the MAG works together with payments industry stakeholders and advocates for merchants' interests. The MAG represents 200 U.S. merchants which account for over $4.8 trillion in annual sales at over 580,000 locations across the U.S. and online. MAG members employ over 14 million associates.

As the FDIC seeks to strengthen consumer protections and operational risk management in the banking system, the MAG and its members wish to emphasize the importance of regulatory measures that encourage innovation and deliver tangible benefits to all customers of the financial system.

The MAG's comments focus on three key areas where adjustments to the proposed regulatory approach are necessary to avoid unintended consequences that could limit competition, inhibit innovation, or strain the partnerships between insured depository institutions (IDIs) and fintechs. These areas include:

1. the potential of fintechs to contribute to innovation and foster greater competition within the payments ecosystem;
2. the potential challenges posed by heightened scrutiny of fintech partnerships, such as increased operational complexity and barriers to collaboration; and
3. recommendations for a balanced regulatory framework that protects consumers while enabling continued innovation.

I. The Importance of Fintech Participation and Innovation

Fintechs have the potential to significantly enhance the payments industry, introducing customer-focused innovations that may reduce costs, improve transaction speeds, and increase payment flexibility for

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merchants and consumers. Innovations such as budgeting apps integrated with transaction accounts, tools to monitor and build credit, and fintech-enabled payment solutions (e.g., Stripe, Square) have met a growing demand for more personalized, flexible, and cost-effective financial services.[1]

Indeed, recent studies highlight the consumer's growing reliance on fintech solutions, with approximately 49.7% of U.S. households utilizing some form of online, non-bank payment account.[2]

The payments industry, traditionally dominated by a small group of established players, has seen emerging competition driven by fintech-led innovations. This competition has not only lowered barriers for merchants but has also provided consumers with a wider array of payment options that better suit their needs.

The Department of Justice's recent lawsuit against Visa over its debit practices highlights how the payments landscape has long been shaped to the advantage of its most dominant players, limiting competition and hindering innovation.[3] The case demonstrates how dominant payments companies have sought to blunt competition from fintech entrants, underscoring the need to enhance the ability of fintechs to disrupt the status quo and drive meaningful advancements in the payments landscape.

As competition intensifies, banks are increasingly exploring partnerships over direct competition.[4] Collaborations between fintech firms and IDIs play a critical role in driving innovative solutions that benefit all parties. According to a survey by Cornerstone Advisors, U.S. banks identified their top three partnership priorities as payment facilitation and money movement, fraud and risk management, and mobile wallets.[5] These collaborations align fintech innovation with the stability of the banking system, fostering consumer confidence.

The FDIC's regulatory approach should aim to preserve and support these innovations, allowing consumers to continue benefiting from emerging advancements in the payments ecosystem. The FDIC's proposed rule, however, may inadvertently impede such progress by placing disproportionate burdens on smaller fintechs, limiting their capacity to compete with established financial institutions.

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[1] *The Future of Global Fintech: Towards Resilient and Inclusive Growth*, **World Economic Forum** *(Jan. 2024), at 4.*

[2] *National Survey of Unbanked and Underbanked Households*, **Federal Deposit Insurance Corporation** *(Nov. 2024), at 7.*

[3] *See* Complaint, *United States v. Visa Inc.* (S.D.N.Y. filed Sept. 24, 2024)

[4] *Embracing Innovation: How Traditional Banks Can Compete in the Age of Fintech*, Heitmeyer Consulting (n.d.)

[5] *United We Thrive: The Untapped Power of Bank-Fintech Partnerships*, Bain & Company (Dec. 2023)

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II. Concerns Regarding Heightened Scrutiny of Fintech Partnerships

The MAG has observed an increasing focus by the FDIC on regulating relationships between IDIs and fintechs, as evidenced by recent RFIs and NPRMs.[6] While we appreciate the FDIC's intent to bolster consumer confidence, we are concerned that the heightened scrutiny and additional compliance obligations may deter IDIs from partnering with fintechs, thereby stifling competition and innovation. Here, the burdens of regulatory scrutiny will inure to the benefit of dominant incumbent players in the industry.

The proposed rule on custodial accounts introduces several significant operational burdens on IDIs, including:

- **Daily Reconciliations and Periodic Validations**: The requirement for IDIs to reconcile and validate account records daily with fintech partners adds considerable complexity, especially for smaller fintechs without the resources of larger banks.
- **Continuous Access to Third-Party Records**: Mandating that IDIs maintain continuous access to third-party records would further strain these partnerships, raising privacy, operational, and cost concerns.
- **Annual Certification and Reporting Requirements**: These requirements introduce additional costs and administrative burdens that could disproportionately impact smaller fintechs. The goal of greater transparency for customers of the banking system can be accomplished through less restrictive means.

These stringent compliance requirements risk creating barriers to entry and innovation, disproportionately favoring established financial institutions over non-bank fintechs.

We are also concerned that the broader regulatory scrutiny on fintech partnerships could inadvertently draw in merchant marketplaces. It is critical to distinguish merchant marketplaces—which hold funds for sellers before disbursing payments—from fintechs that offer accounts where users can "deposit money" (e.g., Venmo or Cash App). Our comments emphasize this concern, urging the FDIC to ensure that merchant marketplaces are not unintentionally included in regulations designed for other areas of the fintech ecosystem.

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[6] *FDIC Proposes New Recordkeeping Requirements for Custodial Accounts*, Mayer Brown (Sept. 2024) ("[T]he FDIC and other regulators remain interested in the substance of bank-fintech arrangements...recently extend[ing] the comment period for the agencies' Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses. Furthermore, the federal banking agencies have been carefully reviewing bank-fintech relationships, and have issued several enforcement actions to banks in connection with partner lending programs and BaaS arrangements.").

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III. Recommendations for a Balanced Regulatory Approach

The MAG acknowledges the FDIC's commitment to bolstering consumer protections and reducing operational risks within the banking system. However, it is crucial that regulatory measures are carefully crafted to avoid penalizing both fintechs and merchants that play a vital role in modernizing the payments ecosystem.

To strike the right balance, the MAG recommends the following adjustments to the broader regulatory approach:

1. **Ensuring Clear Distinction in Regulatory Requirements**: Differentiate clearly between the various types of fintechs—specifically, those offering custodial deposit accounts versus those merely facilitating payments or holding funds for merchants—to ensure that regulations targeting deposit-based fintechs do not inadvertently affect merchant marketplaces and payment facilitators by creating a chilling effect on nascent competition that would benefit consumers.
2. **Customers/Beneficiaries of the Financial System:** Consider the interests of all financial system customers, not just those of failed institutions. The FDIC's mandate should encompass fostering a competitive, innovative ecosystem that benefits all customers, including those served through fintech partnerships and modern payment solutions.

The MAG and its members are committed to fostering a competitive, innovative payments ecosystem that benefits both merchants and consumers. We appreciate the FDIC's consideration of the merchant perspective and welcome the opportunity to engage further in this rulemaking process to ensure the FDIC achieves its objectives without imposing undue burdens on the industry.

Sincerely,

[redacted]

John Drechny
CEO
Merchant Advisory Group