STONECASTLE

November 7, 2024

Via Electronic Submission

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: James P. Sheesley
Re: Comments RIN 3064 – AG07

RE: Request for Comment on Proposed Issuance of Rules and Regulations: Recordkeeping for Custodial Accounts RIN 3064-AG07

Summary

We support the FDIC's goal of improving the accuracy and timeliness of beneficial ownership information. However, as currently drafted, the proposed rule could unintentionally drive recordkeeping activities outside the oversight of Federal and State financial institution regulatory authorities. This would undermine the FDIC's intent, as unregulated custodianship was a key factor in creating the very risks the rule aims to mitigate. To strengthen the rule's effectiveness, we recommend an explicit exemption for regulated banks and trust companies, which would encourage this activity to remain within regulated custodianship.

Market Conditions and Financial Architecture

StoneCastle Partners, LLC ("StoneCastle") appreciates the opportunity to comment on the proposed Recordkeeping for Custodial Accounts rule published in the *Federal Register* (Vol. 89, No. 191) on October 2, 2024 (the "Proposed Rule"). For over two decades, StoneCastle has supported community banks by providing capital, deposits, and other essential services, while actively engaging with State and Federal regulators. We believe in safeguarding the safety and soundness of the U.S. financial system, protecting consumers, and upholding compliance standards to prevent financial misuse.

While "fintech" companies have introduced alternative financial products, the core fundamentals of their offerings are not novel.[1] However, some of the structures noted in the Proposed Rules add lightly—or entirely unregulated—layers over traditional banking, sometimes obscuring activities and enabling non-regulated parties to offer products resembling traditional bank accounts. This shift has moved control away from regulated financial institutions and increased risk for consumers and the banks serving them.

Custodial deposit accounts themselves are not novel; institutions have long used regulated custodians for recordkeeping and safeguarding assets, with pass-through insurance regulations in place for decades. The FDIC's historic rule on "Recognition of deposit ownership and fiduciary relationships[2]" was predicated on the assumption that custodial accounts would be managed by institutional-grade, regulated custodians, who specialize in recordkeeping and asset protection. StoneCastle has successfully utilized regulated custodial deposit accounts for over 20 years.

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[1] As an example, the primary feature set of nearly all of the products offered to end-users in question is a basic demand or savings account with a routing number, the ability to originate/receive ACHs and in some cases, a debit card as a payment device. While many secondary feature sets are often added (e.g., "boost-like" shopping rewards) they do not change or alter the core banking features which have been offered by banks for decades. No one needs to, or likely would, partner with a bank to offer coupons. It is unreasonable to believe that adding "coupons" to a traditional checking account changes the nature of the checking account itself.

[2] 12 CFR § 330.5

We share the FDIC's concerns regarding the increased use of custodial accounts by unregulated or lightly regulated entities. While the FDIC seeks to reduce risk through the Proposed Rule, *the risk arises primarily from unregulated or lightly regulated entities operating custodial deposit accounts—not from traditional regulated custodians.*

Comments on Proposed Rule 375

While we recognize the challenges the FDIC faces when constructing these rules we believe the Proposed Rule has several shortcomings that may hinder the FDIC's objectives.

First, the Proposed Rules creates unneeded complexity for hundreds of community banks who present no material risk. The Proposed Rules note that "between 600 and 1,100" insured depositories would be covered, but only a few dozen depositories actually conduct the operations which are targeted by the Proposed Rule. This complexity can create new undesired risks including: (i) more information security risk by exposing full profile customer personal identifiable information, (ii) pressuring community bank earnings by adding a large amount of expense in order to comply, as their existing systems are not configured for such data integration, and (iii) increasing operational risks by increasing the complexity of community bank core operating systems.

Second, the Proposed Rules may create significant correspondent banking and inter-bank issues for many community banks who create no material cited risk. The Proposed Rule lacks explicit exemptions for financial institutions such as banks and trust companies regulated by Federal or State financial institution regulatory agencies who utilize a correspondent bank to access services. Approximately 69% of all FDIC insured banks (more than 3,100 in total)[3] are not members of the Federal Reserve system and rely on services from another bank, requiring many to utilize omnibus accounts at a correspondent bank. A direct read of the proposed rule would cause thousands of community banks to need to develop feeds of their entire customer base and share their most critical business information with a potential competitor. We do not believe this is the FDIC's intent, because each of these entities are already held to a higher standard than all exempted entities.[4]

Third, and most critically, trust departments of banks and non-depository trust companies are not exempted. The business model and legal framework of regulated financial charters is centered on recordkeeping and safekeeping of customer assets in a fiduciary capacity under the highest standards in law. By not exempting trust departments and non-depository trust companies, the Proposed Rules may unintentionally shift business from regulated entities that are highly experienced providing exactly what the FDIC seeks (i.e., quality of records, reconciliation and availability of data) to entities that are not regulated or less experienced in such operations. The Proposed Rules as written, could incentivize regulatory arbitrage, shifting recordkeeping to unregulated or less regulated parties such as investment advisors or homeowners associations, rather than regulated custodians.

[3] Data from the Federal Financial Institutions Examination Council's National Information Center as of 10/4/2024.

[4] The Proposed Rule cites that "the FDIC believes such entities are generally subject to other recordkeeping requirements that would ensure that beneficial owners' interests are available if necessary" when explaining exemptions for entities such as "…housing associations governed by State law, and accounts holding security deposits tied to…leasehold interests." It is beyond reasonable debate that banks, trust companies and other entities regulated by Federal and State banking authorities have a significantly higher burden and expertise with respect to recordkeeping and compliance than a homeowner's association, and all other nine exemptions. Further, due to oversight by these Federal and State banking agencies it is reasonable to conclude that the availability of the beneficial information to the FDIC on a timely basis is substantially more likely with, for example, a State regulated trust company than from a homeowner's association.

Suggested Exemption

The FDIC could achieve its recordkeeping objectives without unintended consequences by explicitly exempting regulated custodians. Trust and custody structures overseen by the FDIC and other financial institution regulators already meet stringent standards for recordkeeping and asset protection. We propose the following:

(i) clarify that the Proposed Rules do not apply to financial institutions regulated by a Federal or State financial institution regulator, or

(ii) provide an explicit exemption to the Proposed Rules for State and Federally regulated financial institutions who are legally permitted to provide trust and custody services. The suggested language for the exemption: **"A custodial account opened by a financial institution regulated by a Federal or State bank regulator, so long as such entity maintains records on the beneficial owners and can produce such records in a timely manner."**

Benefits of the Suggested Exemption

Implementing this exemption would yield the following benefits:

- **Incentivizes Regulated Custodianship**: It keeps custodial activities within the regulated system, where Federal and State authorities already have oversight;
- **Alignment with BSA/AML Standards**: Regulated institutions are subject to the same Bank Secrecy Act, Anti-Money Laundering, and compliance standards as other insured depositories;
- **Cost Efficiency**: Rather than shifting large expense to community banks, traditional custodians offer efficient recordkeeping solutions at low cost (typically 0.02% to 0.08% of assets under custody), costs that can be easily absorbed by fintechs;
- **Reliability and Durability**: Regulated custodians possess significant processing resources, ensuring continuous, fast, and reliable record access for the FDIC; and,
- **Enhanced Consumer Protection**: Trustees and custodians are bound by fiduciary duties, offering the highest standard of protection for customer assets.

We believe that the FDIC agrees with this perspective, as demonstrated in the Proposed Rules, which provides an exemption for accounts holding only trust assets on the basis that a trustee "already has a duty under State law to maintain records regarding the beneficial owners of the funds."[5]

The recordkeeping requirements of a financial institution regulated by a Federal or State bank regulator acting in a custodial capacity differs little, if at all, from that of accounts only holding trust deposits. As an example, a trust company acting as a trustee on a trust deposit and a trust company acting as custodian on a custodial deposit are under the same recordkeeping obligations.

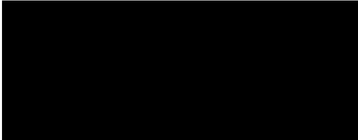
Conclusion

While we believe the Proposed Rule implicitly supports the exemption of regulated custodians, we recommend making this exemption explicit. Such clarification would reinforce the FDIC's goal of timely and accurate recordkeeping by directing custodial activities to the most qualified institutions: regulated banks and trust companies.

[5] Recordkeeping for Custodial Accounts in the Federal Register Vol. 89 No. 191 on Wednesday, October 2, 2024, 80141 *Exemptions*

We strongly urge the FDIC to (a) include an exemption for "a custodial account opened by a financial institution regulated by a Federal or State financial institution regulator, so long as such entity maintains records on the beneficial owners and can produce such records in a timely manner," or (b) provide written clarification to encourage regulated custodianship. The aforementioned parties are the highest legally qualified entities to ensure the "prompt and accurate determination of beneficial owners' deposit insurance coverage in the event of a failure of an IDI…[or] in the event of a failure of any account holder."[6] Either approach would mitigate unintended risks and ensure custodial accounts are managed by qualified, regulated custodians—ultimately protecting consumers and promoting a stable financial system.

Sincerely,



Joshua Siegel
Chief Executive Officer
StoneCastle Partners LLC

[6] Recordkeeping for Custodial Accounts in the Federal Register Vol. 89 No. 191 on Wednesday, October 2, 2024, 80141 *Exemptions*