



Recordkeeping for Custodial Accounts

Comments to the

Federal Deposit Insurance Corporation

Regarding

12 CFR Part 375
RIN 3064-AG07

89 FR 80135 (Oct. 2, 2024)

by the

National Consumer Law Center on behalf of its low-income clients

Filed on January 16, 2025

Introduction

The National Consumer Law Center, on behalf of its low-income clients, submits the following comments regarding the Federal Deposit Insurance Corporation's (FDIC) recent proposed changes to part 375 of its regulations, which would require accurate recordkeeping for custodial deposit accounts with transactional features and prompt payment of deposit insurance to depositors.¹

Throughout its history, the FDIC has helped maintain stability in the nation's financial system and earned consumers' trust. However, the banking landscape has undergone significant changes in recent years leading to increased confusion as to whether consumers' funds are protected by deposit insurance and, at times, practices that impede the protection of those funds. Unfortunately, regulation has not kept pace with these changes as shown by the events following Synapse's bankruptcy.²

NCLC supports the proposed rule. The proposed rule will help ensure that records are up to date, which will ensure that consumer funds are held in a manner that enables them to be insured under the FDIC's rules for pass-through insurance for custodial accounts,³ and assisting the FDIC in prompt determinations of deposit insurance claims if an insured depository institution (IDI) fails. Even though deposit insurance only applies to the failure of an insured depository institution (IDI), the proposed rule may also benefit consumers if a nonbank bank

¹ 12 C.F.R § 375.

² Brewster, Freddy, Schwenk, Katya, "How Your Life Savings Could Digitally Evaporate," The Lever (Jun. 10, 2024) available at <https://www.levernews.com/how-your-life-savings-could-digitally-evaporate/> ("Letters submitted to the bankruptcy judge overseeing the Synapse collapse and online comments suggest many of the users involved were confused about how or whether their money was insured by the government through the Federal Deposit Insurance Corporation.")

³ See Recognition of deposit ownership and fiduciary relationships, 12 C.F.R. § 330.5; Fed. Deposit Ins. Corp., Gen. Counsel Op. No. 8, Insurability of Funds Underlying Stored Value Cards and Other Nontraditional Access Mechanisms, 73 Fed. Reg. 67,155, 67,156 (Nov. 13, 2008).

service provider fails. Up-to-date recordkeeping will allow consumer funds to be traceable to the bank holding the funds, (if the funds are held at a bank), where the funds may be recoverable.

The proposed rule may help prevent the problems consumers experienced in the aftermath of the Synapse bankruptcy by “promoting timely access by consumers to their funds, even in the absence of the failure of an IDI.”⁴ However, the proposed rule alone will not address the confusion about FDIC insurance or resolve all of the problems encountered by consumers in the wake of the Synapse bankruptcy.

As the FDIC stated in its introduction to the proposed rule, in many cases where consumers were impacted by the Synapse bankruptcy, “it was advertised that the funds were FDIC-insured, and consumers may have believed that their funds would remain safe and accessible due to representations made regarding placement of those funds in IDIs.”⁵ However, nonbanks are never protected by deposit insurance, and even if the custodial account bank fails, it is impossible for the consumer to know if the funds held in custodial accounts were held in an insurable manner before the bank failure. As a result, NCLC urges the FDIC to consider prohibiting the use of the FDIC name by nonbanks in marketing to prevent future consumer harm,⁶ as Senators Warren and Van Hollen have urged.⁷ Additionally, we urge the FDIC to consider prohibiting the use of the words “bank” and “banking” by nonbanks in marketing.

⁴ 89 FR 80135 (Oct. 2, 2024) at 80135.

⁵ 89 FR 80135 (Oct. 2, 2024) at 80135.

⁶ NCLC and eight other public interest organizations filed comments urging the FDIC to take these measures in response to the FDIC’s Request for Information Regarding the FDIC Official Sign and Advertising Requirements, False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC’s Name or Logo available at <https://www.nclc.org/wp-content/uploads/2023/04/2023.04.6-FDIC-Comment.pdf>. We reiterate that request here.

⁷ Letter from Sen. Elizabeth Warren & Sen. Chris Van Hollen to Chairman Martin Gruenberg et al. (Sept. 11, 2024), available at https://www.warren.senate.gov/imo/media/doc/warren_van_hollen_letter_to_prudential_regulators_on_b_aas_oversight_91124.pdf.

We appreciate the opportunity to respond to the FDIC's request for comments and to the following specific questions:

Custodial Deposit Accounts with Transactional Features

- **The proposed definition of “custodial deposit account with transactional features” generally relies on three elements: (1) the account is established for the benefit of beneficial owners; (2) the account contains commingled deposits of multiple beneficial owners; and (3) the beneficial owners may authorize or direct a transfer from the custodial deposit account to a party other than the account holder or beneficial owner. The FDIC believes this definition would include the types of custodial deposit accounts that would present significant complexity in a deposit insurance determination. Should the FDIC consider alternative approaches to defining the “custodial deposit accounts with transactional features” that would generally be subject to the proposed rule?**

We support the proposed definition. However, the FDIC should confirm that the proposed definition will cover a situation where there is more than one party in between the IDI and the beneficial owners.

- **Should the rule's recordkeeping requirements instead apply to all custodial deposit accounts, not only to those with “transactional features” as described in the proposed rule? Why and what would be the benefits or challenges of applying the requirements to all custodial deposit accounts?**

Possibly. NCLC agrees that the greatest need is for daily reconciliation of the balances of accounts that have transaction features that enable those balances to fluctuate significantly. But requiring that the IDI have clear records of the beneficial owners of all funds held in custodial accounts would promote the safety of and confidence in all such accounts. Moreover, there may be some custodial deposit accounts that may not have transactional features but that nonetheless pose challenges in identifying beneficial owners.

- **Are custodial deposit account arrangements becoming more complex in the industry to the point where it would not be clear who is an account holder in the case of an IDI's failure? If so, how can the proposal better add clarity to support the FDIC's policy objectives?**

Yes. Custodial deposit account arrangements are becoming more complex. A fintech or intermediary working on behalf of the fintech may deposit consumer funds across multiple custodial deposit accounts at a single IDI, deposit funds from multiple consumers into a single custodial deposit account, or spread funds across more than one IDI. In almost all cases, the consumer who gave the fintech their funds to deposit does not know how the fintech or intermediary chose to deposit those funds or where they are. Funds may be swept from one account to another without any notice to the consumer, and some funds may also be held on the company's books in noncustodial, uninsured accounts. But it is impossible for consumers to know where their funds are. For example, PayPal's user agreement states:

Except when PayPal acts as your agent and custodian to place funds in one or more banks insured by the Federal Deposit Insurance Corporation (FDIC) that we choose in our discretion ("Program Banks"), as provided below, any balance in your Balance Account and any funds sent to you which have not yet been transferred to a linked bank account or linked debit card if you do not have a Balance Account, represent unsecured claims against PayPal that are not eligible for FDIC pass-through insurance.⁸

Although the proposed rule would require an IDI to know who the beneficial owner is, a consumer, who may or may not be the beneficial owner as defined under the proposed rule, may still be harmed by the complexity of a fintech account holder's distribution of funds. If an IDI fails, a consumer may only be able to access part of their funds depending on whether the fintech or intermediary deposited the consumer's funds in multiple accounts at multiple IDIs or outside of custodial accounts, and/or whether the fintech or the consumer is considered the beneficial

⁸ PayPal User Agreement (updated Oct. 28, 2024), <https://www.paypal.com/us/legalhub/useragreement-full> (last visited Dec. 30, 2024).

owner. The same would be true if the fintech fails and a consumer's funds are deposited in multiple IDIs, especially if some funds are not in insured custodial accounts.

- **Should there be a minimum threshold for applying the requirements of the rule?**

No. NCLC agrees with the FDIC that setting a threshold would result in disparate treatment of “otherwise similarly situated depositors in the event of an IDI failure if one depositor's funds were in a custodial deposit account that did not meet the thresholds to be covered by the proposal while another's did meet the thresholds.”⁹ All consumers should be protected in the event of a failure of an IDI or in the event that an intermediary or fintech ceases to conduct business, as in the case of Synapse. A straightforward approach applying to all custodial accounts within the scope of this rule will ensure consumers are protected.

Exemptions

- **The proposal would exempt custodial deposit accounts established by or on behalf of one or more brokers or dealers under the Securities and Exchange Act of 1934, and investment advisers under the Investment Advisers Act of 1940. Although these entities are already subject to recordkeeping requirements under federal and state laws in addition to regulatory supervision, given the risks described in this proposal, should these entities entirely be exempted from the proposal's requirements? Are there circumstances where some brokers or dealers or related accounts should not be exempted from the proposal to ensure that the proposal's policy objectives are being satisfied? If so, why and how should this exemption be revised?**

No, custodial deposit accounts held by brokers or dealers should not be exempted from the proposal's requirements. The line between bank accounts and brokerage accounts is blurring as many fintechs such as Robinhood, Cash App, and others provide both banking and brokerage services. Funds moving between different types of accounts could pose problems. For example, it is alleged that Synapse migrated some of its demand deposit accounts into brokerage accounts, though they would otherwise operate like custodial deposit accounts with transactional features.

⁹ 89 FR 80135 (Oct. 2, 2024) at 80147.

Some fintech banking apps like CashApp also hold brokerage accounts and claim the discretion to put funds in brokerage accounts:

“By maintaining funds in your Cash App Balance and/or Savings Balance, you appoint the Company as your agent for the purpose of holding your funds at our Program Bank or a brokerage at the Company’s sole discretion. (See Section III.5.) This includes the right to conduct cash management through overnight sweep operations. These sweep operations allow the Company, through banking partners, non-bank money market mutual funds, or third-party brokerages to manage your funds. Funds held with our Program Banks remain eligible for FDIC deposit insurance, subject to certain conditions, in the event a Program Bank holding the funds fails. Funds held with a brokerage are not eligible for FDIC pass-through deposit insurance.”¹⁰

The complexity of the relationships between custodial deposit accounts and brokerage accounts makes it prudent to apply a clear set of recordkeeping rules to all such accounts. SEC rules might protect those accounts, but they are unlikely to be as robust as the proposed rule.

Expected Effects

- **Would the proposed rule have any costs, benefits, or other effects that the FDIC has not identified?**

While NCLC agrees that the proposed rule would have many benefits that are significant enough to warrant the FDIC finalizing the rule, it is unclear whether the proposed rule would address some of the risks associated with custodial deposit accounts unique to fintech-bank partnerships, even with accurate record keeping. If a fintech collapses, it is still unclear how quickly consumer beneficial owners could be given access to funds deposited at an IDI and what

¹⁰ Cash App Terms of Service, Effective: February 7, 2024, Last Updated: December 18, 2024, <https://cash.app/legal/us/en-us/tos> (last visited Dec. 30, 2024).

that process would look like, even if the fintech and IDI comply with the proposed rule. For example, even if Evolve Bank had complied with the proposed rule in the case of the Synapse bankruptcy, it is unclear how quickly the many impacted consumers would have been able to access their funds. It is unclear how quickly the bankruptcy trustee would have released the funds to the fintech third parties that had contracted with Synapse.

Additional Comments

As the FDIC notes, non-banks have increasingly misused the official advertising statement, FDIC-Associated Terms, and FDIC-Associated Images to the detriment of consumers.¹¹ For example, Cash App once advertised on its website that “with a Cash Card, your Cash balance is FDIC-insured through our partner banks, which means the federal government promises to protect it.”¹² This is misleading insofar as Cash App fails to explain that funds may not be insured if the account does not have a Cash Card. It is also possible that funds accessed through the Cash Card are not continuously held in insured accounts with pass-through insurance, and may be transferred from Cash App’s non-FDIC insured accounts to insured accounts when purchases are made. Such representations by non-banks can be false and misleading and present a high risk of confusing consumers as to whether they are dealing with an IDI and whether deposit insurance applies to their funds.

¹¹ See, e.g., FDIC, “FDIC Issues Cease and Desist Letters to Five Companies For Making Crypto-Related False or Misleading Representations about Deposit Insurance” (Aug. 19, 2022), <https://www.fdic.gov/news/press-releases/2022/pr22060.html>.

¹² Cash App, <https://cash.app/bank> (last accessed March 21, 2023).

We strongly encourage the FDIC to consider prohibiting the use of the FDIC name by nonbanks in marketing,¹³ and to consider prohibiting the use of the words “bank” and “banking” by nonbanks in marketing.¹⁴

Thank you for the opportunity to submit these comments. With questions, please contact Carla Sanchez-Adams, National Consumer Law Center, csanchezadams@nclc.org.

Yours very truly,

National Consumer Law Center, on behalf of its low-income clients

¹³ Although many non-banks already disclose that they are not a bank, they do so in fine print footnotes or in a separate section of their websites, unlikely to be read by consumers. *See, e.g.*, Chime, <https://www.chime.com/online-banking/> (last accessed December 26, 2024) (Chime discloses at the very bottom of the page in fine print that it “is a financial technology company, not an FDIC-insured bank. Banking services provided by The Bankcorp Bank, N.A. or Stride Bank, N.A., Members FDIC. Deposit insurance covers the failure of an insured bank. Certain conditions must be satisfied for pass-through deposit insurance coverage to apply.”).

¹⁴ *See, e.g.*, mobile finance apps, Porte, <https://www.joinporte.com/> (last accessed March 21, 2023) (“Banking built for you. Porte believes your banking experience is about more than money. With account alerts, charitable giving, and mobile capture, we’ve built a mobile banking experience around you. Download the app today to open an account.”); Cash App, <https://cash.app/bank> (last accessed December 26, 2024) (“BANK ON YOURSELF”).