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The FDIC's Proposed "Synapse" Rule Affects Deposit Accounts Opened by Fintech Custodians

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By Mercedes Kelley Tunstall
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On September 17th, the Federal Deposit Insurance Corporation ("FDIC") issued a **proposed rule entitled "Recordkeeping for Custodial Accounts"** with comments due sixty days from the date of publication in the Federal Register (it has not yet been published). The rule impacts a variety of custodial accounts and has the potential to significantly impact prepaid cards, payment apps and fintech-related deposit offerings because the banks holding the funds in custody will now need to impose additional requirements and policies on these kinds of accounts. As it is, fintechs can find it challenging and expensive to find a bank willing to maintain these kinds of accounts for them. This rule could make that particular pain point much worse.

We have described the proposed rule below, but first, the rule has already acquired two nicknames. The first is the "FBO Rule" referring to the titling often used for custodial deposit accounts where the funds are being held in custody "for the benefit of" the depositor, or "FBO accounts". The second nickname is the "Synapse Rule", referencing the collapse of Synapse Financial earlier this year. Synapse, **as the FDIC has explained**, "was a deposit broker that facilitated customer deposits for various fintech companies looking for banking services." When Synapse filed for bankruptcy some of Synapse's fintech clients were unable to access the deposits on behalf of their customers timely. The demise of Synapse has really shaken the bank regulators, with no less than four significant announcements since then referencing Synapse, including this proposed rule, but also the FDIC's proposed **"Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions"** rule, the joint statement with the Federal Reserve and the Office of the Comptroller of the Currency ("OCC") regarding **Bank-Fintech arrangements**, and the joint **Request for Information on Bank-Fintech relationships**. The regulators' concern is for good reason, as this proposed rule explains, "Since May 2024, the FDIC National Center for Consumer and Depositor Assistance has received more than a thousand inquiries, complaints, and concerns from consumers regarding the Synapse bankruptcy. Published reports further suggest that some of those consumers affected by the Synapse bankruptcy had placed the funds in accounts through a fintech that they used for day-today living expenses thereby intensifying the effect of their loss of access."

The proposed rule affects a subset of FBO accounts, specifically only "custodial deposit accounts with transactional features", which is defined to mean a deposit account that meets these three requirements – (1) the account is established for the benefit of beneficial owners; (2) the account holds commingled deposits of multiple beneficial owners; and (3) a beneficial may authorize or direct a transfer through the account holder from the account to a party other than the account holder or beneficial owner." (Beneficial owner in this context is not intended to incorporate the meaning of "beneficial owner" for anti-money laundering and know your customer ("KYC") purposes.) "[T]he the FDIC intends to apply the proposed recordkeeping requirements only to custodial deposit accounts that are established and used in a manner that allows beneficial owners to direct a transfer of funds from the account to another party – for example, to make purchases or pay bills."

Practically speaking, this means that FBO accounts in which prepaid card funds are kept, as well as those FBO accounts that are held by payment apps and other fintech solutions, would be covered by the proposed rule. There are some exemptions from the definition – all of the following would be exempted – FBO accounts that only hold trust deposits, FBO accounts established by governmental depositors, FBO accounts established by investment advisors and broker/dealers, attorney IOLTA accounts, FBO accounts maintained in connection with employee benefit plans and retirement plans, and accounts held by mortgage servicers, HOAs and real estate agents, among others.

The obligations that arise when there is a "custodial deposit account with transactional features" fall upon the insured depository institution ("IDI") and mainly relate to requiring the IDI to maintain its own records regarding the beneficial owners of the funds in the FBO accounts. Specifically, IDIs will need to maintain their own ledgers of beneficial owner names, the balance attributable to each beneficial owner and the ownership category applicable to the deposited funds (e.g., joint deposit, etc.). In terms of maintaining these accounts, the IDIs would need to conduct reconciliations of the account "no less frequently than at the close of business daily". Many accounts covered by this rule presently reconcile far less frequently than daily. IDIs also must create appropriate compliance policies and procedures and annually obtain a certification from the CEO/COO of the IDI stating that the recordkeeping requirements were properly implemented and tested, and that everything is in compliance with the policies and procedures.

The proposed rule does allow IDIs to utilize third parties to maintain the required records, which could mean that the IDIs would be able to rely upon the prepaid card companies or fintechs to manage the ledgers as they presently do. However, the IDI “would be required to have direct, continuous, and unrestricted access” to the records, which would be achieved by establishing secure real-time data exchanges between the IDI and the third party. Further, the IDI that utilizes a third party to maintain the records would need to develop a “contingency plan” tailored to each third party. Also, the proposed rule prescribes a set of contractual requirements that would govern the relationship between the IDI and the third party recordkeeper, and, of course, the “IDI would not be permitted, through any contract or agreement, to shift its responsibility for ensuring that the requirements of the proposed rule are satisfied. The proposed rule also would not limit, in any way, an IDI’s ability to include further risk mitigation measures in contracts with third parties, and IDIs would be encouraged to include additional measures as they deem appropriate.”

The UK’s PRA Publishes Near-Final Basel 3.1 Rules

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By Alix Prentice
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On 12 September 2024, the UK’s banking regulator, the Prudential Regulation Authority ("PRA") published its second policy statement on implementation of the Basel 3.1 standards in the form of near-final rules (**PS9/24**). This note considers some of the key ‘concessions’ PS9/24 gives, as well as where the PRA has got to on its considerations of the future prudential treatment of securitisations.

1. Implementation date: Having already extended it by six months, the PRA has elected to move the implementation date for Basel 3.1 standards for another six months to 1 January 2026. The overall transitional period remains the same, so that full implementation remains due by 1 January 2030.
2. Changes to the treatment of SME lending: The PRA’s original proposal to remove the SME support factor under Pillar 1 has been adjusted. The PRA has listened to concerns about the effect of access to capital for SMEs and has now included Pillar 2A adjustments to ensure that there should be no increase in overall capital requirements for SME exposures.
3. A more risk-sensitive approach to valuing residential real estate: In order to simplify and render more risk-sensitive, the near-final rules now include a requirement for firms to obtain a new valuation once every five years in order to make sure that products that do not involve ‘natural’ revaluation events are not disadvantaged. In addition, the requirement for firms to adjust valuations to reflect the value of the property sustainable over the lifetime of the loan has been removed.
4. The ‘output floor’: The PRA has considered responses and has introduced an adjustment in its near-final rules to reflect total expected loss amounts ("EL") and accounting provisions, which should lead to a more accurate capital ration when compared to that which would have applied if all exposures had been assessed on the standardised basis.

Securitisations

In its first Basel 3.1 implementation proposal, the PRA discussed the application of the output floor to securitisation exposures and proposed that it would apply the output floor to firms using internal models in the same way as those using standard approaches. The PRA received a number of consultation responses concerned about the effect of this strategy on the economic competitiveness of UK securitisations, and in In DP 3/23 (for our note on this, please see **here**), proposed a number of alternative options. These remain the subject of industry feedback and will be the subject of a future consultation.

Next steps

The PRA does not anticipate any further changes to the rules as set out in PS9/24 and notes that they are said to be ‘near-final’ as their implementation depends on the Government first revoking existing legislation, to be replaced with PRA firm-facing rules.

Sharing the Real World—Article 12 Can Unlock DePINs for TCF Banks

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When a Trade & Commodity Finance bank makes a secured loan to a commodities trader, the ultimate origin of the collateral is physical commodities. Even if the collateral transforms into intangibles like receivables, forward book or contract rights—it all started out with physical stuff.

I have recently been thinking about how the Uniform Commercial Code's ("UCC") new Article 12 might interface with one of the current preoccupations in the digital asset space: *decentralized physical infrastructure networks*, or DePINs. It occurred to me that DePINs might catch the eye of commodity banks and their customers. After all, the word "physical" is right in the name.

But what are DePINs?

You can think of DePINs as being akin to crowdsourcing. They are a way to incentivize a blockchain community to share existing physical assets, or contribute to development of new ones. DePINs have been used to share resources like surplus server space, computing power on GPUs, decentralized wireless networks, and decentralized energy grids for renewable energy producers. DePINs come in two types. They might be *physical* resource networks, dealing with real world assets ("RWAs") that are tangible—like raw materials, equipment or transportation. Or, they might be *digital* resource networks, which deal with intangible resources—things like data, information and software. Adding AI to a DePIN can make each even more powerful and useful. Observers anticipate that the practical applications of DePINs will continue to expand.

Use cases for DePINs to date lean toward ideals of democratization of capital markets—letting small players come together to break down centralized ownership of critical infrastructure. So the role of a bank—by definition a centralized capital source—might seem anomalous if you picture DePINs solely as networks of passionate amateurs.

But there might be more to it than that. One problem with scaling DePINs is that widely decentralized individuals might not have access to the capital needed to acquire expensive physical infrastructure. Is the guy next door going to build a power plant in his garage? Possible, but unlikely. And, like the Lyft driver who starts out by sharing her personal car but later wants to add a whole fleet of cars, the trick is getting the money to do it.

Banks, of course, are in the business of bridging just that kind of capital need. (That's what things like midstream financing are all about.) With some careful structure and attention to compliance, one could envision a DePIN structure as a viable takeout for a bank loan that provides capital so the DePIN can scale to a critical mass.

But hold up, you say—isn't the goal of DePINs to *get rid of* centralized infrastructure, including financial infrastructure like banks?

To be fair, that is the tenor of much conversation of DePIN proponents. The stubborn thing about "real world assets," though, is that you still have to deal with the real world. And in the real world, banks aren't going away any time soon. Banks' traditional customers are probably not disappearing. But DePINs could theoretically *expand* the market for bank capital.

A better way to think about an innovation like DePINs is not as a revolution to overthrow traditional finance, but as a way to help TradFi and DeFi grow into each other.

One thing that all DePINs rely on, though, is *tokenization*—the technological and legal process of representing RWAs as digital tokens on a distributed ledger network. Indeed, representing RWAs as tokens is the *only* way a DePIN can make sense. The underlying resource, whether it is itself physical or digital, must in all cases be represented digitally. The contributors to DePINs are compensated in network tokens, which participants might use to pay for use of the resource.

And it is exactly here where it is critical for TCF banks to think about new Article 12 of the UCC.

For example, let's say a clever commodity trader participates in a DePIN organized by an oil pipeline and its users, to digitize and trade capacity. That trader might convert its traditional paper transportation contracts into digital tokens,

contributing the capacity it holds to the network. The DePIN—knowing its users—might even engineer its smart contracts to facilitate tokenized forward contracts or other derivatives for the pipeline capacity. Presto—the valuable asset of pipeline capacity could achieve a new liquidity.

However, when that commodity trader comes to a TCF bank looking to borrow against those DePIN tokens, the bank would need to analyze the viability of those tokenized assets as collateral. In the U.S., that's where Article 12 enters the chat. Article 12 is a new amendment to the UCC that provides a legal framework for electronic assets. The intent behind Article 12 is to create more certainty for electronic assets like DePIN digital tokens, and thus to enhance their financeability.

And, while Article 12 has not yet been enacted in all U.S. states, it is already the law in many critical states (such as Delaware and D.C.). TCF banks urgently need to understand Article 12 *today*.

After all, those DePIN digital tokens might pop up in your collateral pool tomorrow!

If you would like to discuss further how Article 12 and the related changes to the UCC might impact tokenized RWAs and other digital asset finance, please get in touch with me or any of Cadwalader's experienced team of blockchain finance lawyers. **https://www.cadwalader.com/practice/blockchain-cryptocurrency-and-digital-assets**