

June 9, 2020

Via Electronic Mail – comments@fdic.gov

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20529
Attention: Robert E. Feldman, Executive Secretary

Re: Brokered Deposits (RIN 3064-AE94)

Ladies and Gentlemen:

Bankruptcy Management Solutions, Inc., doing business as Stretto (“**Stretto**”), is pleased to comment on the Federal Deposit Insurance Corporation’s (“**FDIC**”) notice of proposed rulemaking (“**NPR**”)¹ regarding revisions to the FDIC’s brokered deposit regulations.² Stretto is a broad-based bankruptcy services company that, among other things, provides Chapter 7 bankruptcy case management software (“**Chapter 7 Software**”) to Chapter 7 trustees.³ In connection with this particular business line, Stretto coordinates placement of deposits on behalf of Chapter 7 trustees at various bank partners who have painstakingly integrated with Stretto’s software platform. In turn, the Chapter 7 trustees use these deposit accounts to facilitate distributions and payments from debtors’ assets to creditors, professionals, and other parties in interest.

Subject to certain clarifications requested below, Stretto agrees with the FDIC that the “primary purpose” exception to the definition of “deposit broker” should apply to any

¹ 85 Fed. Reg. 7453 (Feb. 10, 2020). The initial deadline to comment on the NPR was April 10, 2020. On April 2, 2020, the FDIC extended the public comment period for the NPR through June 9, 2020, in light of the challenges associated with COVID-19.

² On February 6, 2019, the FDIC published for comment an advance notice of proposed rulemaking regarding the FDIC’s comprehensive review of brokered deposits (the “**ANPR**”). On May 7, 2019, Stretto submitted a comment letter to the FDIC in response to the ANPR (the “**ANPR Comment Letter**”, attached hereto as Exhibit 1) arguing that, among other things, the primary purpose exception should apply to deposits placed at banks in connection with the provision of bankruptcy management software services to Chapter 7 trustees.

³ Stretto’s software is also used occasionally by clients to coordinate deposits at partner banks in connection with receiverships, assignments for the benefit of creditors, and some chapter 11 cases. All arguments set forth herein in favor of the “primary purpose exception” apply equally to such deposits.

agent or nominee who, like Stretto, places customers' funds into transactional accounts for the purpose of enabling payments.⁴ More specifically, because any deposits generated in connection with Chapter 7 Software are used exclusively to pay the claims against, and costs of, a debtor's estate and are merely incidental to Stretto's primary intent in providing bankruptcy management services, Stretto (and similar Chapter 7 bankruptcy software providers) should not be deemed a deposit broker, regardless of whether the trustee-depositors are paid interest. In order to provide greater legal clarity, the placement of deposits for Chapter 7 trustees at bank partners in connection with the provision of Chapter 7 Software should automatically qualify for the primary purpose exception, absent extraneous circumstances. Nonetheless, the placement of such deposits is commonly known within the consumer bankruptcy industry and is sufficiently simple and straightforward that any application submitted by a Chapter 7 bankruptcy software provider, like Stretto, to avail itself of the primary purpose exception should receive expedited processing and approval by the FDIC.

Below, Stretto also answers certain questions posed in the NPR that apply to Chapter 7 bankruptcy software providers.

I. The primary purpose of Chapter 7 bankruptcy software providers is not the placement of deposits.

Under Chapter 7 of the United States Bankruptcy Code, a debtor may enter into liquidation proceedings through which the debtor's assets are collected, liquidated, and distributed to creditors.⁵ At the outset of a Chapter 7 bankruptcy proceeding, the United States Trustee ("UST")⁶ for the applicable region appoints a private bankruptcy trustee (a "Chapter 7 trustee") to the case from a panel of trustees using a blind rotation system.⁷

⁴ 85 Fed. Reg. 7459, 7462.

⁵ Certain assets are exempt from creditors and remain in the debtor's possession rather than being turned over to the Chapter 7 trustee as part of the bankruptcy estate.

⁶ USTs are appointed by the United States Attorney General under the United States Trustee Program, which was established by the Bankruptcy Reform Act of 1978 and is the arm of the Department of Justice that is tasked with monitoring and protecting the integrity of various aspects of the United States bankruptcy system. The Executive Office for United States Trustees ("EOUST") provides general policy and legal guidance and oversees the United States Trustee Program's substantive operations.

⁷ The blind rotation system is intended to result in a fair and equitable distribution of cases among all trustees on the panel. The order of the rotation is not available to the public. U.S. Department of Justice, EOUST, *Handbook for Chapter 7 Trustees* at 2-4; *see also* 11 U.S.C. § 701(a). The trustee is initially appointed on an interim basis and, in some Chapter 7 cases, certain creditors may choose to nominate and elect a non-panel trustee under 11 U.S.C. § 702. If no such trustee is elected, the interim panel trustee serves throughout the life of the case. All references to bankruptcy trustees in this letter refer to these Chapter 7 panel trustees.

The private trustee administers the debtor's estate, and distributes net proceeds of the liquidation of the estate to creditors after payment of administrative costs.

Chapter 7 trustees receive a small, \$60 administrative fee for each Chapter 7 case they administer,⁸ but are primarily compensated in the form of a commission that is based on the amount of assets disbursed or turned over to creditors and other interested parties.⁹ If there are no assets in the debtor's estate, the trustee receives no compensation other than the \$60 administrative fee. In approximately ninety-five percent (95%) of all Chapter 7 cases, there are no assets in the bankruptcy estate eligible for distribution to creditors.¹⁰ The trustee, however, must still fulfill several fiduciary obligations, including (1) reviewing the debtor's bankruptcy filing; (2) verifying the debtor's supporting documents; (3) determining whether the debtor has any non-exempt assets; and (4) filing interim and final reports required by the UST and EOUST. Chapter 7 Software automates many of these processes and helps to assure that the trustee complies with applicable monitoring and reporting requirements. Because of the scope of the trustee's responsibilities and the small percentage of cases in which the trustee will receive a commission on the estate's assets, Chapter 7 Software is a vital component of the trustee's business, as Chapter 7 trustees do not have the resources to manually perform required tasks for essentially no compensation in the vast majority of cases to which they are assigned.¹¹ Indeed, as USTs have made clear, Chapter 7 Software is fundamental to the United States bankruptcy system and the effective administration of Chapter 7 cases.¹²

Estates that generate funds for distribution to creditors need a bank account to hold such funds pending distribution, as required by the UST's rules. Stretto and other bankruptcy software providers partner with banks approved by the applicable UST to provide these deposit accounts, which requires the bank's systems to be integrated with Stretto's software – a process that generally takes more than a year to fully implement. Nearly all deposits generated in connection with Stretto's Chapter 7 Software are placed

⁸ 11 U.S.C. § 330(b).

⁹ 11 U.S.C. § 326.

¹⁰ See, e.g., United States Trustee Program, "Preliminary Report on Chapter 7 Asset Cases: 1994 to 2000" at 7 (June 2001), *available at*: <https://www.justice.gov/sites/default/files/ust/legacy/2011/07/13/Publicat.pdf> ("Historically, the vast majority (about 95-97 percent) of chapter 7 cases yield no assets.").

¹¹ To provide an idea of the scope of the trustee's responsibilities, approximately 470,000 Chapter 7 bankruptcies were filed in each of the last two years. Assuming an even distribution of cases among panel trustees in all districts, each trustee would be responsible for administering over 500 bankruptcies per year, of which approximately 25 on average would result in compensation for the trustee other than the \$60 administrative fee.

¹² See, e.g., UST's Statement in Support of Chapter 7 Trustee's Application to Incur Administrative Expense Claims, *In re Midwest Hyperbaric Institute, P.C.*, No. 11-19836 at ¶ 25 (Bankr. N.D. Ill.) ("Integrated case management software and banking services are necessary for the efficient and effective administration of cases by chapter 7 trustees. They are an actual, necessary expense that benefits the bankruptcy estate.").

into non-interest bearing deposit accounts¹³ that the trustees open with the bank through Chapter 7 Software,¹⁴ and the bank pays Stretto a monthly referral fee calculated by reference to the deposit balance. These referral fees are based on market rates of interest for similar deposit accounts. Stretto refers each trustee client to one of Stretto's bank partners after a consultation with the trustee to evaluate the trustee's particular needs. The selection of the bank partner is based on a number of factors related to the trustee's case management needs, such as branch proximity and business hours, and the selection of a particular bank does not affect the trustee's access to Stretto's case administration support.

In summary, Chapter 7 bankruptcy software providers are engaged in the business of providing a comprehensive, integrated software solution for Chapter 7 trustees to manage Chapter 7 cases, only approximately 5% of which require the opening of a deposit account (for Chapter 7 estates with liquidated assets). The placement of deposit accounts is merely incidental to the Chapter 7 business line and the trustee's administration of the debtor's estate, and certainly does not constitute such businesses' primary purpose.

II. The ANPR incorrectly analyzed the primary purpose exception with respect to Chapter 7 bankruptcy software providers.

Without citing any prior FDIC publications or opinions,¹⁵ the ANPR stated that the FDIC has viewed the primary purpose exception as being unavailable to accounting or similar software (*e.g.*, bankruptcy management) providers it has considered.¹⁶ The ANPR added that the FDIC historically has not recognized a difference between providing integrated accounting software and providing access to certain deposit accounts.¹⁷ However, as described in Stretto's ANPR Comment Letter, the ANPR's analysis did not reflect the unique characteristics of Chapter 7 cases, nor would classifying deposits generated in connection with Chapter 7 Software as "brokered deposits" advance the

¹³ Only approximately 0.1% percent of deposit accounts opened by Chapter 7 trustees with Stretto's Chapter 7 Software bear interest and such accounts only provide nominal actual interest payments.

¹⁴ When establishing a new trustee as a client, Stretto's personnel assist the trustee in establishing the relationship between the selected bank and the trustee, and in opening the initial deposit accounts at the partner bank. Once this initial relationship is established, the trustee, through Chapter 7 Software, opens additional accounts for new Chapter 7 cases as needed, and the Chapter 7 Software automates most of the account opening process.

¹⁵ 84 Fed. Reg. at 2373. The treatment of accounting or similar software providers is not addressed in the FDIC's "Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits", FIL-42-2016, Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits (June 30, 2016, revised July 14, 2016), and, to Stretto's knowledge, has not been addressed in a publicly available Advisory Opinion.

¹⁶ 84 Fed. Reg. at 2373.

¹⁷ *Id.* and accompanying text.

purposes of Section 29 of the Federal Deposit Insurance Act (the “**FDI Act**”) – namely, combating the abuse of “hot money” deposits by troubled institutions.¹⁸

However, in the subsequent NPR, the FDIC acknowledges that:

[T]he definition of ‘deposit broker,’ and its corresponding staff interpretations, may not be as relevant compared to the deposit placement arrangements that exist in the market today. Notably, in recent times, banks collaborate with third parties, including financial technology companies, for a variety of business purposes including access to deposits. Moreover, banks are increasingly relying on new technologies to engage and interact with their customers, and it appears that this trend will continue given rapid technological evolution.¹⁹

Accordingly, through the revisions proposed in the NPR, “the FDIC intends to modernize its brokered deposit regulations to reflect recent technological changes and innovations that have occurred” since the regulations were first adopted.²⁰ As discussed below, the NPR corrects the errors made in the ANPR’s analysis.

III. The NPR properly excludes Chapter 7 bankruptcy software providers from the definition of “deposit broker” pursuant to the primary purpose exception.

Under the new framework of the NPR, Chapter 7 bankruptcy software providers, like Stretto, would be properly excluded from the definition of “deposit broker” under the

¹⁸ See, e.g., Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (April 19, 1989) (remarks of Sen. Murkowski) (noting that the primary concerns Congress had with respect to brokered deposits were the acceptance by troubled banks of high-interest rate CDs purchased from a broker to fund rapid growth of high-risk assets and to offset runoff in core deposits). The FDIC has identified three principal issues with respect to brokered deposits, which reflect similar concerns: rapid growth, volatility, and franchise value. 84 Fed. Reg. at 2369. As elaborated in Stretto’s ANPR Comment Letter, deposits generated in connection with Chapter 7 Software cannot be used to fund rapid growth and are stable. Stretto is not aware of any analysis by its banking partners or the FDIC with respect to the franchise value of such deposits. However, because such deposits cannot be used to fund rapid growth and are not volatile, the treatment of deposits generated in connection with Chapter 7 Software as brokered does not further any public policy goal. It may, in fact, harm the public interest because of Chapter 7 Software’s critical role in the United States bankruptcy system.

¹⁹ 85 Fed. Reg. 7453.

²⁰ *Id.*

primary purpose exception with respect to deposits generated in connection with Chapter 7 Software.²¹

As you know, Section 29 of the FDI Act and the FDIC's regulations include an exception to the definition of "deposit broker" for "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."²² The NPR expands this exception for deposit placements that enable transactions or payments, subject to an application process. Specifically, the NPR states that:

[T]he primary purpose of an agent's or nominee's business relationship with its customers will not be considered to be the placement of funds if the agent or nominee places depositors' funds into transactional accounts for the purpose of enabling payments.²³

Additionally, under the NPR:

[I]f an agent or nominee places 100 percent of its customer funds into transaction accounts at depository institutions and no fees, interest, or other remuneration is provided to the depositor, then it would meet the primary purpose exception of enabling payments, subject to providing information as part of an application process. In such a case, the FDIC would conclude that the primary purpose of the agent's or nominee's business is to enable payments.²⁴

Even if the software provider or bank "pays any sort of interest, fee, or provides any remuneration, (e.g., nominal interest paid to the deposit account)" to the depositor, then the primary purpose exception would still apply provided that the primary purpose is "truly to enable payments."²⁵ Under such circumstances, the FDIC would consider a number of factors, including the volume of transactions in customer accounts, the interest, fees, or other remuneration provided, and "an explanation of how its customers utilize its services *for the purpose* of making payments and not for the receipt of a deposit placement

²¹ For the reasons set forth in Stretto's ANPR Comment Letter, Stretto still maintains that Stretto is not engaged in the business of either (1) placing or (2) facilitating the placement of deposits with respect to estate funds in Chapter 7 bankruptcy cases for purposes of the definition of "deposit broker", and thus application of the primary purpose exception should be unnecessary. See Exhibit 1.

²² 12 U.S.C. § 1831f(g)(2)(I); 12 C.F.R. § 337.6(a)(5)(ii)(I).

²³ 85 Fed. Reg. 7459.

²⁴ *Id.*

²⁵ *Id.* at 7459-60.

service or deposit insurance.”²⁶ Stretto’s Chapter 7 business line satisfies the NPR’s expanded primary purpose exception in several ways.

First, as noted above, nearly all of the deposit accounts coordinated by Stretto for Chapter 7 trustees do not bear any interest or fees, and with respect to the 0.1% of deposit accounts that do, interest payments are nominal. In any event, the interest rate paid to Chapter 7 trustees should be irrelevant when determining whether deposit accounts opened by such trustees in connection with Chapter 7 Software are brokered deposits. The primary purpose of Stretto’s Chapter 7 software business line is the same regardless of how much the trustee-depositors get paid: providing a comprehensive, integrated software solution for Chapter 7 trustees to manage Chapter 7 cases. Accordingly, Stretto recommends that, in the context of such deposit accounts, the FDIC should not consider the amount of interest or other remuneration paid to trustee-depositors when determining whether the primary purpose exception applies. To the extent the FDIC believes that such remuneration materially impacts purpose, Stretto recommends that the FDIC establish a measure of materiality (*e.g.*, either a set measurement of 0.50% or a measurement fluctuating with the Federal Reserve target range equal to one-quarter of the top of such target range) under which remuneration should be deemed *de minimis* and therefore irrelevant to the primary purpose consideration.

Second, Stretto’s primary purpose is not to provide a deposit placement service. Stretto’s Chapter 7 Software provides a range of critical services to Chapter 7 bankruptcy trustees. Indeed, without the automation and efficiencies of Chapter 7 Software, bankruptcy trustees would not be able to perform their functions. Because of the scope of the trustee’s responsibilities and the small percentage of cases in which the trustee will receive a commission, a Chapter 7 trustee could not operate a viable business without Chapter 7 Software that automates reporting and tracking of cases, preparation of reports, and other key elements of the trustee’s functions. Chapter 7 Software provides a full case management solution to Chapter 7 trustees, only one aspect of which is to assist in the placement of funds from the 5% of Chapter 7 estates that actually have funds to distribute.

Third, Stretto’s primary purpose is not to provide deposit insurance. As discussed above and in the ANPR Comment Letter, connecting Chapter 7 trustees to deposit accounts is a minor part of the overall services Stretto provides to Chapter 7 trustees. Furthermore, the EOUST generally expects Chapter 7 trustees to use a single bank for each estate, which prevents the Chapter 7 trustee from dividing an estate’s deposits among multiple banks to maximize the amount of available deposit insurance. Moreover, each bank that opens accounts for Chapter 7 trustees must enter a Uniform Depository Agreement (“**UDA**”) with the UST for the applicable region. The UDA requires funds deposited in these accounts to be fully insured, and, if the aggregate amount on deposit for an estate in a single bank exceeds the deposit insurance limits, that the bank collateralize the excess funds with

²⁶ *Id.* at 7462, 7466 (emphasis in original).

securities deposited with the appropriate Federal Reserve Bank.²⁷ Therefore, if a bankruptcy estate's assets exceed \$250,000, the excess funds are collateralized and not directed to another bank.²⁸ As a result, unlike, for example, brokered CDs that divide large sums among multiple banks (and that are marketed as providing an investor with deposit insurance in excess of the deposit insurance maximum), the primary purpose of Chapter 7 Software is not to provide deposit insurance, but to provide a Chapter 7 case management solution that complies with applicable bankruptcy law and regulation with respect to maintenance of estate funds pending distribution to creditors.²⁹

Additionally, as the FDIC expressly noted in the NPR, Stretto's bank partners could greatly benefit from the NPR's proposed revisions to brokered deposit regulations. The proposed rule would provide greater legal clarity regarding the treatment of brokered deposits and remove the stigma associated with accepting such deposits, thereby incentivizing more institutions to accept these deposits.³⁰ FDIC insurance assessments for accepting institutions likely would decrease.³¹ And perhaps most importantly for the Chapter 7 industry:

The proposed rule could incentivize the development of banking relationships between small, FDIC-insured institutions and other firms. The new opportunities could spur growth in the third party deposit placement industry, potentially resulting in greater access to, or use of, bank deposits by a greater variety of customers.³²

IV. Stretto's responses to certain questions posed in the NPR.

- **Question 10:** Is it appropriate to make available the primary purpose exception to third parties whose business purpose is to place funds in transactional accounts to enable transactions or make payments?
 - Answer: Yes. This standard considers clear and objective evidence that such third parties' primary purpose is not the placement of deposits.

²⁷ See, e.g., U.S. Department of Justice, EOUST, *Handbook for Chapter 7 Trustees* at 5-9 (Oct. 1, 2012). As discussed above, very few Chapter 7 estates would include sufficient assets to result in deposits in excess of deposit insurance limits. See *supra* note 9 **Error! Bookmark not defined.**

²⁸ See *id.*

²⁹ The FDIC previously has determined that the primary purpose exception applies if a regulation requires a third party to deposit the funds of another party with a bank, which is the case with Chapter 7 trustees. See FDIC Advisory Opinion 94-39 (Aug. 17, 1994) ("[The] 'primary purpose' when depositing the funds is to satisfy the mandate of [SEC rules], not to provide a deposit-placing service").

³⁰ 85 Fed. Reg. 7464, 7468-69.

³¹ *Id.* at 7464, 7469.

³² *Id.* at 7469; see also *id.* at 7464.

- **Question 11:** Are there particular FDIC staff opinions of general applicability that should or should not be codified as part of the final rule? If so, which ones, and why?
 - Answer: Stretto is unaware of any staff opinions applicable to Chapter 7 bankruptcy software providers, but to the extent any exist, such opinions – as well as all language in the ANPR suggesting that Chapter 7 bankruptcy software providers could not qualify for the primary purpose exception – should be stricken from the record or otherwise expressly superseded by the NPR’s revised regulations for all the reasons set forth herein.
- **Question 18:** Are there commonly known deposit placement arrangements not mentioned [in the NPR] that are sufficiently simple and straightforward that applications for such arrangements should receive expedited application processing, as described above?
 - Answer: Yes. The placement of deposits for Chapter 7 trustees at bank partners in connection with the provision of Chapter 7 Software is commonly known within the consumer bankruptcy industry and is sufficiently simple and straightforward that any applications submitted by Chapter 7 bankruptcy software providers should be expeditiously processed and readily approved by the FDIC.
- **Question 19:** Are there other deposit placement arrangements with respect to which the FDIC should provide additional clarity as part of this rulemaking?
 - Answer: Yes. Per the above, and in the interest of providing greater legal clarity, the placement of deposits for Chapter 7 trustees at bank partners in connection with the provision of Chapter 7 Software should automatically qualify for the primary purpose exception, absent extraneous circumstances.
- **Question 21:** Are the criteria for considering and approving primary purpose applications based on enabling transactions appropriate?
 - Answer: Generally, yes. However, as explained above, the amount of interest or other remuneration paid to Chapter 7 trustees on account of deposit accounts opened in connection with Chapter 7 Software should be irrelevant when determining whether such deposits are brokered deposits. Indeed, the primary purpose of Stretto’s Chapter 7 software business line is the same regardless of how much the trustee-depositors get paid: providing a comprehensive, integrated software solution for Chapter 7 trustees to manage Chapter 7 cases. To the extent the FDIC feels that material interest or remuneration creates an issue with respect to the primary purpose, the FDIC should establish a materiality test establishing a *de minimis* floor beneath which such interest or remuneration should be deemed irrelevant.

- **Questions 23 & 25:** Is it appropriate to require reporting from nonbank entities that have received approval for a primary purpose exception? Should the FDIC require IDIs to report on behalf of such nonbank entities instead? Are there other ways the FDIC should consider to ensure that applicants that receive the primary purpose exception remain within the relevant standards? Is it appropriate for the FDIC to require IDIs to monitor third parties for eligibility for the primary purpose exception? Are there additional or better ways to ensure that third parties continue to remain eligible for the exception?
 - Answer: Stretto agrees that an agent or nominee who places, or facilitates the placement of, deposits at multiple insured depository institutions (“IDIs”) and seeks a primary purpose exception should initially apply on its own behalf, given that the information required to complete an application will be in possession of such agent or nominee.³³ However, if, as the NPR provides, “IDIs would be responsible for monitoring a nonbank third parties’ eligibility for the primary purpose exception,”³⁴ Stretto disagrees that it would be “more efficient for the nonbank third party to report directly to the FDIC”³⁵ Instead, the nonbank third parties should provide the requisite information to IDIs, and such IDIs – as entities directly regulated by the FDIC – should be responsible for preparing and submitting ongoing reporting.

V. Conclusion.

For the reasons discussed herein, Stretto agrees that the primary purpose exception should apply to Chapter 7 bankruptcy software providers, like Stretto, that coordinate placement of funds in transactional accounts at bank partners on behalf of Chapter 7 trustees for the purpose of enabling distributions and payments from a debtor’s estate. The FDIC should recognize this deposit placement arrangement as qualifying per se for the primary purpose exception and, if required, any application submitted by a Chapter 7 bankruptcy software provider should be expeditiously processed and readily approved by the FDIC.

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³³ *Id.* at 7461.

³⁴ *Id.* at 7463.

³⁵ *Id.* at 7462.

Stretto appreciates the opportunity to comment on the NPR, and would welcome the opportunity to discuss it further with the FDIC staff. Should you have any questions, please contact Stretto's General Counsel, Chris Updike, by phone at (714) 716-1903 or by email at chris.updike@stretto.com.

Sincerely,



Eric Kurtzman
Chief Executive Officer

cc: Chris Updike

Exhibit 1

ANPR Comment Letter

May 7, 2019

Via Electronic Mail – comments@fdic.gov

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20529
Attention: Robert E. Feldman, Executive Secretary

Re: Brokered Deposits (RIN 3064-AE94)

Ladies and Gentlemen:

Bankruptcy Management Solutions, Inc., doing business as Stretto (“Stretto”), is pleased to comment on the Federal Deposit Insurance Corporation’s (“FDIC”) advance notice of proposed rulemaking (“ANPR”)¹ regarding the FDIC’s comprehensive review of brokered deposits. Stretto is a broad-based bankruptcy management software company that supports a wide range of bankruptcy cases and insolvency proceedings, including consumer bankruptcies, corporate restructurings and receiverships. An important aspect of Stretto’s business is the provision of Chapter 7 bankruptcy case management software (“Chapter 7 Software”) to bankruptcy trustees.

For the reasons discussed in this letter, Stretto believes that the deposits associated with its Chapter 7 Software should not be treated as brokered deposits both as a matter of policy and application of the statute. Use of Chapter 7 Software by a bankruptcy trustee does not raise the issues that the FDIC historically has cited as its primary concerns with brokered deposits. Stretto is not engaged in the business of either (1) placing or (2) facilitating the placement of deposits generated in connection with Chapter 7 bankruptcy cases, and, therefore is not a deposit broker with respect to such deposits. Even if the FDIC were to view Stretto as a deposit broker with respect to these deposits, the primary purpose exception should be available.

¹ 84 Fed. Reg. 2,366 (Feb. 6, 2019).

I. Background of Chapter 7 bankruptcy liquidation proceedings and Chapter 7 Software.

Under Chapter 7 of the United States Bankruptcy Code, a debtor may enter into liquidation proceedings through which the debtor's assets that are not exempt from creditors are collected, liquidated and distributed to creditors.² At the outset of a bankruptcy proceeding under Chapter 7, the United States Trustee ("UST")³ for the applicable region appoints a private bankruptcy trustee to the case from a panel of private trustees using a blind rotation system.⁴ The private trustee administers the debtor's estate, and distributes net proceeds of the liquidation of the estate to creditors.

Bankruptcy trustees receive a small, \$60 administrative fee for each Chapter 7 case they administer,⁵ but are primarily compensated in the form of a commission that is based on the amount of assets disbursed or turned over to creditors and other interested parties.⁶ If there are no assets in the Chapter 7 estate, the trustee receives no compensation other than the \$60 administrative fee. In approximately 95 percent of all Chapter 7 cases, there are no assets in the bankruptcy estate eligible for distribution to creditors.⁷ The trustee, however, must still fulfill several obligations, including (1) reviewing the debtor's bankruptcy filing; (2) verifying the debtor's supporting documents; (3) determining whether the debtor has any non-exempt assets; and (4) filing interim and final reports required by the UST and EOUST. Chapter 7 Software automates many of these processes, and helps to assure that the trustee complies with

² Assets that are exempt from creditors remain in the debtor's possession and are not turned over to the Chapter 7 trustee as part of the bankruptcy estate.

³ USTs are appointed by the United States Attorney General under the United States Trustee Program, which was established by the Bankruptcy Reform Act of 1978 and is the arm of the Department of Justice that is tasked with monitoring and protecting the integrity of various aspects of the United States bankruptcy system. The Executive Office for United States Trustees ("EOUST") provides general policy and legal guidance and oversees the United States Trustee Program's substantive operations.

⁴ The blind rotation system is intended to result in a fair and equitable distribution of cases among all trustees on the panel. The order of the rotation is not available to the public. U.S. Department of Justice, EOUST, *Handbook for Chapter 7 Trustees* at 2-4; *see also* 11 U.S.C. § 701(a). This trustee is appointed on an interim basis and, in some Chapter 7 cases, certain creditors may choose to nominate and elect a non-panel trustee under 11 U.S.C. § 702. If no such trustee is elected, the interim panel trustee serves throughout the life of the claim. All references to bankruptcy trustees in this letter refer to these Chapter 7 panel trustees.

⁵ 11 U.S.C. § 330(b).

⁶ 11 U.S.C. § 326.

⁷ *See, e.g.*, United States Trustee Program, "Preliminary Report on Chapter 7 Asset Cases: 1994 to 2000" at 7 (June 2001) (hereinafter referred to as the "2000 UST Study"), *available at* <https://www.justice.gov/sites/default/files/ust/legacy/2011/07/13/Publicat.pdf> ("Historically, the vast majority (about 95-97 percent) of chapter 7 cases yield no assets.").

applicable monitoring and reporting requirements. Because of the scope of the trustee's responsibilities and the small percentage of cases in which the trustee will receive a commission on the estate's assets, Chapter 7 Software is a vital component of the trustee's business, as bankruptcy trustees do not have the resources to manually perform required tasks for essentially no compensation in the vast majority of cases to which they are assigned.⁸ Indeed, as USTs have made clear, Chapter 7 Software is fundamental to the United States bankruptcy system and the effective administration of Chapter 7 cases.⁹

Estates that generate cash for distribution to creditors need a bank account to hold cash pending distribution, as required by the UST's rules. Stretto and other software providers partner with banks approved by the applicable UST to provide these deposit accounts, which requires the bank's systems to be integrated with Stretto's software. Stretto and other Chapter 7 Software companies generally provide Chapter 7 Software to bankruptcy trustees free of charge. Deposits generated in connection with Stretto's Chapter 7 Software typically are placed into non-interest bearing deposit accounts that the trustees open¹⁰ with the bank through the Chapter 7 Software, and the bank pays Stretto a monthly referral fee calculated by reference to the deposit balance. These referral fees are based on market rates of interest for similar deposit accounts. Stretto refers each trustee client to one of Stretto's bank partners after a consultation with the trustee to evaluate the trustee's particular needs. The selection of the bank partner is based on a number of factors related to the trustee's case management needs, such as branch proximity and business hours, and the selection of a particular bank does not affect the trustee's access to Stretto's case administration support.

⁸ To provide an idea of the scope of the trustee's responsibilities, approximately 470,000 Chapter 7 bankruptcies were filed in each of the last two years. Assuming an even distribution of cases among panel trustees in all districts, each trustee would be responsible for administering over 500 bankruptcies per year, of which approximately 25 on average would result in compensation for the trustee other than the \$60 administrative fee.

⁹ See, e.g., UST's Statement in Support of Chapter 7 Trustee's Application to Incur Administrative Expense Claims, *In re Midwest Hyperbaric Institute, P.C.*, No. 11-19836 at ¶ 25 (Bankr. N.D. Ill.) ("Integrated case management software and banking services *are necessary* for the efficient and effective administration of cases by chapter 7 trustees. They are an actual, necessary expense that benefits the bankruptcy estate.") (emphasis added).

¹⁰ When establishing a new trustee as a client, Stretto's personnel assist the trustee in establishing the relationship between the selected bank and the trustee, and in opening the initial deposit accounts at the partner bank. Once this initial relationship is established, the trustee, through the Chapter 7 Software, opens additional accounts for new Chapter 7 cases as needed, and the Chapter 7 Software automates most of the account opening process.

II. The FDIC should not treat providers of Chapter 7 Software as deposit brokers with respect to deposits generated in connection with Chapter 7 bankruptcy cases.

A. Discussion of accounting or related software providers in the ANPR.

In the ANPR, the FDIC discusses providers of accounting or related software products that contemplate the bank using the same software as the providers' clients and notes that the FDIC views these providers as deposit brokers (unless they meet one of the exceptions to the definition of deposit broker, such as the primary purpose exception) because they place deposits, on behalf of their clients, at one or a group of preferred banks.¹¹ The ANPR specifically identifies bankruptcy management as an example of the type of accounting service such software companies provide.¹²

The ANPR also discusses the primary purpose exception's application to providers of accounting or related software products. The ANPR notes that in analyzing the argument that the primary purpose of the software company is to provide accounting services and that the placement of deposits is incidental to that purpose, FDIC "staff has not distinguished between providing integrated accounting software and providing access to a deposit account that offers core banking functions (such as daily cash management)" in previous cases staff has reviewed.¹³ The ANPR also notes that volume-based fees paid by the bank to the software provider result in staff having viewed "software companies [as] incentivized to place funds of prospective depositors at preferred banks because of the fees that the placement generates."¹⁴ This analysis does not reflect the unique characteristics of Chapter 7 cases, as described in more detail below.

B. Classifying deposits generated in connection with Chapter 7 Software as brokered does not further the purposes of Section 29 of the Federal Deposit Insurance Act ("Section 29").

As the legislative history makes clear, Congress enacted Section 29 to combat the abuse of "hot money" deposits by troubled institutions.¹⁵ The FDIC has identified three

¹¹ 84 Fed. Reg. at 2,373.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ See, e.g., Senate Congressional Record, Proceedings and Debates of the 101st Congress, First Session, 135 Cong. Rec. S4238-01, 1989 WL 191889 (April 19, 1989) (remarks of Sen. Murkowski) (noting that the primary concerns Congress had with respect to brokered deposits were the acceptance by troubled banks of high-interest rate CDs purchased from a broker to fund rapid growth of high-risk assets and to offset runoff in core deposits).

principal issues with respect to brokered deposits, which reflect similar concerns: rapid growth, volatility and franchise value.¹⁶

Deposits generated in connection with Chapter 7 Software cannot be used to fund rapid growth and are stable. Stretto is not aware of any analysis by its banking partners or the FDIC with respect to the franchise value of such deposits. However, because such deposits cannot be used to fund rapid growth and are not volatile, the treatment of deposits generated in connection with Chapter 7 Software as brokered does not further any public policy goal. It may, in fact, harm the public interest because of Chapter 7 Software's critical role in the United States bankruptcy system.

1. Rapid Growth

Chapter 7 Software cannot be used to seek deposits quickly to fund rapid growth. The only source of these deposits is funds that result from the liquidation of assets in a Chapter 7 bankruptcy, which are limited by the amount of assets in estates being liquidated. As a result, partner banks have no ability to rapidly generate deposits through Stretto. The universe of possible depositors is extremely limited, as there are fewer than 900 Chapter 7 panel trustees in the United States, and Stretto believes that the majority of Chapter 7 estates have a balance of less than \$5,000.¹⁷ Moreover, Stretto's product is a full-service bankruptcy case management solution (regardless of the number of cases to which a trustee is assigned that will have assets available for distribution) and Stretto does not solicit deposits from Chapter 7 trustees on a stand-alone basis,¹⁸ nor do Chapter 7 trustees use the software primarily as a deposit-placement tool.¹⁹ Finally, as discussed

¹⁶ 84 Fed. Reg. at 2,369.

¹⁷ See 2000 UST Study at 12 ("The majority of [Chapter 7] asset cases have receipts of less than \$5,000."). Between 1994 and 2000, nearly 54.6 percent of all Chapter 7 asset cases (or 110,000 cases) generated cash from liquidated assets of less than \$5,000. Only 1.6 percent of all Chapter 7 asset cases (or 3,179 cases) over the same period generated cash from liquidated assets of more than \$500,000. See 2000 UST Study at 12. In Stretto's experience, these findings have not changed significantly. Approximately 94 percent of Chapter 7 cases managed through Stretto's Chapter 7 Software are non-asset cases. Of those cases that generate assets for distribution to creditors, the average account balance is approximately \$40,000. However, the median account balance (which adjusts for the outliers represented by the limited number of cases that generate more significant assets) is only approximately \$4,000.

¹⁸ Stretto markets its Chapter 7 Software as a full-service case management solution; any reference to deposit accounts is due to the necessity of the accounts as part of the overall case management solution and is merely ancillary to Stretto's overall product offering.

¹⁹ As noted, approximately 95 percent of all Chapter 7 cases do not result in *any* deposits. Chapter 7 trustees use Chapter 7 Software because it provides an end-to-end solution for many of the duties and responsibilities that the trustee must carry out and which are largely unrelated to the deposit of funds generated through liquidation of the bankruptcy estate.

below, Chapter 7 trustees are subject to a number of constraints that inhibit their ability to move funds into or out of a bank quickly.

2. Volatility

Deposits generated in connection with Chapter 7 Software are not volatile and are not likely to “flee” for higher rates or if the bank becomes troubled. Deposits generated in connection with Chapter 7 Software are historically stable. The average duration of a Chapter 7 case is 1.3 years, and the deposit account is maintained for so long as the case is pending. Although there may be interim distributions from a Chapter 7 account during the pendency of the bankruptcy proceeding, the final distribution from the account occurs at case conclusion. Moreover, Stretto believes that the majority of Chapter 7 accounts hold less than \$5,000.²⁰ As a result, the conclusion of a case (or even several cases in succession) is not likely to result in a departure of significant funds relative to all accounts maintained by the trustee.

Chapter 7 trustees are also subject to a number of constraining expectations and requirements imposed by the EOUST in connection with deposit accounts that cause the relationships to be “sticky.” These include a general expectation that the trustee will deposit each estate’s funds at a single banking institution,²¹ and requirements that (1) estate funds must be placed with a bank that has entered into a Uniform Authorized Depository Agreement (a “UADA”) with the UST²²; (2) the trustee must maintain a separate account for each estate; and (3) the trustee must notify the UST of any intent to transfer estate accounts to another bank.²³ Because of these restrictions, moving deposits to another bank would involve migrating numerous accounts, and would result in significant inconvenience and costs for the Chapter 7 trustee. As a result, a trustee is very unlikely to suddenly move deposits. Furthermore, a bankruptcy trustee develops significant relationships and familiarity with its bank and Stretto over time, which further reduces the probability that the trustee will “flee” for another institution.

Moreover, Stretto’s software necessarily requires integration with a bank’s systems, for example, to provide the trustee with account monitoring capabilities. This integration process is complex and there is a several-months period (between 9 and 15 months in Stretto’s experience) of technology and operations integration that must occur before Chapter 7 trustees have the ability to deposit funds at the bank. As a result, Stretto

²⁰ See *supra* note 17.

²¹ See U.S. Department of Justice, EOUST, *Handbook for Chapter 7 Trustees* at 5-7.

²² If a bank wishes to accept deposits made in connection with a Chapter 7 case on a national basis, it generally must execute a UADA with the UST in each of 21 regions and a similar agreement with the applicable administrators in each of Alabama and North Carolina, which are bankruptcy administration states that do not operate within the jurisdiction of the EOUST.

²³ U.S. Department of Justice, EOUST, *Handbook for Chapter 7 Trustees* at 5-7 – 5-10 (Oct. 1, 2012).

is only able to partner with a new bank after significant time and expense, which in turn results in long-lasting relationships between Stretto's trustee clients and its partner banks. The bank transition process is also laborious and time-intensive for a trustee that desires to move deposits to another bank, and requires multiple, coordinated steps. The transition process also results in some amount of "down time" (in some cases, as long as three weeks or more) for the trustee during which time he or she does not have access to banking services for existing accounts, such as the ability to make payments to the estate's creditors.

3. Franchise Value

Stretto is not aware of any evidence that deposits generated in connection with Chapter 7 Software are less attractive to purchasers of failed banks. Even if deposits generated in connection with Chapter 7 Software do not have franchise value, this should not be determinative of whether such deposits should be treated as brokered. Because deposits generated in connection with Chapter 7 Software cannot be used to fund rapid growth and are not volatile, the public policy underlying Section 29 would not be served by classifying such deposits as brokered. In fact, because of the importance of Chapter 7 Software to the United States bankruptcy system, treatment of these deposits as brokered may harm the public interest if it were to reduce the ability of Stretto and others to find banks willing to accept these critical deposits.

C. Stretto should not be treated as a "deposit broker" as defined in Section 29 and in the FDIC's regulations with respect to deposits generated in connection with Chapter 7 Software.

The FDIC states in the ANPR that a deposit broker is a third party who "is in the business of either (1) placing funds, or (2) facilitating the placement of funds . . . of another third party (such as its customers)."²⁴ This is consistent with Section 29 and the FDIC's regulations, which both define a "deposit broker" as "any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties."²⁵ However, FDIC staff historically seemingly has not placed significance on the words "in the business of" in its interpretations, and has construed the term "facilitating" so expansively that any deposit to which a third party has any connection is potentially deemed to be brokered.²⁶

²⁴ 84 Fed. Reg. at 2,371.

²⁵ 12 U.S.C. § 1831f(g)(1); 12 C.F.R. § 337.6(a)(5).

²⁶ See, e.g., FDIC, Advisory Opinion No. 17-02 (June 19, 2017) ("[T]he companies you describe appear to be placing or facilitating the placement of deposits at the Bank and would therefore meet the definition of deposit broker unless covered by one of the statutory or regulatory exceptions."); FDIC, Advisory Opinion No. 16-01 (May 19, 2016) ("[T]he term 'facilitating the placement of deposits' is interpreted broadly to include actions taken by third parties to connect insured

Stretto does not view itself as being engaged in the business of either (1) placing or (2) facilitating the placement of deposits with respect to deposits generated in connection with Chapter 7 Software. Stretto is instead engaged in the business of providing a service to assist in managing every aspect of the Chapter 7 cases administered by Stretto's customers, only approximately 5 percent of which require the opening of a deposit account for Chapter 7 estates with liquidated assets. Stretto believes that this demonstrates that the opening of deposit accounts is merely incidental to Stretto's business and the trustee's administration of the debtor's estate. Because Stretto is not engaged in the business of either (1) placing or (2) facilitating the placement of deposits with respect to funds in Chapter 7 bankruptcy estates, the FDIC should not treat it as a "deposit broker," and deposits generated in connection with Stretto's Chapter 7 Software should not be classified as brokered.

D. Even if Stretto were a deposit broker, the "primary purpose" exception should apply.

If the FDIC were to view Stretto as a deposit broker, Stretto should be excluded under the primary purpose exception with respect to deposits generated in connection with Chapter 7 Software. Section 29 and the FDIC's regulations include an exception to the definition of "deposit broker" for "an agent or nominee whose primary purpose is not the placement of funds with depository institutions."²⁷ Although the treatment of accounting or similar software providers is not addressed in the FDIC's "Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits"²⁸ and, to Stretto's knowledge, has not been addressed in a publicly available Advisory Opinion, the ANPR states that the FDIC has viewed the primary purpose exception as being unavailable to those software providers it has considered.²⁹

As described above, the ANPR notes that the FDIC historically has not recognized a difference between providing integrated accounting software and providing access to certain deposit accounts.³⁰ Stretto believes the FDIC should reconsider the ANPR's analysis, and where, as here, the overwhelming majority of services provided are not banking services and the deposit account is clearly incidental to the overall

depository institutions with potential depositors."); FDIC, Advisory Opinion No. 92-79 (Nov. 10, 1992) ("In common usage, the term 'facilitate' means 'to free from difficulty or impediment; to make easy or less difficult.' The activities of the associations clearly make it easier for the investor to place its deposits with the bank . . . [and, therefore,] the associations . . . are 'deposit brokers' as that term is defined in [Section 29].").

²⁷ 12 U.S.C. § 1831f(g)(2)(I); 12 C.F.R. § 337.6(a)(5)(ii)(I).

²⁸ FIL-42-2016, Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits (June 30, 2016, revised July 14, 2016) (referred to herein as the "FAQs").

²⁹ 84 Fed. Reg. at 2,373.

³⁰ See *supra* note 13 and accompanying text.

provision of bankruptcy management services, the primary purpose exception should be available. Application of the FDIC's analysis would lead to a particularly perverse result where, as in Stretto's case, the principal purpose of the deposit account is not to provide core banking functions such as daily cash management but instead to provide a secure vehicle to maintain the bankruptcy estate's monetized assets pending distribution to creditors. Indeed, there is an entire regulatory scheme governing these deposit accounts, as discussed above.

The FDIC has applied the primary purpose exception in contexts where it is clear that the purpose of the deposit account is not to provide the customer with core banking functions. For example, subject to certain criteria, broker-dealers that sweep funds from client brokerage accounts to deposit accounts are not deposit brokers because the primary purpose of the broker-dealer "is to facilitate the customers' purchase and sale of securities."³¹ Similarly, a bank that placed customer deposits securing credit card loans at another bank was not a deposit broker because its primary purpose was "to obtain a perfected security interest in collateral, not to provide a deposit-placing service to its customers."³² In addition, the FDIC has determined that the primary purpose exception applies if a regulation requires a third party to deposit the funds of another party with a bank, which is the case with deposits placed on behalf of Chapter 7 trustees.³³ For the reasons discussed in this letter, a similar analysis should be applied to deposits generated in connection with Chapter 7 Software, *i.e.*, that the primary purpose of depositing funds through the Chapter 7 Software is to comply with applicable statutory and regulatory requirements to hold funds pending disbursement to creditors.

With respect to the "agent or nominee" element of the exception, Stretto should be viewed as acting as the bankruptcy trustee's agent or nominee in placing the deposits with banks. Because Stretto provides, through its Chapter 7 Software, the functionality for a trustee to open deposit accounts at the trustee's instruction, Stretto should be treated as acting on behalf of the trustee for purposes of the primary purpose exception.

With respect to the "purpose" element of the exception, in determining whether the primary purpose exception is applicable, the FDIC has not considered objective standards such as the agent's overall business purpose, but has instead reviewed the "primary intent" of the agent or nominee in placing the deposit.³⁴ Even under this narrow

³¹ FDIC Advisory Opinion 05-02 (Feb. 3, 2005).

³² FDIC Advisory Opinion 94-13 (March 11, 1994).

³³ See FDIC Advisory Opinion 94-39 (Aug. 17, 1994) ("[The] 'primary purpose' when depositing the funds is to satisfy the mandate of [SEC rules], not to provide a deposit-placing service . . .").

³⁴ See, *e.g.*, 84 Fed. Reg. at 2,372 ("In determining whether a deposit-placement activity is incidental to some other purpose [and is not the primary purpose], staff reviews the reason or intent of the third party when acting as agent or nominee in placing the deposits . . ."); FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005) ("[T]he FDIC has taken the position that 'primary purpose' means 'primary intent.'").

reading of the exception, Stretto's primary purpose is not to place or facilitate the placement of deposits.³⁵ Stretto's primary intent in providing the Chapter 7 Software is to aid in the administration of the bankruptcy estate. In its discussion of accounting and related software providers, the ANPR states that in analyzing particular arrangements FDIC staff currently reviews whether the placement of third-party funds is for a substantial purpose other than to provide (1) deposit insurance or (2) a deposit-placement service.

Stretto's primary purpose is not to provide deposit insurance (indeed, this is not even a "substantial purpose" of Stretto's business). Connecting trustees to deposit accounts is a minor part of the overall services Stretto provides to Chapter 7 trustees. Furthermore, the EOUST generally expects Chapter 7 trustees to use a single bank for each estate, which prevents the Chapter 7 trustee from dividing an estate's deposits among multiple banks to maximize the amount of available deposit insurance.

Moreover, each bank that opens accounts for Chapter 7 trustees must enter a UADA with the UST for the applicable region. The UADA requires funds deposited in these accounts to be fully insured, or, if the aggregate amount on deposit for an estate in a single bank exceeds the deposit insurance limits, that the bank collateralize the excess funds with securities deposited with the appropriate Federal Reserve Bank.³⁶ Therefore, if a bankruptcy estate's assets exceed \$250,000, the excess funds are collateralized and not directed to another bank.³⁷ As a result, unlike, for example, brokered CDs that divide large sums among multiple banks (and that are marketed as providing an investor with deposit insurance in excess of the deposit insurance maximum), the primary purpose of Chapter 7 Software is not to provide deposit insurance, particularly by maximizing the insurance available to clients, but to provide a Chapter 7 case management solution that complies with applicable bankruptcy law and regulation.

With respect to the second factor the FDIC identified, Stretto's primary purpose is not to provide a deposit-placement service. Stretto's Chapter 7 Software provides a range of critical services to Chapter 7 bankruptcy trustees. Indeed, without the automation and

³⁵ Although the FDIC has not historically examined the overall business of the third party in determining the agent's primary purpose, Stretto notes that it is engaged in a number of businesses that are entirely unrelated to the placement of deposits. For example, Stretto provides software and data solutions to attorneys and other legal professionals to assist with bankruptcy case management and due diligence, further demonstrating that the primary purpose of Stretto's overall business is not to place or facilitate the placement of deposits, but to provide an end-to-end bankruptcy technology platform to the various parties involved in the administration of a bankruptcy case. Moreover, less than 7 percent of Stretto's personnel and business costs are related to the aspects of Stretto's business that are connected to banking services.

³⁶ See, e.g., U.S. Department of Justice, EOUST, *Handbook for Chapter 7 Trustees* at 5-9 (Oct. 1, 2012). As discussed above, very few Chapter 7 estates would include sufficient assets to result in deposits in excess of deposit insurance limits. See *supra* note 17.

³⁷ See *id.*

efficiencies of Chapter 7 Software, bankruptcy trustees would not be able to perform their functions. Because of the scope of the trustee's responsibilities and the small percentage of cases in which the trustee will receive a commission, a Chapter 7 trustee could not operate a viable business without Chapter 7 Software that automates reporting and tracking of cases, preparation of reports and other key elements of the trustee's functions. Chapter 7 Software provides a full case management solution to Chapter 7 trustees, only one aspect of which is to assist in the placement of funds from the bankruptcy estate. To reiterate, approximately 95 percent of Chapter 7 cases managed through Stretto's software result in *no* cash for deposit.

In applying the primary purpose exception, FDIC staff reviews factors that "might indicate whether the third-party agent is incentivized to place deposits" at the bank to determine if the "primary intent" of the third-party agent is the placement of deposits.³⁸ In the context of accounting and other software, the FDIC notes in the ANPR that in previous arrangements the FDIC has reviewed, "there is typically a contractual volume based fee being paid by the bank to the software company," and, "[a]s a result, staff has viewed that the software companies are incentivized to place funds of prospective depositors at preferred banks because of the fees that the placement generates."³⁹

In the instances where the FDIC staff has issued public guidance on the issue of fees in connection with the primary purpose exception, it has considered whether a bank pays a volume-based fee for deposits without conducting a further analysis to determine if the primary purpose of the third-party agent is, in fact, to place or facilitate the placement of deposits.⁴⁰ That is, FDIC guidance suggests that if a third party receives a volume-based fee from the bank, then that is the end of the analysis, and the primary purpose exception is not available. The plain language of Section 29 and the FDIC's regulations apply the primary purpose exception to any third-party agent whose primary purpose is not the placement of deposits without identifying criteria or limitations. As a result, the existence of volume-based fees alone should not result in a determination that the third-party agent is a deposit broker where neither Section 29 nor the FDIC's regulations compel that conclusion.

³⁸ See 84 Fed. Reg. at 2,372.

³⁹ *Id.* at 2,373.

⁴⁰ See, e.g., FAQs question E9 ("The primary purpose exception is *not* applicable when the intent of the third party is to earn fees through the placement of the deposits.") (emphasis in original); FAQs question E12 ("Other factors . . . might indicate that the primary purpose of the card is to provide access to the account at the insured depository institution. This conclusion *would be confirmed by the payment of fees or commissions* . . . by the insured depository institution as compensation for distributing or marketing the cards.") (emphasis added); FDIC Advisory Opinion 92-51 (Aug. 3, 1992) (applying the "primary purpose" test to determine that, "[i]f the depository institution receives a fee for its account from the depository institution with which it places the funds of the trust, the trust department is a deposit broker as to that trust").

Even if the FDIC continues to view volume-based fees as “indicative” of brokered deposits in some instances, that is clearly not the case with respect to deposits generated in connection with Chapter 7 Software because Stretto does not have the ability to effectively steer deposits to its partner banks. Although Stretto determines the partner bank to which a trustee is assigned, Stretto, and even its trustee clients, cannot, for the reasons discussed above, know in advance whether a Chapter 7 estate that is being managed through the software will be in possession of non-exempt assets and, therefore, have any funds to deposit, or what the amount of the deposits may be.⁴¹ Moreover, because of the difficulty in transitioning a trustee to a new bank, Stretto is disincentivized from steering trustees to an institution to seek higher rates. Not only would steering a trustee to a new bank result in business disruption for the trustee, but it may result in loss of business for Stretto since transitioning to a new bank also provides the trustee the opportunity to reevaluate its Chapter 7 Software provider.

In addition, treating deposits that are related to the Chapter 7 Software as brokered deposits misunderstands the fundamental purpose of the partnerships between Stretto and its partner banks. An important function of the Chapter 7 Software is to fulfill the trustees’ responsibility to manage and oversee all estate accounts, which would not be feasible for the trustees to perform manually due to the volume of cases they are assigned. This necessarily requires integration of the Chapter 7 Software with the partner banks’ systems, which generally takes more than a year to fully implement. As a result, Stretto does not partner with banks based on the amount of the referral fee the bank offers, but rather based on the ability of the bank to integrate the Chapter 7 Software into its systems and whether the bank meets EOUST guidelines. In other words, Stretto is not incentivized to steer deposits to partner banks in exchange for higher referral fees, but must necessarily partner with banks to be able to offer a complete case management solution, which is vital to bankruptcy trustees and to the U.S. bankruptcy system more generally.

For the foregoing reasons, Stretto’s primary purpose is not the placement of deposits, notwithstanding that banks may pay a “volume-based” referral fee. Stretto’s primary purpose is to provide a comprehensive solution for Chapter 7 trustees to manage Chapter 7 cases in an efficient manner that complies with applicable UST and other requirements imposed on the trustees. Stretto also reiterates that Chapter 7 Software is necessary for the effective administration of Chapter 7 cases. The treatment of deposits generated in connection with Chapter 7 Software as brokered could have severe consequences to the United States bankruptcy system. Because of the costs to banks of accepting brokered deposits, a bank may choose not to partner with Stretto or other Chapter 7 Software providers, which reduces the ability of Chapter 7 trustees to effectively administer their assigned estates and impedes the efficient administration of

⁴¹ As discussed above, Chapter 7 trustees are assigned to cases on a random basis, and are responsible for determining if the estate holds non-exempt assets to be liquidated after the case is assigned. The Chapter 7 trustee establishes a relationship with Stretto and the bank before this determination is made.

Chapter 7 liquidations, thereby harming both debtors and creditors. Stretto urges the FDIC to consider these potential harms in view of the arguments presented above and not treat deposits generated in connection with Chapter 7 Software as brokered.

III. Conclusion.

For the reasons discussed in this letter, the FDIC should give effect to Section 29's purpose as described in this letter and should exclude Chapter 7 Software providers as described in this letter from the definition of "deposit broker" with respect to deposits generated in connection with Chapter 7 Software, either by recognizing that such providers (1) are not engaged in the business of either (x) placing or (y) facilitating the placement of deposits, or (2) qualify for the primary purpose exception.

* * *

Stretto appreciates the opportunity to comment on the ANPR, and would welcome the opportunity to discuss it further with the FDIC staff. Should you have any questions, please contact Chris Updike by phone at (714) 716-1903 or by email at chris.updike@stretto.com.

Sincerely,



Eric Kurtzman
Chief Executive Officer
Bankruptcy Management
Solutions, Inc.,
doing business as Stretto

cc: Chris Updike
(Bankruptcy Management Solutions, Inc. d/b/a Stretto)