October 30, 2024

Chief Counsel's Office
Attention: Comment Processing
Docket ID OCC-2024-0014
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219

Federal Reserve Board of Governors
Attn: Ann E. Misback, Secretary of the Board
Comments, Docket No. OP-1836
Mailstop M-4775
2001 C Street NW
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James P. Sheesley
Assistant Executive Secretary
Attention: Comments, RIN 3064–ZA43
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses; OCC Docket ID OCC-2024-0014; FDIC RIN 3064-ZA43; Federal Reserve Docket No. OP-1836 (July 31, 2024)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the above-captioned request for information ("RFI"),[2] published jointly by the Federal Reserve Board of Governors, the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, "the Agencies"). The RFI seeks comment on the nature of bank-fintech arrangements, their implications, the risk management of these arrangements, and whether enhancements to supervisory guidance may be helpful in addressing the associated risks.

When conducted responsibly, bank use of third-party services can benefit the public by reducing the cost of banking products. Bank-fintech arrangements also hold the potential to improve the convenience and availability of banking services, and in particular can benefit community banks by enabling them to provide services that otherwise would be infeasible for them

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses; OCC Docket ID OCC-2024-0014; FDIC RIN 3064-ZA43; Federal Reserve Docket No. OP-1836 (July 31, 2024); https://www.govinfo.gov/content/pkg/FR-2024-07-31/pdf/2024-16838.pdf.

to provide in-house. However, even when conducted responsibly, the proliferation of these partnerships poses very serious challenges to regulators as more core banking functions are sourced outside the regulatory perimeter. Moreover, the potential for systemic risk increases if problems emerge at a very large fintech or one that serves many banks or any number of large banks, which is inevitable as fintechs continue to grow. At their worst, bank-fintech partnerships can amount to little more than renting out the bank charter to generate revenue from unscrupulous, unregulated actors who have a casual attitude toward compliance with banking laws and regulations, and whose business models appear to be built on deceiving customers. The Agencies can and must do more to address the risks posed by these partnerships, so that banks can benefit from these arrangements without endangering themselves, the public, or financial stability.

As discussed in more detail below, Better Markets recommends that the Agencies:

1. codify elements of existing third-party risk guidance in their enforceable safety and soundness standards implementing section 39 of the Federal Deposit Insurance Act ("Safety and Soundness Standards");[3]
2. make greater use of their examination and enforcement authority over banks' Institution Affiliated Parties ("IAPs"); and
3. amend the Call Reports to include a schedule to identify third parties that provide material customer-facing deposit-taking, lending, or payment services for (or in partnership with) the reporting bank.

In addition, the FDIC has an obligation to do more to address the proliferation of flagrantly misleading representations by fintechs about deposit insurance. The FDIC must use its formal enforcement authority to punish and thereby deter this highly consequential lawbreaking. It should:

1. hold both the fintech and the partner bank formally and publicly accountable for the misleading statements;
2. amend parts 328.102 and 328.106 of its regulations to remove what amounts to an implicit free pass for first offenders;
3. amend its regulations to require banks to collect and maintain adequate information about the individual depositors in custody accounts;
4. publish a detailed informational resource for the public, explaining the legal status of customer funds in a fintech bankruptcy, and describing in plain English why and how customers can lose money in these bankruptcies and steps they can take to protect themselves; and
5. amend part 328.102 of its regulations to identify as misleading any third-party's advertisement regarding arrangements with FDIC-insured partner banks that do not clearly

[3] *See Interagency Guidelines Establishing Standards for Safety and Soundness* 12 C.F.R. part 30, Appendix A (OCC); 12 C.F.R. part 208, Appendix D-1 (Board); and 12 C.F.R. part 364, Appendix A (FDIC) (issued pursuant to section 39 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831p1).

and accurately disclose the treatment of customer accounts in bankruptcy if the third-party fails.

BACKGROUND

Like most other companies, banks employ services provided by a variety of outside professionals and businesses, and they have done so for many years. Responsible use by banks of outside services can benefit the public by reducing the costs of banking services and by providing small banks with a way to offer products that they might not otherwise be able to offer. As described by the Agencies and other observers of the banking industry, however, a growing number of banks are essentially delegating important parts of their lending, deposits, or payments activities to third-party fintech firms.

Increasing reliance by banks on fintechs to provide banking services is a serious matter of concern for a number of reasons. Broadly speaking, and most fundamentally, the U.S. framework of banking laws and regulations is predicated on the societal importance of a safe-and-sound banking system that supports economic growth, complies with consumer protection laws, and safeguards the financial system from being used for illicit purposes. Fintech partners of banks are outside the perimeter of day-to-day bank regulation and may treat their legal obligations less seriously, undermining bank regulation and compromising its effectiveness in achieving these societal goals. They are also typically less stable financially than banks, and the bankruptcy of a fintech can adversely affect partner banks as well as a host of retail customers who may have been deceived into believing their funds were as safe as they would be in a bank.

Fintechs perform a wide array of services for banks, from back-office functions to interacting directly with customers to provide core banking products such as deposits, payments and, loans. Arrangements in which a fintech provides customer-facing services on behalf of a bank are sometimes referred to as Banking as a Service, or BaaS. A recent estimate stated that fewer than 100 U.S. community banks have arrangements with fintechs to provide BaaS.[4] Looking more broadly at all types of arrangements with fintechs, a recent study by the U.S. Treasury Department cited estimates that two-thirds of all banks and credit unions entered into fintech partnerships between 2018 and 2021.[5]

Powerful economic incentives can be expected to drive continued bank-fintech partnerships in the future. As McKinsey and Company wrote in 2021:

> The many fintechs established every year need banking partners to provide access to bank accounts, payments, and lending. Big technology companies and other

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[4] S&P Global, *Small Group Of Banking-as-a-Service Banks Logs Big Number of Enforcement Actions* (Jan. 23, 2024), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/small-group-of-banking-as-a-service-banks-logs-big-number-of-enforcement-actions-80067110 (accessed Aug. 27, 2024).

[5] U.S. Department of the Treasury, *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets, Report to the White House Competition Council* 28 (Nov. 2022), https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf.

> nonbanking players can build and offer financial services but are unable to "become" banks themselves in the United States and many other markets where the regulatory bar for doing so is high. That leaves banking as a service as the only means for fintechs to offer customers embedded finance.[6]

Given the financial incentives for fintechs to offer banking services to the public without being regulated in the normal course of business as a bank, and banks' access to insured deposits and the payments system, it is not surprising that bank-fintech partnerships are becoming increasingly prevalent.[7]

In response to the increase in bank-fintech partnerships, and observed instances of unsafe and unsound third-party risk management practices and violations of laws and regulations associated with these arrangements, financial regulators have issued a number of significant reports and guidance documents related to third-party risk in recent years. These include the 2022 Treasury study noted above; the Agencies' *Interagency Guidance on Third-Party Relationships: Risk Management*, published in June 2023;[8] the Financial Stability Board's 2023 report on enhancing third-party risk management and oversight, published in December 2023;[9] the Basel Committee's *Principles for the sound management of third-party risk*, published for comment in July 2024; and the Agencies' *Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services,* also published in July 2024.[10]

In broad terms, bank-fintech partnerships can cause three types of harm:

1. excessive reliance on deposits or loans sourced from third parties, or failures of third-party platforms, could compromise the safety and soundness of individual banks;

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6 McKinsey & Company, *What the embedded-finance and banking-as-a-service trends mean for financial services* (Mar. 1, 2021), https://www.mckinsey.com/industries/financial-services/our-insights/banking-matters/what-the-embedded-finance-and-banking-as-a-service-trends-mean-for-financial-services.

7 *See, e.g.*, Federal Reserve Board of Governors, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, *Interagency Guidance on Third-Party Relationships: Risk Management*, 88 Fed. Reg. at 37921 (June 9, 2023), https://www.govinfo.gov/content/pkg/FR-2023-06-09/pdf/2023-12340.pdf; Department of the Treasury, *supra* note 5 at 28; Basel Committee on Banking Supervision, *Principles for the sound management of third-party risk*, Consultative Document at 1 (July 2024), https://www.bis.org/bcbs/publ/d577.pdf.

8 *Id*.

9 Financial Stability Board, *Final Report on Enhancing Third-Party Risk Management and Oversight–A Toolkit For Financial Institutions And Financial Authorities* (Dec. 2023), www.fsb.org/wp-content/uploads/P041223-1.pdf.

10 Federal Reserve Board of Governors, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, *Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Service* (July 25, 2024), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20240725c1.pdf.

2. the fintech partner could conduct its activities in ways that violate laws designed to protect consumers and prevent the use of the financial system for illicit purposes; and
3. third-party risks manifesting at a sufficiently large fintech, or at a sufficiently large group of banks, could cause widespread deposit withdrawals and systemic risk.

As discussed below, the first two types of harm already are occurring, while the possibility of widespread systemic problems arising from bank-fintech partnerships has not yet happened in the U.S., but it could well happen in the future.

The Agencies' recent enforcement actions related to third-party risk, the FDIC's series of advisory letters to nonbank entities regarding misleading deposit insurance representations, and the April 22, 2024, bankruptcy of Synapse Financial Technologies, Inc. and subsequent events,[11] all demonstrate that safety-and-soundness concerns, and violations of law and customer harm associated with these arrangements, are real and in some cases severe. The enforcement actions, the advisory letters, and the Synapse bankruptcy are discussed in turn below.

Formal enforcement actions. Better Markets conducted a best-efforts review of formal agency enforcement actions that were issued between January 1, 2023, and August 31, 2024, and identified 29 actions that included language directing the recipient to take some action related to third-party risk (Table 1). The extent and nature of third-party risk issues identified by these formal actions varied considerably by bank, and no conclusions should be drawn about the financial condition of individual banks in Table 1.

Most of the actions listed in Table 1 cited the bank for unsafe and unsound practices; two actions specifically cited credit risks or credit concentrations arising from loans sourced from third parties. Remediation steps ordered by the Agencies and agreed on by the banks sometimes were as simple as commitments to ensure third party arrangements do not result in violations of law, or that the bank's board would regularly review the bank's use of third parties. In a number of actions, banks were ordered to develop risk management programs for third-party risk incorporating a number of specific elements. Sometimes, remediation steps were much more extensive and included timelines for required policies, lookback studies to identify any suspicious electronic payment activity by fintech partners, permission or nonobjection from the agency before the bank enters into any new fintech partnership, and a variety of other provisions.

The large majority of the actions in Table 1 cited violations of law. More than half of the actions cited violations of the Bank Secrecy Act ("BSA") including in a few cases regulations of the Office of Foreign Asset Control ("OFAC"). The BSA and associated regulations are intended to prevent the use of the financial system for illegal purposes, and it is particularly relevant when fintech partners are engaged in payments activities or sourcing deposits on behalf of the bank. A

[11] For the Synapse bankruptcy, *see* Jelena McWilliams, *In re Synapse Financial Technologies, Inc*., Chapter 11 Trustee's Third Status Report (June 21, 2024), https://www.cravath.com/a/web/TuPGwDdX7zyWeATdGJCkc/9cXbw9/9890-287-06_20_2024-pacer287-main-document-012731-00001-central-district-of-california.pdf.

fair reading of the orders is that the fintech partners were not taking—nor had their partner banks been demanding that they take—adequate steps to comply with this important law.

Table 1. Selected banking agency formal actions related to third-party risk January 1, 2023 - August 31, 2024

Entity name	Date	Type	Agency
Customers Bank	5-Aug-24	Agreement	FRB
Green Dot Bank	19-Jul-24	C&D, CMP	FRB
The State Exchange Bank	8-Jul-24	Consent	FDIC
Evolve Bank & Trust	11-Jun-24	C&D	FRB
Thread Bank	21-May-24	Consent	FDIC
Comerica Bank & Trust, N.A.	4-Apr-24	Agreement	OCC
First Fed Bank	26-Mar-24	CMP	FDIC
Piermont Bank	27-Feb-24	Consent	FDIC
Sutton Bank	1-Feb-24	Consent	FDIC
Lineage Bank	30-Jan-24	Consent	FDIC
Blue Ridge Bank, N.A.	24-Jan-24	Consent	OCC
First & Peoples Bank And Trust Company	28-Dec-23	Consent	FDIC
Choice Financial Group	18-Dec-23	Consent	FDIC
First Fed Bank	21-Nov-23	Consent	FDIC
Comenity Servicing, LLC	20-Nov-23	Consent	FDIC
North Side Federal Savings and Loan Association of Chicago	16-Nov-23	Agreement	OCC
The Upstate National Bank	16-Nov-23	Consent	OCC
B2 Bank National Association	14-Nov-23	Agreement	OCC
Herring Bank	24-Oct-23	Consent	FDIC
Vast Bank, National Association	23-Oct-23	Consent	OCC
Metropolitan Commercial Bank	16-Oct-23	C&D, CMP	FRB
Discover Bank	25-Sep-23	Consent	FDIC
Small Business Bank	1-Sep-23	C&D	FRB
Regions Bank	14-Aug-23	CMP	FRB
American Express National Bank	25-Jul-23	CMP	OCC
Farmington State Bank	18-Jul-23	C&D	FRB
First National Bank	27-Jun-23	Agreement	OCC
Cross River Bank	8-Mar-23	Consent	FDIC
Lake Shore Savings Bank	9-Feb-23	Consent	OCC

Source: Best-efforts review by Better Markets. Actions listed are those including some requirement to improve third-party risk management. Details vary widely and no conclusions should be drawn about the financial condition of any of these banks. C&D refers to cease-and-desist orders. CMP refers to civil money penalties. All the actions were with the consent of the banks and reflect binding orders or enforceable agreements. Orders can be found at: https://www.federalreserve.gov/supervisionreg/enforcementactions.htm; https://apps.occ.gov/EASearch; and https://orders.fdic.gov/s/searchform.

Other violations of law specifically cited by the Agencies in these orders related to the Truth in Lending Act (cited in 3 orders), Electronic Funds Transfer Act (2 orders), National Flood Insurance Act (2 orders), Truth in Savings Act (1 order), Equal Credit Opportunity Act (1 order), Real Estate Settlement Procedures Act (1 order), and the prohibition against unfair or deceptive acts or practices contained in section 5 of the Federal Trade Commission Act (2 orders). Again, the orders indicate that the Agencies concluded that the fintech partners, and the banks in their oversight role of the fintech arrangements, were not complying with these important consumer protection laws.

Our best-efforts review of the actions in Table 1 found no specific mention of violations of laws prohibiting misleading statements about deposit insurance coverage. We know, however, as discussed below, that a number of fintechs have made such statements.

FDIC advisory letters. Better Markets identified 22 advisory letters that the FDIC sent to fintechs and related entities in 2022, 2023 and so far in 2024, demanding that these entities cease and desist from making false and misleading claims about deposit insurance coverage (Table 2).[12] Each advisory letter contains examples of what the FDIC believed were the fintech's false or misleading claims. Details differ across the letters, but frequently recurring themes include language implying or flatly stating—falsely—that the fintech itself is FDIC insured, that the fintech customer's funds are protected by the FDIC in the event the fintech fails, or that crypto assets or stocks are protected by FDIC insurance. One entity went so far as to register the Internet domain name "FDICCrypto.com," where users were redirected to a crypto trading platform. A few of the FDIC letters were not sent to fintechs but to fintech or crypto trade publications that ran advertisements stating that various fintechs were FDIC-insured.

A few details about these letters are especially important. First, the example language quoted in a number of the letters, to all appearances, represents ***egregious misrepresentations likely to deceive customers and that could severely harm them financially***. Forceful and timely responses are warranted. The advisory letters do appear to be issued quite timely: the proponents of "FDICCrypto.com," for example, received their advisory letter within a few weeks of registering that domain name.

Second, these advisory letters were issued pursuant to part 328.106, "Informal Resolution," of the FDIC regulations regarding advertisement of deposit insurance, and they amounted to warnings that if the conduct did not stop, formal action ***could*** follow. As will be described in more detail elsewhere in this letter, the FDIC has the authority to issue formal cease and desist actions, impose civil money penalties, or make criminal referrals regarding these false or misleading

[12] All but one of the FDIC letters in Table 2 can be found at Prohibition under Section 18 (a)(4) of the Federal Deposit Insurance (FDI) Act | FDIC. As of October 15, 2024, that site lists 23 letters, two of which are English and Spanish versions of a letter sent to a what appears to be an import company. Those do not appear in our Table 2. The site does not include the FDIC's August 2023 letter to Atmos Financial. That letter, which is cited in the January, 2024 letter to Atmos, does appear in our Table 2.

statements. As happened with the 29 formal actions in Table 1, formal orders could be issued by agreement or consent, if agreement could be reached, avoiding the need for litigated proceedings.

Table 2. Selected FDIC Advisory Letters Regarding Deposit Insurance Misrepresentations

Entity	Date
PrizePool, Inc.	18-Mar-24
AmeriStar, LLC HighLine Gold, LLC	18-Mar-24
Atmos Financial (two letters)	19-Jan-24 16-Aug-23
BybitcoinEx, Inc.	19-Jan-24
ORGANO Payments, Inc. and its subsidiary OGPay	19-Jan-24
Horizon Globex GmbH, which operates Upstream Exchange	19-Jan-24
Zil Money Corporation	19-Jan-24
Unbanked, Inc	4-Aug-23
Money Avenue, LLC	15-Jun-23
OKCoin USA, Inc.	15-Jun-23
Utoppia Inc	24-Mar-23
Zera Financial	15-Feb-23
CEX.IO Corp	15-Feb-23
Captainaltcoin.com	15-Feb-23
Banklesstimes.com	15-Feb-23
CryptoNews.Com	18-Aug-22
Cryptosec.info	18-Aug-22
SmartAsset.com	18-Aug-22
FDICCrypto.com	18-Aug-22
FTX, US	18-Aug-22
Voyager Digital, LLC*	28-Jul-22

Source: Better Markets review of FDIC website.
* The letter to Voyager Digital was joint with the Federal Reserve.

As far as we can tell, however, the FDIC has thus far taken ***no formal actions regarding false or misleading deposit insurance representations***.

Third, ***we found no indication that the FDIC has held any banks formally accountable for false and misleading statements about deposit insurance made by their fintech partners.*** None of the 29 orders in Table 1 related to third-party risk cited violations related to misleading deposit insurance statements made by fintech partners. None of the 22 advisory letters to fintechs in Table 2 mentioned any bank partners. The only conclusion is that either no misleading statements about deposit insurance have been made by banks' fintech partners, or that some of the misleading statements were made by banks' fintech partners but the FDIC has thus far not taken formal action to hold the partner banks accountable.

The Synapse bankruptcy. Most recently, developments in the spring and summer of 2024 further underscored the potential for severe consumer harm that can result when fintech partnerships with banks go wrong. On April 22, 2024, Synapse Financial Technologies, Inc. entered Chapter 11 bankruptcy. By its own description, Synapse was a technology company that served as an intermediary between fintechs and certain banks. Synapse stated it had:

> [P]roprietary technology and software which essentially allows financial technology platforms called 'fintechs' to provide certain financial products and services to the fintechs' customers (referred to as end users or depositors) through certain banking providers and financial technology providers.[13]

The bankruptcy trustee's third status report identified four "Partner Banks" of Synapse: Evolve Bank & Trust (Federal Reserve-regulated); Lineage Bank (FDIC-regulated); AMG National Trust (OCC-regulated); and American Bank, N.A. (OCC-regulated).[14] The same report explained that end users' funds were deposited in the Partner Banks through Synapse.[15] In describing the arrangement from the perspective of one of the Partner Banks, the Federal Reserve wrote:

> [The bank] has pursued a business strategy that primarily involves offering deposit accounts and payment processing services to financial technology companies ("fintech partners") that, in turn, offer various financial products and services to end-user customers, either directly or through a partnership with other entities.[16]

The trustee report stated that most end-user funds placed at the Partner Banks in this way were held in omnibus "For Benefit Of" Accounts ("FBO Accounts").[17] The report also explains that Partner Banks have indicated that:

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[13] *Id.* at 1.

[14] *Id.* at 3.

[15] *Id.* at 7.

[16] Board Of Governors Of The Federal Reserve System, *In the Matter of Evolve Bancorp, Inc., West Memphis, Arkansas and Evolve Bank & Trust, West Memphis, Arkansas*, Cease and Desist Order, 1 (June 11, 2024), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20240614a1.pdf.

[17] McWilliams, *supra* note 11 at 3.

> [T]hey hold end-users' funds in FBO Accounts held either in the name of Synapse or Synapse Brokerage and were not aware which end-user's funds may comprise any one FBO Account.[18]

As it transpired, there were significant obstacles to determining which end users' funds had been placed at which banks. Thus, for example, "On May 13, 2024, … Evolve alleged that it had been denied access to [Synapse's] computer systems and had been forced to freeze end user accounts."[19]

Moreover, the trustee report described severe and material irregularities in Synapse's general ledger balances provided to partner banks compared with actual flows of funds, and it also raised concerns about funds that appear to have gone missing. The bottom line as expressed in the June 21, 2024, trustee report:

> Synapse's bankruptcy has left ***tens of thousands of end-users*** of financial technology platforms that were customers of Synapse stranded without access to their funds.[20]

Finally, as if all this were not bad enough, the trustee report explained:

> As of the time of the Initial Report, reconciliation efforts indicated an estimated shortfall of $85 million between the cash held in FBO Accounts among all Partner Banks and the Synapse trial balance. … As of the time of this Report, the shortfall estimate continues to be in the range of $65 – $96 million.[21]

As of August 30, 2024, the trustee reported that over $60 million of the $219 million of FBO funds held at the Partner Banks as of May 24, 2024, had not yet been distributed,[22] and that **"**The aggregate ***$65 million - $95 million estimated shortfall*** has not changed since the Seventh Status Report."[23]

The extent of the recordkeeping problems—although it is not yet clear if some or all of these shortfalls may be due to illegal conduct—is evident from the August 30, 2024, trustee report:

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18 *Id*. at Appendix A at 2.

19 *Id*. at 1.

20 *Id*. at Appendix A at 2 (emphasis added).

21 *Id*. at 6.

22 *See* page 4 of Chapter 11 Trustee's Eighth Quarterly Bankruptcy Report *(Synapse Financial Tech. Inc.)* (Aug. 30, 2024, Bankr.. C.D. Cal. 2024), https://www.bloomberglaw.com/public/desktop/document/SynapseFinancialTechnologiesIncDocketNo124bk10646BankrCDCalApr222/4?doc_id=X5I2AJIDBR29DABK91SV3KGRVT0.

23 *Id.* at 6; the upper end of the range for the estimated shortfall changed from $96 million in the third status report to $95 million (emphasis added).

> The April 29, 2024 ledger provided to Evolve by Synapse showed, for one Synapse Brokerage platform, an increase of approximately $85 million in end user funds at Evolve in one day, when during that period Evolve received only $2,686,233 of incoming end user funds.[24]

In simpler language, Synapse's records show more deposits of end user funds into Partner Banks than Partner Banks' record show that they received.

In short, more than four months after the bankruptcy, it remained unknown how between $65 million and $95 million could simply go missing. What is clear, however, is that the vaunted "fintech ecosystem" in this instance appears to have been good at gathering customers' funds, but incapable of keeping track of those funds or giving them back to their rightful owners.

Debacles like this cause severe financial harm to ordinary people. Moreover, if they occurred with a larger third-party entity, they could trigger widespread deposit runs and financial instability. It is therefore appropriate that the Agencies have issued this RFI and that they take strong, decisive steps to prevent the recurrence of such problems. Our comments, which follow a summary of the RFI, contain specific recommendations for such steps.

SUMMARY OF THE RFI

The RFI states that the Agencies are seeking information about the nature of bank-fintech arrangements, their implications, the risk management of these arrangements, and whether enhancements to supervisory guidance may be helpful in addressing the associated risks. It indicates that the Agencies have observed arrangements between banks and fintech companies for the provision of banking services to customers, and that there are a range of risks associated with these arrangements.[25]

As described in the RFI, banking products within the broad categories of deposits, payments, and loans provided to customers through bank-fintech arrangements include deposits, peer-to-peer payments, debit cards, contactless payments, Automated Clearing House transactions, wire transfers, and loans.[26] Other key functions performed by fintechs in these arrangements can include complaint handling, customer identification and due diligence, preparing or making disclosures, monitoring transactions, maintaining customer account ledgers, preparing marketing materials, or directly communicating with customers.[27]

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24 *Id*. at Exhibit B at 2.

25 Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses, *supra* note 2 at 61578.

26 *Id.* at 61579.

27 *Id*. at 61581.

The RFI notes that even though a bank's fintech partner may be performing activities for the bank, the bank itself remains accountable for compliance with applicable law.[28] In this respect, it calls out the risk of bank non-compliance with the BSA and related regulations, and the risk of misleading representations about deposit insurance coverage, and it notes that risks may increase when the fintech is the dominant player in the relationship or the bank is dependent on fintech-generated revenue streams. Moreover, the RFI notes that a bank's ability to comply with certain laws may require it to have information about the customers to whom the fintech is providing services on behalf of the bank, even if the bank itself does not have a direct relationship with those customers or even if they are not named as account holders with the bank.[29]

The RFI addresses issues associated with fintechs' deposit-taking activities on behalf of banks in some detail. It notes that in these arrangements, the fintechs often maintain the detailed deposit records of individual customers whose funds it has gathered for placement in the bank, while the bank's records will show only an omnibus account of the fintech, often titled to indicate it is for the benefit of end users, but without underlying detail about those end users.[30] It states that a fintech's role in providing disclosures may increase the risk of inaccurate or misleading statements about federal deposit insurance. In particular, the RFI notes that customers may not know how or whether they are dealing with a bank or the fintech partner, and they may not understand that the FDIC does not protect them from a nonbank fintech company's failure.[31]

The RFI also describes risks that can arise specifically from rapid growth in a bank's use of fintech arrangements, or from a concentrated dependence on such arrangements.[32] These include growth outstripping the ability of the bank's compliance and risk management functions to keep pace, resulting in BSA, consumer protection, or fair lending violations; difficulty keeping up with a high volume of transaction monitoring alerts associated with fintech payment activity; an increase in the likelihood of data breaches, service interruptions or fraud; and the risk that large deposit inflows will be imprudently invested in longer maturity assets, thereby exacerbating interest rate risk. Concentration-related risks include loans sourced from third parties comprising imprudently high percentages of a bank's loan portfolio, and liquidity risk arising from excessive dependence on deposits sourced from fintech partners.

The RFI concludes with numerous questions soliciting information about a variety of issues about the range of practices being observed in bank fintech arrangements and the management of risk in those arrangements. Three of those questions, expressed in abbreviated form, are as follows:[33]

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[28] *Id*.

[29] *Id*. at 61583.

[30] *Id.* at 61579.

[31] *Id*. at 61581-82.

[32] *Id*. at 61582.

[33] *Id*. at 61584.

- To what extent would additional clarifications or further guidance be helpful to banks with respect to bank-fintech arrangements?
- What data would be helpful for the Agencies in monitoring developments regarding bank-fintech arrangements?
- In what ways might bank-fintech arrangements function as transmission mechanisms to amplify financial shocks (i.e., threaten financial stability)?

Better Markets' comments on the RFI are organized around these three questions. They are summarized below and discussed in more detail in the subsequent section.

SUMMARY OF COMMENTS

Better Markets commends the Agencies for publishing the RFI, and for their recent interagency statement on third party deposit arrangements with fintechs; these are useful educational resources and contributions to the dialogue on an important set of issues. Bank-fintech arrangements have the potential to reduce the cost and improve the convenience and availability of banking services. Moreover, they can benefit community banks by enabling them to offer products and services that they might otherwise be unable to provide. That said, the Agencies can and ***must*** do more to address the risks posed by these partnerships, so that banks can benefit from these arrangements without endangering themselves, the public or financial stability.

Question. To what extent would additional clarifications or further guidance be helpful to banks with respect to bank-fintech arrangements?

Bankers, fintechs, and the general public would benefit from clear and enforceable legal and risk-management guardrails—comprising both the regulatory framework and its enforcement—to reduce risk and, where necessary, to deter and punish misconduct. Moreover, the public clearly needs a better understanding of the risks to which they are exposed when they entrust money to a fintech. Better Markets recommends the following:

- **Comment 1**. Selected aspects of existing supervisory guidance on third-party risk management should be codified in the Agencies' enforceable Safety and Soundness Standards implementing section 39 of the Federal Deposit Insurance Act.
- **Comment 2**. When warranted, the Agencies should use their authority to examine fintechs acting as bank IAPs, should include specific named fintech partners as respondents on public enforcement actions pursuant to section 8 of the FDIC Act, and should identify in the public orders the fintech's legal violations or other deficiencies that the Agencies determined had occurred.
- **Comment 3**. Rather than relying solely on informal advisory letters, the FDIC should use its enforcement authority to take formal cease and desist actions, levy civil money penalties, and, where appropriate, make criminal referrals to deter and punish entities making false or misleading representations about federal deposit insurance.

Appropriate and timely public punishment is essential for both informing the industry and the public while also deterring future misconduct.

- **Comment 4**. Formal or informal actions involving deposit insurance misrepresentations in connection with bank-fintech partnerships must hold both the fintech *and* the partner bank accountable.
- **Comment 5**. The FDIC should issue an Interim Final Rule to amend parts 328.102 and 328.106 of its regulations to remove what amounts to an implicit free pass for first offenders.
- **Comment 6**. The FDIC should amend its regulations to ensure that insured depository institutions in receipt of custodial accounts can promptly and timely identify amounts owed to the individual depositors in those accounts.
- **Comment 7**. The FDIC should publish, and publicize, a detailed report explaining the legal status in bankruptcy of funds gathered by fintechs from end users and placed in bank deposit accounts, in the event the fintech fails. The report should describe in plain English how and why retail account holders can lose money in a fintech bankruptcy and identify steps they can take to protect themselves.
- **Comment 8**. The FDIC should amend part 328.102 of its regulations to identify as misleading any third-party's advertisement regarding deposit arrangements with FDIC-insured partner banks that do not clearly and accurately disclose in plain English the treatment of customer accounts in bankruptcy if the third-party fails.

Question: What data would be helpful for the Agencies in monitoring developments regarding bank-fintech arrangements?

- **Comment 9**. The Agencies should propose amendments to the Call Reports to require banks to list third party entities that engage in material amounts of customer-facing deposit taking, payments, or lending for or in partnership with the reporting bank.

Question: In what ways might bank-fintech arrangements function as transmission mechanisms to amplify financial shocks (i.e., threaten financial stability)?

- **Comment 10.** A scenario similar to the Synapse bankruptcy, if played out on a larger scale involving a larger fintech entity or many banks, could result in widespread deposit withdrawals from banks, significant financial harm to Main Street Americans, and a bank liquidity crisis. This possibility elevates the importance of the Agencies' taking actions such as those described in comments one through nine above.

COMMENTS

The first eight comments below address the actions the Agencies should take to strengthen the guardrails around bank-fintech arrangements and to educate the public. Comment 9 addresses the data the Agencies should begin to collect, and Comment 10 addresses systemic risk.

I. SELECTED ASPECTS OF EXISTING SUPERVISORY GUIDANCE ON THIRD-PARTY RISK MANAGEMENT SHOULD BE CODIFIED IN THE AGENCIES' ENFORCEABLE SAFETY AND SOUNDNESS STANDARDS IMPLEMENTING SECTION 39 OF THE FEDERAL DEPOSIT INSURANCE ACT.

Supervisory guidance is too frail a reed to constrain the powerful economic incentives underlying the expansion of bank fintech partnerships—indeed, the Agencies themselves have taken the view that guidance is unenforceable. Accordingly, we urge the Agencies to codify selected components of third-party risk management guidance into the Agencies' enforceable Standards for Safety and Soundness.

In particular, certain elements of third-party risk management that the Agencies have identified in their guidance[34] as being important are so fundamental that they warrant being codified in the Safety and Soundness Standards, under the heading of operational risk. These include:

(i) for banks that have material third-party arrangements, an obligation for the bank to have and adhere to written policies designed to ensure that significant activities of third parties on behalf of the bank are conducted in compliance with laws and regulations and consistent with the safety and soundness of the bank;

(ii) an obligation that contracts that banks enter into with TPSPs for core banking functions must specify the obligations of the third party and the banking organization to comply with applicable laws and regulations;

(iii) an obligation that such contracts must provide the banking organization with the right to receive accurate, comprehensive and timely information about the activities the TPSP conducts on the bank's behalf, including but not limited to information on compliance with laws and regulations and on incidents and material changes to the services of TPSPs or their supply chains, and that they must provide the banking organization with the right to audit and require timely remediation if issues arise; and

(iv) an obligation that such contracts must explicitly inform the third party that the performance of activities by third parties for the banking organization is subject to regulatory examination and oversight,[35] and requirements for appropriate retention

[34] Interagency Guidance on Third-Party Relationships: Risk Management, *supra* note 7.

[35] *See* 12 U.S.C. § 1464(d)(7)(D) for savings associations and 12 U.S.C. § 1867(c)(1) for banks. These state, "[W]henever a depository institution that is regularly examined by an appropriate Federal banking agency …. causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises … such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depository institution itself on its own premises."

of, and access by the bank regulatory agency to, all relevant documentation and other materials.[36]

II. WHEN WARRANTED, THE AGENCIES SHOULD USE THEIR AUTHORITY TO EXAMINE FINTECHS ACTING AS BANK IAPS, SHOULD INCLUDE SPECIFIC NAMED FINTECH PARTNERS AS RESPONDENTS ON PUBLIC ENFORCEMENT ACTIONS PURSUANT TO SECTION 8 OF THE FDIC ACT, AND SHOULD IDENTIFY IN THE PUBLIC ORDERS THE FINTECH'S LEGAL VIOLATIONS OR OTHER DEFICIENCIES THAT THE AGENCIES DETERMINED HAD OCCURRED.

Better Markets believes that fintechs involved in partnerships with banks would generally meet the statutory definition of an IAP. IAPs include "any ….agent for an insured depository institution; any … consultant, joint venture partner, and any other person as determined by the appropriate Federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and … any independent contractor … who knowingly or recklessly participates in [illegal or unsafe and unsound conduct] … which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution."[37]

Banks, and their fintech IAPs, are subject to the full array of formal enforcement actions described in section 8 of the Federal Deposit Insurance Act, including but not limited to cease-and-desist orders, temporary cease-and-desist orders, requirements for remediation or restitution, limitations on activities, prohibition of individuals from further participation in the affairs of institutions, and civil money penalties.[38] Enforcement authority over IAPs is more than theoretical: all the orders identified as "consent" or "C&D" in Table 1 either state explicitly that the order is binding on IAPs (for FDIC and Federal Reserve orders) or state that enforcement action may be taken against IAPs (for OCC orders). Moreover, as noted above, the Agencies may examine the activities of banks' IAPs.

In short, the Agencies have the authority to take meaningful action directly against fintech partners engaged in illegal conduct or conduct that endangers the safety and soundness of banks. For example, the Agencies could assess civil money penalties against a bank's fintech partner if

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[36] *See* Interagency Guidance on Third-Party Relationships: Risk Management, *supra* note 7 at 37929, for the overarching principle of bank accountability embodied in obligation (i), and at 37932 and 37934, for the rights and obligations that should be included in TPSP contracts.

[37] 12 U.S.C. § 1813(u).

[38] 12 U.S.C. § 1818. Regarding cease and desist orders for example, 12 U.S.C. § 1818 (b)(1) states, " If, in the opinion of the appropriate Federal banking agency, any insured depository institution, depository institution … *or any institution-affiliated party* is engaging or has engaged … or is about to engage … in an unsafe or unsound practice in conducting the business of such depository institution, or is violating or has violated ... a law, rule, or regulation, or any condition imposed in writing … the appropriate Federal banking agency for the depository institution may issue and serve upon the depository institution *or such party* a notice of charges in respect thereof." (Emphasis added.)

warranted. When warranted by the misconduct, naming fintech partners as respondents to public formal enforcement actions, and identifying that misconduct in those actions, would be entirely appropriate and would incentivize more responsible conduct and accountability by other fintechs.

III. RATHER THAN RELYING SOLELY ON INFORMAL ADVISORY LETTERS, THE FDIC SHOULD USE ITS ENFORCEMENT AUTHORITY TO TAKE FORMAL CEASE AND DESIST ACTIONS, LEVY CIVIL MONEY PENALTIES AND, WHERE APPROPRIATE, MAKE CRIMINAL REFERRALS TO DETER AND PUNISH ENTITIES MAKING FALSE OR MISLEADING REPRESENTATIONS ABOUT FEDERAL DEPOSIT INSURANCE. APPROPRIATE AND TIMELY PUBLIC PUNISHMENT IS ESSENTIAL FOR BOTH INFORMING THE INDUSTRY AND THE PUBLIC WHILE ALSO DETERRING FUTURE MISCONDUCT

In its review of formal enforcement actions by the three agencies issued between January 1, 2023, and August 31, 2024, Better Markets found no enforcement actions that cited violations related to misrepresentations about deposit insurance. The FDIC advisory letters listed in Table 2 are not legally binding orders, and they amount in effect to requests to stop making false and misleading statements, along with a warning that if the misrepresentations do not stop, formal action could follow.

Federal law prohibits any person from knowingly misrepresenting the deposit insurance status of various financial obligations.[39] Any violation of this prohibition is to be subject to civil money penalties.[40] When a bank, or a fintech that is acting as an IAP of that bank (and any fintech partner would be an IAP, as noted above), makes misleading statements about deposit insurance, the primary regulator of the partner bank has authority to issue an enforcement action against the bank or the fintech or both.[41] If the FDIC is not the bank's primary regulator, it may recommend in writing that the regulator take an enforcement action, and ultimately the FDIC may take the action itself against the bank or its partner fintech.[42] For ***any person*** making misrepresentations that is not a bank or an IAP of a bank, the FDIC has jurisdiction and may take cease and actions or temporary orders to cease and desist.[43]

Misleading representations by fintechs can also violate the FTC Act's prohibition against deceptive practices and the Gramm Leach Bliley Act's prohibition against obtaining customer information by false pretenses, as cited in the Federal Trade Commission's announcement of a settlement with Voyager Digital Holdings, Inc., and a suit against its CEO, for misrepresentations regarding deposit insurance:

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[39] 12 U.S.C. § 1828(a)(4); see also 18 U.S.C. 709.

[40] 12 U.S.C. § 1818 (c)(4)(C).

[41] 12 U.S.C. § 1828 (a)(4)(C).

[42] 12 U.S.C. § 1828 (a)(4)(D).

[43] 12 U.S.C. § 1828 (a)(4)(E).

> According to the complaint, the defendants violated the FTC Act by falsely claiming that consumers' deposits were FDIC insured. What's more, the FTC alleged they violated the Gramm-Leach-Bliley Act by using false statements to get customers' financial information – in this case, their bank account numbers, routing numbers, and cryptocurrency wallet addresses.[44]

Moreover, if the FDIC becomes aware of conduct that it believes violates the prohibition in 18 U.S.C. § 709 against false or misleading statements about deposit insurance, it may notify the FDIC's Office of Inspector General for referral to the appropriate criminal law enforcement authority.[45] That section of the U.S. Code states that "whoever" makes such misrepresentations:

> Shall be punished as follows: a corporation, partnership, business trust, association, or other business entity, by a fine under this title; an officer or member thereof participating or knowingly acquiescing in such violation or any individual violating this section, by a fine under this title or imprisonment for not more than one year, or both.[46]

In short, not only does federal law prohibit misleading statements about deposit insurance coverage, it also provides ample enforcement tools to address such misconduct. Yet there is a significant disconnect between the Agencies' approach to most third-party risk issues, which has involved numerous formal enforcement actions in 2023 and 2024, and the approach to misleading deposit insurance representations by third parties, none of which, as far as we are aware, have been cited in formal banking agency actions. The lack of formal penalties or enforcement by the banking agencies for entities that make egregious misrepresentations about deposit insurance amounts to a regulatory failure. The FDIC is the lead agency for purposes of this issue. It should address the disconnect and begin using its authority more forcefully.

IV. FORMAL OR INFORMAL ACTIONS INVOLVING DEPOSIT INSURANCE MISREPRESENTATIONS IN CONNECTION WITH BANK-FINTECH PARTNERSHIPS MUST HOLD BOTH THE FINTECH AND THE PARTNER BANK ACCOUNTABLE.

There is another striking difference between the Agencies' approaches to most third-party risk issues on the one hand, and deposit insurance misrepresentations on the other. Consistent with the agencies' guidance about accountability of the bank for actions taken on its behalf by third parties, the enforcement actions in Table 1 were, with one exception, addressed to banks and bank holding companies. In contrast, the advisory letters in Table 2 are all directed at fintechs or fintech-related nonbank entities; no partner banks are mentioned. In our best-efforts review of all agency

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[44] Federal Trade Commission, FTC Business Blog, *Set phasers to false: FTC challenges crypto company Voyager's bogus "FDIC insured" claim*, (Oct. 12, 2023), https://www.ftc.gov/business-guidance/blog/2023/10/set-phasers-false-ftc-challenges-crypto-company-voyagers-bogus-fdic-insured-claim.

[45] 12 C.F.R. § 328.105

[46] 18 U.S.C. § 709.

formal public enforcement actions between January 1, 2023 and August 31, 2024, we identified no instances where a bank was cited for misleading statements by its fintech partners about deposit insurance coverage.

As noted above, Evolve Bank and Trust and Lineage Bank were partner banks of Synapse and both are the subject of formal actions listed in Table 1. The Federal Reserve's Evolve order, issued about six weeks after the Synapse bankruptcy, cites no legal violations regarding misleading deposit insurance representations and in fact never mentions the subject.[47] The FDIC's Lineage order, issued in January 2024, does require the bank to conduct, "an evaluation of consumer compliance and misrepresentation of deposit insurance risk posed by the Bank's relationship with each FinTech Partner,"[48] but it does not cite any finding of misrepresentations about deposit insurance by fintech partners.

Moreover, in the Voyager case cited above, the fintech partner of an insured bank was subject to formal action by the FTC for deceptive statements about deposit insurance, but no public formal action was taken by the Agencies to hold the partner bank accountable for this deception. Specifically, the FTC noted that Voyager's partner bank was Metropolitan Commercial Bank, and that Voyager's advertisements with respect to this partner arrangement were deceptive.[49] On October 16, 2023, more than a year after the Voyager bankruptcy and shortly after the FTC announced a $1.65 billion judgment against Voyager and legal action against its CEO, the Federal Reserve issued an order against Metropolitan Commercial Bank that contained no mention of the misleading deposit insurance representations made by its fintech partner.[50]

The lack of formal, public accountability for the partner banks of fintechs that make false and misleading deposit insurance claims is inexplicable, given the Agencies' repeated pronouncements that banks are accountable for actions taken on their behalf by third parties. It is also a disservice to the public, which deserves to know which FDIC-insured entities are involved with fintechs making misleading statements about deposit insurance. The Agencies must hold banks in these arrangements accountable when they take deposits raised by partner fintechs that make false and misleading claims about deposit insurance.

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47 *In the Matter of Evolve Bancorp, Inc., West Memphis, Arkansas and Evolve Bank & Trust, West Memphis, Arkansas*, *supra* note 16.

48 Federal Deposit Insurance Corporation, *In the Matter of Lineage Bank, Franklin, Tennessee*, Docket Number FDIC-23-0041b at 9 (Jan. 30, 2024). For FDIC orders, the docket number may be typed into a web browser to obtain a link to the order. Following the link will result in downloading the document rather than merely viewing it.

49 Federal Trade Commission, *supra* note 44.

50 Board Of Governors Of The Federal Reserve System, *In The Matter Of Metropolitan Commercial Bank, New York, New York* (Oct. 16, 2023), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20231019a1.pdf.

V. THE FDIC SHOULD ISSUE AN INTERIM FINAL RULE TO AMEND PARTS 328.102 AND 328.106 OF ITS REGULATIONS TO REMOVE WHAT AMOUNTS TO AN IMPLICIT FREE PASS FOR FIRST OFFENDERS.

Part 328.102 of the FDIC's regulations, which prohibits false or misleading statements about deposit insurance, sets out a three-part test to define when the FDIC will deem a misrepresentation about deposit insurance to have been made knowingly. Paraphrasing, the three-part test is that the person (i) has made false or misleading representations; (ii) has been advised by the FDIC in an advisory letter (discussed below) that such representations are false or misleading; *and* (iii) thereafter, continues to make these, or substantially similar, representations.[51]

Part 328.106 of the FDIC's regulations, which addresses informal resolution, states that if the FDIC becomes aware that a person may be making false or misleading representations regarding deposit insurance, the FDIC may issue an advisory letter. It goes on to state, among other things:

> Where a recipient of an advisory letter described in paragraph (a) of this section provides the FDIC with the requested written commitments within the timeframe specified in the letter, and where any required remediation has been verified by FDIC staff, the FDIC will generally take no further administrative enforcement against such a party under § 328.107.[52]

Taken together, these two provisions seem to all but guarantee that there will be a free pass for first offenders regarding deposit insurance misrepresentations. The message in part 328.106 is that if the FDIC catches a person making false or misleading deposit insurance claims, it will issue an advisory letter asking that person to stop. If the misconduct stops, there will be no formal penalty. The message in part 328.102 is that the FDIC will not find a misrepresentation to have been made knowingly unless the person has first received an advisory letter and then continued to make the same or similar misrepresentations. A literal reading could even suggest that after receiving an advisory letter, a person could try making substantially different misrepresentations, and the informal process would merely start over with a new advisory letter.

These two provisions appear to suggest an FDIC predisposition to use formal action to address deposit insurance misrepresentations *only as a last resort*. Yet the result is that the regulations all but provide an open invitation for entities to attract retail funds by making deceptive assurances about bank partnership arrangements, knowing that there will be no penalty if they are caught. This is a highly inappropriate set of incentives that puts consumers at risk of severe financial harm.

Better Markets urges the FDIC to revise these parts of its regulations to convey explicitly that there will be no formal penalty for misrepresentations about deposit insurance ***only*** if the FDIC has a strong basis for believing the misrepresentations were both inadvertent and unlikely to cause

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[51] 12 C.F.R § 328.102(b)(6).

[52] 12 C.F.R § 328.106(c).

harm, and that the sending of an advisory letter is ***not*** a precondition for formal action or further factual determinations by the FDIC. Moreover, the consumer harm arising from events such as the Synapse bankruptcy suggests sufficient urgency to warrant the use of an Interim Final Rule to make these amendments.

VI. THE FDIC SHOULD DEVELOP AND SEEK COMMENT ON WAYS TO ENSURE THAT INSURED DEPOSITORY INSTITUTIONS IN RECEIPT OF CUSTODIAL ACCOUNTS CAN PROMPTLY AND TIMELY IDENTIFY AMOUNTS OWED TO THE INDIVIDUAL DEPOSITORS IN THOSE ACCOUNTS.

On September 17, 2024, the FDIC approved publication of a Notice of Proposed Rulemaking ("NPR") that includes such recordkeeping requirements for some types of custodial accounts.[53] Better Markets will review and comment on the NPR.

VII. THE FDIC SHOULD PUBLISH, AND PUBLICIZE, A DETAILED REPORT EXPLAINING THE LEGAL STATUS IN BANKRUPTCY OF FUNDS GATHERED BY FINTECHS FROM END USERS AND PLACED IN BANK DEPOSIT ACCOUNTS, IN THE EVENT THE FINTECH FAILS. THE REPORT SHOULD DESCRIBE IN PLAIN ENGLISH HOW AND WHY RETAIL ACCOUNT HOLDERS CAN LOSE MONEY IN A FINTECH BANKRUPTCY AND IDENTIFY STEPS THEY CAN TAKE TO PROTECT THEMSELVES.

A number of high-profile fintech bankruptcies, including those of Synapse Financial Technologies, Inc., Voyager Digital Holdings, Inc., and FTX Trading, Ltd. and its affiliated companies, have focused public attention on the risks to retail customers who place funds with fintechs in the belief that their funds are protected, based on various assurances about fintechs' arrangements with partner banks.

In the Synapse bankruptcy, as discussed in detail above, many end users have not received distributions, even after several months, because accurate records of the interests of end users in omnibus deposit accounts in the name of Synapse have thus far not been reconstructed. Moreover, there is a shortfall in the range of $65 million to $95 million, reflecting an unexplained gap between the end user funds that Synapse claims to have deposited at banks and the smaller amount of funds that banks claim to have received.

In the July 2022 Voyager bankruptcy, the bankruptcy judge approved a reorganization plan in March 2023.[54] The approved plan was intended by Voyager to maximize its ability to make distributions to account holders in crypto rather than cash.[55] Moreover, the judge explained that

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[53] Federal Deposit Insurance Corporation, *Recordkeeping for Custodial Accounts*, RIN 3064-AG07 (Sept. 17, 2024), https://www.govinfo.gov/content/pkg/FR-2024-10-02/pdf/2024-22565.pdf.

[54] *Voyager Digital Holdings, Inc. et al.*, No. 22-10943 (MEW) (Bankr. S.D.N.Y, Mar. 11, 2023), https://www.nysb.uscourts.gov/sites/default/files/opinions/312840_1170_opinion.pdf.

[55] *Id.* at 5.

since there were not enough assets to satisfy all claims in full, no customer would get a full recovery of his or her funds.[56] In fact, Voyager had incorrectly represented that its account holders' funds were protected by FDIC insurance.[57]

Regarding the November 2022 bankruptcy of FTX, in August 2024, the U.S. District Court for the Southern District of New York ordered FTX to pay $12.7 billion in monetary relief to FTX customers and victims of FTX's fraud. The court noted that while FTX had claimed that customer assets were held in custody by FTX and that FTX segregated customer assets from its own assets, in fact, customer funds were commingled and misappropriated.[58]

These episodes illustrate three fundamental issues about the safety of end user funds placed with fintechs (or indeed with any nonbank company) in the event of the fintech's failure. *First,* accurate books and records of each end user's identity and account balance must exist. The failure thus far to produce such records related to Synapse has rightly attracted much attention and outrage and prompted the FDIC's recent NPR.

Second, equally fundamental, and distinct from the quality of books and records, is the legal status of end user funds under the bankruptcy code. If a fintech enters bankruptcy, a judge will oversee the process of identifying all the assets of the fintech and the claims against it and distributing the assets among the various claimants in a manner consistent with the bankruptcy code. Depending on the facts, retail end users may not have priority over other claimants, meaning they will share pro rata in any losses. For example, the judge overseeing the Voyager bankruptcy wrote:

> [Two] parties also asked that they be allowed to withdraw the assets that were listed in their accounts, rather than receiving merely pro rata distributions. … I simply cannot allow that. If one customer were to withdraw everything that had been listed in that customer's account, it would just mean that the next customer would get less. The whole point of the Bankruptcy Code is to make sure that everybody gets equal distributions. Since there is not enough to pay all claims in full, no customer can get a complete recovery of what was listed in his or her account. That is simply a basic matter of bankruptcy.[59]

In other words, even if the books and records are perfect, and depending on the specific financial arrangements, end users are at risk of not getting all their money back in a fintech bankruptcy,

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[56] *Id.* at 49.

[57] Federal Trade Commission, FTC Business Blog, *Set phasers to false: FTC challenges crypto company Voyager's bogus "FDIC insured" claim* (Oct. 12, 2023), https://www.ftc.gov/business-guidance/blog/2023/10/set-phasers-false-ftc-challenges-crypto-company-voyagers-bogus-fdic-insured-claim.

[58] Commodity Futures Trading Commission, *CFTC Obtains $12.7 Billion Judgment Against FTX and Alameda*, (Aug. 8, 2024), https://www.cftc.gov/PressRoom/PressReleases/8938-24.

[59] *Voyager Digital Holdings, Inc. et al.*, No. 22-10943 (MEW) (Bankr. S.D.N.Y., Mar. 11, 2023), at 49, https://www.nysb.uscourts.gov/sites/default/files/opinions/312840_1170_opinion.pdf.

even when the fintech has deposit arrangements with partner banks. If the legalities of the financial arrangements are such that account holders will simply have a claim on the bankruptcy estate and share losses with other creditors if the fintech fails, then any form of advertising that encourages fintech customers to think that their funds are protected in a fintech failure is an egregious misrepresentation that puts consumers at great risk and disadvantage.

Specific contractual arrangements may provide greater protection to end users. For example, the distribution to the Voyager account holders was effected by transferring their accounts (subject to losses as noted above) to a different crypto company, Binance.US. To allay concerns about the safety of accounts transferred to Binance, Binance agreed to language in the bankruptcy reorganization plan documents and in the judge's order to the effect that the assets transferred to Binance by Voyager will always be held in strict trust and in custody for customers, and that Binance will not have beneficial interests in those assets.[60]

The *third* fundamental issue is that the fintech's promised treatment of customer funds may not materialize. For example, the Voyager bankruptcy judge wrote:

> [P]ublic statements by the persons currently handling the bankruptcy of FTX have indicated that there was an enormous disparity between the way that FTX actually operated, and the way it actually used customer assets, as opposed to what it had represented to its customers. I am also aware of the examiner's report about the conduct of business at Celsius, and how the custody of customer assets at that firm may have differed from public statements as to how customer assets were being treated.[61]

Compounding the risk is that end users are unlikely to be knowledgeable about the priority of their claims in bankruptcy—and even those who are knowledgeable may have no way of knowing whether the promised treatment of customer accounts is being faithfully implemented.

The FDIC should assume more responsibility for educating the public about the risks to which they are exposed when they place funds with fintechs based on reassuring but potentially misleading statements about deposits with partner banks. It is not enough to simply require a disclosure that the fintech is not a bank and is not FDIC-insured if most people do not understand the implications of that statement. The FDIC should publish an educational resource for the public explaining in plain English the legal status of customer funds in a fintech bankruptcy, exactly why and how retail customers can lose money in such a scenario, the contractual arrangements they should insist on if they are seeking safety for their funds, and whether there are ways for them to assure that contractual promises are being kept. Moreover, the FDIC should reinforce the publication of this educational resource with additional amendments to part 328.102, as discussed below.

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[60] *Id*. at 21.

[61] *Id*. at 7.

VIII. THE FDIC SHOULD AMEND PART 328.102 OF ITS REGULATIONS TO IDENTIFY AS MISLEADING ANY THIRD-PARTY'S ADVERTISEMENT REGARDING DEPOSIT ARRANGEMENTS WITH FDIC-INSURED PARTNER BANKS THAT DO NOT CLEARLY AND ACCURATELY DISCLOSE IN PLAIN ENGLISH THE TREATMENT OF CUSTOMER ACCOUNTS IN BANKRUPTCY IF THE THIRD-PARTY FAILS.

Part 328.102 of the FDIC's regulations prohibits false or misleading representations about deposit insurance and goes on to define what constitutes a statement about deposit insurance. It states that a violation is a statement that contains either material misrepresentations or omits material information, that would have the tendency or capacity to mislead a reasonable customer. It then lists the types of statements that would be deemed to be material misrepresentations or would be deemed to omit material information.

Better Markets is concerned that some statements could materially mislead customers into believing that funds they place with a third party for deposit in a bank are safe, but without being in technical violation of part 328.102. These are statements that—while making all currently required disclosures including that the third party is not a bank, that the FDIC only insures deposits if a bank fails, and that the availability of pass-through insurance coverage depends on the satisfaction of certain conditions—state or imply that even if the third party fails, the customer's funds on deposit at banks will simply be returned to the customer. This may be a material and important omission if, based on the specific arrangements, because the customer's funds could be tied up in a lengthy bankruptcy proceeding, subject to pro rata loss sharing with other creditors, or both.

These types of statements trade on the public's trust in banks. If a large fintech failed and the facts of that failure involved customers suffering losses or long delays in recovery on funds that had been placed in banks, the result could be widespread runs on fintechs and a possible liquidity crisis for banks. The FDIC should amend part 328.102 to include such statements in the definition of "statements about deposit insurance" and to identify as misleading any third-party's advertisement regarding deposit arrangements with FDIC-insured partner banks that do not accurately disclose in plain English the treatment of customer accounts in bankruptcy if the third-party fails.

IX. THE AGENCIES SHOULD PROPOSE AMENDMENTS TO THE CALL REPORTS TO REQUIRE BANKS TO LIST THIRD PARTY ENTITIES THAT ENGAGE IN MATERIAL AMOUNTS OF CUSTOMER-FACING DEPOSIT TAKING, PAYMENTS, OR LENDING FOR OR IN PARTNERSHIP WITH THE REPORTING BANK.

Given the proliferation of arrangements in which fintechs provide core banking services on behalf of partner banks, there would be considerable benefits to bank regulators and the public if data on these arrangements were publicly available in an electronic and readily accessible format. From a consumer's perspective, simply knowing which entity he or she is dealing with, and in what capacity, may be helpful in knowing where to go for help in the event a problem arises.

From a regulatory perspective, consumer complaints lodged against a third-party provider and tabulated in some public forum could be readily cross-checked to identify partner banks and facilitate the consumer protection supervision process. If an operational or financial problem emerged at a third-party provider, such data would enable the rapid identification of banks that may be affected. Data on bank partnerships with third parties also could facilitate the identification of potential systemic risks in situations where the third-party partners with large banks or with many banks.

Currently, Schedule RC-M (Memoranda) of the Call Reports already requires banks to list:

- URLs of all other public-facing Internet Web sites that the reporting institution uses to accept or solicit deposits from the public, if any; and
- Trade names other than the reporting institution's legal title used to identify one or more of the institution's physical offices at which deposits are accepted or solicited from the public, if any.[62]

To insert an additional question on this schedule requiring insured banks to identify third-party entities that engage in material amounts of customer-facing deposit taking, payments, or lending on behalf of the reporting bank would have broad conceptual consistency with the above two questions that are already included; furthermore, it would have the substantial public benefits described above. With the materiality clause included, all banks should have this information readily available—and if they do not, they clearly should from a risk-management perspective.

X. <u>A SCENARIO SIMILAR TO THE SYNAPSE BANKRUPTCY, PLAYED OUT ON A LARGER SCALE INVOLVING A LARGER FINTECH ENTITY OR MANY BANKS, COULD RESULT IN WIDESPREAD DEPOSIT WITHDRAWALS FROM BANKS, SIGNIFICANT FINANCIAL HARM TO MAIN STREET AMERICANS, AND A BANK LIQUIDITY CRISIS. THIS POSSIBILITY ELEVATES THE IMPORTANCE OF THE AGENCIES' TAKING ACTIONS SUCH AS THOSE DESCRIBED IN COMMENTS ONE THROUGH NINE ABOVE.</u>

We have seen with the failures of Silicon Valley Bank and Signature Bank how fast social media can spread concerns that can lead to rapid deposit outflows from banks; fintechs can experience similar rapid withdrawals of customer funds. A combination of circumstances involving increasing bank reliance on fintechs to gather deposits, problems at a large fintech that serves many banks or a number of large banks, and social-media-driven widespread public concern about the safety of funds placed at fintechs could cause widespread deposit outflows and a liquidity crisis at banks. Moreover, policy responses to such a crisis could be complicated by financial

[62] Federal Financial Institution Examination Council, Consolidated Reports of Condition and Income, Schedule RC-M (Memoranda), question 8, https://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_202409_f.pdf. There are three versions of these quarterly reports for banks of different sizes; all three versions require banks to report this information.

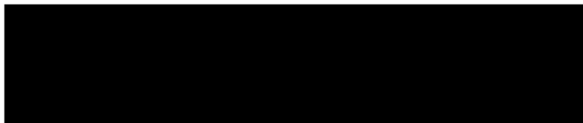
regulators' finding it legally or politically difficult to stem end-user flight from fintechs by providing a guarantee of fintech obligations.

Some of the recommendations above may be especially relevant to preventing such a scenario. These include, most notably, Comment 9's recommendation for a listing in Call Reports of third parties providing material amounts of deposit-taking, payments, or lending on behalf of banks. Having such a listing would facilitate regulators' ability to identify exposures of large banks, or large numbers of banks, to the same third party. In turn, this could focus examination efforts pursuant to the Agencies' authority to examine IAPs, as suggested in Comment 2.

CONCLUSION

We hope these comments are helpful as you consider how best to address the serious and substantial issues raised by recent growth in the use of bank-fintech partnerships.

Sincerely,



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