January 16, 2025

James P. Sheesley, Assistant Executive Secretary
Attention: Comments—RIN 3064–AG07
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Recordkeeping for Custodial Accounts; RIN: 3064–AG07; Document Number 2024–22565; 89 FR 80135 (Oct. 2, 2024)

Dear Mr. Sheesley:

Better Markets[1] appreciates the opportunity to comment on the proposed rule ("Proposal")[2] from the Federal Deposit Insurance Corporation ("FDIC" or "Agency") that would establish recordkeeping requirements for some custodial accounts held by FDIC-insured banks. The Proposal is a response to a massive rip-off of tens of thousands of ordinary Americans, that was exposed by the April 2024 bankruptcy of Synapse Financial Technologies, Inc. Far from being merely a technical recordkeeping issue, this Proposal relates to the legal and moral duty banks have to keep track of, and safeguard, the funds of depositors, many of whom live from paycheck to paycheck and are one unexpected expense away from life-changing harm.

The many victims of the Synapse debacle had placed funds in fintech partners of Synapse—funds that they were led to believe would be held in safe, secure bank accounts. Instead, these victims have heard the worst sentence a banker can utter to a depositor: "I am sorry, but we have no record of your deposits."

Victims include people who used their Synapse-placed accounts for day-to-day living expenses.[3] Others used their accounts to save for important life events: for example, a former Texas schoolteacher, who had placed over $280,000 with Synapse partners that she was saving

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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 Recordkeeping for Custodial Accounts; RIN: 3064-–AG07; Document Number 2024–22565; 89 FR 80135 (Oct. 2, 2024); https://www.govinfo.gov/content/pkg/FR-2024-10-02/pdf/2024-22565.pdf.

3 *Id*. at 80135.

towards the purchase of a house, was recently informed by Evolve Bank and Trust that she would receive only $500 of her funds.[4]

The FDIC's current regulations do not require banks to ascertain the identities or account balances of the underlying individual depositors in custodial accounts. Instead, the regulations are limited to describing how the FDIC will make insurance determinations if a bank fails. Yet the Synapse bankruptcy makes clear that under the current rules, with the failure of a deposit-placing fintech, the account records of individual depositors may be in disarray or nonexistent. This situation is outrageous and must be corrected.

For these reasons, Better Markets supports the need for FDIC recordkeeping requirements for custodial accounts and commends the FDIC for the step it is taking with this Proposal. At the same time, however, the Proposal's requirements apply to such a limited set of custodial accounts that it leaves the door wide open for future Synapse-like debacles that devastate the lives of Main Street Americans. Consequently, Better Markets recommends that the FDIC strengthen the Proposal by changing it in three ways:

- Remove the exemption for nontransaction accounts;
- Remove the exemption for reciprocal deposit placement arrangements; and
- Remove the exemption for accounts established by or on behalf of one or more brokers, dealers, or investment advisers.

Finally, the preamble describes the broader context for the Proposal, including the proliferation of deposit gathering arrangements through bank-fintech partnerships, the Synapse bankruptcy, and the use of misleading representations by some fintechs about deposit insurance, and it describes actions that the banking agencies, and the FDIC in particular, have taken to address these issues. Better Markets has previously made recommendations to the FDIC regarding these matters, and this letter briefly reiterates some of those recommendations.[5]

BACKGROUND

On April 22, 2024, Synapse Financial Technologies, Inc. entered Chapter 11 bankruptcy.[6] By its own description, Synapse was a technology company that served as an intermediary between fintechs and certain banks. Synapse stated it had:

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4 Hugh Son, *'I have no money': Thousands of Americans see their savings vanish in Synapse fintech crisis*, CNBC (Nov. 22, 2024), https://www.cnbc.com/2024/11/22/synapse-bankruptcy-thousands-of-americans-see-their-savings-vanish.html.

5 Better Markets Comment Letter, *Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses* (Oct. 30, 2024), https://bettermarkets.org/wp-content/uploads/2024/10/Better-Markets-Comment-Letter-RFI-Bank-Fintech-Arrangements.pdf.

6 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.

> [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.[7]

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).[8] The same report explained that end users' funds were deposited in the Partner Banks through Synapse.[9] 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.[10]

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").[11] The report also explains that Partner Banks have indicated that:

> [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.[12]

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."[13]

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

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7 *Id.* at 1.

8 *Id*. at 3.

9 *Id*. at 7.

10 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.

11 McWilliams, *supra* note 6 at 3.

12 *Id*. at Exhibit A at 2.

13 *Id*. at 1.

raised concerns about missing funds. 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.[14]

As if all this were not bad enough, a significant amount of funds that customers placed with the so-called Synapse eco-system for deposit at banks is missing. In the August 30, 2024, report, the trustee wrote "The aggregate ***$65 million - $95 million estimated shortfall*** has not changed since the Seventh Status Report."[15] The report went on to state:

> 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.[16]

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

News from the bankruptcy trustee's November 13, 2024, status report[17] was no better. The reported aggregate shortfall of $65 million to $95 million continued to exist,[18] and:

> Although many end users still have not received the amount of deposits due to them based on the Synapse ledger, the estate does not have the funds to implement an independent reconciliation nor any remaining operations or employees to participate in these efforts.[19]

The missing money problem appears especially acute for accountholders whose funds were (at least apparently) deposited by Synapse at Evolve Bank and Trust. The trustee wrote:

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

15 Jelena McWilliams, *Chapter 11 Trustee's Eighth Quarterly Bankruptcy Report (Synapse Financial Technologies Inc.)* at 6 (Aug. 30, 2024), https://www.bloomberglaw.com/public/desktop/document/SynapseFinancialTechnologiesIncDocketNo124bk10646BankrCDCalApr222/4?doc_id=X5I2AJIDBR29DABK91SV3KGRVT0.

16 *Id*. at Exhibit B at 2.

17 Jelena McWilliams, *In re Synapse Financial Technologies, Inc., Chapter 11, Twelfth Status Report* (Nov. 13, 2024), https://www.cravath.com/a/web/hGJXkWmwK6jd4jVFFM2zHr/9Fa4fn/9890-453-11_12_2024-pacer453-main-document-012731-00001-central-district-of-california.pdf.

18 *Id*. at 9.

19 *Id*. at 3.

> As of the time of this Report, Evolve has declined to provide most details of the outcome of its reconciliation to the Trustee beyond publicly available information due to pending litigation, including reconciled account balances for individual end users or aggregate balances for Fintech Partners or for all Synapse accounts held at Evolve. As a result, the Trustee has less information on the anticipated distributions by Evolve than even the end users. The Trustee is aware from direct communications from end users and publicly available information that ***Evolve has notified certain end users that it holds funds for those end users—and therefore will pay to such end users—in amounts considerably less than shown on the Synapse ledger or through Evolve's reconciliation efforts***.[20]

Reports about the effects on ordinary people are wrenching. As one report put it:

> The impact of the ledger failure has been ruinous for thousands of American FinTech customers, many of whom have lost sums that include life savings of hundreds of thousands of dollars and who have collectively borne the brunt of the tens of millions in unaccounted-for funds.[21]

The former Texas schoolteacher who is owed over $280,000 and has been told by Evolve that she is entitled to $500, as mentioned above, is just one among thousands of people whose trust has been betrayed. Even much smaller financial losses can be felt keenly and have lasting effects, as in the example of a Virginia woman who lost $800 and told Newsweek that she has lost trust in banks and would now rather keep her savings in a mattress.[22]

The victims of Synapse are right to feel that the financial regulatory system has failed them. Banks are not currently required to have any record of the deposits of the individual customers whose funds are pooled by a fintech and deposited with them. With regard to recordkeeping of the amounts owed to the individual customers whose deposits have been pooled, the FDIC's only concern has been with its ability to make deposit insurance determinations in the event the bank fails. The FDIC regulations state:

> If the deposit account records of an insured depository institution disclose the existence of a relationship which might provide a basis for additional insurance. . . the details of the relationship and the interests of other parties in the account must be ascertainable ***either*** from the deposit account records of the insured depository institution ***or*** from records maintained, in good faith and in the regular course of

20 *Id*. at 4.

21 *Trustee Report Sheds New Light on Synapse Bankruptcy*, PYMNTS (Nov. 26, 2024), https://www.pymnts.com/partnerships/2024/what-synapses-court-filings-reveal-about-the-future-of-bank-fintech-partnerships/.

22 Rachael O'Connor, *Woman Loses Access to Over $800 After Online Bank Goes Bust*, NEWSWEEK (Nov. 29, 2024), https://www.newsweek.com/woman-loses-access-thousands-savings-online-bank-bust-1991048.

> business, by the depositor or by some person or entity that has undertaken to maintain such records for the depositor.[23]

The possibility that a company whose business is pooling funds of customers for deposits in banks would fail and would not have records of where customers' funds were placed, was clearly never considered.

SUMMARY OF THE PROPOSAL

Subject to a list of specific exemptions, the Proposal would generally require banks that hold custodial deposit accounts with transactional features to maintain records that identify, for each custodial account, the underlying beneficial owners, the balances attributable to each beneficial owner, and the ownership capacity in which each beneficial owner holds the deposited funds.[24] It would require these records to be maintained electronically in a specified format, and subject them to internal controls, including account balance reconciliations conducted at least daily.[25]

The Proposal also would allow the required records to be maintained by the bank through a third party, subject to certain conditions. The conditions include that the bank must have unrestricted access to the records of the beneficial owners, including in the event of disruptions or failure of the third party, that reconciliation of these records would be required, and that the third party's records by be validated by a person independent of the third party.[26]

The Proposal would exempt a significant set of custodial deposits from its proposed recordkeeping requirements. Paraphrasing freely, and omitting legal citations for the sake of brevity, the proposed exemptions are for:[27]

1) Accounts only holding trust deposits;
2) Accounts established by a government depositor;
3) Accounts established by or on behalf of one or more brokers; dealers; or investment advisers;
4) Accounts established by an attorney or law firm on behalf of clients, commonly known as Interest on Lawyers Trust Accounts, or functionally equivalent accounts;
5) Accounts held in connection with certain employee benefit plans or retirement plans;

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23 12 C.F.R. § 330.5(b)(2) (emphasis added).

24 Recordkeeping for Custodial Accounts, *supra* note 2 at 80142.

25 *Id*. at 80142.

26 *Id*. at 80140.

27 *Id*. at 80141-42 and 80152-53.

6) Accounts maintained by real estate brokers, real estate agents, title companies, or qualified intermediaries in which funds from multiple clients are deposited and held in connection with a real estate transaction;
7) Accounts maintained by a mortgage servicer in a custodial or other fiduciary capacity;
8) Accounts where Federal or State law prohibits the disclosure of the identities of the beneficial owners of the deposits;
9) Accounts maintained pursuant to an agreement to allocate or distribute deposits among participating insured depository institutions in a network for purposes other than payment transactions of customers; and
10) Accounts exclusively holding security deposits tied to ownership or leasing of residential or commercial property.

The Proposal would require banks that hold custodial deposits that are within its scope to have written policies and procedures to achieve compliance with its requirements.[28] A bank's failure to maintain compliance, the Proposal notes, "could be addressed" through the examination process or enforcement actions.[29] It also notes, ". . . certain circumstances may implicate misrepresentations of deposit insurance, which are covered under section 18(a)(4) of the FDI Act."[30]

SUMMARY OF COMMENTS

Better Markets commends the FDIC's willingness to take concrete steps to protect customers whose funds are bundled by third parties, such as fintechs, and deposited in custodial accounts at banks. No depositor wants to hear their banker utter the sentence, "I am sorry, but we have no record of your deposit." Yet that was precisely what tens of thousands of depositors heard following the Synapse bankruptcy. The Proposal would take important first steps to prevent a recurrence of such a debacle. Accordingly, we strongly support the establishment of bank recordkeeping requirements for custody deposits.

Better Markets is concerned, however, that the proposed exemptions from the requirements are so expansive that they leave wide open the possibility of future Synapse-like episodes in which consumers are left in limbo and without access to needed funds because of sloppy recordkeeping. To better protect Americans from again being defrauded and victimized, Better Markets offers three specific recommendations to strengthen the Proposal.

In addition, accurate recordkeeping alone is not sufficient to ensure that customers will get all their deposits back in the event of a fintech failure. This Proposal is part of a bigger picture, and in fact, the preamble to the Proposal emphasizes the broader context of this rule in light of recent events. It emphasizes all the steps the agencies are taking to ensure appropriate risk

[28] *Id*. at 80143.

[29] *Id*. at 80144.

[30] *Id*.

management of bank-fintech partnerships and all the steps the FDIC is taking to address misrepresentations about deposit insurance.[31] Accordingly, Better Markets is reiterating recommendations it has made to the FDIC, dealing with other steps the FDIC should take to protect consumers who place funds with fintechs for deposit at banks (comment V below).[32]

I. In accordance with the Proposal, there is an urgent need for the FDIC to establish bank recordkeeping requirements for custody deposits.

II. To close a significant loophole in the Proposal, nontransaction deposits should not be outside the scope of the recordkeeping requirements.

III. To close a significant loophole in the Proposal, reciprocal deposit placement arrangements should not be exempt from the recordkeeping requirements.

IV. To close a significant loophole in the Proposal, accounts established by or on behalf of one or more brokers, dealers, or investment advisers should not be exempt from the recordkeeping requirements.

V. As described in a recent comment letter from Better Markets, the FDIC should take additional steps to protect the public from risks associated with bank-fintech deposit placement arrangements.

COMMENTS

I. IN ACCORDANCE WITH THE PROPOSAL, THERE IS AN URGENT NEED FOR THE FDIC TO ESTABLISH BANK RECORDKEEPING REQUIREMENTS FOR CUSTODY DEPOSITS.

Americans in large and increasing numbers are entrusting their money to fintechs that partner with banks. An estimate from 2022 stated that 68 million U.S. customers have opened a "fintech bank account," and that 30 million of these people use a fintech as their primary financial institution.[33] The FDIC, however, has ***no*** requirement that ***individual*** fintech customer deposits placed with a bank must be identifiable to the bank.

The Synapse bankruptcy has demonstrated the catastrophic financial damage to individual customers that a lack of recordkeeping can cause in the event of a fintech bankruptcy. If the FDIC's current lack of bank recordkeeping requirements is not addressed, the public will continue to be exposed to the risk of future Synapse-like debacles. Many victims of such episodes, like many of

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31 *Id*. at 80138–39.

32 Better Markets Comment Letter, *supra* note 5.

33 *Why Have 68M US Consumers Opened a FinTech Bank Account?* PYMNTS (Oct. 13, 2022) https://www.pymnts.com/disbursements/2022/why-have-68m-us-consumers-opened-a-fintech-bank-account/.

the Synapse victims, will suffer grievous financial harm. With many people blurring the distinction between fintechs and banks, customer confidence in the banking system could rapidly disappear and bank runs could become widespread.

For these reasons, Better Markets agrees with the broad direction of the Proposal to establish bank recordkeeping requirements for custody deposits. The proposed exemptions from the requirements are so broad, however, that the Proposal does not adequately protect the public from future Synapse-like events. Accordingly, we make the following three recommendations to strengthen the proposal.

II. TO CLOSE A SIGNIFICANT LOOPHOLE IN THE PROPOSAL, NONTRANSACTION DEPOSITS SHOULD NOT BE OUTSIDE THE SCOPE OF THE RECORDKEEPING REQUIREMENTS.

The proposed recordkeeping requirements apply only to "custodial deposit accounts with transactional features" and even then only subject to certain exemptions. The limitation of the requirements to transactional deposits means that fintech customers who place funds in, say, time deposit products, may again find that their lives are upended in a future Synapse-like fintech failure because there is no record of their deposits.

The Proposal offers little comment about why it exempts nontransaction deposits from the recordkeeping requirements. In an apparent attempt at an explanation, the Proposal states regarding transaction deposits:

> The transactional nature of these accounts, including high volumes of per customer transfers and digital payments, significantly increases the amount of activity compared to other types of custodial deposit accounts.[34]

Presumably, the argument being made here is that because of the lower speed and volume of account activity in nontransaction accounts, it is safe to assume that adequate records can be reconstructed for those accounts from the fintech, and therefore banks should not be required to have the deposit records. We disagree with this logic and conclusion.

The implicit assumption in the Proposal that a Synapse-like disaster cannot happen with nontransaction deposits or that such a disaster would have less damaging consequences is unwarranted. If a Synapse or similar future entity can fail to have adequate records of transaction accounts, it can also fail to have those records of nontransaction accounts. Consumers whose funds are being placed in bank deposits should have the security of knowing that banks have adequate records of their deposits—whether those deposits are transaction deposits or nontransaction deposits. Simply put, the Proposal's blanket exemption from recordkeeping requirements for nontransaction deposits should be eliminated.

[34] Recordkeeping for Custodial Accounts, *supra* note 2 at 80140.

III. TO CLOSE A SIGNIFICANT LOOPHOLE IN THE PROPOSAL, RECIPROCAL DEPOSIT PLACEMENT ARRANGEMENTS SHOULD NOT BE EXEMPT FROM THE RECORDKEEPING REQUIREMENTS.

The Proposal exempts from the recordkeeping requirements accounts maintained under an agreement to allocate deposits among banks in a network for purposes other than making payment transactions. In these arrangements, often referred to as reciprocal deposit networks, an administrator places deposits across multiple banks to ensure that no customer's deposit exceeds the insurance limit. These arrangements are widely used by banks and exempting them could have far-reaching and devastating consequences; at year-end 2023, for example, 44 percent of banks reported reciprocal deposits on their Call Reports.[35]

In support of the exemption for reciprocals, the Proposal says only the following:

> If the network only allows clients to deposit and retrieve their funds from the network of IDIs, its activity should not present difficulty in making a deposit insurance determination.[36]

In other words, the Proposal simply assumes that even though the network banks may have no record of the customers' deposits, those records will reliably be available from the reciprocals provider even if that provider fails. As the Synapse experience has proved, there is no basis for this rosy assumption.

If a large provider of reciprocal deposits were to fail and records of customers' deposits were unavailable, the effects could be catastrophic, both for the individual victims and for the stability of the banking system. In light of the Synapse experience, it is surprising and disheartening that the FDIC has taken the view that banks should not have a duty to have the deposit records of individual reciprocals customers. In short, banks should have these records, and the final rule should correct this important weakness of the Proposal.

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[35] Edward S. Prescott & Grant Rosenberger, *Reciprocal Deposits and the Banking Turmoil of 2023*, FEDERAL RESERVE BANK OF CLEVELAND ECONOMIC COMMENTARY 3 (Aug. 13, 2024), https://www.clevelandfed.org/publications/economic-commentary/2024/ec-202414-reciprocal-deposits-and-banking-turmoil-2023.

[36] Recordkeeping for Custodial Accounts, *supra* note 2 at 80142.

IV. TO CLOSE A SIGNIFICANT LOOPHOLE IN THE PROPOSAL, ACCOUNTS ESTABLISHED BY OR ON BEHALF OF ONE OR MORE BROKERS, DEALERS, OR INVESTMENT ADVISERS SHOULD NOT BE EXEMPT FROM THE RECORDKEEPING REQUIREMENTS.

The Proposal exempts from the recordkeeping requirements "accounts established by or on behalf of one or more brokers, dealers or investment advisers." In support of this exemption, the Proposal states that these entities are already subject to "recordkeeping requirements under Federal and State laws in addition to regulatory supervision."[37]

The question at issue, however, is whether ***banks*** should have a duty to have these deposit records, or whether they can rely solely and without any verification process on the records of these brokers, dealers, and investment advisors. As with the exemption for reciprocals, the Proposal assumes that there will be no Synapse-like entities among the universe of brokers, dealers, and investment advisors that place deposits with banks, crash and burn, and leave others to pick up the pieces without reliable records to work from.

"Brokers, dealers, and investment advisors" constitute a large and diverse set of entities. These firms will have opportunities to compete with, or work with, fintechs, to deploy technology in new ways to gather investors' funds and place them at banks. Within this universe there will be firms that push the competitive envelope aggressively, skirt rules, take shortcuts, and in some cases even misappropriate customer funds. There is no reason to assume there could not be a Synapse-like event involving sweep deposits placed in banks by one of these firms.

For this reason, Better Markets recommends that the final rule eliminate this broker/dealer/investment-advisor exemption to better protect bank depositors.

V. AS DESCRIBED IN A RECENT COMMENT LETTER FROM BETTER MARKETS, THE FDIC SHOULD TAKE ADDITIONAL STEPS TO PROTECT THE PUBLIC FROM RISKS ASSOCIATED WITH BANK-FINTECH DEPOSIT PLACEMENT ARRANGEMENTS.

The Proposal takes a key step to fill the regulatory vacuum that allowed the Synapse recordkeeping debacle to happen. It is important to remember, however, that accurate records alone cannot prevent customers from being victimized in bank-fintech deposit placement arrangements. If the deposit-placing fintech fails, good records can establish the customer's ***claim*** on the bankruptcy estate but cannot guarantee the estate will have enough assets to pay the claims in full. This is what is happening so far with the Synapse bankruptcy as a result of the missing $65-$95 million discussed above. If that money is never found, accurate depositor records will provide only the small consolation of keeping score of the amount of each customer's losses.

The potential for customers to be victimized in fintech deposit-placement arrangements is

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[37] *Id*. at 80141.

heightened by recurring instances of misleading or outright false statements made by some fintechs about deposit insurance. This recurring problem is noted in the Proposal, as is the response by the FDIC and the other banking agencies to these types of statements, and to the risks in bank-fintech arrangements more broadly.

In its comment letter in response to a recent interagency Request for Information, Better Markets provided several recommendations for steps the FDIC and the banking agencies should take to protect the public from risks in bank-fintech arrangements.[38] That letter contains an extensive discussion of the recommendations and the reasons for them. Here, we simply list the letter's recommendations that are most pertinent to fintech deposit placement arrangements, preceded in each case with a brief introduction.

First, advertising or other statements by fintechs that state or imply they are FDIC insured, that crypto-currencies are FDIC insured, or that the FDIC protects fintech customers if the fintech fails—none of which are true—have occurred with regularity. Yet we have found no instances where the FDIC exercised its legal authority to punish a fintech for violations of laws against such misrepresentations. Instead, the FDIC has issued only warning letters advising fintechs that if such statements do not stop, formal action could follow. Better Markets made the following recommendation:

- 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.[39]

Second, the banking agencies have emphasized that banks are accountable for legal violations occurring in connection with activities performed on their behalf by third parties. They have held banks accountable for third-party legal violations many times, including for violations of the Bank Secrecy Act, Fair Lending, and other laws. Yet we have found no instances where the FDIC (or any banking agency) formally cited a partner bank for the illegal deposit insurance misrepresentations made on its behalf by its fintech partner. We made the following recommendation:

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38 Better Markets Comment Letter, *supra* note 5.

39 *Id*. at 7-9 for discussion of FDIC advisory letters regarding misrepresentations about deposit insurance, and 16-19 for discussion of FDIC's and banking agencies' legal authorities to punish such misrepresentations and their failure to do so thus far.

- Formal or informal actions involving deposit insurance misrepresentations in connection with bank-fintech partnerships must hold both the fintech ***and*** the partner bank accountable.[40]

Third, the FDIC's own regulations in effect pre-commit the Agency not to take formal enforcement action against first offenders who make illegal misrepresentations about deposit insurance. Moreover, the FDIC's regulations defining misleading statements about deposit insurance allow fintech advertising to commit material sins of omission, by failing to disclose in plain English what the status of customer funds would be in the event the fintech fails. We made the following recommendations:

- 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.
- The FDIC should amend part 328.102 of its regulations to identify as misleading any third-party 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.[41]

Fourth, the FDIC's efforts to educate the public about the risks that exist in fintech deposit-placement arrangements have thus far been low-key and non-specific. The message of the FDIC Consumer News publications that address this topic has been that FDIC insurance only applies in a bank failure and that if a fintech fails, customers may get back some or all of their funds, and it may take some time.[42] Missing is any prominence or directness given to the message about customer risk of loss: as an example, an August 2022 Consumer News article contained the statement, "A non-bank's company failure or bankruptcy may result in delays in accessing your money, even when your money was deposited in a bank for your benefit," avoiding any explicit mention of the possibility of loss.[43] Also missing is any explanation of the legalities of bankruptcy and why the customer's deposit might not simply be returned in full to the customer if the fintech failed; any discussion of the experience with fintech failures including the extent of losses and delays experienced by customers; and any discussion of contractual terms customers should be looking for if safety of principal is important to them. We made the following recommendation:

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40 *Id*. at 5-7 for discussion of banking agencies' enforcement actions holding banks accountable for legal violations attributable to third-party activities generally, and 18-19 for discussion of their failure thus far to hold banks accountable for their fintech partners' misrepresentations about deposit insurance.

41 *Id*. at 20-21 for discussion of the implicit free pass to first offenders in parts 328.102 and 328.106, and 24 for discussion of the additional disclosure Better Markets recommends in part 328.102.

42 Federal Deposit Insurance Corporation, CONSUMER NEWS, https://www.fdic.gov/consumer-resource-center/fdic-consumer-news, (last visited Jan. 10, 2025). FDIC Consumer News articles we reviewed that form the basis of the statements in this paragraph are listed at this link as appearing in June 2024, July 2023, and August 2022.

43 *The Importance of Deposit Insurance and Understanding Your Coverage,* FDIC CONSUMER NEWS (Aug. 2022), https://www.fdic.gov/consumer-resource-center/2022-08/importance-deposit-insurance-and-understanding-your-coverage.

- 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.[44]

Finally, the banking agencies and the public have no centralized, regularly updated data on bank-fintech deposit gathering arrangements. Such data would make it easier for customers to understand who they are dealing with if they have questions or complaints; help regulators identify which banks may be affected by problems or legal violations at a particular fintech; and help regulators identify emerging systemic concentrations of bank exposure to fintechs. We made the following recommendation:

- The FDIC should work with the other federal banking agencies to 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.[45]

CONCLUSION

We hope these comments are helpful as the FDIC works to finalize its critically important Proposal to establish bank recordkeeping requirements for custody deposits.

Sincerely,

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44 Better Markets Comment Letter, *supra* note 5 at 21-23 for discussion of the need for the FDIC to more proactively educate the public about the risks to which customers are exposed in bank fintech deposit placement arrangements.

45 *Id.* at 24-25 for discussion of Better Markets' recommendation regarding the collection in Call Reports of information about material bank fintech arrangements.