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Bank-Fintech Partnerships Hold Promise but Banking Agencies Must Do More to Protect the Public

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October 30, 2024

Today, tens of millions of Americans use banking services provided by fintech firms operating in partnership with banks. These services range from mobile payment apps, to lending, to deposit placement arrangements, and more. However, few who use fintechs know that they are almost entirely unregulated and that the users are exposed to serious risks, including crippling financial losses. There's no question that many bank-fintech partnerships have numerous potential benefits such as reducing the cost and increasing the convenience and availability of banking services, and enabling community banks to offer services that they could not otherwise provide in-house. But those potential benefits must be balanced with the risks, and consumers and financial stability need to be protected.

That's because too many instances over the last few years have shown that when bank-fintech partnerships go wrong, they can go very wrong, and losses can add up quickly. Laws have been broken, customer funds have been misappropriated or gone missing, and accountholders have lost access to funds over extended periods. Deposit placement arrangements have come under particular scrutiny. Selected examples include:

Fintech misrepresentations about deposit insurance. For nearly a century, FDIC deposit insurance has been trusted by Main Street Americans, who have not lost a penny of insured funds since the FDIC was created. In recent years, though, fintech companies have endangered this trust by claiming that funds customers place with them are also FDIC-insured, when in fact they are not.

Since 2022, the FDIC has sent 22 advisory letters to fintech companies, demanding that they cease making false and misleading statements about deposit insurance.[i] Details vary, but recurring ***false statements*** cited in these letters include:

- the fintech is FDIC-insured;
- the FDIC will protect the fintech customer if the fintech fails; and
- the FDIC insures cryptocurrency.

Despite their tough wording, the FDIC letters were ***not*** binding orders; instead, the letters were only warnings that if the misconduct did not stop, the FDIC ***could,*** at some point,

exercise its authority to take formal enforcement actions. Inexplicably, the FDIC has not publicly used its authority to address this misconduct by holding either the fintechs, or their partner banks, formally accountable. As Better Markets has written previously, the FDIC needs to find the will to use its formal enforcement authority to address this misconduct.

Bankruptcy of Voyager Digital Holdings, Inc. Voyager entered bankruptcy in July 2022. It subsequently settled with the Federal Trade Commission ("FTC") for having made illegal, deceptive statements assuring its customers that funds placed by Voyager at its partner bank were FDIC-insured. Voyager accountholders' funds were tied up in a multi-year bankruptcy proceeding, with a second wave of distributions occurring in August, 2024. The FTC's forceful response against Voyager is commendable; in disappointing contrast, the banking agencies have again done nothing publicly to hold the partner bank formally accountable for the deception.

Bankruptcy of FTX Trading, Ltd. FTX and its affiliates entered bankruptcy in November 2022. FTX, a crypto company that, incredibly, had been allowed to gain control of a bank, claimed that customer assets were held separately from FTX's own assets. However, the court found that customer funds were actually commingled with FTX's funds and misappropriated. The court ordered FTX to ***pay $12.7 billion to victims of its fraud***. FTX's CEO was incarcerated and FTX accountholders are still waiting to receive their bankruptcy distributions.

Bankruptcy of Synapse Financial Technologies, Inc. Synapse entered bankruptcy in April 2024. Synapse was a middleman, standing between other fintechs and partner banks. Synapse would place funds belonging to customers of the other fintechs into partner banks. Unfortunately, it later became clear that Synapse, at a minimum, was not keeping sufficient records of its transactions (and facts may develop that indicate more nefarious actions happened as well). As a result, tens of thousands of customers lost access to their funds when it proved initially impossible to reconstruct which deposits held at partner banks belonged to which fintech customers, and distributions to customers still are far from complete. Worse, the bankruptcy trustee reports that $65 million to $95 million is missing, as Synapse's records show that it deposited more money at partner banks than the partner banks' records show was received.

Debacles such as these ***cost hardworking Americans*** who believed the misleading fintech assurances about deposit arrangements with partner banks lots of money they cannot afford to lose. If repeated on a larger scale with a very large fintech—and it is inevitable that fintechs will continue to grow in size and importance—the result could be an abrupt loss of confidence in the bank-fintech model or in banks more generally, with rapid deposit withdrawals and a liquidity crisis. Simply put, the banking agencies ***must*** do more to ensure banks can benefit from fintech arrangements without endangering themselves, the public, or financial stability.

Better Markets recommends that the banking agencies:

1. Implement clear and enforceable regulatory standards for banks' third-party risk management;

2. Make more forceful use of their examination and enforcement authority over banks' fintech partners;
3. Amend Call Reports to require banks to identify third parties that conduct material amounts of deposit-taking, payments, or loans for the bank or in partnership with the bank.

Better Markets recommends that the FDIC:

1. Use its formal enforcement authority to hold both fintechs and their partner banks publicly accountable for misleading statements about deposit insurance;
2. Eliminate from its regulations what is, in effect, a free pass for first offenders that make misleading statements about deposit insurance;
3. Require banks to collect and maintain adequate information about the individual depositors in custody accounts (the need for this was demonstrated by the Synapse debacle);
4. Publish an 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. Change its regulations to identify as misleading statements about deposit insurance any third-party's advertisement regarding arrangements with FDIC-insured partner banks that do not clearly and accurately identify the treatment of accountholders funds in the event of the failure of the third party.

These recommendations are discussed in more detail in Better Markets' response to the banking agencies' Request for Information regarding bank fintech arrangements. The FDIC has also requested comment on a proposed rule to require banks to have more information about the individual underlying depositors in certain custody deposits.

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[i] 21 of the 22 letters can be found on a dedicated page on the FDIC website. As of October 15, 2024, that site lists 23 letters. We have excluded 2 letters which were sent to an import company. The 22nd letter—a 2023 letter to Atmos Financial—is referenced in the FDIC's January 2024 letter to Atmos.

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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