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Sent via secure email

October 29, 2024

Board of Directors
b4,b8

Subject: Crypto-Related Activities Supervisory Feedback Letter (Letter)

Dear Members of the Board:

This letter serves as supervisory feedback regarding b4,b8 (Bank) crypto-related activities. Additional feedback may be warranted during future regulatory oversight activities (such as examinations, targeted reviews, visitations, and off-site reviews) or if circumstances change with crypto-related partnership.

On April 7, 2022, the FDIC issued Financial Institution Letter (FIL)-16-2022, *Notification of Engaging in Crypto-Related Activities*. FIL-16-2022 requested that all FDIC-supervised institutions that intend to engage in, or that are currently engaged in, any activities involving or related to crypto-assets (also referred to as "digital assets") promptly notify the appropriate FDIC Regional Director.

On May 3, 2022, The Bank notified the FDIC and the b8 b8 via electronic letter (letter) of its crypto-related activities related to two third-party partners: b4,b8 b4,b8 The letter noted that the Bank launched a credit card product called b4,b8 in b4,b8 with b4,b8 The letter also noted that the b4,b8 is an b4,b8 b4,b8 The letter also indicated a partnership with b4,b8 for the following two services: a money market account for b4,b8 end-users to send fiat dollars to and from the b4,b8 Platform, and a proposal to originate open-end consumer loans to b4,b8 collateralized by either securities or crypto-assets that an end-user purchases and holds on the b4,b8.

On September 19, 2022, the FDIC notified the Bank that the review of the previously noted partnerships was ongoing and would be separated from the July 18, 2022, Safety and Soundness Examination. Furthermore, an update meeting was held with the Bank on January 26, 2023, to gather additional details and receive an update on both aforementioned third-party partners. The Bank has since terminated the b4,b8 partnership.

SUPERVISORY FEEDBACK SUMMARY

Crypto-related activities may pose safety and soundness and consumer protection risks to the institution and its customers. The types and levels of risks are dependent on the type of activity, implementation of the activity, and controls designed to mitigate risks. Examples of risks that may be present include, but are not limited to, compliance, legal, operational, third-party, and strategic. Facilitating customer crypto-asset trading alongside traditional banking products and services may also present heightened risk to the Bank's customers, such as:

- Confusion about the role of the financial institution in crypto-transactions;
- Lack of understanding about the nature and risks associated with crypto-asset products;
- Inability to differentiate between non-deposit products and traditional banking products, such as deposit accounts; and,
- Misunderstanding the applicability of Federal deposit insurance coverage.

The FDIC's *Advisory to FDIC-Insured Institutions Regarding FDIC Deposit Insurance and Dealings with Crypto Companies*, issued on July 29, 2022, via FIL-35-2022, may serve as a useful resource for the Board and management regarding risks and concerns arising from crypto-assets offered by, through, or in connection with, insured depository institutions. In addition, Part 328, Subpart B of the FDIC's Rules and Regulations, titled "False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo," can apply to non-banks, such as crypto companies. (*See* 12 CFR Part 328, Subpart B.) Accordingly, the Bank should determine if its third-party risk management policies and procedures effectively manage crypto-related risks, including compliance risks related to Part 328, Subpart B.

The *Joint Statement on Crypto-Asset Risks to Banking Organizations* (Joint Statement), issued on January 3, 2023 by the FDIC, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency, and via FIL-01-2023, may also serve as a useful resource for the Board and management regarding crypto-asset risks. Events over the last few years across the crypto-asset sector have been marked by significant volatility and have exposed vulnerabilities in the sector. These events highlight a number of key risks associated with crypto-assets and crypto-asset sector participants that banking organizations should be aware of, including those outlined in the Joint Statement.

b4,b8 Supervisory Feedback Summary

While management has taken numerous actions, such as developing policies, progress reports, and underwriting requirements, certain risks related to the b4,b8 were not fully evaluated or considered based on the documents provided by the Bank. The FDIC acknowledges that significant time has passed since the Bank performed due diligence on b4,b8 and that the Bank has likely updated multiple risk assessments, monitoring reports, and overall structure of the partnership. However, Bank management needs to perform additional diligence to ensure the relationship is properly assessed and reflects the Bank's desired risk appetite with accompanying controls. This includes, but is not limited to, a variety of additional assessments that are needed around the b4,b8 relationship such as the functionality of the

b4,b8 and the account creation involved with b4,b8 In addition, various concerns were noted in the Compliance Risk Assessment that need management attention. The material growth of this partnership, coupled with the Bank's January 2023 downgrade of b4,b8 partnership to a negative outlook, stresses the importance for the Board to reevaluate a number of areas associated with this partnership.

Most recently, the b8 and b4,b8 b4,b8 which appears to be a related party of b4,b8, entered into a b4,b8 b4,b8 Management should in its review, at a minimum, consider any related concerns with compliance, management, governance, and internal audit.

Additional information is noted below on the relationship between b4,b8

DETAILED FINDINGS AND FEEDBACK

b4,b8 Corporate Governance

b4,b8

Various documents, including Bank management's New Partner Product Approval form, discuss a variety of roles and responsibilities in regards to the referenced parties above. However, a number of specific due diligence areas, such as Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT), Vendor Management, and Information Security reference b4,b8 rather than the specific entity, party, or principal that may be providing the service. Bank management needs to perform additional due diligence to ensure the relationship is properly assessed and reflects the Bank's desired risk appetite with accompanying controls. For

[1] b4,b8

example, further review and due diligence is needed to clarify which entities are involved with which services. Failure to properly identify specific critical parties involved in the legal partnership with the Bank may result in material disruptions or unknown deficiencies that could change the Bank's outlook on a relationship. Management can refer to FIL 29-2023 *Interagency Guidance on Third-Party Relationships: Risk Management* for examples of considerations in the area of due diligence.

In addition, management should revisit the Program Agreement with b4,b8 with respect to the adjustable tangible net worth definition lacks details surrounding the fair value methodology to be used with a digital asset loan, as well as any definition for a digital asset loan. Failure to provide clear and understandable definitions could lead to a dispute or mismanagement of the program requirements.

b4,b8 Rewards Program

b4,b8

In addition, the ambiguity around self-custody or a centralized custodian introduces potential for customer confusion, consumer harm, and legal uncertainty. For example, customers may be surprised by reward-related fees and crypto-asset transaction limitations if they are unexpectedly required to arrange a custody arrangement for their crypto-asset rewards with b4,b8 or another party. By not clearly stating that the customer is required to arrange for custody of their crypto-assets at b4,b8 or a related interest, the Rewards Agreement lacks clarity for communicating fees for converting, selling, or holding crypto-asset rewards, as well as any de minimis limitations when converting small rewards balances to U.S. Dollars. Furthermore, the Rewards Agreement lacks commentary regarding b4,b8 or the Bank's potential rights to re-hypothecation arrangements that could allow the pledging of a user's crypto-assets for other services that the consumer has no interest in.

Due diligence and risk assessments performed by the Bank were silent regarding the previously noted items. Failure to understand and assess risks related to custody and re-hypothecation could lead to significant operational and legal risk if platform operations become disrupted, or if crypto-assets are receiving custody services that are different than what is disclosed to the end-user.

Potential Undisclosed Account Openings

Management's evaluation and due diligence of the b4,b8 User Agreement[2] (User Agreement) between b4,b8 and it's applicability with the b4,b8 credit card issued through b4,b8 is insufficient. The Bank and the companies previously referenced may be incorrectly applying provisions from the User Agreement to b4,b8 credit cardholders. Some of those provisions address the opening of b4,b8 user accounts, as well as the applicability of certain laws and regulations, and account investigations.

Specifically, at the credit card application stage, the consumer must agree to b4,b8 User Agreement. The User Agreement notes a variety of services that b4,b8 provides such as account creation, customer oversight, and the various types of digital assets available on their platform. This User Agreement appears to represent an agreement between b4,b8 and any users of b4,b8 platform, regardless of whether the consumer requests a credit card or not.

However, the same User Agreement includes a brief section on credit cards. In short, the credit card section states that one's b4,b8

b4,b8

The discrepancies between the User Agreement and the Card Holder Agreement may create customer confusion. The b4,b8 Card Holder Agreement lacks a variety of provisions present in the User Agreement that likely cover activities related to the crypto-rewards feature that

b4,b8

b4,b8 or related entities provide to credit cardholders. Given that b4,b8 appears to have applied a variety of the provisions of the User Agreement, which are not included in the b4,b8 Card Holder Agreement, b4,b8 or the Bank may be executing activities outside of the end-user's legitimate expectations. Thus, crypto-trading accounts and a variety of other services at b4,b8 or their related companies may be opened or pushed down to credit cardholders without proper consent.

In correspondence with bank management, management stated their belief that the entirety of the User Agreement is applicable to the b4,b8 Card. This is further supported by risk assessments and other documents referencing the User Agreement. The carve out in the User Agreement indicating that only the provisions of the Card Holder Agreement apply to the b4,b8 Card represents a clear oversight that has not been considered or properly evaluated by bank management. Management needs to revisit the User Agreement and evaluate the language to determine what actions may be necessary to properly communicate the terms and conditions to end-users, especially with regard to the creation of crypto-asset accounts. Furthermore, the risk assessment's lack of consideration or discussion of this User Agreement and the applicability of the Card Holder Agreement is concerning and should be reconsidered.

Initial Compliance Risk Assessment

The Bank completed the Initial Compliance Risk Assessment prior to the launch of the b4,b8 Card. While the Initial Compliance Risk Assessment appropriately identified some consumer protection weaknesses, the document does not clearly communicate the overall scope of review, nor does the document clearly explain that resource constraints at b4,b8 contribute to some pre-implementation compliance weaknesses.

The Initial Compliance Risk Assessment presents conflicting information about the effectiveness of b4,b8 compliance resources. The document states that there are resource weaknesses, but contradicts itself and says that there are not resource weaknesses. The Initial Compliance Risk Assessment includes a section about "Risks/Concerns," with a subsection for "Compliance Resources." The opening paragraph in this subsection states that b4,b8 compliance program is lacking resources." The document then describes two other significant compliance concerns surrounding Equal Credit Opportunity and the Fair Debt Collection Practices Act. After highlighting the need for more resources, the subsection ends with a paragraph that contradicts the initial statement about resource needs, stating "[t]hese three Compliance concerns have been resolved. Throughout implementation, b4,b8 has demonstrated that it has sufficient experience at hand and resources dedicated to the card product."

The discrepancy is again repeated in the section titled "Platform Resources Considerations." In this section, the Initial Compliance Risk Assessment states, b4,b8 appears to have only one person dedicated to Compliance .. b4,b8 must ensure that additional Compliance resources are added to the b4,b8 team." The next paragraph contradicts the first section by mentioning that b4,b8 "has proved to have sufficient resources and staff in place to monitor and oversee regulatory compliance." After stating conflicting information about the adequacy of compliance resources, the document ultimately mentions that b4,b8 plans to hire additional compliance staff.

Oversight of vendor capabilities is an important part of an effective third-party vendor management program. It is important to clearly understand the quality and availability of a vendor's staffing resources. Without a clear understanding, and communication of a vendor's resource constraints, Board and management may not be able to proactively identify and mitigate the risk of consumer harm.

CONFIDENTIALITY NOTICE

This Letter is confidential and may not be disclosed or made public in any manner under Part 309 of the FDIC Rules and Regulations (12 CFR Part 309). Please notify the FDIC immediately if you receive a subpoena or other legal processing calling for the production of this Letter or a description of its content.

ACTION REQUESTED

- The Board needs to ensure these matters are fully addressed to effectively mitigate risk to the institution and consumers.
- Please review this Letter at the next Board of Directors meeting and document your review in the Board minutes.
- FIL-16-2022 requests that all FDIC-supervised institutions should promptly notify their respective Regional Director if the bank is intending to engage in any activities involving or related to crypto-assets. Management is reminded to notify the San Francisco Regional Director if the Bank is active with or considering any new partners involving crypto-related activities.
- Within 45 days of the date of this letter, please provide a written response to both the FDIC and the UDFI.

Written correspondence should be addressed to my attention at the San Francisco Regional Office, and sent as a PDF document through the FDIC's Secure Email portal (https://securemail.fdic.gov) using the following e-mail address: SFMailroom@FDIC.gov. Information on how to use secure email and FAQs about the service can be found at https://www.fdic.gov/secureemail/.

If you have any questions, please contact RMS Assistant Regional Director Debra Rhodes at b6, RMS Case Manager b6,b8 DCP Assistant Regional Director Matthew Sheeren at b6 or DCP Compliance Technology Specialist b6,b8

Sincerely,

PAUL WORTHING

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Paul Worthing
Regional Director
San Francisco Regional Office

cc: b8