FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION
Division of Risk Management Supervision
Division of Depositor and Consumer Protection

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October 6, 2023

Board of Directors
[redacted]

Subject: Transmittal Letter: Joint Examination Team (JET) Visitation Crypto-Related Activities Review at [redacted]

Dear Members of the Board:

On April 4, 2022, management initiated a new digital service through a third party, [redacted] and its affiliated entities (collectively [redacted]. This service, the [redacted] (Platform), allows retail deposit customers the option to buy, hold, and sell Bitcoin, and was embedded in the bank's online banking platform and mobile application ([redacted] Services) provided by [redacted].

After becoming aware of the activity, FDIC Dallas Regional Office representatives met with bank management on June 21, 2022, and requested that the bank provide notification as requested by FIL-16-2022 and pause onboarding new customers. Bank management notified the FDIC on July 8, 2022, and confirmed that the bank suspended new customer acceptance, but allowed existing customers to continue to trade. On July 14, 2022, the FDIC notified the bank's Board via letter that the agency was reviewing these activities and would be providing supervisory feedback, and requested that the bank refrain from expanding the service until the review's completion.

On October 31, 2022, an FDIC joint examination team from Division of Risk Management (RMS) and Division of Depositor and Consumer Protection (DCP), together with participation from the [redacted], began a joint visitation of the bank. The purpose of the visitation was to review the bank's new digital service offering customers the ability to purchase, hold, and sell Bitcoin via a third party arrangement. While finalizing visitation findings, on July 20, 2023, bank management notified the FDIC that [redacted] terminated its agreement with the bank effective immediately via a letter dated [redacted] The FDIC is providing the following high-level comments, which summarize key findings from the information reviewed during the visitation and prior to the termination of the arrangement, to help inform management on the bank's third-party risk management practices. These findings include a [redacted] that requires corrective action.

SCOPE OF THE REVIEW

The October 31, 2022, visitation was led by DCP Examiner-in-Charge (EIC) [redacted] and RMS EIC [redacted] The visitation focused on understanding and assessing the bank's risk

and compliance management frameworks governing the [redacted] Services. This includes, but was not limited to, management's actions to evaluate the services prior to implementation, processes established to identify, manage and mitigate potential risks presented by these services, and ongoing monitoring processes developed to oversee these services.

BACKGROUND

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 nondeposit products and traditional banking products, such as deposit accounts; and,
- Misunderstanding the applicability of Federal deposit insurance coverage.

SUPERVISORY FEEDBACK

The overall risk management and compliance management frameworks governing the [redacted] Services did not sufficiently identify, measure, monitor, and control existing risks. The Board is accountable for ensuring sufficient oversight, prudent risk appetites, and the effective identification, measurement, monitoring, and control of risks through the establishment of appropriate policies, procedures, risk assessments, internal controls, and review processes.

Management's strategic planning, initial due diligence and project implementation of the [redacted] Services was largely informal, lacked independence and Board oversight, was heavily reliant on [redacted]-provided information and on [redacted]'s relationship with [redacted], and was not sufficiently comprehensive for the initiative's significant strategic impact. The initial due diligence process was overly reliant on vendor-provided documents, and sufficient independent assessment and analysis was not evidenced. Further, Board minutes do not reflect any discussion of the [redacted] Services, and Board oversight appears limited to the inclusion of [redacted] as a potential vendor on the [redacted] meeting agenda and approving the new [redacted] Policy shortly before product launch.

Policies and written procedures governing the activities are either too brief or nonexistent. Further, bank management stated that they consider the [redacted] Service a non-deposit investment product, which appears to be inconsistent with the bank's internal [redacted] Policy, which states that [redacted]

[redacted] A documented legal permissibility analysis conducted prior to the project's implementation was not evidenced, and the bank's existing project management policies were not appropriately applied, resulting in inadequate project oversight by both the Board and senior management.

While no crypto-asset specific risk assessments were performed, the BSA/AML and OFAC Risk Assessment was updated to include crypto activities, but the additions were relatively minimal and did not address the more significant non-AML related risks. The outsourced vendor review of [redacted] was limited in both scope and depth, and did not assess certain key elements, such as financial analysis and operating controls, and the bank's internal review did not flag these issues. Further, management conducted an initial vendor review of [redacted] which included a consideration section titled "[redacted]," however, it does not address Unfair or Deceptive Acts or Practices under Section 5 of the Federal Trade Commission Act (UDAP), Electronic Fund Transfers (Regulation E), or FDIC Part 328 Advertisement of Membership, False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo (FDIC Part 328). For example, in assessing potential risks related to Part 328, the analysis did not consider the restrictions on using the official advertising statement when advertising non-deposit products and the prohibitions against misrepresentations about deposit insurance and the misuse of the FDIC's name or logo, with respect to representations regarding Bitcoin.

Audits of the program were not performed or scheduled, and formal monitoring and activity report review processes were not established. Bank management was not familiar with all the reporting mechanisms available in [redacted] and did not determine what information was relevant to track to assess and control ongoing risks. Therefore, it is unknown if sufficient information was available and accessible to bank management. Also, the bank provided informal training to bank employees that included a background on Bitcoin and bank prepared FAQs; however, there was no formal training discussing the responsibilities of the bank and its employees in providing customer service for the [redacted] Service. Further, the bank's Complaint Policy was not updated to address the bank's responsibility or procedures for handling complaints or risks specific to the [redacted] Service.

The risk for customer confusion was heightened due to the [redacted] Service, which is a nondeposit product, that is only accessible to customers through the Bank's existing online banking and mobile application (app) platforms where FDIC-insured deposit products are also accessible. Management did not sufficiently enhance the compliance management system to identify and mitigate consumer compliance considerations related to this crypto-asset service.

In the various electronic pages presented to customers during the enrollment process, and when subsequently accessing the [redacted] Service or viewing the [redacted] through the [redacted] widget on the home page, some information was provided on the nature and risks related to the service, but such information was inconsistently presented, and the placement, format, and timing of such language was not always clear and conspicuous. Also, the terms and conditions or terminologies used in [redacted] disclosures, the online banking or mobile app screens, and bank

stated system parameters did not always align. For example, the information provided by Bank management states that there is a $[redacted] minimum purchase amount and a $[redacted] daily transaction limit. However, the terms and conditions that are provided to customers only disclose the $[redacted] buy limit per transaction.

Management developed a variety of marketing materials for the Platform, which were distributed physically at branches and through social media. These marketing materials advertise [redacted]. For example, one Bitcoin poster includes [redacted] with additional information in the fine print that Bitcoin is not FDIC insured, may lose value, and is not guaranteed by the bank. However, it did not include language that Bitcoin is not a deposit or other obligation of the institution. Also, this Bitcoin poster and a Bitcoin flyer both included the "Member FDIC" logo which contributed to a [redacted] of FDIC's Part 328.3(e)(2), which describes the requirements for non-deposit product advertisements. Please refer to the *Violations of Laws and Regulations* section below for additional details.

RESOURCES

The following Financial Institution Letters (FIL), along with their references and attachments, provide useful guidance to assist the Board and senior management related to considering offering crypto-related activities:

- FIL-54-2014: Filing and Documentation Procedures for State Banks Engaging, Directly or Indirectly, in Activities or Investments that are Permissible for National Banks
- FIL-16-2022: Notification of Engaging in Crypto-Related Activities
- FIL-35-2022: Advisory to FDIC-Insured Institutions Regarding Deposit Insurance and Dealings with Crypto Companies
- FIL-01-2023: Joint Statement on Crypto-Asset Risks to Banking Organizations
- FIL-29-2023: Interagency Guidance on Third-Party Relationships: Risk Management

Also, the *February 15, 1994 Interagency Statement on Retail Sales of Nondeposit Investment Products* may be a useful resource for Bank management when considering how to ensure clear and conspicuous language is provided to customers when offering nondeposit products.

VIOLATIONS OF LAWS AND REGULATIONS

Level 2/Medium Severity Apparent Violation

ADVERTISEMENT OF MEMBERSHIP - SUBPART A

The Federal Deposit Insurance Act (12 U.S.C. §§ 1818, 1819 (Tenth), 1820(c) and 1828(a)), as implemented by the Advertisement of Membership rule, 12 C.F.R. § 328.3(e), prohibits a financial institution from including the official advertising statement, or any other statement or symbol implying or suggesting the existence of Federal deposit insurance, in any advertisement

relating solely to non-deposit products and hybrid products. In mixed advertisements, a financial institution must clearly segregate the official advertising statement as provided in § 328.3(e)(4).

The bank is in apparent violation of this regulation, as multiple advertisements were developed and distributed that related solely to non-deposit products offered through the Platform, but displayed the FDIC official advertising statement. Examiners reviewed in-house advertisements developed by the bank related to the third-party crypto-asset service offered by [redacted], through the bank's online banking platform and mobile application provided by [redacted], that allowed deposit customers the option to buy, hold, and sell bitcoin. During 2022 certain advertisements for the [redacted] Platform (Platform) were physically displayed at branches and posted on the bank's social media channels. These advertisements each provided varying levels of detail regarding the Platform, but at a minimum, each included the bank's name and referenced bitcoin. For example, one advertisement included the bank's name in several places, the Bitcoin logo and reference to bitcoin, and additional information in the fine print that Bitcoin accounts and services are provided by [redacted] and that bitcoin is not FDIC insured, may lose value, and are not guaranteed by the bank. In addition, four [redacted] advertisements were posted to the bank's account relating solely to Bitcoin or the Platform. However, these advertisements also included an image of the FDIC official advertising statement "Member FDIC" in violation of FDIC's Part 328.3(e)(2)'s restrictions applicable to advertisements relating solely to non-deposit products.

The root cause of this violation is marketing personnel's misinterpretation of the Advertisement of Membership Rule. Although established procedures require that all advertisements be reviewed prior to publication, it is not clear whether the social media platforms are reviewed to ensure that non-deposit product advertisements are clearly disclosed. Bank management has since removed all but one of the Bitcoin advertisements on [redacted]

Examiners recommend that management review the remaining advertisement (if not previously removed from [redacted]), enhance advertising training for personnel creating and posting advertisements, and monitor activities to ensure that all advertisements, including social media postings, are reviewed prior to publication.

ACTION REQUESTED

In order to assess the implementation of the bank's [redacted] wind down plan, please provide this office with copies of the following records by October 31, 2023: 1) summary of key dates that termination benchmarks were completed; 2) account closure data and reconciliations reports; 3) a copy of the final [redacted] account closure notices provided to customers directly or posted on customer accounts; 4) copies of training material or general talking points provided bank staff on the wind down process; and, 5) information on customer complaints or inquiries received during the wind down process. After the FDIC's review of the documents, the FDIC will determine whether additional information is necessary to close this matter.

Further, the Board should review this Letter at their next meeting and document their review in the minutes. For the [redacted] of False Advertising, Misrepresentation of Insured Status and Misuse of FDIC's Name or Logo regarding the advertising of the Bitcoin Service, please confirm management commitment to corrective action by providing a written response within 30 days of receipt of this Letter. The bank should retain a complete record and supporting documentation of corrective action taken for review at the next consumer compliance examination.

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 process calling for the production of this Letter or a description of its content.

If you have any questions, please contact RMS Assistant Regional Director J. Mark Love at [redacted] or DCP Acting Assistant Regional Director Rafael Valle at [redacted]. Written correspondence should be addressed to Kristie K. Elmquist, Regional Director, FDIC, Dallas 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: DALMailRoom@fdic.gov. Information about how to use secure email and FAQs about the service can be found at https://www.fdic.gov/secureemail/.

Sincerely,

Kristie Elmquist

Kristie K. Elmquist
Regional Director

cc: [redacted]