Federal Deposit Insurance Corporation
Division of Risk Management Supervision
350 5th Avenue, New York, NY 10018

New York Regional Office

April 25, 2022

Board of Directors
[redacted]

Subject: Questions Related to [redacted]

Dear Members of the Board:

On February 22, 2022, the FDIC, Office of the Comptroller of the Currency, and Board of Governors of the Federal Reserve System met with the [redacted] and its member banks at the time. At that meeting, it was evident that the [redacted] had yet to finalize the use cases or functionality of the product and the Operating Rules by which the [redacted] and its members would be governed. The discussion indicated phases or versions of the product, with future solutions, and, subsequently, the FDIC has received revised information outlining three models under consideration for the [redacted] program.

In our letter to you on April 22, 2022, the FDIC stated it has a number of questions based on the discussion and information provided to date. The initial questions are attached and we request responses by June 9, 2022. As noted in our prior letter, we expect you to satisfactorily address these and any subsequent questions (in advance of implementation) to ensure the bank is operating in a safe and sound manner.[1] This is consistent with FIL-16-2022, which requests that institutions provide information necessary to allow the agency to assess the safety and soundness, consumer protection, and financial stability implications of such activities.

Written correspondence should be addressed to Jessica A. Kaemingk, Acting Regional Director, FDIC, New York Regional Office, and sent as a PDF document through the FDIC's Secure Email portal (https://securemail.fdic.gov/) using the following email address: NYMailRoom@fdic.gov. Information about 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 Assistant Regional Director Ashley M. Amicangioli at [redacted].

Sincerely,
Jessica A. Kaemingk
Acting Regional Director

[1] See e.g., Section 39 of the Federal Deposit Insurance Act and Part 364 of the FDIC Rules and Regulations.

Attachment – [redacted] Questions

CC: [redacted]
Federal Reserve Bank of New York

[redacted] Questions

1. **Governance and Structure of [redacted]**
   a. Describe the activities conducted by [redacted]; the assets held by [redacted] the services [redacted] provides to [redacted] banks; and the relationship between [redacted] and [redacted] banks.
   b. Describe the governance in place for [redacted] private protocol within the [redacted] blockchain, including the processes for decision-making, key participants, and key personnel. In your response, indicate the extent to which (i) [redacted] will participate in or exercise control over governance of [redacted] private protocol within the [redacted] blockchain; and (ii) participants on the private protocol could make decisions that would have binding effect with respect to [redacted], including over [redacted] objections.
   c. Describe what role, if any, [redacted] and [redacted] will play in the governance of the [redacted].
   d. Describe what role, if any, non-member, participating banks will play in the governance of [redacted] private protocol, including whether such banks will be restricted in conducting any activities related to the public [redacted] blockchain.
   e. Provide the terms of the [redacted] smart contract, the rules of the [redacted] blockchain and the private protocol, and any documents that describe the terms of such smart contract. Identify the party responsible for creating and coding such terms into the smart contract.
   f. Explain in detail the consensus mechanism for the [redacted] blockchain. Identify all persons that control 5 percent or more of the staking assets for the blockchain and provide the percentage controlled.
   g. Explain any dispute resolution processes contemplated with respect to [redacted] members.
   h. Provide a list of the fees [redacted] has already paid to [redacted], and estimated expenses moving forward. In your response, please clarify what the fees are for and whether there are expectations of periodic payments to [redacted].
   i. Discuss the permissibility of [redacted] membership in [redacted] under section 24 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831a, and part 362 of the FDIC Rules and Regulations, 12 C.F.R. part 362.
   j. Clarify whether [redacted] operates a node or is otherwise involved in validating transactions on the [redacted] blockchain or the private protocol. Identify other entities that operate as a node or otherwise validate transactions. Explain how such nodes are assigned; the role they serve; the governance process for nodes; and whether the nodes for the [redacted] private protocol are the same or different than [redacted] nodes.
   k. Describe what involvement, if any, [redacted] may consider in non-[redacted] related activities of the [redacted] blockchain.
   l. Identify the steps that [redacted] would need to take if it chooses to exit the [redacted].
   m. Describe key third-party relationships that the [redacted] and the [redacted] will enter into with respect to [redacted] activities. In your response, please address any

contemplated relationships with [redacted], [redacted] and their affiliates.

n. If the applications for [redacted] include business-to-business payments, merchant payments, and peer-to-peer payments, explain whether different governance protocols would be adopted to ensure privacy, confidentiality and/or data security for the different types of customers and their data.
o. Explain any restrictions in place regarding the use of data related to [redacted] transactions. In your response identify the parties with access to such data and the type(s) of data they can access and any controls monitoring the use of such data. Explain the rights and responsibilities with respect to privacy and/or data security violations.
p. Explain the extent to which [redacted] transactions will make use of an off-chain contract execution environment.
q. Provide a copy of the Operating Rules.
r. Describe any insurance that is contemplated to cover loss or malfeasance at the [redacted] or [redacted] bank-level.
s. Explain whether [redacted] banks or participating banks are required to sign exclusivity agreements with the [redacted]. In your response, clarify whether [redacted] banks or participating banks are allowed to join other similar [redacted]

2. Classifications.

a. Explain the difference, if any, between the [redacted] use of the terms "[redacted]" "[redacted]" and "[redacted]" (Note these questions use the term "[redacted]" but should be read broadly if there is a difference in these terms.)
b. The website [redacted] (last visited on 3/31/2022) uses the terms "[redacted]" and "[redacted]" Clarify [redacted] understanding of [redacted]
c. Explain whether the [redacted] identify the issuing bank and how, if at all, this distinction is apparent to banks and/or customers.
d. Explain the basis for [redacted] determination that its participation in the [redacted], including all the activities that it would conduct as part of the [redacted] is permissible under applicable law.

3. Accounting.

a. Explain how funds exchanged for [redacted] are reflected on the balance sheet of [redacted]
b. Explain whether and how the [redacted] themselves are or will be reflected on the balance sheet of [redacted]
c. Explain whether reserves will be held in connection with the [redacted] liabilities and, if so, whether such reserves be held as cash or in the form of specific assets. If reserves are held, explain whether they serve as collateral for the [redacted].
d. Provide example general ledger entries for [redacted]; transfer of [redacted] to a customer of another [redacted] bank; burning of [redacted]; and settlement of due-to/due-from balances among [redacted] banks. Please provide a chart depicting the flow of funds.

4. Exposure to Other Members of the [redacted].

a. Explain how [redacted] mitigates the risk of intraday (or over-the-weekend) exposures to other [redacted] banks. In your response, describe any controls in place to protect [redacted] from the failure of a fellow [redacted] bank during the term of these exposures.

b. Explain the liability, if any, [redacted] would have to holders of [redacted] issued by another [redacted] bank upon such bank's failure.

5. Risk Management and Controls.

a. Describe the role of the board in reviewing and approving bank participation in the [redacted] and [redacted] activities.

   i. Explain the process by which [redacted] board and/or management assessed [redacted] authority to participate in the [redacted]?

   ii. Identify the legal risks (including permissibility, if applicable) [redacted] Bank's board considered when deciding whether to participate in the [redacted] Explain how the [redacted] plans to mitigate and manage those risks.

   iii. If participation in the [redacted] was approved by the board, explain the basis upon which the board approved [redacted] participation while key questions related to liability, membership, operating rules, and use cases have not been finalized.

   iv. If participation in the [redacted] was not approved by the board, explain management's authority to enter into the activity without board approval.

b. Explain the type of risk assessment and due diligence that was performed and identify key personnel involved in such activities.

c. Explain whether management identified relevant expertise needed to engage in this activity.

d. Explain whether [redacted] established any dollar volume-based limitations on customer activity or bank level activity (on a daily basis) (for example, to monitor total exposure/volume).

e. Explain whether the bank will upgrade or change any systems or procedures to allow for this activity.

f. Describe the risk management systems, processes, and controls in place or in development with respect to [redacted] activities, including the minting and burning of [redacted], maintenance of [redacted] wallets, and participation in the [redacted] blockchain.

g. Describe the risk management systems, processes, and controls that [redacted] and the [redacted] have put in place to monitor and mitigate potential risks posed by the public [redacted] blockchain, including those related to blockchain governance disputes, software defects, and changes in protocol rules.

h. Explain how [redacted] public, permissionless nature impacts [redacted] ability to mitigate risks related to security and privacy.

i. Explain how [redacted] will mitigate operational risk where a step in the transfer process does not occur as expected.

j. Provide any continuity plans if the [redacted] blockchain fails, including operational errors or delays in processing and system outages.

k. Describe [redacted] efforts to conduct due diligence and assess the risks of engaging in the [redacted] smart contract.
l. Explain how [redacted] will ensure that the amount of funds in the omnibus deposit account matches, at a minimum, at all times the aggregate amount of [redacted] in its customers' wallets.
m. Describe any testing [redacted] is conducting or will conduct in relation to the [redacted] blockchain, [redacted] smart contract, or other aspects of its participation in the [redacted].
n. Describe and provide documentation of vulnerability analysis that has been performed related to the smart contracts.

6. Settlement.

a. Explain when the final settlement of a transaction facilitated by [redacted] occurs, where it is recorded, and whether there are any dependencies on the public [redacted] blockchain for settlement finality.
b. Provide a detailed account of what "[redacted]" is and for what it will be used. In your response, include whether it has a set price or whether its price can fluctuate.
c. Explain whether [redacted] will be paying "[redacted]" fees directly to update the [redacted] blockchain ledger and, if so, to whom such fees are paid.
d. Explain whether [redacted] plans to hold "[redacted]" and, if so, (i) how it will be reflected on [redacted] balance sheet and (ii) how much [redacted] plans to hold. If its price can fluctuate, explain how [redacted] intends to account for variations in the price of "[redacted]."
e. Provide a description of the accounting methods and treatment used for "[redacted]" held by [redacted] (including initial recording and any subsequent entries).

7. Use Cases.

a. Provide a detailed description of planned and potential use cases for [redacted].
b. Explain how the [redacted] differs from other bank-offered peer-to-peer payments platforms (e.g. [redacted]). Explain if the [redacted] interacts with any such platforms.
c. Explain whether and how the [redacted] is developing an alias directory (e.g. email addresses). If so, explain (i) whether such directory will be housed by a central party, or such data will be stored in a decentralized manner; how any personal identifiable information (PII) stored in the alias directory will be protected.
d. Explain how customers effectuate peer-to-peer payments (e.g., in banks' own apps or via a third-party app).
e. Identify and describe safeguards that will be put in place to mitigate the risk that customers send funds to an unintended recipient.
f. Provide screen shots to show the customer's user experience.

8. Consumer Protection.

a. Identify the fees and other charges that will be imposed on [redacted] customers that elect to use [redacted] to conduct transactions.
b. Describe the anticipated process for managing complaints from [redacted] customers related to [redacted].

c. Explain any steps [redacted] will take to ensure consumers understand any difference in protections between [redacted] and traditional banking products.
d. Describe network rules, systems, and practices that will be put in place to protect consumers. For example, explain the rights consumers will have to dispute errors, payments mistakenly sent to the wrong party, or payments related to fraud. Describe how [redacted] and the [redacted] will ensure such disputes are resolved in a timely basis and in accordance with network rules and applicable laws and regulations.
e. Explain whether [redacted] or any other entity will indemnify customers for breaches to the wallets.
f. Explain whether consumers are required to enter into an agreement with [redacted] (or another entity) to maintain a wallet.
g. Describe any representations that [redacted] is making or plans to make regarding the applicability of FDIC deposit insurance.
h. Describe any representations that [redacted] is making or plans to make regarding the stability of [redacted], including regarding reserves.
i. Explain whether responsibility for approval of advertising and marketing materials rests with individual [redacted] banks or the [redacted] as a whole, or if there is some other arrangement.
j. Identify the consumer data that will be shared with the [redacted] and its participants, as well as any controls in place to protect PII and limit sharing. In your response, indicate whether any PII will be stored on a distributed ledger and describe any disclosures regarding data sharing that [redacted] intends to provide.