Bank Regulators Issue Warnings on Fintech and Banking as Disasters Pile Up

By Pam Martens and Russ Martens: July, 2024

Last Thursday, the Board of Governors of the Federal Reserve System (the Fed), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), the federal supervisors of banks, issued 11 pages of warnings on what could go wrong when federally-insured banks get in bed with uninsured and untested financial technology companies. These financial technology companies are lovingly called Fintechs on Wall Street and in Silicon Valley where big money can be made by venture capitalists who bring the sexy-sounding Fintech startup as an IPO (Initial Public Offering) to investors on Wall Street. The Wall Street firm, in return, gets a nice payday in underwriting fees and a law firm also gets paid as counsel to the underwriters.

Federal banking regulators have been in a frenzied scramble to deal with the growing fallout of disastrous marriages between Fintech and federally-insured banks.

You might recall that after news broke that the fraudster crypto exchange, FTX, was using Silvergate Bank for deposits, there was turmoil at Silvergate, forcing it into eventual voluntary liquidation. (See Disgraced Silvergate Bank Hints It May Not Be Able to Cover All of Its Deposits; Fed Slaps It with a Cease and Desist Consent Order.)

Then there is the mess with the Fintech payment app, Zelle. Things are so bad with that app that the U.S. Senate's Permanent Subcommittee on Investigations had to hold a hearing on May 21. The Chair of that Subcommittee, Richard Blumenthal, opened the hearing with this:

"The banks of America have a dirty little secret. It's called Zelle. And it's not just Zelle, it's other P2P paid platforms—apps that people use to transfer money among their bank accounts. In the case of Zelle, it is nearly instantaneous. It's almost always irreversible. And it is owned by banks.

"In fact, Zelle is the largest peer-to-peer payment app. It's actually operated by Early Warning Services, which in turn is owned and operated by the seven largest banks. And Zelle is often integrated into consumers' existing online bank accounts and mobile apps.

"Zelle markets itself as 'A fast and easy way to send and receive money.' But, as this Committee has found, a fast and easy way to lose money is often what happens on Zelle. And that is probably a more accurate catchphrase for Zelle and for other P2P platforms as well. What distinguishes Zelle is speed, permanence, and bank ownership, and that's really the reason why we are focusing on Zelle, but the other platforms deserve attention as well. In fact, it's less well known than other payment

apps like Cash App and Venmo, but Zelle is by far the largest—several times its nearest competitor, and it is approximately three times larger than its nearest rival.

"Zelle transfers are nearly instant and irreversible, and by the time a consumer knows they've been scammed, usually it's too late to do anything about it—at least according to Zelle and according to the banks that own, control, and in effect operate Zelle.

"Just three banks, J.P. Morgan Chase, Bank of America, and Wells Fargo handled 73% of all Zelle transactions in 2023…."

The most recent embarrassment for U.S. banking regulators was the bankruptcy filing by Synapse Financial Technologies, a fintech startup that had financial backing from Andreessen Horowitz, the giant Menlo Park, California venture capital firm that has morphed into a major funder of the Super PAC, Fairshake, that is attempting to pack the U.S. Senate with crypto sycophants come the election in November. (See Crypto Just Got Exponentially More Dangerous: Meet Fairshake.)

Synapse describes itself as "a finance platform" that "provides payment, card issuance, deposit, lending, compliance, credit and investment products as APIs [Application Programming Interface] to more than 18 million end users." Very sexy stuff to Wall Street.

Far less sexy is the fact that Synapse's failure has prevented "More than 100,000 Americans with $265 million in deposits" to become locked out of their bank accounts since May, according to CNBC.

How big is the scope of this potential Fintech/Banking disaster? *The Hill* reported this last week:

"While the numbers vary, fintech companies have been valued today at more than $1 trillion. There is another $2.5 trillion in cryptocurrencies represented by 10,000 different coins, as well as about $1.3 trillion in synthetic and derivative crypto securities being sold by Wall Street. Blackrock and Grayscale have accumulated $42 billion under management in their Bitcoin Spot ETFs in just the six months since the Securities and Exchange Commission approved them."

In addition to issuing the 11-page warning, the federal banking regulators simultaneously issued a 32-page RFI (Request for Information) to the banks, seeking specific information on the entanglements of the federally-insured bank with all things Fintech.

Question 14 on the RFI seems to drill down to a core problem in this loosey goosey world of federally-insured banking and Fintech. It asks:

"In the context of bank-fintech arrangements, how are deposit accounts usually titled? Describe the range of practices reconciling bank deposit

account records with the fintechs' records. Generally, what party holds and maintains the account records? Describe the structure in place to exchange accurate customer information between the bank and the fintech company and how the agreements between banks and fintech companies generally address these matters. Describe any additional controls that banks or fintechs may use to provide for accurate reconciliations."