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The Federal Deposit Insurance Corporation (FDIC) heightens its enforcement of the Federal Deposit Insurance (FDI) Act

Crypto companies and bank service providers are left to address potential violations: Reviewing the recent chain of events and identifying potential next steps

The FDIC has zeroed in on banks providing services to crypto companies (e.g., entities offering financial-related products to retail consumers) and nonbanks providing crypto services that are not fully living up to the requirements of section 18(4)(a) of the FDI Act.[1] This part of the FDI Act forbids actions including improper use of FDIC branding as well as misleading advertisements or intentionally erroneous communications about deposit insurance coverage.[2] However, firms continue to have challenges adhering to this aspect of the statute, evidenced by 165 cases, between 2019 and 2020, where the FDIC used informal actions in response to misleading claims about deposit insurance.[3] The FDIC has recently taken several steps to raise awareness concerning deposit insurance and more specifically the identification, investigation, and enforcement of deposit insurance-related law. The agency's recent actions show its intent that disclosures, governance, and oversight about the applicability of FDIC insurance are compliant with regulatory requirements. Here, we take a closer look at the five insights and five action steps most relevant to crypto companies and partnering banks.

Five insights you should know

1. On May 17, 2022, the FDIC issued a Financial Institution Letter outlining its final rule on "False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo" (Final Rule).[4] The Final Rule bans a range of activities involving inaccurate claims of insurance coverage and inappropriate use of the agency's image and name to signal insurance coverage for ineligible products.[5] Effective since July 5, 2022, the Final Rule comes on the heels of the FDIC's growing observance of "misuse" and "misrepresentations" of the agency's branding and insurance coverage. The Final Rule is expected to principally impact nonbanks. One key aspect of the Final Rule for nonbanks that "make representations about deposit insurance" is the need to state the FDIC-insured banks where the nonbanks' customers can make deposits.

2. The Final Rule sets forth a formalized process that the FDIC can use to determine if activities are deemed violations, and it designates an agency official to address incoming questions and issues.[6] Under the Final Rule, the FDIC's General Counsel has delegated authority to "initiate and prosecute" formal enforcement actions executed based on violations of Section 18(4)(a).[7] While the General Counsel can pursue formal enforcement actions, the agency believes that implementation of the Final Rule will more commonly result in informal actions (e.g., advisory letters), as has been the case historically.

3. In late July, the FDIC issued an updated fact sheet further clarifying the relationship between deposit insurance coverage and crypto companies.[8] The fact sheet communicates the FDIC's concern that against the backdrop of recent disruptions at crypto companies (e.g., paused withdrawals or operations), certain of their customers may—based on expressed or implied communications—be under the impression that uninsured products offered by crypto companies are backed by the FDIC.

4. Over the past few months, the FDIC issued cease-and-desist letters to several crypto companies asserting "potential violations of Section 18(4)(a)" of the FDI Act.[9] The letters represent informal actions, convey specific offenses, and prescribe corrective action. Taken together, the final rule, updated fact sheet, and recent informal actions signal the agency's commitment to ensuring the accuracy of communications by crypto companies regarding deposit insurance.

5. Senator Patrick J. Toomey (R-PA) sent a letter, dated August 16, 2022, to FDIC Director and Acting Chairman Martin Gruenberg stating that the agency "may be improperly taking action to deter banks from doing business with lawful cryptocurrency-related (crypto-related) companies."[10] The letter contains examples of reported FDIC actions, including blocking a bank creating a pathway from its virtual applications to a crypto company's trading platform, deterring bank lending to crypto companies, and urging downgrades of a classification for an outstanding crypto-related credit.[11] The letter requests the FDIC's written response to six clarifying questions about the agency's recent activities and their legal footing by August 30, 2022.

Five actions to consider

For nonbanks, including crypto companies:

1. **Reinforce consumer compliance program** – Confirm a consumer compliance framework exists that addresses core inherent risks related to miscommunications about FDIC deposit insurance as well as other consumer protection matters (e.g., Unfair, Deceptive, or Abusive Acts or Practices). Routinely assess the compliance program emphasizing, at a minimum, risk identification and controls, consumer complaints response and analysis, monitoring and testing, and issue escalation and resolution. Confirm the program is anchored in expectations communicated by the Consumer Financial Protection Bureau and US Department of Justice.

2. **Review customer-facing websites, platforms, pop-ups, chatbots, hyperlinks, social media accounts, mobile apps, and marketing materials** – Confirm that use of the FDIC's logo along with any statements about the FDIC, FDIC-insured products, and the applicability of the FDIC's deposit insurance coverage are accurate and in alignment with the requirements of the FDI Act.

For banks that partner with crypto companies:

3. **Confirm compliance of third parties** – In conjunction with ongoing third-party risk management activities, banks should consider the assessment of crypto companies' adherence to the applicable requirements of the FDI Act. Identification of noncompliance should be confronted and addressed.

4. **Fortify internal control protocols and activities** – Update and implement internal controls to reflect the requirements of the Final Rule related to deposit insurance coverage and insured banking products. Establish accountability in terms of the necessary monitoring, reporting, review of the entire third-party risk program, and stakeholder management processes.

5. **Revise existing policies and procedures to incorporate specific aspects of FDI Act compliance** – Confirm that policies and procedures reflect sufficient detail to determine if an incorrect statement has been made or misleading information has been conveyed. Policies and procedures should assign responsibilities and outline action steps that should be taken in the event of noncompliance with Section 18(a)(4). In some cases, banks may need to develop and formalize new processes in this area.

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Endnotes

1. Federal Deposit Insurance Corporation (FDIC), "Federal Deposit Insurance Act," last updated August 31, 2021.
2. See 12 U.S.C. 1828(a)(4); FDIC, Federal Deposit Insurance Act.
3. FDIC, "False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo," *Federal Register* 87, no. 106, June 2, 2022.
4. FDIC, "FDIC issues final rule relating to false advertising, misrepresentations about insured status, and misuse of the FDIC's name or logo," May 17, 2022.
5. FDIC, "False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo."
6. Ibid.
7. Ibid.
8. FDIC, "Fact Sheet: What the public needs to know about FDIC deposit insurance and crypto companies," July 28, 2022.
9. FDIC, "FDIC and Federal Reserve issue letter demanding Voyager Digital cease and desist from making false or misleading representations of deposit insurance status," press release, July 28, 2022; FDIC, "FDIC issues cease and desist letters to five companies for making crypto-related false or misleading representations about deposit insurance," press release, August 19, 2022.
10. United States Senate, Committee on Banking, Housing, and Urban Affairs, "Letter addressed to FDIC Director and Acting Chairman Martin Gruenberg from Senator Patrick J. Toomey," August 16, 2022.
11. Ibid.