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Original Article

Crisis at Evolve Bank: A Wake-Up Call for the Fintech Industry

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Abstract: *The Evolve-Synapse crisis underscores the systemic risks arising from the convergence of traditional banking and fintech. The 2024 collapse of Synapse Financial Technologies, a key intermediary for Evolve Bank, left thousands of customers unable to access their funds, revealing critical vulnerabilities in financial oversight. This crisis highlights the perils of inadequate regulation, governance failures, and moral hazard in fintech-bank partnerships. At its core, the issue stems from the principal-agent problem, exacerbated by misaligned incentives, opacity in risk management, and regulatory blind spots. Unlike traditional banking models, where agency conflicts primarily exist between shareholders and executives, fintech collaborations introduce additional layers of risk due to outsourcing and fragmented oversight. This paper explores the legal, economic, and societal implications of the crisis, emphasizing the need for stronger regulatory safeguards and better-aligned incentives. It proposes a framework to enhance transparency through real-time risk reporting and stricter capital buffer requirements for fintech firms to mitigate systemic risks. Additionally, it advocates for centralized regulatory oversight to eliminate jurisdictional arbitrage and ensure fintech firms operate under consistent supervision alongside banks. To reduce moral hazard, the paper recommends implementing "bail-in" provisions, where fintech investors, rather than taxpayers, absorb financial losses, reinforcing market discipline. Furthermore, incentive structures should be redesigned to align fintech firms' risk exposure with financial responsibility, ensuring sustainable innovation without compromising stability. By integrating agency theory, this study underscores the necessity of regulatory adaptation to balance financial innovation with resilience, offering policy recommendations to prevent future crises and promote stability in the evolving financial ecosystem.*

Keywords: *Agency Theory, Banking Integration, Evolve-Synapse Crisis, Financial Regulation, Fintech Innovation.*

I. INTRODUCTION

In recent years, the financial sector has witnessed a profound transformation, driven by the integration of traditional banking institutions with cutting-edge financial technologies or fintech (Allen, 2020; Chen, 2024; Davey, 2024). This merger has led to a surge in digital payments, loans, and investment services, providing greater accessibility and efficiency in financial markets (Varma *et al*., 2022). However, the rapid evolution of this fintech ecosystem has also introduced significant challenges, particularly in terms of regulatory oversight, risk management, and systemic stability (Gomber *et al*., 2018; Arner *et al*., 2016).

The case of Evolve Bank and Synapse Financial Technologies is emblematic of these challenges. Evolve, a small regional bank, capitalized on its relationship with Synapse, a fintech platform, to offer digital banking services. The partnership enabled Evolve to tap into the growing digital finance market while Synapse leveraged the bank's infrastructure to process transactions for a wide range of platforms. However, in 2024, Synapse filed for bankruptcy, leaving numerous customers unable to access their deposits. The subsequent fallout revealed glaring deficiencies in the regulatory framework that governs these partnerships, as well as significant gaps in risk management practices (Zohar *et al*., 2019).

This incident underscores a broader concern: the risks associated with the convergence of traditional banking and fintech are not sufficiently addressed by existing regulations (Li, 2020). While the benefits of this integration are clear, including enhanced financial inclusion and improved efficiency, the risks posed by inadequate oversight and governance mechanisms are equally significant. These risks are compounded by moral hazard issues, as fintech firms often operate with minimal regulatory constraints, while banks are left to bear the systemic risks associated with these ventures (Bernanke, 2013).

The collapse of the Evolve-Synapse partnership highlights three central issues: first, the shortcomings of current financial deregulation; second, the governance failures within fintech-bank partnerships; and third, the role of moral hazard in exacerbating systemic risks. Agency theory provides a theoretical framework to better understand the principal-agent relationship between fintech firms and traditional banks (Bergen, 1992). This framework illustrates how misaligned incentives between these two parties, exacerbated by the presence of FDIC insurance, contribute to risky behavior and systemic vulnerabilities (Fama & Jensen, 1983; Penati and Protopapadakis, 1988; Pennacchi, 2006).

In the context of fintech-bank collaborations, agency theory involves conflicts of interest that arise when there is a separation between ownership and control, as seen in the relationship between shareholders (shareholders) and control (bank executives). An additional layer of agency conflict arises as banks collaborate with fintech firms to deliver financial services (Bosse, 2014). The misalignment of incentives, particularly in terms of risk-taking, can lead to inefficient and potentially harmful outcomes (Eisenhardt, 1989).

FDIC insurance plays a significant role in these partnerships. While FDIC insurance is designed to protect depositors in the event of a bank failure, it can inadvertently encourage excessive risk-taking among fintech firms. By transferring the risks of failure to the bank and, ultimately, the taxpayer, fintech firms may have less incentive to exercise prudence in their operations. This moral hazard problem is particularly concerning when combined with the opaque and fragmented regulatory environment that characterizes the fintech sector (Fahy, 2021; Merton, 1977).

Regulatory gaps contributed to the Evolve-Synapse crisis. Although regulatory frameworks exist for traditional banking institutions, these frameworks often fail to adequately address the unique risks posed by fintech firms. The lack of centralized oversight, insufficient capital requirements, and minimal transparency in the operations of fintech firms contribute to an environment where risky behavior can flourish without appropriate scrutiny (Golembe, 2020; Boot & Thakor, 2011).

In the following sections, a series of regulatory interventions are proposed to address these issues. Recommendations focus on enhancing transparency, improving capital buffers for fintech firms, and establishing a more centralized and comprehensive regulatory framework that encompasses both traditional banks and fintech firms. These measures aim to reduce systemic risks and ensure that the benefits of fintech innovation can be realized without compromising financial stability (G20, 2020; Liu & Molyneux, 2019).

II. LITERATURE REVIEW

A) Introduction

The integration of traditional banking with fintech innovation has transformed the financial sector, offering increased efficiency, expanded access to financial services, and new business models. However, it has also introduced novel risks and regulatory challenges. The collapse of Synapse Financial Technologies and its impact on Evolve Bank in 2024 highlights the vulnerabilities inherent in these partnerships. This literature review examines the legal, economic, and governance implications of fintech-bank collaborations, focusing on financial deregulation, governance failures, and moral hazard. It also explores regulatory strategies to mitigate systemic risks and balance innovation with stability (Yoshimori, 2025).

B) The Evolution of Fintech-Bank Partnerships

Fintech companies have disrupted traditional banking by leveraging technology to provide innovative financial services, such as digital payments, peer-to-peer lending, and automated wealth management (Philippon, 2016). Banks, in turn, have sought partnerships with Fintech firms to enhance their digital offerings and remain competitive (Arner et al., 2017). These collaborations, while beneficial, often blur the lines between banking and technology, creating regulatory ambiguities and risk misalignments (Thakor, 2020).

Agency theory serves as a valuable lens for analyzing governance complexities and risk asymmetries in fintech-bank partnerships. Traditionally, the principal-agent problem manifests in banking due to the separation between ownership and control, wherein shareholders (principals) rely on bank executives (agents) to manage financial operations responsibly (Fama & Jensen, 1983). However, in fintech-bank collaborations, agency conflicts become more intricate as banks outsource essential financial services to fintech firms, leading to potential misalignment of incentives and reduced transparency in risk management (Philippon, 2016). The divergence in strategic objectives—where fintech firms prioritize innovation and market expansion over financial prudence—further exacerbates these conflicts. Additionally, the existence of Federal Deposit Insurance Corporation (FDIC) protection introduces moral hazard concerns, as fintech firms may engage in riskier financial activities under the presumption that partnering banks will absorb potential losses, thereby weakening their incentives for prudent risk-taking (Boot et al., 2021). The failure of Synapse, a key intermediary for Evolve Bank's digital banking operations, demonstrates how a breakdown in oversight can disrupt financial stability.

C) Regulatory Arbitrage and Financial Fragility

Kane's analysis of the 2008 Global Financial Crisis builds on themes he explored in earlier financial crises, particularly the Savings and Loan (S&L) crisis of the 1980s. He argues that financial regulation is inherently prone to failure due to perverse incentives, regulatory arbitrage, and the expectation of government bailouts, which collectively encourage excessive risk-taking. One of the central mechanisms he identifies is regulatory arbitrage, wherein financial institutions shift risky activities to the shadow banking sector—such as investment banks, hedge funds, and structured finance vehicles—to avoid traditional oversight while still benefiting from implicit government guarantees (Kane, 2010). Through securitization and off-balance-sheet entities, banks masked systemic risks, exacerbating financial instability (Acharya et al., 2011). Kane's framework emphasizes that such loopholes not only persisted after the S&L crisis but became more sophisticated, allowing financial firms to externalize risks onto taxpayers.

A key pillar of Kane's critique is the moral hazard created by the "Too Big to Fail" (TBTF) doctrine, which he argues encouraged financial institutions to take on excessive leverage and engage in high-risk financial products, such as subprime mortgage-backed securities and credit default swaps (Kane, 2009). This implicit government backstop was evident in the cases of Lehman Brothers, AIG, and Citigroup, where market participants anticipated federal intervention in times of crisis (Taylor, 2009). Kane also highlights the role of regulatory capture, asserting that regulators, influenced by political and industry pressure, systematically underestimated financial risks and delayed necessary interventions (Baker, 2010). The government's response, including the Troubled Asset Relief Program (TARP) and emergency Federal Reserve lending, ultimately transferred financial losses from banks to taxpayers, reinforcing the precedent of bailouts (Calomiris and Haber, 2014). Kane warns that, without structural reforms to address these systemic incentives, financial crises will continue to follow a recurring pattern. He calls for stronger accountability measures to curb reckless risk-taking and criticizes the revolving door between financial regulators and Wall Street, which weakens enforcement and perpetuates cycles of regulatory failure. His insights remain highly relevant as financial markets evolve, with emerging forms of shadow banking and speculative activities posing new regulatory challenges.

The recent collapse of Synapse Financial Technologies, a fintech company that provided banking-as-a-service (BaaS) through partnerships with Evolve Bank & Trust, echoes Kane's warnings about regulatory arbitrage and financial fragility. Synapse, which served as an intermediary between fintech firms and banks, promised innovative financial solutions while operating within a fragmented regulatory framework that lacked clear oversight. Similar to the shadow banking practices Kane critiques, Synapse leveraged banking relationships to facilitate financial transactions without bearing the full regulatory burdens of a traditional bank. However, its failure disrupted access to customer funds and exposed vulnerabilities in the fintech sector, particularly the risks associated with third-party banking partnerships. The collapse underscores the persistent issue of financial institutions sidestepping regulatory scrutiny while relying on traditional banks to provide stability—a modern-day parallel to the off-balance-sheet entities and risk externalization seen in past crises.

The Evolve-Synapse crisis highlights the ongoing challenge of integrating fintech innovation within a stable financial system. As Kane's work suggests, the combination of regulatory gaps, implicit guarantees, and moral hazard continues to fuel financial instability. Without comprehensive regulatory adaptation to address these emerging risks, fintech failures may contribute to broader systemic disruptions, reinforcing the need for proactive oversight and structural reforms.

D) Regulatory Challenges

The legal and regulatory challenges in fintech-bank collaborations have been extensively examined in financial law and economic literature, with scholars offering different perspectives on the implications of financial deregulation. Some argue that deregulation fosters financial innovation and enhances competition (Philippon, 2016), while others warn of heightened systemic risks and moral hazard concerns (Rajan, 2006). The collapse of financial institutions such as Silicon Valley Bank has highlighted the perils of asset-liability mismatches and the insufficiency of existing regulatory safeguards (Acharya & Richardson, 2009). Legal scholars have also noted the deficiencies in consumer protection frameworks, particularly in instances where fintech intermediaries fail to uphold their fiduciary responsibilities (Zingales, 2015).

Regulatory scholars have extensively debated the effectiveness of existing legal frameworks in mitigating agency conflicts within fintech-bank partnerships. While financial regulations such as the Bank Secrecy Act (BSA) and the Dodd-Frank Act establish compliance requirements for banks, they often fall short in addressing the indirect risks posed by their fintech collaborators (Omarova, 2020). This regulatory gap enables fintech firms to engage in high-risk financial activities with minimal oversight, potentially exposing consumers and financial institutions to systemic vulnerabilities (Arner et al., 2017). The collapse of Synapse exemplifies these shortcomings, as its financial mismanagement and misallocation of customer funds went undetected until its bankruptcy, ultimately leaving thousands of depositors without recourse (Zetzsche et al., 2017). This paper builds upon these discussions by exploring the legal failures evident in the Evolve-Synapse case, with a particular focus on liability, fiduciary duties, and the broader implications for regulatory oversight.

The historical development of fintech regulation traces back to the early 2000s when digital payment systems and peer-to-peer lending platforms emerged as disruptive forces in financial markets. The 2008 financial crisis further accelerated regulatory scrutiny of non-bank financial entities, leading to increased oversight through legislative measures such as the Consumer Financial Protection Bureau (CFPB) and enhanced Anti-Money Laundering (AML) regulations. However, the exponential growth of fintech in the 2010s, driven by advances in artificial intelligence, blockchain technology, and decentralized finance (DeFi), has outpaced traditional regulatory frameworks, necessitating a more adaptive approach to financial oversight (Arner et al., 2017).

The rapid transformation of financial technology necessitates an agile regulatory framework that effectively balances risk management with the encouragement of innovation. Scholars have proposed various regulatory strategies to address these evolving challenges. Armour et al. (2016) emphasize the need for a technology-neutral regulatory framework that ensures consistent oversight across both traditional and fintech entities. Awrey (2021) advocates for a principles-based regulatory approach, arguing that rigid, rule-based frameworks struggle to adapt to the fast-paced evolution of financial technology. Additionally, Casey and Niblett (2017) suggest leveraging regulatory technology (RegTech) to enhance compliance and supervision, reducing systemic risk without stifling innovation. While regulatory sandboxes and innovation hubs have been implemented to facilitate fintech experimentation, their effectiveness in preventing financial instability remains contested.

The integration of fintech and traditional banking presents both opportunities and risks. While technological advancements enhance financial accessibility and efficiency, they also introduce governance and regulatory complexities that warrant careful oversight. The failure of Synapse underscores the critical need for a comprehensive regulatory framework that balances financial innovation with systemic stability. By analyzing the Evolve-Synapse case through the theoretical lens of agency theory and financial law, this paper contributes to the ongoing discourse on fintech regulation and offers policy recommendations aimed at strengthening oversight mechanisms and consumer protection frameworks.

E) Regulatory Challenges and Policy Recommendations

Regulatory frameworks have struggled to keep pace with the rapid evolution of fintech-bank partnerships. Traditional banking regulations are designed for institutions with clear governance structures and risk controls, whereas fintech firms often operate across multiple jurisdictions, complicating regulatory enforcement (Arner et al., 2020). The fragmentation of oversight creates opportunities for regulatory arbitrage, where firms select jurisdictions with the least stringent requirements (Gabor and Brooks, 2017).

Several policy measures can address these challenges. First, enhanced risk disclosure requirements should be mandated for fintech-bank partnerships to improve transparency and accountability (Claessens et al., 2018). Real-time reporting of asset-liability mismatches can help regulators detect emerging risks and intervene proactively. Second, tailored capital buffer requirements for fintech firms engaged in lending and payments would ensure that these entities maintain adequate reserves to absorb shocks (Boot et al., 2021).

Third, centralized oversight is crucial to prevent jurisdictional fragmentation. Regulatory bodies such as the Federal Reserve, FDIC, and SEC should coordinate supervision of fintech-bank partnerships to ensure consistent enforcement. Expanding stress-testing frameworks to include fintech-specific risks would also enhance systemic resilience (Philippon, 2019). Finally, requiring fintech firms to establish contingency funds or participate in industry-wide insurance mechanisms could mitigate counterparty risks and reduce reliance on FDIC-covered banks.

F) Conclusion

The integration of traditional banking and fintech innovation presents both opportunities and challenges. While these partnerships can enhance financial services, they also introduce governance failures, regulatory gaps, and systemic risks. The collapse of Synapse Financial Technologies serves as a stark reminder of the vulnerabilities in fintech-bank collaborations. Addressing these issues requires a comprehensive regulatory approach that enhances transparency, imposes appropriate capital requirements, and strengthens supervisory oversight. Future research should focus on empirical analyses of fintech-bank failures to refine regulatory strategies and promote financial stability.

III. METHOD: DEVELOPING THE AGENT THEORY FOR FINTECH-BANK INTEGRATION

The collapse of Synapse Financial Technologies and its repercussions for Evolve Bank in 2024 underscore the structural vulnerabilities that arise from the integration of fintech firms within the traditional banking system. As a regional bank turned fintech enabler, Evolve expanded its market reach by facilitating digital transactions for multiple platforms through its partnership with Synapse. However, when Synapse declared bankruptcy in 2024, thousands of customers lost access to their deposits, revealing critical gaps in regulatory oversight, financial governance, and risk management. This failure highlights the systemic risks posed by fintech-bank collaborations, where regulatory arbitrage, opaque operational structures, and moral hazard distort market incentives. In the absence of robust supervisory mechanisms, fintech firms can accumulate substantial financial exposure while evading direct oversight, creating contagion risks that extend beyond their immediate counterparties.

This crisis can be analyzed through the lens of agency theory, particularly in the context of FDIC-insured banking partnerships. Traditionally, the principal-agent problem emerges in banking due to the separation of ownership and control, where shareholders (principals) rely on bank executives (agents) to act in their best interests (Jensen & Meckling, 1976). However, fintech-bank collaborations introduce an additional layer of agency conflict, as banks delegate critical operational functions to fintech firms while retaining ultimate regulatory liability. In this structure, fintech firms prioritize revenue maximization and growth, often engaging in riskier lending and deposit-taking practices, while banks assume compliance obligations and potential systemic exposure. This misalignment is further exacerbated by FDIC insurance, which creates an implicit safety net that reduces fintech firms' incentives to exercise prudence, fostering moral hazard and excessive risk-taking.

The Evolve-Synapse crisis illustrates how misaligned incentives, regulatory gaps, and moral hazard collectively destabilize fintech-bank partnerships. Evolve Bank pursued fintech collaborations to expand its deposit base, yet it lacked direct control over Synapse's risk exposure, making it vulnerable to operational failures and compliance shortfalls. Meanwhile, Synapse prioritized aggressive expansion, leveraging uninsured deposits and regulatory loopholes to scale its financial services while minimizing direct oversight. The presence of FDIC insurance further distorted incentives, as fintech firms operated under the assumption that insured banking entities would absorb potential losses, ultimately weakening market discipline and amplifying systemic fragility. This case underscores the urgent need for enhanced regulatory alignment, robust fintech capital requirements, and improved oversight mechanisms to prevent similar crises in the future.

Mathematically, the agency problem in joint fintech-bank structures can be expressed as follows:

$$U_{Bank} = \ max_e[\alpha \cdot \pi(e) - C(e)]$$

where U_{Bank} represents the utility of the bank, α denotes the proportion of profits retained by the bank, $\pi(e)$ is the profit function dependent on effort e, and $C(e)$ signifies compliance and monitoring costs. Similarly, the fintech firm's utility function can be formulated as:

$$U_{Fintech} = max_e[(1-\alpha) \cdot \pi(e) - R(e)]$$

where $R(e)$ represents regulatory and capital requirements, which fintech firms often seek to minimize through jurisdictional arbitrage. This divergence in utility maximization reflects the fundamental agency conflict: fintech firms prioritize revenue growth and minimal regulatory burdens, while banks bear disproportionate compliance costs and systemic risk exposure. The introduction of FDIC insurance further exacerbates this misalignment, as fintech firms leverage insured deposits for riskier lending and investment activities, operating under the assumption that insured banks will ultimately absorb potential losses.

This agency misalignment directly contributed to Synapse's collapse and its impact on Evolve Bank. Fintech firms, including Synapse, maximized profits by expanding financial services without fully accounting for risk, while banks like Evolve facilitated these transactions without direct control over the fintechs' underlying balance sheets. FDIC insurance created a false sense of security, where fintechs assumed that failures could be absorbed by insured banking entities, inadvertently fostering moral hazard and systemic fragility.

Synapse and Evolve appeared to exploit this gray area by marketing services under the umbrella of a regulated, FDIC-insured institution, while many customer deposits were either not insured or only indirectly protected. This created a false perception of safety—consumers believed their funds were fully secure because the transactions were routed through an insured bank. In reality, deposit allocation, operational control, and insurance coverage were fragmented and not clearly communicated. The principal-agent problem was intensified by this regulatory uncertainty: Synapse prioritized growth and risk-taking, assuming Evolve (and, by extension, the FDIC) would absorb any fallout.

In agency theory terms, Synapse likely internalized a high value of bailout probability, increasing its incentive to engage in riskier practices without fearing the full consequences. The lack of FDIC clarity and weak oversight transferred the downside risk to consumers, who unknowingly bore exposure to financial failure.

Moral hazard in fintech-bank partnerships can be quantified using the following incentive structure:

$$U_{Fintech} = max_e[(1-\alpha) \cdot \pi(e) - R(e) + \ \beta F]$$

Where β represents the probability of a bailout, and F denotes expected financial support. As β increases, fintech firms have fewer incentives to limit risk-taking, increasing systemic vulnerabilities. In the case of Synapse's bankruptcy, this moral hazard manifested in several ways. Fintech firms leveraged FDIC-insured banking partnerships to gain customer trust, even though many of their products were not fully insured. Simultaneously, Evolve Bank became over-reliant on fintech relationships, assuming that regulatory intervention would mitigate any fallout rather than preparing for direct financial exposure. As a result, consumers unknowingly assumed risks, believing their fintech accounts were protected, while regulators failed to clarify the extent of deposit insurance, further amplifying systemic risks.

Addressing these agency conflicts within fintech-bank collaborations requires a multi-pronged regulatory approach. First, regulators must mandate real-time risk disclosures to mitigate opacity in fintech-bank partnerships, particularly in asset-liability mismatches. Second, a centralized oversight framework integrating banking, securities, and fintech regulators is necessary to prevent regulatory arbitrage and fragmented supervision. Third, tailored capital buffer requirements for fintech firms engaged in lending and payments would help internalize systemic risks, reducing over-reliance on insured banks. Additionally, contractual contingent liability clauses should be incorporated to ensure fintech firms remain accountable in cases of operational failures or insolvencies. Finally, stress-testing frameworks should be expanded to include fintech-specific risks, enabling regulators to model contagion effects within the broader financial system.

By closing these regulatory gaps, policymakers can mitigate agency conflicts, reduce systemic vulnerabilities, and foster a stable fintech-bank ecosystem under FDIC insurance. Future research should focus on empirical validation through case studies and quantitative modeling of fintech-bank failures, integrating systemic risk contagion models with real-world financial data to refine regulatory interventions and inform policy design for emerging fintech ecosystems.

IV. RESULTS

FDIC insurance alone is insufficient to mitigate the counterparty risks inherent in fintech-bank partnerships. When a fintech firm fails, partner banks may still bear financial obligations linked to fintech customers, even if those customers are not direct depositors of the bank. This dynamic imposes additional financial strain on banks, increasing their exposure to liquidity and solvency risks, which in turn could elevate the likelihood of bank failures. Given these risks, a more robust regulatory framework is necessary to ensure stability in the fintech ecosystem and the broader financial system.

To address these challenges, policymakers must extend prudential oversight to fintech firms engaged in quasi-banking activities, ensuring compliance with capital and liquidity requirements similar to those imposed on traditional financial institutions. One approach is to require fintech firms to establish reserve funds or contribute to an industry-wide insurance mechanism, thereby reducing over-reliance on FDIC-insured banks as backstops for systemic risk. Additionally, incorporating "bail-in" provisions—where fintech investors, rather than taxpayers, absorb financial losses—would reinforce market discipline and reduce systemic vulnerabilities. Such measures would align financial incentives within fintech-bank partnerships and internalize potential costs associated with financial distress.

A comprehensive regulatory approach must also address agency conflicts, moral hazards, and systemic vulnerabilities through enhanced risk disclosure, capital requirements, and centralized supervisory oversight. First, regulators should impose stricter transparency and disclosure mandates, requiring real-time reporting of asset-liability mismatches within fintech-bank arrangements. Such measures would reduce opacity, enabling early intervention and mitigating liquidity crises akin to the recent collapse of Synapse. For example, mandatory disclosure of fintech firms' funding structures and transaction flows would allow regulators to assess interconnected risks and preempt systemic disruptions.

Second, reducing moral hazard in fintech operations necessitates the implementation of contingent liability rules that align financial responsibility with risk exposure. Capital adequacy requirements should be adapted to fintech firms engaged in lending, payments, and other financial services. Given fintech firms' tendency to exploit jurisdictional arbitrage to circumvent traditional banking regulations, extending Basel III capital standards to these entities would be a logical step. Implementing a risk-based capital framework tailored to fintech operations would ensure sufficient buffers against financial shocks while discouraging excessive leverage and risk concentration.

Third, regulatory oversight must be centralized to address jurisdictional fragmentation. The current regulatory landscape allows fintech firms to operate under a disparate set of rules, often leveraging gaps between banking, payments, and securities regulations. A unified oversight framework—potentially integrating the FDIC, Federal Reserve, and Securities and Exchange Commission (SEC)—would promote regulatory consistency and mitigate systemic blind spots. Furthermore, expanding stress-testing mechanisms to include fintech-specific risks would enhance resilience by simulating adverse scenarios and assessing potential contagion effects across the financial system.

By implementing these regulatory measures, policymakers can cultivate a fintech ecosystem that balances innovation with financial stability while mitigating systemic risks posed by fintech-bank partnerships. A well-calibrated regulatory framework should internalize firm-specific and systemic risks, ensuring that capital requirements and oversight mechanisms effectively deter excessive risk-taking without stifling financial innovation.

Mathematically, an optimal regulatory constraint can be expressed as:

$$\min_{R} \sum_{i=1}^{N} [\lambda_i(\sigma_i^2 + \gamma_i \cdot L_i)]$$

Where R represents the regulatory capital requirement, σ_i^2 denotes firm-specific risk, L_i is the leverage ratio of a firm i, and γ_i captures the systemic risk contribution of each fintech entity. By calibrating λ_i, regulators can enforce capital requirements proportional to the systemic risk posed by individual firms.

To comprehensively address the principal-agent problem, regulation must enhance risk transparency, impose robust capital safeguards, and ensure centralized oversight. An effectively designed regulatory framework not only curtails moral hazard but also preserves the potential for innovation within fintech-bank collaborations.

Despite the implementation of stringent regulatory measures, failures in fintech-bank partnerships remain possible under several conditions:

1. **Regulatory Arbitrage and Loopholes:** Fintech firms often operate within a fragmented regulatory landscape, exploiting inconsistencies across banking, securities, and consumer finance laws. If oversight fails to eliminate these loopholes, firms may engage in high-risk activities that circumvent capital and liquidity requirements, increasing systemic vulnerabilities.
2. **Information Asymmetry and Hidden Risk Exposure:** Even with enhanced transparency mandates, banks may struggle to accurately assess fintech firms' underlying risk exposures due to opaque business models and complex financial products. If risk assessment methodologies fail to capture systemic interdependencies, undetected vulnerabilities can precipitate abrupt financial crises.
3. **Unintended Consequences of Regulation:** Stricter capital requirements and compliance mandates may inadvertently incentivize fintech firms to shift risk off-balance sheet or seek alternative financing mechanisms outside the regulatory perimeter. This shadow banking effect weakens systemic oversight and can amplify financial fragility.
4. **Bailout Expectations and Persistent Moral Hazard:** Even under stringent regulatory regimes, expectations of government intervention—such as FDIC bailouts—can encourage excessive risk-taking by fintech firms and their banking partners. If fintech firms anticipate that partner banks will receive government support during distress, they may engage in reckless lending and poor asset management.
5. **Exogenous Shocks and Contagion Risks:** While regulatory frameworks primarily address endogenous risks, external shocks—such as economic downturns, cyberattacks, or liquidity crises—can still trigger failures. Fintech firms with high leverage and insufficient liquidity buffers are particularly vulnerable to these disruptions.

Mathematically, the probability of failure (P_f) in a regulated fintech-bank partnership can be represented as:

$$P_f = 1 - \Phi\left(\frac{\mu_R - \sigma_S}{\sigma_R}\right)$$

Where $\Phi(\cdot)$ is the cumulative distribution function of the standard normal distribution, μ_R represents the expected return on regulatory compliance, σ_R denotes regulatory enforcement uncertainty and σ_S captures systemic risk factors. If regulatory enforcement is weak (σ_R is high) or systemic risk is elevated (σ_S is high), the probability of failure increases.

In conclusion, while effective regulation can significantly mitigate financial instability, it cannot entirely eliminate the risk of fintech failures. Policymakers must continuously adapt regulatory frameworks to evolving financial innovations, ensuring that oversight mechanisms remain resilient against emerging threats and systemic vulnerabilities.

V. DISCUSSION: FINANCIAL LAWS FOR FINTECH COMPANIES

A) Regulatory Gaps in the Current Framework

One of the most significant challenges in the existing regulatory landscape is the inadequate oversight of fintech firms operating in the financial sector. Regulatory frameworks such as the Dodd-Frank Act (12 U.S.C. § 5301 et seq.) and Basel III, while essential for maintaining stability in traditional banking, were not designed with the rapid growth and disruptive nature of fintech in mind (Barth et al., 2019). The result is a regulatory vacuum where fintech firms often exploit gaps in oversight to bypass certain compliance requirements, a phenomenon known as regulatory arbitrage. The Office of the Comptroller of the Currency (OCC) has attempted to address this by offering special-purpose national bank charters for fintech companies, yet regulatory clarity remains elusive.

The regulatory focus on traditional banking models fails to account for the complexity of fintech business models. Decentralized finance (DeFi) platforms, for instance, often operate outside the purview of centralized financial institutions. Regulators struggle to assess the potential systemic risks these firms pose, particularly regarding contagion and liquidity crises (Goodhart & Hoffmann, 2019). The Financial Stability Oversight Council (FSOC), authorized under the Dodd-Frank Act, has identified the need for enhanced regulatory measures, including increased reporting requirements for large fintech entities to assess systemic risks.

B) Capital Adequacy and Systemic Risk

A recurring concern in fintech regulation is capital adequacy. The absence of clear, standardized capital requirements for fintech firms leaves them vulnerable to liquidity crises, potentially resulting in widespread financial instability (IMF, 2021). While Basel III provides a comprehensive framework for traditional banks, fintech firms often do not fall under its scope, allowing them to circumvent capital requirements through innovative financial products. The Economic Growth, Regulatory

Relief, and Consumer Protection Act (S.2155, 2018) attempted to ease compliance for smaller financial institutions but did not sufficiently address fintech firms' capital adequacy concerns. The SEC and OCC have suggested implementing modified Basel III-like regulations tailored to fintech companies, ensuring they maintain sufficient capital reserves.

Systemic risk is another critical issue requiring legislative intervention. The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) have both expressed concerns about the systemic risks posed by fintech firms involved in high-frequency trading, digital assets, and lending. The Payment Services Act (15 U.S.C. § 6801 et seq.) also provides some oversight, but gaps remain in regulating large-scale fintech operations. To mitigate systemic risks, the FSOC has proposed subjecting large fintech firms to stress testing requirements similar to those applied to systemically important financial institutions (SIFIs).

C) Consumer Protection and Transparency

Consumer protection remains a significant challenge in fintech regulation. Fintech products often lack transparency, making it difficult for consumers to make fully informed decisions. The Consumer Financial Protection Bureau (CFPB), established under the Dodd-Frank Act, has made strides in regulating traditional banking products but has limited authority over certain fintech services (Dodd-Frank, 12 U.S.C. § 5511). The Fair Credit Reporting Act (15 U.S.C. § 1681 et seq.) provides some consumer protections, but it does not adequately cover fintech credit scoring models, which rely on alternative data sources.

Legislation could require fintech firms to adhere to strict disclosure and transparency standards, ensuring consumers understand financial product risks. The Truth in Lending Act (TILA, 15 U.S.C. § 1601 et seq.) mandates clear disclosure of loan terms but does not fully apply to fintech lending platforms. The CFPB has advocated for amendments to TILA to cover fintech lenders, thereby enhancing consumer protections against predatory lending and fraud.

D) Legislative Proposals: A Path Forward

To address these challenges, legislative reforms must integrate capital adequacy, consumer protection, and systemic risk oversight into a comprehensive regulatory framework. The creation of a specialized regulatory body within the Treasury Department could play a pivotal role in overseeing fintech operations. This body would coordinate with the SEC, OCC, CFPB, and FSOC to ensure fintech firms comply with rigorous financial standards.

Additionally, the adoption of enhanced capital adequacy standards tailored to fintech firms is necessary. The Bank for International Settlements (BIS) has suggested applying adjusted Basel III principles to fintech companies, ensuring they maintain adequate capital reserves to withstand financial pressures. The Digital Commodities Consumer Protection Act (DCCPA, 2022) also proposes increased oversight of digital asset platforms, which could serve as a model for broader fintech regulation.

Finally, robust consumer protection laws must ensure fintech products are transparent and that consumers are fully informed of the risks involved. Strengthening the CFPB's mandate to regulate digital financial products would provide uniform consumer protections across both traditional and fintech financial services. Legislative efforts to amend TILA, the Equal Credit Opportunity Act (15 U.S.C. § 1691 et seq.), and the Fair Credit Reporting Act to explicitly cover fintech lending and credit scoring practices would further enhance consumer safeguards.

E) Reducing Moral Hazard through Contingent Liability Rules

Reducing moral hazard in fintech operations necessitates the implementation of contingent liability rules that align financial responsibility with risk exposure. One approach is to require fintech firms to absorb a portion of potential losses rather than depending entirely on partner banks. This measure would mitigate excessive risk-taking by ensuring that fintech firms maintain sufficient capital buffers and risk-management strategies. Such a requirement could be integrated into existing financial regulations, such as the capital adequacy standards outlined in the Dodd-Frank Act (12 U.S.C. § 5365), which impose heightened prudential standards on systemically important financial institutions. Expanding these provisions to encompass fintech firms would promote stability within the sector and prevent regulatory arbitrage.

Additionally, incorporating "bail-in" provisions—where fintech investors, rather than taxpayers, bear the costs of financial failures—would reinforce market discipline and reduce systemic vulnerabilities. The Financial Stability Oversight Council (FSOC), established under the Dodd-Frank Act, has the authority to designate certain non-bank financial entities as systemically important, subjecting them to enhanced supervision by the Federal Reserve. Extending this framework to fintech firms with significant financial footprints could ensure that investor-funded resolution mechanisms are in place, similar to the Orderly Liquidation Authority (12 U.S.C. § 5384), which mandates creditor and shareholder losses in the event of a financial institution's failure.

By integrating these measures into existing financial regulatory frameworks, policymakers can enhance the resilience of the fintech sector while minimizing taxpayer exposure to financial instability. Strengthening capital adequacy requirements, combined with investor-funded resolution mechanisms, would create a regulatory structure that balances innovation with financial stability, ensuring that fintech firms operate within a framework of accountability and prudence.

F) Policy Implications and Broader Impact

The proposed reforms have the potential to enhance financial system stability while fostering fintech innovation. By ensuring fintech firms comply with rigorous capital adequacy and transparency standards, policymakers can balance innovation with risk mitigation. Stronger consumer protection measures would ensure that fintech services benefit consumers without exposing them to undue financial risks.

In conclusion, fintech and banking partnerships hold immense potential to revolutionize financial services, but they must be carefully regulated to prevent systemic risks and safeguard consumer interests. Legislative reforms that integrate capital adequacy, systemic risk mitigation, and consumer protection are crucial to ensuring the long-term stability and sustainability of these partnerships.

VI. CONCLUSION

The Evolve-Synapse crisis serves as a stark reminder of the complexities and risks inherent in the growing convergence of traditional banking and fintech. While fintech-bank partnerships have expanded access to financial services, they have also introduced regulatory blind spots, exacerbated principal-agent conflicts, and increased systemic vulnerabilities. The collapse of Synapse in 2024 underscores how inadequate regulatory oversight, misaligned incentives, and moral hazard can create an environment prone to financial instability. This paper has explored the legal, economic, and societal implications of this crisis, with a particular focus on financial deregulation, governance failures, and the broader risks embedded in the fintech-bank ecosystem.

At the heart of this crisis lies the principal-agent problem, which has become more pronounced in fintech-bank collaborations. In addition to the agency conflict in traditional banking models, where shareholders (principals) rely on executives (agents) to act in their best interest, fintech-bank partnerships involve further layers of agency conflict. Banks outsource critical financial services to fintech firms, whose incentives often diverge from those of their banking counterparts, leading to opaque risk management practices and heightened systemic risk. The Evolve-Synapse collapse exemplifies these challenges, as fintech firms operated with insufficient oversight while banks relied on intermediaries whose risk exposure was not adequately accounted for.

The failure of Synapse Financial Technologies—a fintech intermediary that provided banking services for digital platforms—exposed fundamental weaknesses in regulatory oversight and the dangers of uninsured fintech liabilities impacting regulated banks. When Synapse filed for bankruptcy in 2024, customers lost access to their deposits, revealing deep governance failures and regulatory loopholes that allowed systemic vulnerabilities to materialize. The crisis highlighted a critical shortcoming in the current regulatory framework: its inability to effectively address agency conflicts and moral hazard in fintech-bank partnerships. As banks increasingly outsourced financial services to fintech firms, regulators failed to implement adequate monitoring and enforcement mechanisms to mitigate emerging risks.

Moreover, the crisis demonstrated how government guarantees, such as FDIC insurance, can inadvertently encourage excessive risk-taking. The expectation of potential bailouts reduces market discipline, allowing fintech firms to operate with lower capital buffers and riskier business models. To counteract this, regulatory reforms could integrate “bail-in” provisions, ensuring that fintech investors, rather than taxpayers, absorb the costs of financial failures. By aligning financial responsibility with risk exposure, such measures would reinforce market discipline and reduce systemic vulnerabilities.

This paper has proposed a set of recommendations to address these regulatory gaps, emphasizing the importance of enhanced transparency and disclosure requirements, tailored capital buffer requirements for fintech firms, and strengthening regulatory oversight. Enhanced transparency in asset-liability mismatches, which would require real-time reporting of risks within fintech-bank partnerships, is a critical step in reducing opacity and encouraging proactive regulatory intervention. By increasing transparency, regulators can better assess the risks that fintech firms and their banking partners are taking, enabling more informed and timely intervention. Similarly, the imposition of capital buffer requirements on fintech firms would ensure they have sufficient reserves to absorb shocks, thereby internalizing risks that might otherwise spill over to the broader financial system. In turn, these measures would help mitigate systemic vulnerabilities and reduce the likelihood of further failures.

Furthermore, the strengthening of centralized regulatory oversight is critical to address jurisdictional arbitrage, where fintech firms exploit gaps in regulatory frameworks. Currently, fintech firms often operate in a fragmented regulatory environment, allowing them to evade stringent requirements imposed on traditional banks. The creation of a unified oversight framework— integrating agencies like the FDIC, Federal Reserve, and SEC— would ensure consistent supervision across both banking and securities regulations. A more comprehensive regulatory structure would help address the systemic risks posed by fintech firms, whose operations can often be opaque and difficult to monitor.

Despite these recommendations, it is important to acknowledge that no regulatory framework can entirely eliminate the risks associated with financial innovation. The very nature of financial innovation introduces new risks and challenges that regulators may not anticipated. Regulatory arbitrage, for example, remains a persistent threat as fintech firms continue to exploit loopholes in the regulatory landscape. Information asymmetry also remains a challenge, as fintech firms often employ complex financial products and opaque business models that make it difficult for banks and regulators to fully assess their risk exposure. Additionally, moral hazard remains an ongoing issue, as fintech firms may continue to take excessive risks under the belief that they will be bailed out in the event of a crisis. These challenges suggest that while regulations can reduce risk, they cannot fully eliminate it.

Moreover, external factors such as economic downturns, cyberattacks, or unforeseen technological disruptions can amplify systemic vulnerabilities even in well-regulated environments. Exogenous shocks have the potential to exacerbate risks, especially in highly interconnected financial systems like those involving fintech firms and banks. The Evolve-Synapse crisis exemplifies how these types of events can lead to significant financial strain, even if regulatory frameworks are in place to prevent typical operational failures. Therefore, regulators must remain vigilant and adaptive, continuously updating their oversight mechanisms to keep pace with the evolving landscape of financial innovation.

Future research should focus on empirically testing the proposed regulatory interventions through case studies and quantitative analysis of fintech-bank partnership failures. One avenue for further exploration would be to analyze the systemic impact of these partnerships through the lens of systemic risk contagion. By integrating data from real-world financial crises, researchers can assess the true extent of the risks posed by fintech-bank partnerships and refine regulatory measures to better mitigate these risks. Additionally, examining the potential for cross-border regulatory cooperation in overseeing global fintech firms would offer valuable insights into how international collaboration could strengthen financial oversight.

The integration of fintech into traditional banking models has created numerous opportunities for innovation, but it has also introduced significant risks to the financial system. As the Evolve–Synapse crisis has shown, the combination of financial deregulation, governance failures, and moral hazard can have catastrophic consequences. It is essential that regulators take action to address these issues through stronger oversight, enhanced transparency, and more robust capital requirements for fintech firms. At the same time, it is equally important to ensure that the benefits of fintech innovation are not stifled by overly burdensome regulations. The goal should be to create a financial ecosystem where innovation can thrive without jeopardizing financial stability.

In conclusion, the Evolve-Synapse crisis offers a cautionary tale about the perils of unregulated financial innovation. By addressing the agency conflicts, moral hazards, and systemic risks outlined in this paper, regulators can help create a more resilient financial system that balances innovation with stability. Through proactive regulation, strengthened oversight, and improved transparency, policymakers can reduce the likelihood of future crises and protect consumers from the harmful effects of financial mismanagement. By doing so, they will ensure that the future of fintech-bank partnerships is one that is both innovative and secure.

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