

Chapter 10

Bank Regulation of Cryptoasset-Related Activities

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§ 10:1 Introduction

At this stage, “fintech” is firmly a part of the financial system, providing competition with the largest banking organizations and introducing new products, services, and ways of interacting with customers. The growth of cryptoassets and cryptoasset-related companies is another example of the same trend. While these market changes have taken place, the legacy bank regulatory framework has been used in an ad hoc way to address how banking organizations interact and have relationships with nonbank fintech firms and provide cryptoasset-related services and products to customers. In the last few years, however, U.S. federal bank regulators—the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC)—and other regulators have begun efforts to review more holistically how the regulatory framework needs to be updated to address the new market realities. Indeed, the impulse to modernize the regulatory framework is seen at the highest levels of the government, with Treasury Secretary Janet Yellen noting that “When new technologies enable new activities, products, and services, financial regulations need to adjust.”¹

1. Janet L. Yellen, Sec. of the Treas., Remarks Before the Kogod School of Business Center for Innovation at American University: Digital Assets (Apr. 7, 2022), <https://home.treasury.gov/news/press-releases/jy0706>.

This chapter reviews how the bank regulatory framework treats a range of cryptoasset-related activities and the legal authorities regulators may be likely to consider using, elaborating, or expanding on to authorize new activities. In preparing the chapter, our goal was to provide a comprehensive resource for anyone seeking to understand the application of bank regulation to cryptoasset-related activities. To that end, we cover:

- The permissibility of cryptoasset activities for banking organizations, including:
 - The status of efforts by the federal banking agencies to develop a more comprehensive framework;
 - President Biden's executive order regarding digital assets;
 - The policy debate regarding a U.S. central bank digital currency;
 - Permissible activities for national banks and federal savings associations;
 - Nonbank activities of bank holding companies (BHCs) and savings and loan holding companies (SLHCs); and
 - Activities of state-chartered banks;
- Permissible cryptoasset investments for banks and bank holding companies;
- Issues associated with cryptoasset collateralized lending;
- The capital treatment of cryptoasset exposures;
- Prospective stablecoin regulation;
- Limited purpose and special purpose charters for cryptoasset-focused firms;
- State law licensing issues and the available exemptions for banks; and
- Issues relevant to a banking organization's use of a service provider and partnerships with nonbank firms.

Developments in this area are occurring all the time and undoubtedly this chapter will require updates in the future. We hope, however, that in the meantime the chapter is a useful reference to record in one place the various regulatory pieces that will be used to help put together the "future of banking" puzzle.

§ 10:2 Permissible Cryptoasset Activities for Banking Organizations

Blockchain technology is rapidly changing the way assets are created, transferred, stored, and accounted for. Public and private blockchain-based assets, described herein as “digital assets” or “cryptoassets,” are being developed and utilized by private individuals, companies, and even nation-states. These developments signal the early stages of an entirely new financial industry as well as the opportunities and uncertainties that come with it. As the market capitalization and institutional support for digital assets grow, banking organizations that develop the infrastructure for digital asset banking services (including custody, payment processing, and lending offerings) will be well positioned to serve customers participating in this new and evolving asset class(es).

However, banks and banking organizations may only engage in activities regarded by the regulators as permissible, and banking regulators have not yet fully clarified the scope of digital asset activities that fall within this category. This section explains the current state of the law for permissible activities of banking organizations in the United States by first describing the work of federal banking regulators on digital asset issues to date. Next, the section analyzes the permissible activities for national banks and federal savings associations and recent guidance issued by the OCC that bring certain digital asset activities within the business of banking. This is followed by a discussion of the restrictions on the activities of a banking organization that controls a U.S. bank or has a U.S. commercial banking presence. Finally, the section analyzes the ways in which state-chartered banks may engage in the same digital asset activities as their federally chartered counterparts.

§ 10:2.1 *Looking Ahead: Research and Recommendations on Digital Assets*

Prior to 2021, the federal banking agencies primarily took a go-it-alone and somewhat ad hoc approach to innovation issues. In 2021, to increase domestic interagency coordination and to provide greater clarity and collaboration around digital assets, the agencies conducted a series of interagency “policy sprints.”² These policy sprints focused on:

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2. *Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 117th Cong. (Aug. 3, 2021) (statement of Michael J. Hsu, Acting Comptroller of the Currency), <https://www.occ.gov/news-issuances/congressional-testimony/2021/ct-occ-2021-79-oral.pdf>.

- Developing a common taxonomy regarding the use of cryptoassets³ by banking organizations;
- Identifying and assessing key risks, including those related to safety and soundness, consumer protection, and compliance;
- Considering legal permissibility related to potential cryptoasset activities conducted by banking organizations; and
- Analyzing the applicability of existing regulations and guidance and identifying areas that may benefit from additional clarification.

Following their initial policy sprints, the federal banking agencies issued a two-page statement on November 23, 2021, identifying the next steps in their cryptoasset initiative.⁴ Beginning in 2022, the agencies plan to provide greater clarity on issues of legal permissibility and expectations for safety and soundness, consumer protection, and compliance with existing laws in the following areas:

- Cryptoasset safekeeping and traditional custody services;⁵
- Ancillary custody services;⁶
- Facilitation of customer purchases and sales of cryptoassets;
- Loans collateralized by cryptoassets;
- Issuance and distribution of stablecoins; and
- Activities involving the holding of cryptoassets on a balance sheet.

The agencies also plan to evaluate the application of bank capital and liquidity standards to cryptoassets for activities involving U.S. banking organizations and to continue engaging with the Basel Committee on Banking Supervision (BCBS or “Basel Committee”) on

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3. The federal banking agencies use the term “cryptoassets” to generally refer to any digital asset implemented using cryptographic techniques.
 4. FRB, FDIC & OCC, Joint Statement on Crypto-Asset Policy Sprint Initiative and Next Steps (Nov. 23, 2021), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf> [hereinafter Joint Agency Crypto Sprint Statement].
 5. The agencies stated that traditional custody services in this context include facilitating the customer’s exchange of cryptoassets and fiat currency, transaction settlement, trade execution, recordkeeping, valuation, tax services, and reporting.
 6. The agencies stated that ancillary custody services could potentially include staking, facilitating cryptoasset lending, and DLT governance services.

its consultative process in this area.⁷ We discuss the BCBS process in greater detail in section 10:5.1 below.

In early 2022, Acting Comptroller of the Currency, Michael Hsu, stated that custody is at the top of the regulators' list in their cryptoasset initiative.⁸ With respect to such activities, he highlighted that blockchain technology and the governance of certain digital assets present novel issues that warrant additional scrutiny by the regulators.

On March 9, 2022, President Biden issued an Executive Order on Ensuring Responsible Development of Digital Assets,⁹ which addresses a number of digital assets issues, including financial stability, illicit finance, and consumer and investor protection. The executive order is another example of the Biden Administration's "whole of government approach," involving, at various points, the federal financial regulators, the Departments of Commerce, Homeland Security, Justice, State, and Treasury, the Offices of the Director of National Intelligence and Management and Budget, and others.

The executive order requests a number of reports and similar work product from Treasury and other executive agencies, generally within 180 days of the order (September 5, 2022), among them:

- *Treasury Report on CBDCs.* Treasury is required to issue a report on the future of money and payments. The topics in the report are wide-ranging, including financial stability, financial inclusion, relationship with private sector digital assets, the risk of foreign central bank digital currencies (CBDC) replacing existing currencies, national security, and financial crimes. The report is to be conducted in consultation with a number of agencies, including State, Commerce, Homeland Security, National Intelligence, and, presumably, the FRB.
- *DOJ Report on CBDCs.* The Department of Justice (DOJ) is required to report, in consultation with Treasury and the FRB, on whether legislative changes would be necessary to issue a CBDC and, if so, provide a legislative proposal within thirty days of its report.

7. Joint Agency Crypto Sprint Statement, *supra* note 4.

8. Michael J. Hsu, Acting Comptroller, Remarks Before the British American Business Transatlantic Finance Forum Executive Roundtable: The Future of Crypto-Assets and Regulation (Jan. 13, 2022), <https://www.occ.treas.gov/news-issuances/speeches/2022/pub-speech-2022-2.pdf>.

9. Exec. Order No. 14,607, 87 Fed. Reg. 14,143 (Mar. 9, 2022). *See also* The White House Briefing Room, Executive Order on Ensuring Responsible Development of Digital Assets (Mar. 9, 2022), <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>.

- *FSOC Report on Digital Assets.* The Financial Stability Oversight Council (FSOC) is required to issue a report within 210 days of the executive order on the financial stability risks of digital assets and provide policy proposals (both legislative and regulatory) to address such risk.
- *Treasury Report on Consumer, Investor, and Business Protection.* Treasury is required to issue a report on the impact of digital asset adoption on consumers, investors, businesses, and equitable economic growth, and to provide policy recommendations. Treasury will consult with the Federal Trade Commission (FTC), Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), federal banking agencies, and Consumer Financial Protection Bureau (CFPB).
- *Additional Direction for Independent Agencies to Consider Privacy, Consumer, Investor, and Market Protection.* The executive order directs (1) the FTC and CFPB to consider consumer privacy and consumer protection measures, and (2) the SEC, CFTC, FRB, FDIC, and OCC to consider investor and market protection measures.

[A] Payment Stablecoins and the PWG Report

To date, stablecoins have been one of the main areas of focus for the federal banking agencies in the United States. Stablecoins are digital assets designed to have their value pegged to an external reference asset, such as a fiat currency.¹⁰ Stablecoins have been growing in prominence and credibility, with the two most popular stablecoins, Tether and USD Coin (both pegged to the U.S. dollar), passing \$71 billion and \$54 billion in market cap, respectively, notwithstanding the volatility in cryptoasset markets experienced over the summer of 2022.¹¹

Stablecoins have been used in the United States primarily to facilitate trading, lending, and borrowing of other digital assets.¹² However,

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10. Some stablecoin arrangements also use other means to attempt to stabilize the price of the instrument or are convertible to other assets. This section does not further discuss such other forms of stablecoins because public fiat currency-backed stablecoin is the only form that the banking regulators have thus far publicly analyzed.
 11. COINMARKETCAP, TOP STABLECOIN TOKENS BY MARKET CAPITALIZATION (last visited June 14, 2022).
 12. FIN. STABILITY OVERSIGHT COUNCIL, 2021 ANNUAL REPORT (Dec. 17, 2021), <https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf> [hereinafter FSOC ANNUAL REPORT], at 3.6.2.1.

many firms are also exploring ways to promote stablecoins as a means of payment by households and businesses in the traditional, as well as digital (that is, Web3), economy. Regulators remain concerned about the risks such stablecoins may pose (compared, for example, to traditional bank deposits). This section highlights regulators' concerns about stablecoins that have the potential to become widely used as a means of payment, referred to herein as payment stablecoins.

As background, many stablecoins are “minted” in exchange for fiat currency and then are being backed by a variety of “reserve assets.”¹³ Stablecoin holders generally expect to redeem their stablecoins for fiat currency on demand at par. While wary of a number of risks posed by stablecoins as they are designed today, the federal banking agencies have publicly shared the view that payment stablecoins could support faster, more efficient, and more inclusive payments options if they are “well-designed and appropriately regulated.”¹⁴

In particular, the federal banking agencies have considered imposing prudential regulations on payment stablecoin activities. On November 1, 2021, the President's Working Group on Financial Markets (PWG),¹⁵ the FDIC, and the OCC issued a stablecoin report that, among other things, identified prudential risks for payment stablecoins and set forth recommendations for their regulation.¹⁶

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13. Regulators have expressed reservations over how these reserve assets are managed and marketed to users, and there is currently no market standard. Stablecoin arrangements pose risks to stablecoin holders because the reserve assets backing the token are not subject to strict audit requirements and the quantity and quality of collateral held as reserve assets may not correspond to the issuer's claims. In addition, unlike traditional depositors, stablecoin holders may not be FDIC-insured, even if reserve assets are held as cash deposits at IDIs. The potential pass-through coverage for up to \$250,000 for stablecoin holders may or may not apply, depending on how the stablecoin issuer deposited the reserve assets. In addition, creditors other than the stablecoin user may have competing claims on the reserve assets. Terms of redemption rights can also vary considerably across stablecoins. *See* PWG, FDIC & OCC, REPORT ON STABLECOINS (Nov. 2021) [hereinafter PWG REPORT], https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.
 14. PWG REPORT, *supra* note 13, at 1.
 15. The PWG is chaired by the Secretary of the Treasury and includes the Chairs of the FRB, SEC, and CFTC.
 16. PWG REPORT, *supra* note 13. Under current law, systemically important payment firms are subject to heightened supervision and regulation (for example, certain private wholesale payment systems have been designated as FMUs, such as the Clearing House Payments Company L.L.C., The Depository Trust Company, National Securities Clearing Corporation, and The Options Clearing Corporation). In addition, stablecoin issuers may be subject to state and federal money transmitter laws,

The PWG Report recommended for Congress to (1) “promptly” pass legislation to require payment stablecoin issuers to be insured depository institutions (IDIs), including full-scope prudential standards, consolidated supervision, and activities restrictions; and (2) provide federal agencies with significant regulatory authority over custodial wallet providers and other key participants in stablecoin arrangements.¹⁷

One reading of the PWG Report is that it implicitly endorses many of the activities involved in a payment stablecoin arrangement—particularly issuance, redemption, and maintenance of reserve assets—as permissible for all IDIs, which includes state and federally chartered banks and savings associations.¹⁸ However, as discussed in section 10:2.2[A] below, IDIs generally should approach their regulators prior to engaging in any cryptoasset activities.

Activities identified in the PWG Report include:

- Governance functions, including defining and ensuring compliance with standards related to the purchasing, redeeming, holding, and transferring of payment stablecoins;
- Management of reserve assets, involving making investment decisions with respect to the reserve, including with respect to the riskiness of the assets;
- Custody of reserve assets, involving acquiring and holding the assets and executing transactions to facilitate management of reserve assets, in adherence with standards for the payment stablecoin’s reserve assets;
- Settlement, including processing payment stablecoin transactions (for example, to engage in authentication and validation) and, for on-chain transactions, updating the ledger in accordance with the underlying protocol; and

including licensing requirements, unless they qualify for an exception. For more detail on these requirements, see sections 10:8.3 and 10:9.

17. The PWG Report recommended for stablecoin legislation to broadly apply to entities that are domiciled in the United States, offer products that are accessible to U.S. persons or otherwise have a significant U.S. nexus, including custodial wallet providers and other parties in a stablecoin arrangement. As an analogue, today, the Bank Service Company Act and the third-party risk management guidance issued by the federal banking regulators provide a measure of oversight over companies that have significant service provider relationships with banks. For more detail on those relationships, see section 10:10.

18. Subject to the mitigation of risks unique to stablecoin arrangements identified in the report.

- Distribution to users by providing access channels and other services that allow users to obtain, hold, and transact in the payment stablecoin.

Notably, the idea of a special purpose charter for payment stablecoin issuers, which is often issued to non-depository institutions and would provide a more limited regulatory framework for the payment stablecoin issuer, is not among the report's recommendations. As such, a special purpose charter was likely considered by the PWG,¹⁹ one potential inference from the report is that the federal banking regulators do not fully support the engagement in payment stablecoin activities by institutions that are not IDIs or believe that establishing an appropriate regulatory structure for such a special purpose charter would be difficult and therefore risky.²⁰

The legislative recommendation in the PWG Report was based on the identified need to mitigate a number of risks: "run" risk, payment system risks (for example, credit, liquidity, operational, governance, and settlement risks), and competitive and financial stability risks.²¹

To address the run risk caused by a loss of user confidence in a payment stablecoin issuer's ability to honor a redemption request, the PWG Report recommended for the activities of payment stablecoin

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19. For example, the PWG earlier recommended requiring certain types of MMFs to be subject to banking oversight and regulation due to MMF shares' deposit-like characteristics and risk of runs. *See* PWG, REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS 6, 32–35 (Oct. 2010), <https://home.treasury.gov/system/files/136/archive-documents/10.21-PWG-Report-Final.pdf>.
 20. Congress may nonetheless pass legislation providing for a special purpose charter for stablecoin issuers and as of this writing, a number of bills are anticipated that would support such an approach. *See, e.g.*, Stablecoin Innovation and Protection Act of 2022 (draft of Feb. 14, 2022), https://gottheimer.house.gov/uploadedfiles/dd_stablecoin_innovation_and_protection_act_of_2022.pdf [hereinafter Stablecoin Innovation and Protection Act]; Digital Market Structure and Investor Protection Act, H.R. 4741, 117th Cong. (1st Sess. 2021), <https://www.congress.gov/117/bills/hr4741/BILLS-117hr4741ih.pdf> [hereinafter Digital Market Structure and Investor Protection Act]; Stablecoin TRUST Act of 2022 (Apr. 6, 2022), https://www.banking.senate.gov/imo/media/doc/the_stablecoin_trust_act.pdf [hereinafter Stablecoin TRUST Act]; and Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, 117th Cong. (2d Sess. 2021), <https://www.congress.gov/bill/117th-congress/senate-bill/4356?s=1&r=1> [hereinafter Lummis-Gillibrand Responsible Financial Innovation Act].
 21. The report further notes a number of market integrity and investor protection risks posed by speculative digital asset trading and illicit finance concerns that are subject to oversight by the SEC, CFTC, and the Treasury Department through FinCEN.

issuance, redemption, and maintenance of reserve assets to be limited to IDIs.²² Such charter limits would require all payment stablecoin issuers to be subject to banking supervision and regulation at the issuing entity level by one of the OCC, FRB, or FDIC, and at the consolidated holding company level by the FRB.²³ Payment stablecoin issuers would also be subject to capital and liquidity standards, potentially including enhanced prudential standards that address financial stability concerns. Finally, payment stablecoin issuers would be subject to the resolution regime for IDIs under the Federal Deposit Insurance Act (“FDI Act”), protecting any customers’ insured deposits over those of general creditors.

To address payment system risks, the report recommended that federal legislation subject custodial wallet providers to federal oversight and regulation and require appropriate risk management standards for any entity performing activities critical to the functioning of the stablecoin arrangement.²⁴ More broadly speaking, payment

22. As defined in the FDI Act, 12 U.S.C. § 1813(c)(2). With limited exceptions, IDIs are subject to supervision and regulation at both the depository institution and the holding company level. Deposits held at IDIs are covered by deposit insurance, subject to the legal limits, and IDIs have access to emergency liquidity and Federal Reserve services. Further, the PWG Report noted that if the stablecoin issuer is an IDI, the agencies may also be able to examine any stablecoin-related services provided to the issuer bank by third parties, including nonbank entities. *See* PWG REPORT, *supra* note 13, at n.27.

23. 12 U.S.C. § 1841 *et seq.* Note that organizations owning certain types of IDIs (for example, those that are exempt from the definition of “bank” under the BHC Act, such as industrial loan companies and limited purpose trust companies that meet the requirements) would be exempt from the FRB’s consolidated supervision under existing law. *See* 12 U.S.C. § 1841(c)(2). The OCC and the FDIC, however, may still require certain conditions be met by the banking organization under written agreements among the agency, the bank, and the bank’s parent, such as an operating agreement or a capital and liquidity maintenance agreement.

24. As an example, the PWG Report cited the consultative report “Application of the Principles for Financial Market Infrastructures to stablecoin Arrangements” by the Committee on Payments and Market Infrastructures and Board of the International Organizations of Securities Commission. Application of the Principles for Financial Market Infrastructures to stablecoin Arrangements, Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions (Oct. 2021), <https://www.bis.org/cpmi/publ/d198.pdf>. The PWG Report further notes that wallet providers themselves may, as to certain of their activities, be subject to varying levels of regulation and supervision by the states in which they operate, depending on the services provided and the laws and regulations of each state.