National Bank Stablecoin-Reserve Powers

Cite
OCC, Interpretive Letter #1172 – Chief Counsel's Interpretation on National Bank and Federal Savings Association Authority to Hold Stablecoin Reserves

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Website:
https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1172.pdf

Impact Assessment

- The OCC continues to approve novel national-bank activities on a case-by-case basis even as broader rulemakings remain incomplete. Additional authorizations are possible.
- Given the pending election and the controversies surrounding several of these rulings, banks taking advantage of stablecoin-reserve authority may face divestiture risk, especially if activities are said to deviate in any way from this letter.
- Stablecoin reserves may not be easily intermediated, raising bank costs absent offsetting fee or other income. However, the OCC letter does not expressly require sterile reserves.
- It is unclear if these reserve activities could be conducted in concert with other stablecoin activities (e.g., debit cards, payment services) within the same banking organization, but the absence of restrictions suggests that this is possible. If stablecoins prove their worth, a powerful, innovative charter could result.
- The amount of the reserve requirements as well as their nature is ambiguous, creating additional legal uncertainty.

Overview

Continuing Acting Comptroller Brooks' efforts to enhance innovation at national banks and federal savings associations, the agency has now authorized these institutions to hold reserves associated with certain stablecoin offerings. This reflects a general trend in recent OCC actions allowing national banks and federal thrifts to engage in novel activities in which funds placed with the bank or an affiliate might

not be intermediated as is the case in traditional banking organizations. Instead, these banks serve as custodians of funds backing other exposures, as payment-system windows for non-traditional customers, or in other ways that leverage the unique benefits of a banking charter with non-traditional activities often under uncertain prudential standards and otherwise exposed to risks not necessarily captured in the limits placed on the bank. However, these arrangements would, as the OCC intends, increase the ability of U.S. entities to offer cryptoasset and cryptocurrency products.

Impact

This ruling continues the OCC's actions to approve unprecedented activities on a case-by-case basis even as rulemakings creating a broader, transparent framework are incomplete. The first of these is a notice of proposed rulemaking providing broad authority for a scope of new national-bank powers.[1] The second, an advance notice of proposed rulemaking,[2] directly addresses digital and cryptoasset issues in a set of policy questions. The OCC appears now to have answered at least some of them, setting policy for the U.S. even as global deliberations on cryptoassets and cryptocurrency proceed in concert with FRB, FDIC, SEC, CFTC, and Treasury review. The idiosyncratic patchwork of approvals resulting from interpretive letters or even just transaction approvals may create a strong platform of successful charters leading to more transparent innovation across the U.S. agencies in coming years. However, it could also leave just a few institutions with either competitive or comparative advantage or a costly investment that future regulators require it to dismantle.

This issue is not new. Ever since Facebook launched its Libra initiative in 2019, financial institutions, regulators, and central banks have focused on the impact stablecoins such as Libra may have across an array of monetary, regulatory, currency, and financial-stability dimensions. Most recently, the Financial Stability Board released a consultation on stablecoins that, given the global body's mandate, focuses on global stablecoins but still raises an array of considerations also concerning to national regulators and central banks.[3] Numerous speed-bumps are laid out that, the FSB believes, must be resolved before regulated institutions engage in or facilitate stablecoin activities.

The OCC believes the stablecoin arrangements covered by this letter pose none of the problems identified by the FSB. This is correct to some extent because eligible stablecoins must be backed by only one fiat currency – not the "basket" involved in Libra – but the FSB's concerns are not limited only to currency baskets. The pending EU approach to stablecoins is more directly based on the FSB's construct and considerably more prescriptive in numerous respects. Most importantly, it would require that a stablecoin operator or provider be regulated the same way whether housed in a bank or other corporate entity. In the OCC's approach, OCC regulation applies only to reserve accounts and the manner in which a bank decides with which stablecoin providers to do business. As a result, the stablecoin provider may engage in activities or take risks not allayed by reserve

[1] See **CHARTER26**, *Financial Services Management*, June 11, 2020.

[2] See **DIGITAL5**, *Financial Services Management,* June 9, 2020.

[3] See **CRYPTO14**, *Financial Services Management*, April 23, 2020.

requirements. These could put vulnerable consumers or investors at risk and pose additional risks also to the national bank or thrift based not only on the liquidity risks indirectly addressed by the OCC, but also legal and reputational hazard.

Further, the OCC's interpretative letter does not expressly require that reserves be "sterile" – i.e., not used for intermediation, rehypothecated, traded, or otherwise put to use. Indeed, the announcement of this letter put the word reserves in quotation marks, suggesting that reserves here may have a different meaning than ordinarily understood. The nature of reserves and the extent to which they different from the dollar-for-dollar construct also suggested in the letter will have significant bearing on both profitability and risk.

The OCC's opinion seems most directly focused on enabling a new special-purpose bank authorized in Wyoming, Kraken, to honor its promise that a regulated bank will hold dollar-for-dollar stablecoin reserves. However, JPMorgan has pioneered a version of a stablecoin arrangement in which it posts a dollar of fiat currency for a stablecoin used in wholesale transactions. As this is an ongoing activity, it would not appear to require additional authority pursuant to this letter, but variations on the product – e.g., use of powers specific to a national bank focused on custody services – may apply.

In the Kraken case, the state-chartered banking organization is by definition outside the scope of the OCC's authority, but the authority to national banks for reserve services granted in this letter might well apply to other cryptography ventures, including those in existing national banks, that acquire national banks and even operate in bank holding companies. The OCC and FRB have for example authorized Jiko, a fintech venture, to acquire a national bank to handle FDIC-insured deposits associated with a government-bond investment service within a bank holding company. The integration of the non-traditional venture and national-bank charter provides a platform for access to the payment system, debit-card services, and an array of other products.

It is thus possible that the reserve accounts associated with these stablecoin balances could be insured deposits in their own right. As discussed below, the OCC says only that banks must disclose FDIC-insurance status, clarifying in the letter also that reserve balances may be those of the stablecoin account-holder as is the case for certain stored-value cards or uninsured if held by the bank as the equivalent of a merchant reserve or general liability. Action by the FDIC may well be required to clarify this question unless stablecoin account-holders maintain sufficient fiat-currency balances to serve as both account reserves and traditional deposits. In such cases, excess reserves in bank accounts could integrate an array of traditional services with the stablecoin account.

What's Next

The OCC released this letter on September 21. It is effective immediately, with its relationship to the pending OCC actions noted above not made clear. Over the

past two years, Congress has held numerous hearings on Libra[4] and on cryptoassets and cryptocurrency.[5] Although Republicans such as Senate Banking Chairman Crapo (R-ID) want fast action so that the U.S. takes a global lead and Democrats are sometimes more cautious, there has been strong agreement on a bipartisan basis of the need for U.S. action on a policy framework. Congressional action affecting or even overturning OCC case-by-case authorizations is unlikely – this would take new law and none is even pending, let alone probable. However, the next Congress and Administration will surely feel still more need to establish a statutory framework for complex products such as stablecoin. When this advances, existing approvals may be grandfathered – this is often the case – or time-limited or otherwise constrained or reversed. As a result, despite the OCC's landmark action, political risk remains for innovative federal charters.

Analysis

A. Legal Considerations

The interpretive letter expresses no views on stablecoin legitimacy under other laws, covering only national-bank activities with regard to them. It does not make clear if the national bank must ensure that the stablecoin and its activities are permissible under applicable law. Although this appears implicit in the opinion and explicit in other applicable safety-and-soundness rules, the letter does not require national banks to obtain legal opinions or ensure irrevocable rights in uncertain situations as is sometimes the case in complex arenas. However, the bank must conduct due diligence sufficient in relation to the stablecoin's risk that "facilitates" an assessment of laws applicable to the bank, including those related to anti-money laundering laws. Stablecoin customer beneficial owners must be known to the bank.

The OCC also notes that the SEC has issued a staff letter offering to provide stablecoin providers with no-action letters clarifying that these products comply with securities requirements, but it does not make it clear if stablecoins supported by national banks must have actually received no-action letters.

The letter also includes a discussion of why this activity is permissible for national banks and federal thrifts. It cites factors such as the ability of federally-chartered banks clearly to take deposits and the analogy between these reserves and traditional deposits, the OCC's recent decision to allow national banks to provide services to any legal cryptography customer as long as all legal requisites (e.g., AML compliance) are met, and broad authority for powers incidental to those expressly authorized for national banks.[6]

B. Eligible Stablecoins

These are stablecoin that are a unit of cryptocurrency associated with hosted wallets backed by a single fiat currency and redeemable by the holder of the stablecoin on a 1:1 basis for the underlying fiat currency upon submission of a redemption request to the issuer.

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[4] See *Client Report* **CRYPTO12**, October 13, 2019.

[5] See *Client Report* **CRYPTO11**, July 30, 2019.

[6] See **CRYPTO13**, *Financial Services Management*, December 19, 2019.

C. Reserve Terms and Conditions

These are that:

- the bank considers all relevant risks prior to providing this service;
- the stablecoin is housed in a hosted wallet;
- the bank verify at least daily that reserves equal or exceed the number of outstanding stablecoins. However, the letter also states that reserves must equal or exceed fiat currency in the underlying account. Contractual arrangements requiring the stablecoin provider to ensure compliance with this and other terms and conditions is necessary. Audit of compliance may also be appropriate but does not appear to be expressly required;
- the bank determines if the deposit is that of the stablecoin provider or may pass through to the customer for deposit-insurance purposes. Accurate and timely disclosures related to insurance are also required, with FDIC-eligibility dependent on the nature of the deposit as described above; and
- the bank manages the liquidity risk associated with these funds, which is likely to be greater than traditional deposits.

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