



Financial Services Management

FRB Crypto-Activity Constraints

Cite

Federal Reserve Supervisory Letter SR 22-6/CA 22-6: Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations

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Website:

<https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm>

Impact Assessment

- The Fed has instituted a de facto freeze on cryptoasset activities in most of the U.S. banking system pending Reserve Bank decisions about which current or prospective activities meet an array of prudential and policy standards.
- State member banks and BHCs already engaged in cryptoassets may be forced to alter these operations or even divest.
- Specific activities may be approved at individual state member banks and BHCs, with wide variation in those blessed by lead supervisors and the time it takes for this to occur resulting in a patchwork of different cryptoasset activities across the U.S.

Overview

Reflecting the concerns voiced in a recent executive order from President Biden¹ and a subsequent request for views from Treasury,² the Federal Reserve has joined the OCC³ in demanding prior notice from banking organizations that wish to undertake cryptoasset activities. The OCC also warned national banks already engaged in these activities to ensure that they are safe and sound, but the Fed has gone farther. It also demands that state member banks and BHCs already engaged in this sector notify their lead supervisor and ensure that these activities meet safety-and-soundness, compliance, consumer-protection, and other standards. As with the Board's new payment-system guidelines,⁴ Reserve Banks may interpret these cryptoasset thresholds differently, perhaps leading to a patchwork of activities across the banking system.

¹ See *Client Report CRYPTO26*, March 9, 2022

² See *CRYPTO30*, *Financial Services Management*, July 12, 2022.

³ See *CRYPTO22*, *Financial Services Management*, December 1, 2021.

⁴ See *PAYMENT25*, *Financial Services Management*, August 15, 2022.

Impact

As with most other U.S. statements about cryptoassets, the Fed's supervisory letter acknowledges that these assets present numerous opportunities. However, it quickly pivots to an array of warnings about safety and soundness, consumer protection, money laundering, cyber-security, financial stability, and monetary-policy transmission. It thus puts state member banks and BHCs wishing to engage in these activities on notice that they may only do so with express approval by their lead Fed supervisor. This will at the least slow crypto adoption by Fed-regulated banking organizations and ensure that any already in this arena do not presume that their activities are grandfathered. As a result, companies in areas such as crypto custody or those that facilitate client trading will need quickly to review the Board's criteria for permissible activities, bringing any that may be problematic quickly into adherence and then clearing them to avoid costly divestitures that could also pose reputational risk.

One challenge associated with several of the conditions on cryptoasset approval is the absence of any specific standards related to them. The Basel Committee has recently proposed new regulatory-capital standards⁵ while Canada has imposed exposure limits and the EU is working on wide-ranging cryptoasset standards. Fed-supervised institutions may look to these rules as possible guideposts as to what the Fed might demand, but each lead supervisor could have different views. Similarly, the CFPB has yet to detail how consumer-protection standards apply to cryptoassets beyond expressing concern about these risks.⁶ Fed supervisory staff could also have differing views on this critical point. As a result, individual institutions could receive either clearance or objections from their supervisors to like-kind activities under comparable rules, creating a patchwork of activities across the U.S. banking system. Banks might also meet all of a Reserve Bank's criteria but run afoul of the Board on grounds that the charter might impede monetary-policy transmission as was the case for one innovative charter in 2019.⁷

The letter commits the Fed's lead supervisors to respond to all inquiries related to prior notices or continuing activities in a "timely" fashion. In practice, these responses could take months, if not years. As a result, Fed-supervised institutions may now be in the equivalent of a no man's land in which no new cryptoasset-activities begin and those already undertaken are in limbo pending approval for continued operation following any improvements the banking organization thinks necessary for approval. This may put state member banks at a disadvantage to national banks continuing to engage in cryptoasset ventures while new ones slowly advance, but state nonmember banks are in a still more uncertain position because the FDIC has yet to approve any cryptoasset activities or even opine on how or when it might do so. The extent to which the Fed's views govern BHCs – and the letter's language suggests it may – could also freeze even national-bank activities unless these are in any of the unique cryptoasset charters continuing at least in limited operation following approval under the Trump Administration's Acting Comptroller.⁸ Democratic senators have demanded that the OCC freeze any such grandfathered activities or revoke these charters, but it has yet to do so.

⁵ See **CRYPTO19**, *Financial Services Management*, June 15, 2021.

⁶ See *Client Report CONSUMER42*, April 27, 2022.

⁷ See **CHARTER25**, *Financial Services Management*, March 18, 2019.

⁸ See **CRYPTO15**, *Financial Services Management*, September 28, 2020.

What's Next

The Fed issued this letter on August 16; it is effective immediately.

Analysis

This letter applies to all Fed-supervised banking organizations (i.e., state member banks, BHCs, S&LHCs) and any asset using cryptographic “techniques.” Activities within the scope of this letter include, but are not limited to cryptoasset safekeeping and all custody services, facilitation of customer cryptoasset sales or disposition, lending collateralized by cryptoassets, and issuance and distribution of stablecoins.

As noted, companies are instructed to seek prior approval from their lead supervisor before engaging in cryptoasset activities and to notify the Fed of ongoing activities. Reserve Bank and perhaps Board supervisory staff will then provide “relevant supervisory feedback” in a “timely manner.” Banks are also encouraged to consult their state regulators prior to engaging in cryptoasset activities.

It is likely that to enter this field or remain in it, the bank will then need to demonstrate capabilities to address the following concerns:

- legal permissibility, consulting its lead supervisor if there are any ambiguities in the bank’s determination of full authorization under federal and state law. BHCs are to refer to the OCC for permissibility related to national banks and all FDIC-insured institutions are to look to the FDIC. It is unclear if the Fed here means to ensure if a cryptoasset activity has been approved as safe and sound by the FDIC because the FDIC has yet to do so;
- operational risk;
- the risk of third-party relationships;
- financial risk;
- legal risk;
- compliance risk; and
- consumer-protection law and compliance.