

# OCC Clarifies Bank Authority to Hold Stablecoin Reserves Following Guidance on Custody of Digital Assets

September 24, 2020

On Monday, September 21, 2020, the OCC's Chief Counsel published an [interpretive letter](#) confirming the authority of national banks and federal savings associations (together, "banks") to hold deposit "reserves" on behalf of customers that issue certain types of stablecoins. This guidance follows an earlier [interpretive letter](#) published by the Chief Counsel confirming the authority of banks to provide cryptocurrency (including stablecoin) custody services for customers. The letters indicate the OCC's view that, under specified conditions, a bank may engage in core banking activities—deposit taking and custody—with digital assets and digital asset businesses in a safe and sound way. The most recent letter also is a further indication of the willingness of the current OCC leadership to address cryptocurrency and other innovation issues.<sup>1</sup>

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## Stablecoin Reserves

Stablecoins are a type of cryptocurrency designed to have a stable value. Stablecoins are represented by digital tokens that typically convey a legal claim against the issuer or a related party and may also represent an ownership interest in an underlying asset. Stablecoins may be backed by a fiat currency, a commodity or another cryptocurrency. In general terms, one unit of a fiat-backed stablecoin may be exchanged for one unit of the underlying fiat currency. Companies that issue stablecoins may often want to place the funds backing the stablecoin, known as "reserves," with a bank to provide assurance that the issuer has sufficient assets backing the stablecoin.

The Chief Counsel letter<sup>2</sup> confirms that banks may hold such stablecoin reserves, so long as the stablecoin is:

- associated with hosted wallets;<sup>3</sup>

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<sup>1</sup> In addition to the two Chief Counsel letters, the OCC previously issued an advance notice of proposed rulemaking ("ANPR") on its regulations relating to "digital activities." Our summary of the ANPR is available [here](#).

<sup>2</sup> OCC Interpretive Letter #1172.

- 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.

The OCC declined to opine on other types of stablecoins in the letter, including stablecoin transactions involving unhosted wallets.

The letter explained that Banks that provide deposit services for stablecoin reserves must also follow existing rules and standards described below.

- **Federal Deposit Insurance Coverage.** The letter requires banks to provide accurate and appropriate disclosures regarding deposit insurance coverage. Because stablecoin reserves are the same as any other deposit product, banks must follow all laws and regulations relating to deposit insurance coverage, including deposit insurance limits and, if applicable, the requirements for deposit insurance to “pass through” to an underlying depositor.
- **Compliance with BSA and Anti-Money Laundering Obligations.** Banks must ensure that their deposit activities comply the Bank Secrecy Act of 1970 (the “BSA”) and anti-money laundering (“AML”) requirements, including customer due diligence requirements, customer identification requirements and identification and verification of beneficial owners of legal entity customers opening accounts.<sup>4</sup>
- **Compliance with Federal Securities Laws.** Banks must also comply with applicable federal securities laws. On the same day that the OCC letter regarding stablecoin reserves was published, the staff of the Securities and Exchange Commission (the “SEC”) also issued a [statement](#) encouraging any parties seeking to structure and sell digital assets (including stablecoins) or engage in related activities to contact SEC staff with any questions to help ensure that such digital assets are structured, marketed and operated in compliance with the federal securities laws. The statement reminded market participants that whether a particular digital asset is a security under federal securities laws is a facts-and-circumstances determination requiring careful analysis of the nature of the instrument. The statement also highlighted the willingness of SEC staff to engage with and assist market participants in considering activities involving digital assets, including by providing “no-action” letters if appropriate.

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<sup>3</sup> A hosted wallet is a software program that stores the cryptographic keys associated with a particular unit of the cryptocurrency that is controlled by an identifiable third party. By contrast, an unhosted or personal wallet is a wallet controlled by an individual owner of the cryptocurrency.

<sup>4</sup> See [our prior analysis](#) on application of BSA / AML compliance obligations for convertible virtual currencies.

- **Liquidity Risk and Other Risk-Management Considerations.** Banks should develop and implement stablecoin reserve-related activities consistent with sound risk-management principles and the bank's overall business plans and strategies. The OCC notes that banks should identify, measure, monitor and control the risks associated with new activities and conduct diligence as needed to facilitate an understanding of such risks. Further, the letter highlighted that there could be liquidity risks associated with stablecoin reserves that a bank should consider.
- **Contractual Arrangements.** In addition, a bank should have appropriate agreements in place with stablecoin issuers, which may include contractual restrictions or requirements with respect to the assets held in the reserve account. Further, the bank should have appropriate agreements in place to ensure that the appropriate party will be deemed the issuer or obligor of the stablecoin, including, for example, a requirement that the issuer verify and ensure that the deposit balances held by the bank for the issuer are always equal to or greater than the number of outstanding stablecoins issued and mechanisms to allow the bank to verify the number of outstanding stablecoins on a regular basis.

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## Cryptocurrency Custody Services

Earlier this year, in July 2020, the Chief Counsel published an interpretive letter<sup>5</sup> confirming the authority of banks to provide cryptocurrency custody services for customers, reasoning that such services are a digital equivalent of traditional banking services that banks have provided for decades. In contrast to the stablecoin reserves letter, the custody letter encompasses custody of all digital assets, including digital assets not broadly used as currencies or backed by any other assets.

Because digital currencies exist only on the blockchain or distributed ledger on which they are stored, providing custody of cryptocurrencies generally does not entail physical possession of the digital asset. Instead, custodians of digital assets must take possession of the cryptographic access keys to particular units of the digital asset, which are stored in software programs known as wallets. The right to any particular unit of digital currency is transferred from one party to another through the use of these unique cryptographic keys, and the wallet protects the keys from discovery by a third party.

The letter confirms that banks may hold unique cryptographic keys associated with cryptocurrencies on behalf of customers and provide related custody services, including facilitating the customer's cryptocurrency and fiat currency exchange transactions,

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<sup>5</sup> OCC Interpretive Letter #1170.

transaction settlement, trade execution, record keeping, valuation, tax services, reporting or other appropriate services. A bank also may engage a sub-custodian for cryptocurrency it holds on behalf of customers; if the bank does so, it should develop processes to ensure that the sub-custodian's operations have proper internal controls to protect the customer's cryptocurrency.

As with other custody services, these activities are permissible for banks acting in both non-fiduciary and fiduciary capacities. A bank that provides non-fiduciary cryptocurrency custody services essentially would provide safekeeping for the cryptographic key that allows for control and transfer of the customer's cryptocurrency. A bank with trust powers is permitted to conduct cryptocurrency custody activities in a fiduciary capacity, including managing them in the same way the bank would manage any other fiduciary asset, so long as it is in compliance with the terms of the instrument, the OCC's Part 9 fiduciary regulations, applicable state law and any other applicable law.

### **Risk Management Considerations**

The OCC letter provides that cryptocurrency custody activities must be conducted consistent with sound risk management practices and the bank's overall business plans and strategies. As with all other activities, cryptocurrency custody activities must be conducted in a safe and sound manner, including with adequate systems in place to identify, measure, monitor and control the risks of such services. These systems include policies and procedures, effective internal controls and management information systems governing custody services. The OCC also notes that a bank's controls may need to be tailored in the context of digital custody and that specialized audit procedure may be necessary to ensure that such controls are effective for digital custody activities. The letter adds that banks seeking to engage in these activities should conduct legal analysis to ensure the activities are conducted consistent with all applicable laws.

The risks associated with each cryptocurrency custody account must be addressed prior to acceptance through an adequate review process. The due diligence process for such accounts should include a review for compliance with AML rules. Banks should also have an effective information security infrastructure and controls in place to mitigate hacking, theft and fraud prior to custodizing the digital assets. The OCC cautions that different cryptocurrencies may require different risk management procedures and be subject to different OCC regulations and guidance outside of the custody context, as well as non-OCC regulations.

Importantly, the OCC states that banks should consult with OCC supervisors "as appropriate" prior to engaging in any cryptocurrency custody activities.

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## Conclusion

As noted, these interpretive letters show the willingness of the OCC leadership to proactively address innovation issues. Although the letters do not necessarily tread novel legal ground, taken together they begin to show how a bank could provide a comprehensive digital asset offering, such as by holding stablecoin reserves, acting as custodian for customers that wish to hold such stablecoin and, in its role as custodian, facilitating the exchange of the stablecoin and fiat currency and providing trade settlement, execution and other related services. We believe the OCC likely will continue to issue interpretations and take other similar actions under current leadership that will further clarify whether and how banks may participate in the use of digital assets.

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Please do not hesitate to contact us with any questions.

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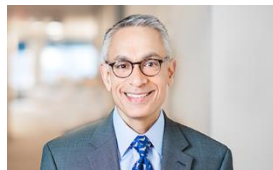


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