

The New York DFS issues guidance for issuers of U.S. dollar-backed stablecoins

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The New York Department of Financial Services (DFS) released guidance outlining reserve, redemption and disclosure requirements for U.S. dollar-backed stablecoins issued by DFS-regulated virtual currency entities.

The DFS' [Guidance on the Issuance of U.S. Dollar-Backed Stablecoins](#) (the Guidance) sets forth certain DFS requirements for U.S. dollar-backed stablecoins issued under its oversight. Its timing was clearly inspired by the recent market turmoil. It is an important development in the regulation of U.S. dollar-backed stablecoins as it is the first guidance from a state regulator. It is also important because the DFS currently regulates the issuers of three of the six largest centralized "dollar-backed" stablecoins in circulation, collectively accounting, according to our calculations, for approximately 13% of circulating U.S. dollar-backed stablecoins globally, or three of the twelve largest U.S. "dollar-pegged" stablecoins in circulation,¹ collectively accounting for approximately 12% of circulating U.S. dollar-pegged stablecoins globally.

Issuers that currently issue U.S. dollar-backed stablecoins under DFS supervision will be required to come into compliance with the Guidance by September 8, 2022, except as to the annual attestation requirements described below, with which issuers must come into compliance in a reasonable period as determined by the DFS.

Applicability and scope of the guidance

All DFS regulated virtual currency businesses are required to receive approval from the DFS for any new products, including issuing stablecoins. The Guidance applies to any U.S. dollar-backed stablecoin "issued under DFS supervision by DFS-regulated virtual currency entities," i.e., entities licensed under 23 NYCRR Part 200 (a BitLicense) or chartered as limited purpose trust companies under the New York Banking Law.

The Guidance makes clear that these new requirements are not exclusive and reminds issuers they are still subject to regulation and oversight relating to cybersecurity and information technology; network design and maintenance and related technology and operational considerations; Bank Secrecy Act/anti-money-laundering and sanctions compliance; consumer protection; and safety and soundness.

Redeemability and policies

Redeemability

The stablecoin issuer must adopt clear, conspicuous redemption policies entitling the redeemer the right to redeem units of the stablecoin from the issuer in a timely fashion at par.

"Timely" redemption is defined in the Guidance as not more than two full business days after the business day on which the [i]ssuer receives a "compliant redemption order," meaning the business day on which:

1. the issuer has received a redemption order; and
2. the holder or the holder's designee has onboarded successfully with the issuer and all other conditions necessary to permit compliant redemption have been met.

Notably, the Guidance would permit the DFS to provide exceptions from the T+2 requirement "in extraordinary circumstances, where DFS concludes that timely redemption would likely jeopardize the reserve's asset-backing requirement or the orderly liquidation of reserve assets."

Policies

The Guidance requires stablecoin issuers to "adopt clear, conspicuous redemption policies, approved in advance by DFS in writing." These policies must confer on "any lawful holder of the stablecoin" a right to redeem their stablecoins at par for the U.S. dollar net of "ordinary, well-disclosed fees." While the Guidance does provide that the right of redemption may be subject to "reasonable, non-burdensome conditions, including otherwise applicable legal or regulatory requirements, such as the ability of the stablecoin holder to onboard successfully with the issuer before redeeming," it is unclear whether this would require a stablecoin issuer with whom onboarding is limited to institutions to allow retail customers to onboard with its redemption platform.

The reserve

The Guidance provides that all stablecoins subject to the Guidance must be fully backed by a reserve of assets, meaning that the market value of the reserve must be at least equal to the nominal value of all outstanding units of the stablecoin as of the end of each business day.

The Guidance requires that the reserve:

	segregated from the proprietary assets of the issuer
Be	held in custody with (i) U.S. state or federally chartered depository institutions with deposits insured by the Federal Deposit Insurance Corporation (FDIC) and/or (ii) asset custodians that are approved in advance by DFS
	held at these depository institutions and custodians for the benefit of the holders of the stablecoin, with appropriate titling of accounts
Consist of	U.S. Treasury bills acquired by the issuer three months or less from their respective maturities
	Tri-party or bilateral reverse repurchase agreements fully collateralized by U.S. Treasury bills, U.S. Treasury notes, and/or U.S. Treasury bonds on an overnight basis. Such arrangements would be subject to
	DFS-approved requirements concerning overcollateralization
	DFS non-objection as to the counterparties
	Government money-market funds, subject to:

DFS-
approved
caps
on
the
fraction
of
reserve
assets
to
be
held
in
such
funds

DFS-
approved
restrictions
on
the
funds,
such
as
a
minimum
percentage
allocation
to
direct
obligations
of
the
Government
of
the
United
States
and
reverse
repurchase
agreements
on
such
obligations

Deposit accounts at U.S. state or federally chartered depository institutions, subject to DFS-approved restrictions such as:

percentage-of-reserve or absolute-dollar-value caps on the assets to be deposited at any given depository institution **and/or**

limitations based on the DFS' conclusions concerning the risk characteristics of particular depository institutions, taking into consideration the amounts reasonably needed to be held at depository institutions to meet anticipated redemption demands.

Attestation

Under the Guidance, the reserve must be subject to a monthly report, made available to the public and delivered to the DFS within 30 days of the covered period,² that details an independent, U.S. licensed, certified public accountant (CPA) examination conducted by applying the attestation standards of the American Institute of Certified Public Accountants (AICPA). The DFS reserves the power to approve in advance in writing the CPA's engagement letter.

The CPA report will be required to attest to management's assertions as of the last business day of the covered period and as of at least one randomly selected business day during the period as to:

1. the end-of-day market value of the reserve, both in aggregate and broken down by asset class;
2. the end-of-day quantity of outstanding stablecoin units;
3. whether the reserve was, at these times, adequate to fully back all outstanding stablecoin units; and
4. whether all DFS-imposed conditions on the reserve assets have been met.

Issuers covered by the Guidance must also obtain an annual attestation report by an independent, U.S. licensed, CPA applying the attestation standards of the AICPA, attesting to management's assertions concerning the effectiveness of the internal controls, structure, and procedures for compliance with the requirements of the monthly attestation. The annual attestation report must be delivered to the DFS within 120 days of the covered period, but, unlike the monthly CPA report, is not required to be made available to the public. The engagement letter covering the annual attestation report is also required to be approved in advance in writing by the DFS.

Resources

Visit our Crypto Regulation Hub for links to congressional proposals related to the regulation of crypto assets and other helpful materials.

[Explore our crypto resources](#)

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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¹ This includes "algorithmic" and other decentralized stablecoins that purport to be redeemable for the equivalent of one U.S. dollar.

² In contrast, the stablecoin issuers covered by this regulation are required to submit quarterly financial statements and audited annual financial statements to the DFS under existing New York Bank Law and 23 NYCRR 200.