

Crypto's integration into the traditional financial system is under more pressure

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The Federal Reserve is placing high hurdles for banks seeking to engage in most cryptoasset-related activities, and the Biden Administration is also signaling an increased resistance toward crypto's integration into the traditional financial system.

The federal government's scrutiny of cryptoasset activities continues to increase. A series of actions released on January 27 by the Federal Reserve and the Biden Administration's National Economic Council clearly signals that efforts to further integrate crypto into the traditional financial system will be closely scrutinized.

Federal Reserve actions

The Federal Reserve has published a [Policy Statement](#) that sets forth its views on the legal permissibility of three types of cryptoasset activities. A key consequence of the Policy Statement is that the Federal Reserve will limit uninsured state member banks' crypto activities as principal to those that are permissible for (1) national banks and (2) state banks where permitted by federal statute or regulations. For those who would like to follow the technical trail, the Federal Reserve has relied upon an interpretation of Section 9(13) of the Federal Reserve Act to extend the application of Section 24 of the Federal Deposit Insurance Act and its implementing regulations under Part 362 to cover not only insured state banks, but also uninsured state member banks.

Our key takeaways are below.

1. Importance of safety and soundness considerations.

The Policy Statement emphasizes that even if an activity is legally permissible, it must also be conducted in a safe and sound manner. The Policy Statement is markedly skeptical that engaging in cryptoasset activities as principal is capable of being conducted in a safe and sound manner – particularly if such activities are conducted on public, permissionless blockchain networks.

Consistent with the views in the Policy Statement, on the same day of its release, the Federal Reserve [denied](#) a special purpose depository institution's application to become a member of the Federal Reserve System on the grounds that “[t]he firm’s novel business model and proposed focus on crypto-assets presented significant safety and soundness risks.”

2. Existing notice and approval requirements still apply.

Even if legally permissible and conducted in a safe and sound manner, a state member bank must still give notice to the Federal Reserve pursuant to [SR Letter 22-6](#) before engaging in a crypto-related activity. Similarly, if a state member bank relies on an authority that is available to a national bank, it must adhere to the terms, conditions and limitations placed on national banks by the OCC with respect to the activity, including any notice or application procedures. This would require, for example, a state member bank to obtain written nonobjection from Federal Reserve supervisory staff before engaging in an activity addressed by OCC [Interpretive Letter 1179](#).

3. **Significance for Fed master accounts.** The Policy Statement appears to target uninsured state banks engaged in cryptoasset activities that may seek to become member banks in order to facilitate access to the Federal Reserve's payment systems. Becoming a member bank would take an uninsured state bank from Tier 3 to Tier 2 under the Federal Reserve's Guidelines for Evaluating Account and Services Requests, and therefore potentially make it easier to receive approval for a master account.

4. **Acting as custodian for cryptoassets is presumptively permissible.** "Nothing in the policy statement would prohibit a state member bank . . . from providing safekeeping services for crypto-assets in a custodial capacity if such activities are conducted in a safe and sound manner and in compliance with consumer, anti-money-laundering, and anti-terrorist-financing laws." This conclusion is consistent with OCC Interpretive Letters 1170 and 1179 for national banks, as well as the fact that custody activities are not principal activities and therefore not subject to the limitations of Section 24 of the Federal Deposit Insurance Act.

5. **Issuing "dollar tokens" may be permissible, but the term's scope is unclear.** The Policy Statement states that member banks may issue "dollar-denominated tokens (dollar tokens) using distributed ledger technology or similar technologies," provided that the conditions set out in OCC Interpretive Letters 1174 and 1179 for national banks are satisfied. But the OCC letters focus on "stablecoins," rather than "dollar tokens," and it is unclear to what extent the two terms are intended to overlap. For example, it appears that dollar tokens may include tokenized demand deposits issued by banks – i.e., deposit coins. The Policy Statement states further that the Federal Reserve "generally believes that issuing tokens on open, public, and/or decentralized networks, or similar systems" – as is standard for existing stablecoins – "is highly likely to be inconsistent with safe and sound banking practices." The Policy Statement differs from the stablecoin-focused legislative proposals released to date, which would allow banks to issue stablecoins without explicitly limiting the type of blockchain network they may operate on.

6. **Investing or trading in cryptoassets as principal is presumptively not permissible.**

The Policy Statement confirms that the Federal Reserve presumptively views investing or trading in "most" cryptoassets as principal in any amount to be impermissible for member banks. But it is unclear what cryptoassets, if any, fall outside of this presumption. A footnote potentially leaves the door open for principal activities involving stablecoins, with the observation that "the OCC has not made a determination addressing the permissibility of a national bank holding cryptoassets as principal, other than 'stablecoins' to facilitate payments subject to the conditions of OCC Interpretive Letter 1179."

As a more fundamental matter, it is not clear what instruments the Federal Reserve believes are "cryptoassets." On the one hand, the Policy Statement says the term does not include cryptoassets "to the extent they are more appropriately categorized within a recognized, traditional asset class." But on the other, the Policy Statement includes only one highly specific example of such an asset, casting doubt on how broadly the Federal Reserve will apply the carveout in practice. The specific example of a recognized, traditional asset class cited in the Policy Statement is "securities with an effective registration statement filed under the Securities Act of 1933 that are issued, stored, or transferred through the system of a regulated clearing agency and in compliance with all applicable federal and state securities laws." It is not clear, for example, how the Federal Reserve would consider securities that were issued in transactions exempt from registration under the Securities Act. Moreover, the Policy Statement proceeds to state that "[t]o the extent transmission using distributed ledger technology and cryptographic techniques changes the risks of a traditional asset (for example, through issuance, storage, or transmission on an open, public, and/or decentralized network, or similar system), the [Federal Reserve] reserves the right to treat it as a 'crypto-asset.'" Thus, it may be impermissible for a member bank to invest or trade in tokenized securities or other financial instruments as principal – even if otherwise considered a "recognized, traditional asset class" – if the Federal Reserve views their tokenization or other use of distributed ledger technology as changing the risks of those instruments. Because classification as a cryptoasset triggers many other supervisory and regulatory considerations, the consequences of this definitional question extend well beyond the ambits of this Policy Statement.

7. **Additional activities.** While the Policy Statement leaves open the possibility that a state member bank may engage in additional activities if it receives the permission of the Federal Reserve under Section 208.3(d)(2) of Regulation H, the Federal Reserve has effectively established a strong presumption against approval. Furthermore, additional activities of insured state member banks would also require approval from the FDIC under its Part 362 regulations.

Biden Administration actions

On the same day, the National Economic Council released a Roadmap for mitigating the risks of cryptoassets that takes a similarly skeptical view of cryptoasset activities, suggesting that the Federal Reserve's concerns are shared across the executive branch. The Roadmap urges regulators to "limit financial institutions' exposure to the risks of digital assets" and issues the stark warning that "[i]t would be a grave mistake to enact legislation that reverses course and deepens the ties between cryptocurrencies and the broader financial system."

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