

April 8, 2022

FDIC Requires Notification of Crypto-Related Activities

FDIC-Supervised Institutions Must Notify the FDIC Before Engaging In Crypto-Related Activities; Those Already Doing So Must Promptly Notify the FDIC.

SUMMARY

On April 7, 2022, the Federal Deposit Insurance Company (“FDIC”) issued a Financial Institution Letter (the “FIL”) articulating its expectations of FDIC-supervised institutions with respect to their crypto-related activities. Noting the FDIC’s concern regarding safety and soundness, financial stability and consumer protection risks, the FIL requires an FDIC-supervised institution to notify the FDIC prior to engaging in such activities. If an FDIC-supervised institution is currently engaged in a crypto-related activity, it must “promptly” notify the FDIC. The FDIC will review the notification, request additional information as needed, consider the risks associated with the activity and, as appropriate, provide supervisory feedback “in a timely manner.”

A. THE FINANCIAL INSTITUTION LETTER

1. Background

The FIL¹ outlines the FDIC’s notification and supervisory procedures for FDIC-supervised institutions² engaging in “crypto-related activities.” “Crypto-related activities” is defined to include: (i) acting as a crypto-asset custodian; (ii) maintaining stablecoin reserves; (iii) issuing crypto and other digital assets; (iv) acting as market makers or exchange or redemption agents; (v) participating in blockchain- and distributed ledger-based settlement or payment systems, including performing node functions; and (vi) related activities such as finder activities and lending.³ The FIL notes that this list includes those bank crypto-related activities

New York Washington, D.C. Los Angeles Palo Alto London Paris Frankfurt Brussels
Tokyo Hong Kong Beijing Melbourne Sydney

that the FDIC is already aware of, but that other activities may fall within the scope of the FIL, and that inclusion of an activity in the definition “should not be interpreted to mean that the activity is permissible for FDIC-supervised institutions.”⁴

In issuing this FIL, the FDIC notes that FDIC-supervised institutions “should be able to demonstrate their ability to conduct crypto-related activities in a safe and sound manner” pursuant to Section 39 of the Federal Deposit Insurance Act and the FDIC’s Part 364 safety and soundness standards. The FIL further notes that, when engaging in, or considering engaging in crypto-related activities, FDIC-supervised institutions “should consider the implications of other relevant statutes and regulations,” including those that relate to the availability and extent of deposit insurance and status as an insured depository institution.⁵

2. Risk Considerations

The FIL provides a non-exhaustive list of crypto-related risks about which the FDIC is concerned, including:

- **Safety and Soundness.** The FIL describes “new, heightened or unique credit, liquidity, market, pricing and operation risks” of crypto-related activities, including: (i) validation and confirmation of ownership; (ii) anti-money laundering and counter-terrorism financing; (iii) cybersecurity; (iv) credit risk exposure, including the ability to measure asset quality, credit risk and counterparty risk exposure and whether a crypto asset is “bankable;”⁶ (v) market risk, including pricing and valuation methodologies; (vi) accounting, auditing and financial reporting treatment; and (vii) liquidity risk exposure.⁷
- **Financial Stability.** The FDIC expresses concern that crypto assets and crypto-related activities may pose systemic risks to the financial system as an “unintended consequence” of the structure of a crypto asset or due to the interconnected nature of certain crypto-related activities. In particular, the FIL notes the possibility of (i) a disruption resulting in a “run” on financial assets backing a crypto asset or crypto-related activity and (ii) operational failures having a destabilizing effect on the insured depository institutions engaging in crypto-related activities.⁸
- **Consumer Protection.** The FIL also notes the FDIC’s concern about risks to consumers, including the risk of customer confusion, and the ability of insured depository institutions to “effectively manage” consumer protection requirements in the context of crypto assets and activities, including those related to unfair or deceptive practices.⁹

3. Notification and Supervisory Procedures

The FIL requires an FDIC-supervised institution to notify the FDIC prior to engaging in a crypto-related activity. If an FDIC-supervised institution is currently engaged in crypto-related activity, it must “promptly” notify the appropriate FDIC Regional Director. The initial notification should “describe the activity in detail and provide the institution’s proposed timeline for engaging in the activity.” The FDIC will then request “information necessary to allow the agency to assess the safety and soundness, consumer protection, and financial stability implications of such activities,” which may vary depending on the type of crypto-related activity at issue. The FDIC will then, as appropriate, provide “relevant supervisory feedback . . . in a timely manner.” The FDIC also encourages firms to notify their state regulators.¹⁰

B. OBSERVATIONS AND IMPLICATIONS

The FIL is the latest pronouncement by federal authorities with respect to the regulation of digital assets and crypto-asset activities.¹¹ The FIL takes an approach similar to the one set out by the Office of the Comptroller of the Currency (“OCC”) in its Interpretive Letter 1179, issued on November 18, 2021.¹² Among other things, the OCC’s Interpretive Letter provides that (1) before engaging in any cryptocurrency activities, a bank is required to notify its OCC supervisory office, in writing, of the proposed activities and must receive written notification of the supervisory non-objection; (2) a bank already engaging in cryptocurrency activities prior to the publication of the OCC’s Interpretive Letter is not required to obtain supervisory non-objection, but it must still provide notice to its OCC supervisory office; and (3) all banks will be expected to demonstrate the sufficiency of their control systems as part of the ongoing OCC supervisory process.¹³ Notably, although OCC Interpretive Letter 1179 confirmed that national banks could engage in certain crypto-related activities, including (i) providing custodial services,¹⁴ (ii) holding stablecoin reserves¹⁵ and (iii) using distributed ledgers and stablecoins to facilitate and engage in payment activities,¹⁶ the FDIC’s FIL declines to weigh in on the permissibility of any crypto-related activities for FDIC-supervised institutions, and neither the FIL nor the Interpretive Letter establishes any deadline for a response by the regulators, or provides certainty that banks will receive the sign-off required to commence the activities.

The concerns raised in the FIL and Interpretive Letter 1179 are legitimate and appropriate subjects of regulatory scrutiny. Nonetheless, there is an underlying question about whether these concerns could result in what is, in effect, a regulatory prohibition on bank involvement in certain crypto-related activities, which is the fastest-growing segment of the financial services industry.

* * *

ENDNOTES

- 1 Federal Deposit Insurance Corporation, *Notification of Engaging in Crypto-Related Activities* (April 7, 2022), available at https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html?source=govdelivery&utm_medium=email&utm_source=govdelivery#letter.
- 2 FDIC-supervised institutions include state-chartered banks and savings institutions that are not members of the Federal Reserve System, as well as state-licensed insured branches of foreign banks. See, e.g., 12 U.S.C. § 1813(q)(2).
- 3 *Id.* at fn. 2. The letter defines “crypto asset” as “any digital asset implemented using cryptographic techniques.” *Id.*
- 4 *Id.*
- 5 12 U.S.C. § 1815; 12 U.S.C. § 1816; 12 U.S.C. § 1818; 12 C.F.R. §§ 333.1 *et seq.*
- 6 The FDIC Risk Management Manual of Examination Policies discusses “bankable” assets in the context of loans classified “Loss.” FDIC Risk Management Manual of Examination Policies, Section 3.2 available at <https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html#letter> (“Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.”).
- 7 FIL, *supra* note 1.
- 8 *Id.* Such financial stability concerns have been raised by others as well, including the Financial Stability Board. See Financial Stability Board, *Assessment of Risks to Financial Stability from Crypto-Assets* (Feb. 16, 2022), available at <https://www.fsb.org/wp-content/uploads/P160222.pdf>.
- 9 FIL, *supra* note 1.
- 10 *Id.*
- 11 See, e.g., (1) President Biden’s Executive Order on Digital Assets (see Sullivan & Cromwell, LLP, “Executive Order on Digital Assets” (March 9, 2022), available at <https://www.sullcrom.com/files/upload/sc-publication-executive-order-on-digital-assets.pdf>); (2) the Federal Reserve’s Discussion Paper on Central Bank Digital Currency (see Sullivan & Cromwell, LLP, “Federal Reserve Discussion Paper on Central Bank Digital Currency: Paper Outlines “Pros and Cons” of a CBDC and Requests Comments from Stakeholders” (January 23, 2022), available at <https://www.sullcrom.com/sc-publication-federal-reserve-discussion-paper-on-central-bank-digital-currency>); (3) the OCC’s interpretive letter regarding the authority of banks to engage in cryptocurrency activities (see Sullivan & Cromwell, LLP, “OCC Issues Interpretive Letter Regarding the Authority of Banks to Engage in Cryptocurrency Activities” (December 21, 2021), available at <https://www.sullcrom.com/sc-publication-occ-issues-interpretive-letter-regarding-authority-of-banks-to-engage-in-cryptocurrency>); (4) the federal banking regulators’ joint statement on their crypto-asset “policy sprint” (see Sullivan & Cromwell LLP, “Federal Banking Agencies Release Joint Statement on Crypto-Asset ‘Policy Sprint’ Initiative” (November 24, 2021), available at <https://www.sullcrom.com/sc-publication-federal-banking-agencies-release-joint-statement-crypto-asset-policy-sprint-initiative>); and (5) the President’s Working Group on Financial Markets’ Report on Stablecoins (see Sullivan & Cromwell LLP, “President’s Working Group on Financial Markets Issues Report on Stablecoins” (November 5, 2021), available at <https://www.sullcrom.com/sc-publication-presidents-working-group-on-financial-markets-issues-report-on-stablecoins>). See also U.S. Securities and Exchange Commission, “Staff Accounting Bulletin No. 121” (March 31, 2022), available at <https://www.sec.gov/oca/staff-accounting-bulletin-121>.

ENDNOTES (CONTINUED)

- 12 OCC Interpretive Letter 1179 (November 18, 2021), available at <https://www.occ.treas.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdf> (“OCC Interpretive Letter 1179”).
- 13 *Id.*
- 14 See Interpretive Letter 1170 (July 22, 2020), available at <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf>.
- 15 See Interpretive Letter 1172 (October 21, 2020), available at <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1172.pdf>.
- 16 See Interpretive Letter 1174 (Jan. 4, 2021), available at <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2a.pdf>.

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.