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Alert | Blockchain & Digital Assets/ Financial Regulatory & Compliance

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Federal Reserve, FDIC, and OCC Issue 2nd Joint Statement Highlighting Liquidity Risks to Banks Engaged in Crypto-Asset-Related Activities

Go-To Guide:

- The Joint Statement addresses the heightened liquidity risks presented by certain funding sources of crypto-asset sector participants and offers examples of risk-management practices.
- The Agencies identify deposits placed by crypto-asset-related entities that are for the benefit of the crypto-asset-related entity's customer and deposits that constitute stablecoin-related reserves as funding sources with heightened liquidity risks.
- The Agencies underscore the importance of monitoring liquidity risks inherent in funding sources from crypto-asset-related entities and establishing and maintaining effective risk management and controls commensurate with the level of risk presented by these funding sources.
- Banking organizations engaging in crypto-asset-related activities should consider conducting a thorough review of their risk management practices and controls in light of this Joint Statement and recent Agency guidance.

On Feb. 23, 2023, the Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) issued a joint statement (Joint Statement) that highlights liquidity risks crypto-asset-related (CAR) funding sources pose to banking organizations and provides some effective practices to manage such risks.[1]

The Joint Statement is the second statement the Agencies have issued concerning CAR risks to banking organizations and demonstrates that the Agencies continue to closely monitor CAR exposures to banking organizations.[2]

The Joint Statement reminds banking organizations to apply existing risk management principles; it ***does not create new risk management principles***.[3] The Joint Statement also notes that banking organizations are neither prohibited nor discouraged from providing banking services to customers of any specific class or type, as permitted by law or regulation.

Funding Sources Identified as Presenting Heightened Liquidity Risks

The Joint Statement identifies key liquidity risks associated with crypto-asset and crypto-asset sector participants that banks should consider. Particularly, the Agencies highlight certain sources of funding from CAR entities that may pose heightened liquidity risks due to the unpredictability of the scale and timing of deposit inflows and outflows.

The Joint Statement identifies deposits placed by a CAR entity that benefit the CAR entity's customers (End Customers) and deposits that constitute stablecoin-related reserves as examples of funding sources with heightened liquidity risks. The Joint Statement discusses factors that contribute to heightened liquidity risks of these funding sources, including End Customer behavior in reaction to market events, media reports, and uncertainty or confusion about deposit insurance coverage, noting these could drive withdrawals and result in deposit volatility, unanticipated stablecoin redemptions, or dislocations in crypto-asset markets.[4]

The Joint Statement further highlights that a banking organization may be exposed to yet further heightened liquidity risks when its deposit funding base is concentrated in CAR entities that are highly interconnected and share similar risk profiles because deposit fluctuations may also be correlated.

Effective Risk Management Practices

After identifying heightened risks, the Joint Statement outlines examples of effective practices for banking organizations to actively monitor liquidity risks inherent in CAR funding sources and establish and maintain effective risk management and controls commensurate with the level of liquidity risk presented by these sources. These effective practices include:

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[1] By "crypto-asset," the Agencies refer generally to any digital asset implemented using cryptographic techniques.
[2] The first joint statement was issued on Jan. 3, 2023. Click here to read the GT Alert concerning this statement.
[3] *See* Federal Reserve, *Interagency Policy Statement on Funding and Liquidity Risk Management*, (Mar. 22, 2010); SR 10-6 (Mar. 22, 2010), FDIC, FIL-13-2010, (Apr. 10, 2010), and OCC, Bulletin 2010-13, (Mar. 22, 2010). For bank holding companies and foreign banking organizations with $100 billion or more in total consolidated assets, *see* 12 C.F.R. § 252.34 and 12 C.F.R. § 252.156, respectively. For national banks and Federal savings associations, *see also* OCC, Interpretive Letter 1172, *OCC Chief Counsel's Interpretation on National Banks and Federal Savings Association Authority to Hold Stablecoin Reserves*, (Sept. 21, 2020) and OCC, *Interpretive Letter 1179*, *Chief Counsel's Interpretation Clarifying: (1) Authority of a Bank to Engage in Certain Cryptocurrency Activities*; and *(2) Authority of the OCC to Charter a National Trust Bank*, (Nov. 18, 2021).
[4] *See* FDIC FIL-35-2022, Advisory to FDIC-Insured Institutions Regarding Deposit Insurance and Dealings with Crypto Companies, (July 29, 2022). Click here to read the GT Alert concerning this advisory.

- Understanding the direct/indirect drivers of potential behavior of deposits from CAR entities, as well as the extent to which those deposits are susceptible to unpredictable volatility.
- Assessing potential concentration or interconnectedness across deposits from CAR entities, along with the associated liquidity risks.
- Incorporating the funding volatility or liquidity risks associated with CAR deposits into contingency funding planning, including liquidity stress testing and, where appropriate, other asset-liability governance and risk management processes.
- Performing robust due diligence and ongoing monitoring of CAR entities that establish deposit accounts, including assessing the representations CAR entities make to their End Customers about such deposit accounts that, if inaccurate, could lead to rapid outflows of such deposits.

The Joint Statement reminds banking organizations that they are required to comply with applicable laws and regulations, which for depository institutions include brokered deposit rules,[5] as applicable, and Consolidated Reports of Condition and Income filing requirements.[6]

Regulatory Outlook

Given the trends in the crypto-asset sector, the Agencies may continue to issue guidance to banking organizations as comprehensive regulations continue to be debated. This is particularly true as events continue to expose vulnerabilities in the crypto-asset sector and key risks associated with crypto-assets and crypto-asset sector participants that banking organizations should consider.

Conclusion

It is important for banking organizations that use certain sources of funding from CAR entities, such as those described above, to actively monitor the liquidity risks inherent in such funding sources and establish and maintain effective risk management and controls commensurate with the level of liquidity risks from these funding sources. Banking organizations engaging in crypto-asset-related activities should consider conducting a thorough review of their risk management practices and controls in light of this Joint Statement and the recent Agency guidance.

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[5] *See* 12 C.F.R. § 337.6.
[6] *See* 12 U.S.C. § 324 (Federal Reserve); 12 U.S.C. § 1817(a); 12 C.F.R. § 304.3 (FDIC); and 12 U.S.C. §§ 161; and 1464(v) (OCC).

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