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## Bank Custody, Trust Banks, and Cryptocurrency

Congress, the White House, and several financial regulators have demonstrated a recent interest in the intersection of banking regulation and cryptocurrency. This interest is underpinned by the trend of cryptocurrency firms seeking various forms of bank charters. This In Focus explains the way that banks—in particular trust banks, which have been the subject of recent cryptocurrency policy discussions—interact with cryptocurrency.

### Fiduciary and Custody Services

Many banks offer fiduciary and custody services, such as managing trust agreements and safekeeping assets. Full-service commercial banks provide fiduciary services and custody services in addition to their core banking activities of deposit taking and lending. In addition, there are a number of limited-purpose banks, including trust banks, which focus exclusively on a narrow set of fiduciary and custody activities. Together, these institutions hold a significant value of assets for their customers. For example, according to data collected by bank regulators, 387 deposit-taking banking institutions held \$259 trillion worth of assets in fiduciary and custody accounts as of September 2021.

Fiduciary services include operating a trust. A trust is a contract that gives an institution authority to hold assets or the titles to assets and manage them on behalf of beneficiaries. These contracts can be structured as either revocable or irrevocable, meaning their terms either can be amended or are permanent, respectively. Often they are used for estate planning purposes, but as discussed below, they are increasingly used to manage cryptocurrency assets.

Non-fiduciary custody services provided by banks typically include the settlement, safekeeping, and reporting of customers' assets, such as marketable securities and cash. In addition, some banks can allow a customer to make additional income on custody assets by loaning these assets to approved borrowers on a short-term basis. In 2020, the Office of the Comptroller of the Currency (OCC) issued guidance clarifying that nationally chartered banking institutions (including trusts) could offer custody services for cryptographic keys associated with cryptocurrency. Further, in 2021, the OCC issued guidance that national banks (including trusts) could issue stablecoins, a type of cryptocurrency with a value pegged to fiat currency, for payment activities.

While some national banks have issued their own stablecoins (for instance, JPMorgan Chase and Wells Fargo issued stablecoins for use among institutional clients), much of the recent banking activity with cryptocurrency has centered around the chartering of trust or custody banks.

### Trust Banks

A trust bank is effectively a bank chartered with the authority to do a limited set of business operations. Typically, trust bank activities focus on holding funds placed in trusts and executing contracts on behalf of the beneficiaries of trust accounts. While trust banks can accept some deposits and make some credit available, they are often restricted from making certain business lines a main source of their operating income. For this reason, trust banks are subject to different regulatory standards than commercial banks are; for example, they are generally not required to have deposit insurance from the Federal Deposit Insurance Corporation (FDIC), and a parent company that owns one may be exempt from the legal definition of *bank holding company* under the Bank Holding Company Act (P.L. 84-511).

Trust banks are chartered at the state level by state banking agencies pursuant to state law or at the federal level by the OCC. State chartering statutes determine the authorities granted to state trust banks. The OCC charters national trust banks as national banks authorized to provide various fiduciary services under Title 12, Section 27a, of the *U.S. Code*. (Title 12, Section 92a, gives the OCC the authority to grant fiduciary powers to national banks.) In addition to providing custody of fiduciary assets as noted above, trust banks (and all national banks) may offer non-fiduciary custodial services (general safekeeping) for assets. Title 12, Section 24, serves as the basis for national banks to offer non-fiduciary custody services.

Using their fiduciary and custody authorities, some trust banks hold cryptocurrency and digital assets in custody and often back those holdings with dollar reserves. Depending on the business model, trust banks can exchange them for other assets if the customer wishes. Since U.S. bank customers cannot deposit cryptocurrency into normal bank accounts, trust banks are serving two main functions for cryptocurrency assets: (1) acting as a de facto bank account where assets are held in safekeeping and backed by dollar reserves (in lieu of FDIC insurance); or (2) acting as a broker, where the institution facilitates transactions on the consumer's behalf.

### Recent Charters for Crypto Firms

There are currently three cryptocurrency firms that have applied for and received conditional approval from the OCC for a national trust charter: Anchorage Digital Bank, Protego Trust Bank, and Paxos National Trust. In addition, there are some notable state-chartered limited purpose banks that are operating in cryptocurrency markets, primarily in Wyoming and New York. Kraken Bank and Avanti Bank received custody charters (similar to a trust charter) from the Wyoming Division of Banking in 2020,

and Paxos holds a state charter from New York’s Division of Financial Services. Recently, New York conditionally approved a partnership between PayPal, a money transmitter, and Paxos to engage in cryptocurrency business. Each of these institutions has a different business model; **Table 1** depicts some of the cryptocurrency activities the banks are undertaking.

**Table 1. Select Bank Cryptocurrency Activities**

Examples of recent banking activities in cryptocurrency

Type of Banking Institution	Cryptocurrency Activities
Full-service national banks (i.e., commercial banks)	Issue stablecoins for payment purposes; participate in blockchain networks; hold cryptocurrency and cryptographic keys in custody.
Limited-purpose national banks (i.e., trust banks)	All of the above, plus offering trading and lending platforms (or facilitating such activities through partnerships); custody and management of stablecoin reserves; payment, exchange, and other agent services for digital assets.
Limited-purpose state banks (e.g., Wyoming Special Depository Institution, New York BitLicense)	Issue stablecoins and tokenized dollars; offer deposit accounts 100% backed by dollar reserves (in lieu of deposit insurance); offer wire transfer and funding services; potentially act as Federal Reserve clearing bank (upon receiving FDIC insurance); partner with businesses to facilitate cryptocurrency transactions.

**Source:** OCC Conditional Charter approvals for Anchorage, Protego, and Paxos; Wyoming Division of Banking, New York Division of Financial Services; Kraken and Avanti websites.

## Debate over Regulating Crypto as Banks

**Charters.** Since 2016, the OCC has shown an interest in chartering various financial technology (fintech) companies as banks, initially by piloting a special purpose national bank (SPNB) charter for fintech firms. This charter met significant legal challenges from the states and has resulted in no SPNB charters to date. The crux of the issue centered on the authority of the OCC to charter fintech institutions that did not take deposits as banks. The OCC’s authority to issue these charters remains in question.

While the OCC’s authority to issue trust charters is clearly laid out in statute, there is still the question of whether the OCC should be issuing trust charters to cryptocurrency firms. On the one hand, these institutions can provide fiduciary and non-fiduciary custody services for cryptocurrency products much the same way they do for dollar-denominated accounts. Further, without an FDIC insurance requirement, trust banks can back holdings with reserves, offering some deposit protection to customers without jeopardizing the government backstop of deposit insurance. On the other hand, there are persistent concerns about the entry of fintechs into the banking system, and the use of trust charters for these firms may draw concern over

regulatory arbitrage, blending commerce with banking, and the potential for systemic risk.

**Deposit Insurance.** Deposit insurance is a government safety net designed to prevent “runs” at banks and protect ordinary citizens seeking to keep their money safe from losses. The recent findings in the November 2021 President’s Working Group on Financial Markets report (issued along with the federal banking regulators) on stablecoins suggest that the Administration may favor regulating issuers of such digital assets as insured depository institutions. To do so, the OCC may need to either require deposit insurance for certain trust banks that issue stablecoins, charter all issuers as full-service national banks (which are required to have deposit insurance), or create a separate regime for chartering these issuers. Many trust institutions are limited in their deposit-taking capacity, and so the effectiveness of deposit insurance on stemming the likelihood of runs is up for debate. Extending deposit insurance to stablecoin issuers extends the federal safety net and inherent moral hazard issues to a product that does not have many of the features that have justified federal insurance for traditional deposits. Further, reserve requirements could offset the risk of consumer losses without the need for a government safety net. Another issue is the authority of the federal government to compel deposit insurance for all issuers without new legislation, particularly among state-chartered issuers. While most states require full-service banks to have FDIC insurance, states do not necessarily require it for limited-purpose banks. For example, Wyoming does not require FDIC insurance for special purpose depository institutions (SPDIs); rather, it requires 100% reserves against the value of cryptocurrency held in SPDIs.

**Reserves and Disclosures.** Another potential area of regulatory concern is the disclosure of reserves that back stablecoin issuers. This was highlighted by the October 2021 charges taken by the Commodity Futures Trading Commission against Tether, a stablecoin issuer that misrepresented the reserves it held against its token. In October 2020, the OCC issued interpretive guidance clarifying that national banks were allowed to receive USD deposits, which may serve as reserves for stablecoins issuers. At the state level, Wyoming requires custody banks that issue stablecoins to hold at all times “unencumbered level 1 high-quality liquid assets valued at 100% or more of their depository liabilities.” These reserves could be vulnerable to runs if the stablecoin holders seek to redeem their holdings for cash simultaneously. However, unlike securities regulation, which requires a disclosure of reserves to investors, no such disclosure to the public is required from banking regulators for trust banks that issue stablecoins or for national banks that hold stablecoin reserves. Thus, it is unclear whether stablecoin market participants can appropriately discern whether they are holding assets backed by the claimed reserves. Legislation could seek to require reserve disclosures for stablecoins, either through anti-money-laundering reporting requirements for issuers that hold reserves in U.S. banks or through banking laws for trusts and insured depository institutions that issue stablecoins or hold their reserves.

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