BLOG

U.S. Federal Banking Regulators Release Joint Statement on 'Liquidity Risks to Banking Organizations Resulting from Crypto-Asset Market Vulnerabilities'

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On February 23, 2023, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the "agencies") issued their second joint statement of the year regarding crypto-asset market vulnerabilities.

As we discussed in a previous post, the agencies' first joint statement of the year focused on risks for banking organizations associated with digital assets and digital asset businesses, such as uncertainties related to custody practices.

In this more recent joint statement, the agencies have drawn their attention to the liquidity risks created by funding from crypto-asset-related entities, and the methods to mitigate such risks.

Liquidity Risks

- Deposits placed by crypto-asset-related entities may be exposed to heightened liquidity risks due to periods of stress, volatility, and related vulnerabilities within the sector. Additionally, deposits can be susceptible to rapid inflows and outflows, when end customers react to crypto-asset-sector-related market events, media reports, and uncertainty.
- The stability of stablecoin deposits may be bound by the demand for such assets, as well as the confidence participants place in a stablecoin's arrangement and reserve management practices.

Effective Risk Management Practices for Banking Organizations

- **Active Monitoring.** Banking organizations should actively monitor the liquidity risks present in crypto-asset funding sources and establish effective risk management controls.
- **Understanding the drivers.** Banking organizations should understand the impact of direct and indirect drivers on crypto-asset deposits and the extent to which such deposits are vulnerable to market instability.
- **Assessing Interconnectedness.** Banking organizations should assess interconnectedness across crypto-asset deposits as well as associated liquidity risks.

- **Contingency Funding Planning.** Banking organizations should incorporate liquidity risks associated with crypto-asset deposits into their contingency funding planning, such as through liquidity stress testing and other risk management processes.
- **Robust due diligence.** Banking organizations should conduct robust due diligence on accounts tied to crypto-asset entities, and carefully review the representations made by such crypto-asset entities.

Last, banking organizations must make sure to comply with applicable regulations for insured depository institutions such as the brokered deposit rule, and the Consolidated Reports of Condition and Income.

Please contact your Winston relationship partner should you have any questions or request further information. We will continue to monitor developments and provide friends of the firm with updates as they become available.

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