

# FinTech, Blockchain & Digital Currency for Community Banks

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# FinTech Overview

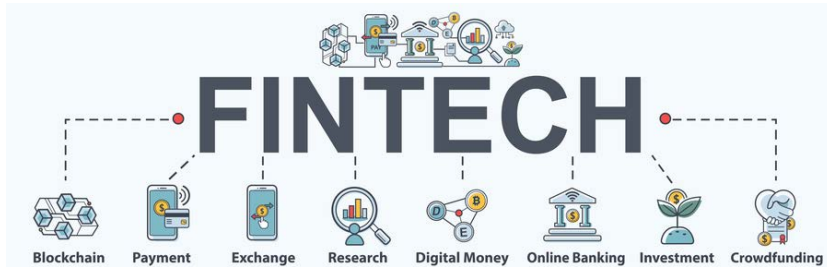
# FinTech Overview

FinTech has multiple meanings:

- Technology that enables provision of existing financial services in more efficient or consumer-friendly way.
- A company that delivers financial services using technology, often in direct competition with other providers, such as banks.



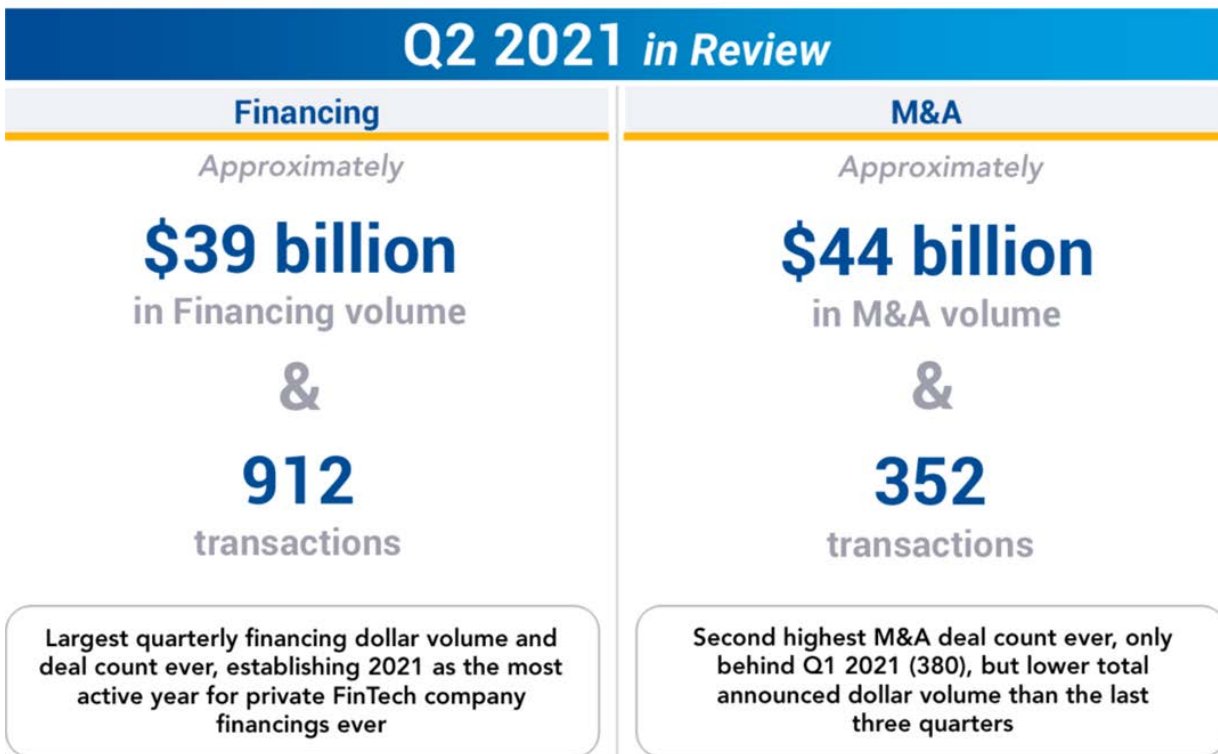
# Bank/FinTech Dynamic



When banks think about fintech, they generally go through a "build/buy/partner" evaluation to decide how to get to market most efficiently.

Decision driven by, among other things, desire to:

- Deliver wanted products and services to customers
- Add new sources of revenue
- Lower costs
- Improve processes





# How Do Banks Engage with FinTech?

- Currently, **37%** of financial companies (*including banks*) offer FinTech-based products or services.
  - At the same time, **94%** of financial companies (*including banks*) are confident that FinTech will drive growth over the coming years.
- For that reason, **47%** of financial companies (*including banks*) plan to increase engagement with FinTech companies.
  - At the same time, **57% of banks** are in the process of building a digital-only subsidiary.
- All FinTech sectors experienced growth during the COVID pandemic. Digital lending experienced a **25% increase**, followed by investing at **23%**, digital banking at **21%**, and payments at **7%**.

# Future of Bank Involvement in Blockchain and Digital Currency



- **40%** of financial companies (*including banks*) see the adoption of blockchain as an important goal for their FinTech plans – particularly with respect to payments and digital currency.
- Blockchain firms – including digital currency firms – experienced record levels of investment in the first two quarters of 2021, totaling **\$8.7 billion** – *more than double for the entire previous year.*




# Blockchain and Digital Currency

# Poll Question

## How would you describe yourself?

- I'm very knowledgeable in cryptocurrencies (maybe even invested)
- I'm crypto-curious (I want to learn more)
- I don't understand cryptocurrencies (it is high risk, and I think crypto holders are crazy)
- I think cryptocurrencies are a passing fad

# Today's Discussion

| Cryptocurrency   | Stablecoin   | CBDC   |    |   |
|--|--|--|----|---|
| <ul style="list-style-type: none"><li>Private-sector issued</li><li>Non-regulated</li><li>Price volatile</li><li>DLT-based</li></ul> | vs   | <ul style="list-style-type: none"><li>Private-sector issued</li><li>Non-regulated</li><li>Stable price</li><li>DLT-based</li></ul> | vs | <ul style="list-style-type: none"><li>Central bank issued</li><li>Regulated</li><li>Stable price</li><li>DLT-based or non-DLT-based</li></ul> |
|   |  |   |    |   |

# Today's Discussion

## Cryptocurrency

- Private-sector issued
- Non-regulated
- Price volatile
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vs

## Stablecoin


- Private-sector issued
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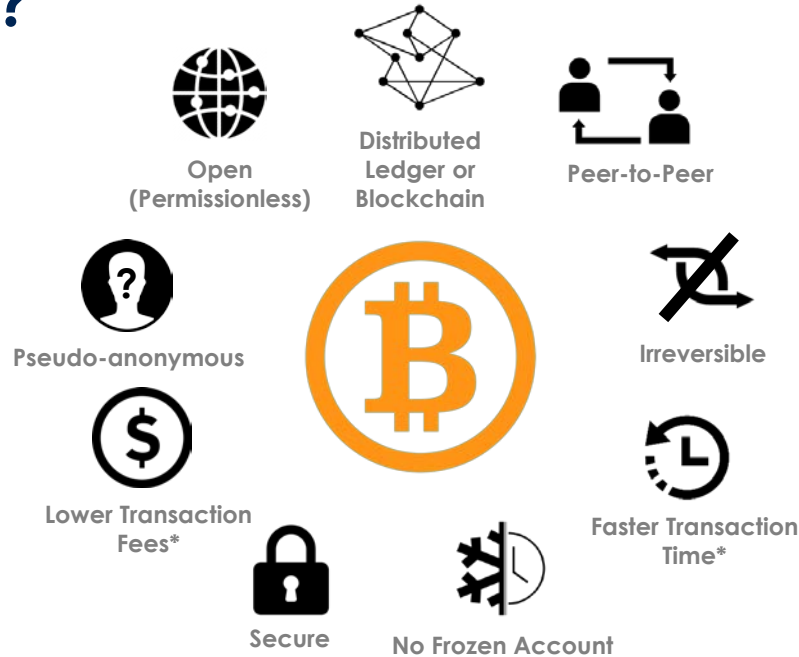
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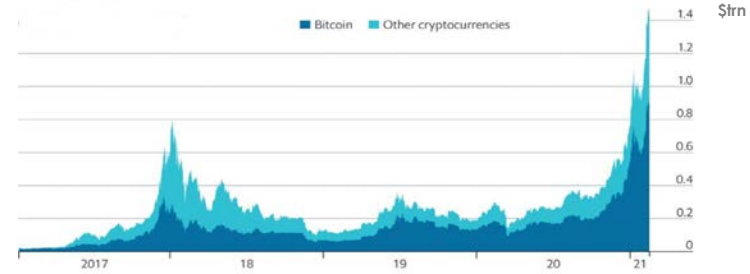
# What is Bitcoin?



\*Cross-border payments



# Cryptocurrency Market



SOURCE Coin Dance | The Economist



Bitcoin



Ethereum



Bitcoin Cash



Ripple



Litecoin



Ardor



IOTA



NEM



Komodo



Waves



Steem



PIVX



Qtum



Stratis



Tether



Zcash



Ark



Nexus



MaidSafeCoin



Bitcoin



Basic Attention Token



Dash



Golem



BitShares



EOS



Decred



Stellar Lumens



BitConnect



Augur



TenX



Monero



Ethereum Classic



NEO



OmiseGO



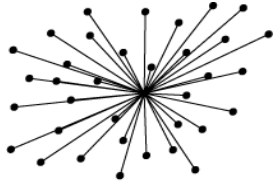
Hshare



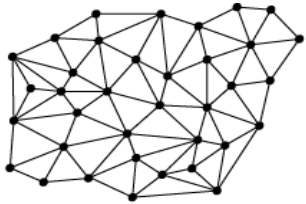
Ionomi



# Blockchain Basics: Introduction to Distributed Ledgers



centralized



distributed



# Regulatory Landscape on Crypto



**July 2020:** The Office of the Comptroller of the Currency (OCC) offered guidance, [Interpretative Letter #1170](#), to national banks and federal savings associations expanding the authority for banks to provide safekeeping services to include custodial services of cryptocurrencies.



**Oct 2020:** The Department Of Justice (DOJ) issued "[Cryptocurrency: An Enforcement Framework](#)" to address the increasing prevalence of cryptocurrencies.



**Jan 2021:** FinCEN is looking to pass new anti-money-laundering rules this year, which will significantly expand disclosures for digital currencies

**Jan –Apr 2021:** [Anchorage, Protego, Paxos](#) \* receives provisional federal bank charter from OCC



**May 2021:** The FDIC issues request for information on digital assets



**Aug 2021:** The OCC, FDIC, and Federal Reserve establish a Digital Assets Sprint Initiative

2019

2020

2021

And beyond



**June 2019:** Financial Crimes Enforcement Agency (FinCEN) Travel Rules aims to improve transparency of crypto transactions and increase data tracking and reporting requirements

\*Crypto companies

**Oct 2020:** The OCC issued [Interpretive Letter #1172](#) addresses banks' authority to hold deposits that serves as reserves for certain stablecoin.

**Jan 2021:** The OCC issued [Interpretive Letter #1174](#) granting permission to (i) participate in the independent node verification networks (INVN) as "nodes" and (ii) use stablecoins to facilitate payment activities and other bank-permissible functions, consistent with applicable law and safe and sound banking practice.



**Mar 2021:** The Financial Action Task Force (FATF) updated its "[Guidance for a risk-based approach to virtual assets and VASPs](#)" of its previous FATF guidance, released in 2019. It has recommended regulating virtual assets in a similar way to traditional finance, mandating customary KYC/AML laws that affect most financial entities.

# Poll Question

**Does your organization plan to offer crypto or blockchain-related products and services?**

- No plans and not interested
- Somewhat interested – we're exploring options
- Yes, we're in the process of implementing or already providing
- Not sure/not applicable

# Crypto Activities by Megabanks

**Banks enter the digital asset custody service space**



BNY MELLON

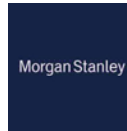
**usbank**



Deutsche Bank

**Offer wealth management clients options for Bitcoin and other cryptocurrencies**

**Goldman Sachs**



**Created a blockchain unit and its own stablecoin for large clients**

**J.P.Morgan**

SOURCE: Company Press Releases

# Community Banks + Crypto

...At a glance

|   |                         |  |   |
|---|-------------------------|--|---|
|  | <b>Custody Services</b> | Allows customers to store crypto assets                      |    |
|  | <b>Bitcoin Rewards</b>  | Customers receive bitcoin rewards                            |    |
|  | <b>Financing</b>        | Bitcoin-backed lending                                       |    |
|  | <b>Banking Services</b> | Offering banking services to crypto companies                |     |
|  | <b>ATM Services</b>     | Cardholders can purchase and redeem bitcoin at ATM locations |    |

## Fintech Partners



SOURCE: Company Press Releases

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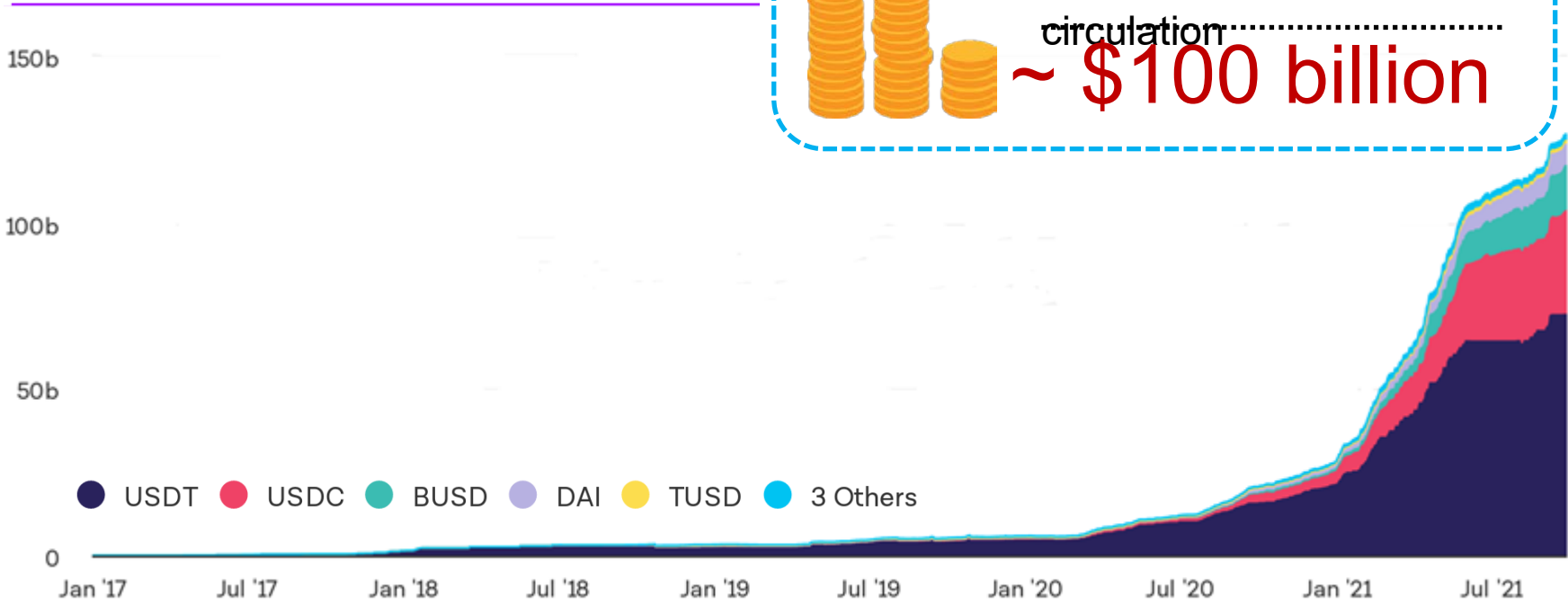


# Stablecoin Market Cap



total balance in circulation ~ \$100 billion

The illustration shows three stacks of gold coins of varying heights. To the right, there are two circular logos: one with a dollar sign (\$) and another with a 'T' inside a circle. Below the logos, the text 'total balance in circulation' is written in black, followed by '~ \$100 billion' in large red font.



SOURCES: COIN METRICS, THE BLOCK  
UPDATED: SEP 29, 2021

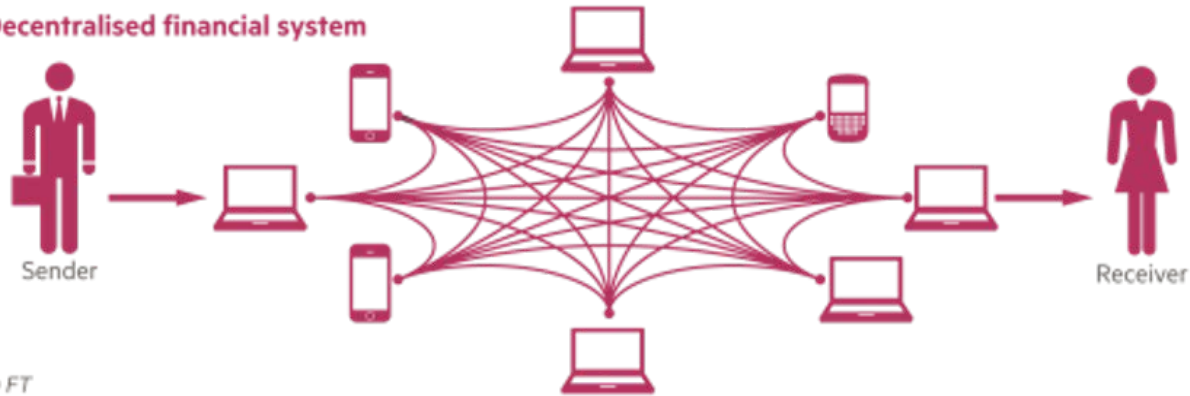
# DeFi

## How decentralised finance works

### Traditional financial system



### Decentralised financial system



© FT



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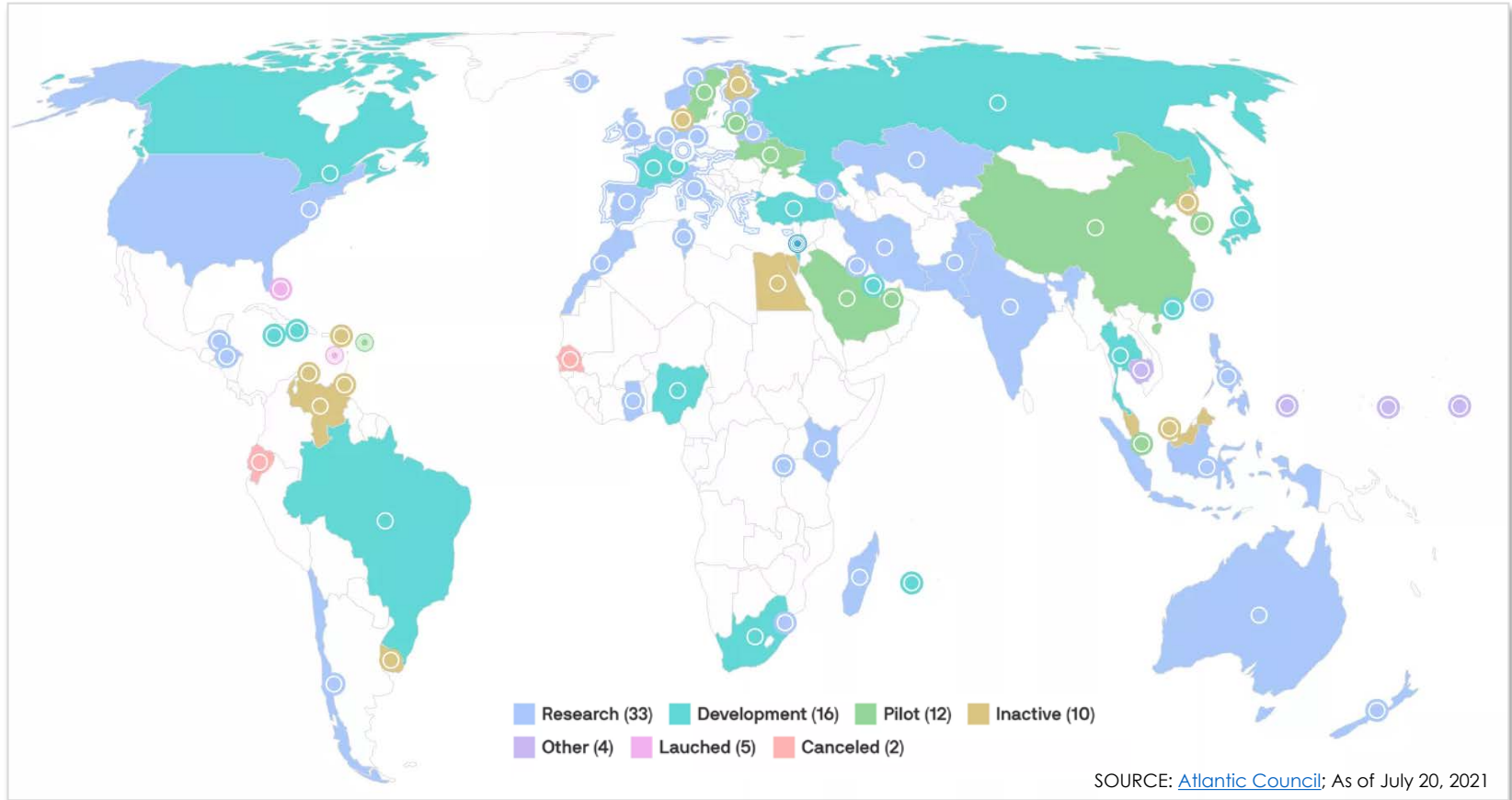
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### CBDC

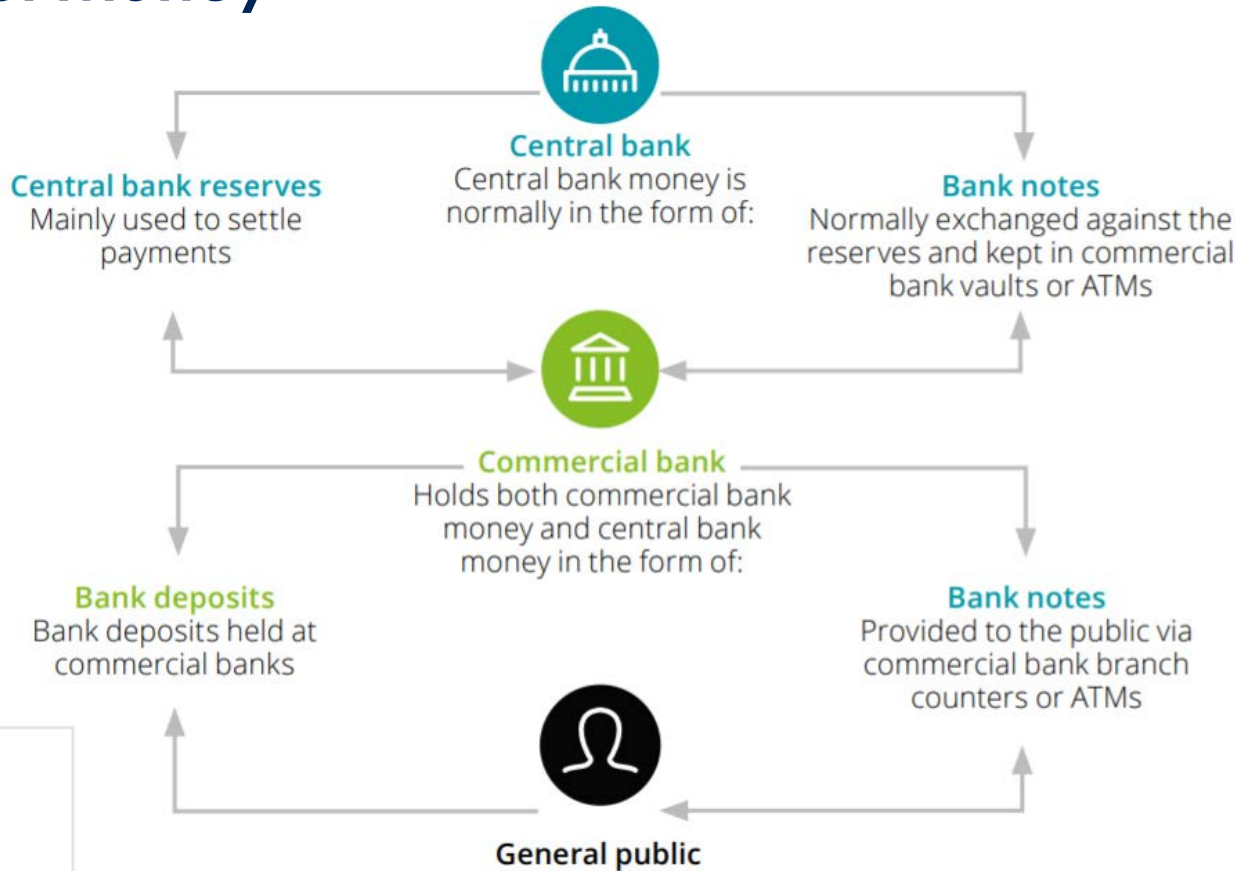
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# CBDC Initiatives Around the World



# Types of Money



SOURCE: Deloitte

# CBDC Design Considerations

## Two Types of CBDCs...

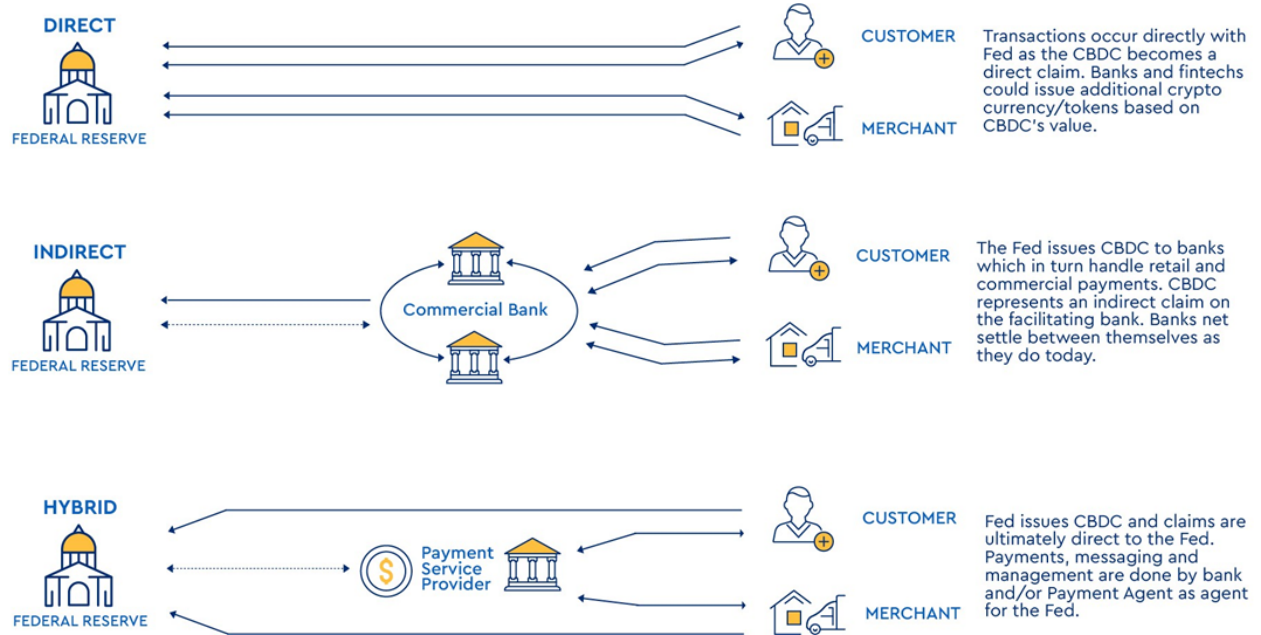
### Wholesale CBDC

Bank-to-bank

### General-Purpose (Retail) CBDC

Digital form of central bank money for the public

## Three Possible CBDC Models



SOURCE: <https://www.linkedin.com/pulse/happen-banking-when-fed-moves-central-bank-digital-currency-nichols/>

# Major CBDC Design / Policy Questions Around...

- › Privacy and traceability (compliance)
- › Financial structure and distribution model
- › Impact on current financial system and players
- › Cross-border support
- › Security design and implications
- › Monetary policy implications
- › Financial inclusion goals
- › Cyber attack defenses
- › Innovation goals
- › Wallet strategy
- › Offline support

SOURCE: Federal Reserve Bank of Boston ([bostonfed.org](https://bostonfed.org))

# Legal and Regulatory Considerations



- Banks are still considered more trustworthy than FinTech companies.

Why is this the case?

**Banks play by the rules.**

# A Matter of Trust



“While 'run fast and break things' may be a popular mantra in the technology space, *it is ill-suited to an arena that depends on trust and confidence.* New entrants need to understand that the financial arena is a carefully regulated space with a compelling rationale underlying the various rules at play, even if these rules are likely to evolve over time.”

— Federal Reserve Governor Lael Brainard, remarks at The Financial Innovation Conference (Dec. 2016).



# Recent Interpretive Guidance

- **OCC Interpretive Letter #1170 (July 2020) – national banks have authority to provide cryptocurrency custody services.**
  - By confirming national banks' authority to custody cryptocurrency, the OCC helped open the door for investment funds to potentially invest in cryptocurrency.
- **OCC Interpretive Letter #1174 (January 2021) – national bank may use new technologies, including independent node verification networks (INVNs) and related stablecoins, to carry out bank-permissible functions, such as payment activities.**
  - Using INVNs to transmit stablecoins and other cryptocurrencies may facilitate payments and support financial transactions in a potentially cheaper, faster, and more efficient manner than centralized payment systems.
- **OCC Conditional Approval of Limited Purpose Trust Bank Charter (April 2021) – limited purpose national trust bank charter approved for Paxos Bank to provide services associated with digital assets.**
  - Potential move towards greater integration of digital currency businesses into the financial regulatory framework.

## Proposed Interagency Guidance on Third-Party Relationships: Risk Management (*notice published July 19, 2021*)



- Federal banking agencies have high expectations for banks partnering with FinTech companies.
- Expiration of comment period extended from 9/17 to 10/18
- Additional IAG 8/27/21: Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks, describes six key areas of due diligence.
- FRB Guidance 9/9/21: Community Bank Access to Innovation through Partnerships, discusses (i) operational technology, (ii) customer-oriented, and (iii) front-end technology partnerships between community banks and FinTechs

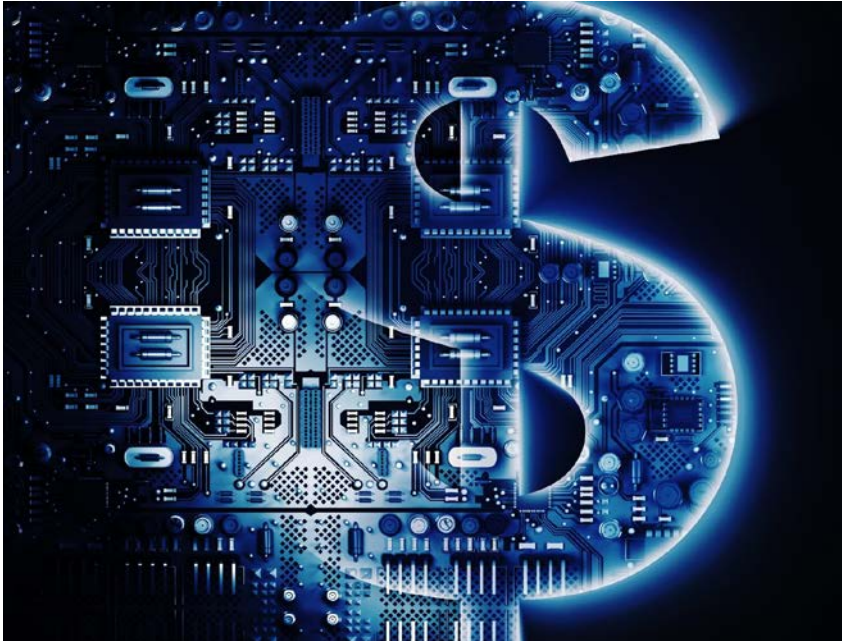
***There are significant risks for banks involved in FinTech – and digital currency is no different.***

Six key topics banks should consider when conducting due diligence on a fintech<sup>1</sup>:

- (1) Business Experience and Qualifications;
- (2) Financial Condition;
- (3) Legal and Regulatory Compliance;
- (4) Risk Management and Controls;
- (5) Information Security; and
- (6) Operational Resilience.

<sup>1</sup> From IAG 8/21 *Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks*

# New Developments in Digital Lending



## Banks should continue to monitor developments:

- SEC – threats to sue Coinbase over digital lending program
- US Treasury – sanctions SUEX for facilitating ransomware attacks
- China outlaws (again) all cryptocurrency
- **Banks offer customers regulatory protections and guardrails as they navigate cryptocurrency – JP Morgan posture on cryptocurrency and tokens**
- **Banks should continue to cautiously consider opportunities to Build, Buy, Partner in Digital Lending**

# Build/Buy/Partner Revisited

Traditionally only banks can perform core activities:  
Taking Deposits, Making Loans, Cashing Checks

In the context of digital lending, FinTechs should consider partnering with Banks to address regulatory uncertainties, and to take advantage of exemptions

Banking as a Service (BaaS) enables licensed banks to integrate their digital banking services directly into other non-bank businesses

The customer can then use the given business's platform to access banking services

The business typically does not touch the customer's money, and thus, is not subject to the regulatory duties imposed on a bank

An inevitable risk with all things FinTech is disintermediation...



# Questions?