

The Crypto Exchange — The Future of Bank-Fintech Collaborations in Digital Finance (Crossover Episode With *Payments Pros* – *The Payments Law Podcast*)

Hosts: Ethan Ostroff and Carlin McCrory

Guest: James Stevens

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Ethan Ostroff (00:03):

Welcome to a special crossover edition of *The Crypto Exchange* and *Payment Pros* podcasts. I am Ethan Ostroff, one of the hosts of *The Crypto Exchange* podcast, and today I am joined by Carlin McCrory from the *Payments Pros* podcast, as well as our partner James Stevens, one of the co-leaders of our firm's Financial Services Industry Group, to talk about the dynamic landscape of bank partnerships in the digital asset space, including how credit unions are getting involved and some of the key considerations for successful partnerships. Before we jump into today's episode, I want to remind our listeners to visit and please subscribe to our blog, TroutmanFinancialServices.com, as well as ConsumerFinancialServicesLawMonitor.com. And don't forget to check out our other podcasts on Troutman.com/Podcast. We have episodes that focus on trends that drive enforcement activity, consumer financial services, credit reporting, and a lot more. Make sure to subscribe to hear our latest episodes, Carlin and James, thanks again for joining me today.

Excited to talk about what's going on in the bank partnership space as it relates to digital assets and payments. Obviously, there is a lot going on these days in the United States concerning the digital asset space. Stable coins are clearly all the rage right now and super hot. I know we'll touch on some of those things, but I thought we might just dive in talking about perhaps some of the potential use cases for bank partnerships in this space and how you're seeing, for example, banks partner with digital asset companies and the types of payment enabling relationships you're starting to see proliferate.

James Stevens (02:00):

Well, thanks for having me on your blogs, Carlin and Ethan. It's nice to be with you both. We are seeing a tremendous amount of demand with respect to payment enablement by firms in the digital asset space that need to facilitate the receipt of fiat currency or that need to be able to enable their customers to send out fiat currency. So typically a bank is the entity in these relationships that has access to the payment networks, and that could be card or ACH or wire or what have you. And what they do through partnership with the digital asset provider is they enable customers who might have money sitting at another bank to fund their account with the digital asset provider, which will allow them to buy the digital assets. And then when those customers want to sell those digital assets and get fiat currency back, the payments go the other direction.

Ethan Ostroff (03:07):

So I mean, to me, James, traditionally we've talked about bank fintech partnerships, right? I don't know, you and Carlin and lots of other folks, our firm have been so actively involved in helping to establish all kinds of different bank fintech relationships. And so when we start talking about this conversation of bank partnerships as it relates to digital assets, to me there's really no meaningful distinction between what we sort of think of as fintechs and these different types of companies that are popping up in the digital asset space. I mean, they're all financial technology companies. Is that how you see it as well?

James Stevens (03:50):

That's correct, Ethan. And to be quite honest, there's really no difference between fintech companies, digital asset companies, or any other service provider or merchant. In fact, one of the largest areas where we help our bank clients partner with people that need payments, like what I was just describing, is in the payroll space, many of which are not at all technologically oriented. So this product and service has a lot of different use cases throughout our economy, but we are certainly seeing it as you said, as the interest in cryptocurrency and stable coins have grown in the past several years. We've certainly seen an uptick in these kinds of relationships in that space, and we anticipate there being a lot more in the future. Another area where we have seen growth is where a bank is providing a deposit capability to the digital asset provider. What that may look like is a demand deposit account that is used to hold fiat in between investments in digital assets, or it could even be, for example, like a savings product where perhaps a firm that is selling digital assets as an investment may want to offer a broader product suite where they can enable people that have a desire to keep some of their assets in a more liquid state for future investment, a bank could offer a savings product.

So that is another area, any kind of embedded deposit account, that's another area where we've seen already a substantial amount of interest by digital asset companies and the banks that are looking to service those companies.

Ethan Ostroff (05:41):

Carlin, do you have any other thoughts about some potential use cases or this, for example, this payment enabling relationships that we see a lot of,

Carlin McCrory (05:48):

I mean, James really hit the nail on the head. We see this in debt escrow, for example, other sorts of payment processing, just general payment processing use cases. We see these sorts of payment enablement accounts.

Ethan Ostroff (06:06):

So with the passage of the GENIUS Act, one of the things that is required is that reserves backing all regulated payment stable coins have to be fully backed by highly stable and liquid assets like T-bills. Right? So do you see other things people are or could be doing with the

passes of the GENIUS Act in anticipated creation of permitted payment, stable coin issuers, for example? How are reserves under the GENIUS Act going to be handled? Are they going to be kept in deposit accounts?

James Stevens (06:43):

Yeah, absolutely. Ethan, that is one of the permissible investments of those reserves. In addition to making direct investments in T-bills and things like that, these providers can simply deposit those reserves into banks. And we think that that is going to be a tremendous opportunity for banks that are looking to provide those kind of deposit services and banks that are already heavily involved in providing a robust set of treasury products and services to their commercial customers. This is just another industry that they could provide those deposit services with respect to. And frankly, I think that we expect this to be one of the biggest ways that banks will get involved directly in stablecoin. The stable coin revolution that might be coming towards us is rather than being direct issuers or having subsidiaries that are direct issuers, is they can provide products and services like what we've talked about already, but also with respect to these deposit reserves. And the beauty of that is that if a bank provides that type of service to one of these providers, they can then take those reserves that have been deposited and leverage them in the way that banks do, which is the sort of miracle of the US banking system.

Ethan Ostroff (08:03):

Do you all see anything in this context of this new scheme of the GENIUS Act and the necessity of reserves being so highly liquid? Do you see anything qualitatively different about that than how treasury services have been sort of traditionally offered?

James Stevens (08:28):

Not really. I did say that people that are providing treasury services in a big way probably have a bigger opportunity because there is certainly liquidity management that has to occur. For example, we have bank clients that will provide banking products to payroll providers I mentioned earlier. And the thing about payroll that we all know is that it typically runs twice a month, which means that there are two periods in a month where the bank gets a huge amount of deposits, they sit there for three or four days, and then they go out the next day. So when a bank and its financial staff and its treasury staff are looking at the funding that's coming in across a banking platform and they're looking at the period of time that that liquidity is expected to be in their hands, they have to come up with robust modeling and techniques and procedures so that they can make sure that they can meet all of the funding obligations, whether that is giving back the depositors the money that have been deposited or whether that's funding loans that are being made on the asset generation side of the business. And so it's not easy, but it's fundamentally the same thing that banks do for a living.

Ethan Ostroff (09:41):

I thought one of the interesting things to talk about today might be a little bit about specifically credit unions and Carlin, I was wondering if you have any thoughts about how credit unions are

getting involved in this space and what might be some barriers to entry and other types of considerations?

Carlin McCrory (10:02):

Yeah, so we have seen that some credit unions are getting involved in this space, but there are some nuances with credit unions that must be considered. For example, the relationship should be analyzed to determine whether these ultimate end users of any sort of product or service may have to purchase a share in order to become a member of the credit union. So if this is a state chartered credit union, for example, we'd need to look at applicable state law to see whether the FinTech could purchase that share on behalf of the end user or whether some sort of notice is required to be provided to that end user. Same thing with federal law, we'd need to look at those requirements as well. And then for purposes of pass through insurance, which is obviously crucial for these types of relationships, there's some 1997 guidance on NCUA's website where insurance can pass through to beneficial owners who are either actual members of the credit union or individuals who are otherwise eligible to maintain an insured account at the credit union. And we've seen credit unions take advantage of this latter example. So if you are a low income designated credit union, for example, you may be able to take advantage of this exemption such that these individuals do not have to become members of the credit union, but can receive pass through insurance. Again, all of this needs to be analyzed on a case by case basis, Ethan, but these are some areas that credit unions should consider in getting involved in this space.

Ethan Ostroff (11:55):

And when we talk about these types of considerations for bank partnerships, and specifically in this digital asset space, what about considerations with respect to the Bank Secrecy Act, anti-money laundering, due diligence monitoring, what are you all seeing and hearing about these considerations? And is there anything sort of unique in your perspective about these considerations as it applies to this context of bank partnerships with digital asset companies?

Carlin McCrory (12:30):

Sure. So OFAC searches need to be run on everyone involved. All parties transmitting money. But for BSA/AML purposes, it really depends on whether the end user becomes a customer of the bank or not. Regardless, we generally see that in these partnerships, the bank is pushing down all of its own BSA/AML duties onto the FinTech partner. So for example, if the end user is becoming a customer of the bank, let's say in a prepaid card program, BSA/AML, and all of those requirements are pushed down onto the FinTech to conduct CIP monitor for suspicious activity and other things on the end users and the bank should be working in coordination with its partner to ensure that all aspects of the program are conducted as legally required. Many of the consent orders from years past have focused on BSA/AML and different aspects of this, and it's been a very common deficiency, like for example, suspicious activity reporting. The bank is the party that has to file SARs, but it's reliant on its FinTech partner to monitor that suspicious activity and report it up to the bank such that the bank can fulfill its obligation to file a SAR.

Ethan Ostroff (14:01):

Right? So it's one of those things traditionally we think about in this bank fintech relationship that engaging a fintech for various services doesn't relieve a bank of its regulatory requirements. Banks also have their own obligations to ensure that any third parties with whom they're engaging or complying with these types of regulatory requirements. Right. So James, any other thoughts that you might have about considerations for bank partnerships in the digital asset space?

James Stevens (14:33):

Yes, Ethan, there's been a high level of enforcement action in the past several years in the bank fintech partnership space, and there's also been a restatement of a lot of the guidance that bank regulators have put out over the about third party relationships like this in the context of these bank fintech partnerships. as a result of all of that guidance, everyone should know that before entering it into any type of relationship like this, the bank is required to engage in significant and robust due diligence on their bank partners. So banks should be prepared to do that. And the digital asset provider that is going to go through it should expect that is coming towards it. They are supposed to also put in place very significant contracts between the parties and the regulators have articulated very clearly over the years what those contracts should and should not say.

And then finally, the expectation is that the bank, because it can't outsource its compliance obligations, is going to have a ability and in fact engage in a significant amount of oversight and monitoring of what its partner is doing, especially to the extent that the bank is outsourcing critical activities like for example, gathering information for know your customer checks that have to go on reporting suspicious activities or bubbling up suspicious activities so the bank can make those reports, servicing and dealing with customer complaints, anything of that nature. Plus just generally the relationship in general and the operational, legal and other risks that arise when a bank and a partner partner in this way. It's incumbent upon the bank to oversee all of that, have the policies and procedures and personnel in-house in order to enable it, to oversee it, and for the partner to understand that that's the environment that they're going to be living in, and make sure that they also have the protocols and the personnel and the procedures they have to both enable the bank to do its monitoring, but also to take care of whatever functions of that get downstream to that digital asset partner of the bank.

Ethan Ostroff (16:54):

Okay, great. Well, thank you Carlin and James for joining me today. And thanks to our audience for listening to today's episode. Don't forget to visit our blogs, [ConsumerFinancialServicesLawMonitor.com](https://www.consumerfinancialserviceslawmonitor.com) and [TroutmanFinancialServices.com](https://www.troutmanfinancialservices.com), and subscribe so you can get the latest updates. We hope you also subscribe to this podcast via Apple Podcast, Google Play, Stitcher, or whatever platform you may use, and we look forward to next time.

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