



ASSOCIATION FOR DIGITAL ASSET MARKETS

July 16, 2021

James P. Sheesley  
Assistant Executive Secretary  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429

**Re: RIN 3064-ZA25: Request for Information and Comment on Digital Assets**

Dear Mr. Sheesley:

The Association for Digital Asset Markets (ADAM) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation (FDIC) request for information and comment on digital assets.<sup>1</sup> ADAM applauds the FDIC's transparent process to provide comment on the developing digital asset industry and the banking sector. The recent emergence of blockchain-enabled digital asset technologies has catalyzed new possibilities in the realm of efficient financial services. However, with these possibilities, there remain several forward-looking areas requiring further thoughtful discussion. ADAM intends to use this comment to expand on those areas to the greatest extent possible. ADAM has a number of members working with insured depository institutions to improve the efficiency and certainty of the financial services backend operations, several members performing custody of digital assets through state and OCC charters, and members developing cutting edge technology platforms for the future of digital assets in our financial system.

We are writing to promote our views of a safe, effective, efficient, inclusive, and innovative financial services sector. Such a system will promote innovation in the U.S., avoid a shadow banking sector and promote the overall stability of the financial system, encourage innovation, and advance the understanding of the potential of blockchain technology.

**About ADAM**

ADAM is a private, non-profit, membership-based association of firms operating in the digital asset markets and is a standards-setting body and self-governing association<sup>2</sup> committed to promoting market integrity and best practices. ADAM works with leading financial firms,

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<sup>1</sup> Request for Information and Comment on Digital Assets, 86 Fed. Reg. 27602 (May 21, 2021) (RFI).

<sup>2</sup> ADAM is a broad-based industry group that includes a wide variety of market participants, including trading platforms, custodians, investors, asset managers, traders, liquidity providers, and brokers. Our members are firms that are active in digital asset markets or seek to participate in those markets. ADAM members include: Anchorage Digital, N.A.; BitGo; BitOoda; BlockFi; BTIG; CMT Digital; Cumberland; Dunamis Trading; Eventus Systems; Fireblocks; FTX.com; FTX.us; Galaxy Digital; Genesis; Grayscale; GSR; HRT; Multicoins Capital; Oasis Pro Markets; Parataxis; Paxos; Sarson Funds; Solidus Capital; Symbiont; WisdomTree; and XBTO. ADAM law firm partners include: Morgan Lewis; DLA Piper; DLx Law, and Murphy & McGonigle.

entrepreneurs, and regulators to develop industry best practices that facilitate fair and orderly digital asset markets. In this vein, ADAM's objectives are to: (1) protect market participants from fraud and manipulation; (2) provide clear standards for efficient trading, custody, and the clearing and settlement of digital assets; (3) encourage professionalism and ethical conduct by market participants; and (4) increase transparency and provide information to the public and governments about digital asset markets. In furtherance of this, ADAM released a principles-based Code of Conduct (Code)<sup>3</sup> in late 2019 that sets certain standards of professional conduct for ADAM members. In particular, the Code addresses the following areas:

- Compliance and Risk Management
- Market Ethics
- Conflicts of Interest
- Transparency and Fairness
- Market Integrity
- Custody
- Information Security and Business Continuity
- Anti-Money Laundering and Countering the Finance of Terrorism

Every ADAM member agrees to adhere to the Code of Conduct. The goal is to bring professional standards into the nascent but rapidly-growing digital asset markets, to develop trust in those markets so that they can flourish.

Our members are at the cutting edge of innovation through the use of new technologies, such as blockchain. However, they recognize that proper regulation and conduct are essential to their businesses and to the development of a sustainable marketplace and public trust. They believe that a diverse financial ecosystem is a source of strength, and they aim to use their technology to find new ways of reaching consumers and work within the current financial system to improve efficiencies.<sup>4</sup>

ADAM and its members are committed to working with lawmakers and regulators to promote responsible innovation in the digital asset space in a manner that expands the availability of financial services. We welcome a clear regulatory picture because our members seek full compliance. As such, we are encouraged by recent actions in the regulatory space such as this FDIC request for comment and the Board of Governors of the Federal Reserve System's request for comment on guidelines (Account Access Guidelines) to evaluate requests for accounts and services at Federal Reserve Banks.<sup>5</sup>

## Comments Overview

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<sup>3</sup> The Code is available at <http://www.theadam.io/code/>.

<sup>4</sup> Bloomberg-Paxos Joins Bank of America's Settlement Network: <https://www.bloomberg.com/news/articles/2021-05-17/bank-of-america-joins-paxos-blockchain-stock-settlement-network>.

<sup>5</sup> Proposed Guidelines for Evaluating Account and Services Requests, 86 Fed. Reg. 25865 (May 11, 2021) (Account Access Guidelines).

As mentioned previously, ADAM’s membership spans across many segments of the digital asset industry. In order to provide a practical and representative comment letter, ADAM has chosen to address the following areas: (1) The Growing Demand for Digital Assets; (2) Current and Potential Digital Asset Use Cases; (3) Supervision and Activities; and (4) The Regulatory Process & Dialogue Moving Forward. In addition to these comments, ADAM and its members hope to serve as a source of general education on digital assets and welcome further engagement with the FDIC to address any unanswered questions.

## **The Growing Demand for Digital Assets**

Over the past year, the demand for digital assets<sup>6</sup> has accelerated rapidly across the world at the corporate and consumer level. At the corporate level, major institutions such as PayPal and BNY Mellon have begun offering services in digital assets, while others, such as MicroStrategy and Tesla, have added digital assets to their corporate reserves. Insurer MassMutual invested \$100 million in bitcoin, providing what it called “measured yet meaningful exposure to a growing economic aspect of our increasingly digital world.”<sup>7</sup> At the consumer level, a recent study found that a majority of Americans either own digital assets or are interested in becoming an owner and that, as time passes, Americans are becoming increasingly curious about the technology.<sup>8</sup> Similarly, a United Kingdom government report by its Financial Conduct Authority found that 5% of UK adults own digital assets and that consumers are more likely to see them as an alternative to mainstream investments.<sup>9</sup> A recent working paper released by the Bank for International Settlements found that digital asset investors tend to be educated, young and digital natives, and found that owners of digital assets increasingly tend to hold their digital assets as investments for longer periods.<sup>10</sup>

The aforementioned studies are extremely helpful in the understanding of the growing corporate and consumer demand for digital assets and allow for thoughtful policy discussions on the best ways to promote consumer protection and the health of the financial system. However, more data is always needed. ADAM encourages the FDIC to include survey questions surrounding digital assets as part of future surveys it conducts on the financial services industry and its customers.

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<sup>6</sup> In a recent Consultative Document entitled “Prudential treatment of cryptoasset exposures” the Basel Committee for Banking Supervision categorized “cryptoassets” to include “tokenized traditional securities”, “cryptoassets with stabilization mechanisms (i.e., stablecoins)” and “other” (which would include bitcoin, ether and other cryptoassets that do not fall into either of the two aforementioned categories). Out of scope of this document but also noted are central bank digital currencies, which are limited at this time but expected to grow substantially in the medium to long term. Finally, not mentioned in the Consultative Document but worthy of consideration are non-fungible digital assets (known as NFTs). See <https://www.bis.org/bcbs/publ/d519.htm>.

<sup>7</sup> Paul Vigna, “MassMutual Joins the Bitcoin Club With \$100 Million Purchase,” The Wall Street Journal (Dec. 10, 2020).

<sup>8</sup> The State of U.S. Crypto Report 2021. <https://www.gemini.com/state-of-us-crypto>.

<sup>9</sup> Financial Conduct Authority Research Note: Cryptoasset Consumer Research 2021.

<https://www.fca.org.uk/publications/research/research-note-cryptoasset-consumer-research-2021#lf-chapter-id-overview-of-key-findings>.

<sup>10</sup> Distrust or Speculation? The Socioeconomic Drivers of U.S. Cryptocurrency Investments Raphael Auer (Bank for International Settlements) and David Tercero-Lucas (Universitat Autònoma de Barcelona), <https://www.bis.org/publ/work951.pdf>.

Additionally, as the FDIC considers the role it will play with regards to certain digital asset-related activities by insured depository institutions (IDIs), ADAM encourages the FDIC to focus on its core missions of consumer protection, safeguarding the financial assets held by IDIs, and promoting safety and soundness in the financial system. This core mission places the FDIC in a unique position amongst regulators to develop meaningful consumer protection guidelines setting out best practices for dealing with digital assets. ADAM believes that thoughtful guidelines directed toward IDIs based on principles of consumer protection can have an impact beyond the banking sector and significantly strengthen the overall digital asset industry. Additionally, if these guidelines provide a pathway to IDI status for institutions seeking FDIC deposit insurance, eligible firms operating in the digital asset space will be encouraged to bring their activities further into the U.S. federal banking system. This will leave consumers better protected, the market will be more secure and offer better products, the FDIC will have greater insight into digital assets, digital asset firms will benefit from the FDIC's extensive supervisory experience and expertise, and there will be incentives to discourage the participation in uninsured shadow banking activities.

### **Current and Potential Digital Asset Use Cases**

As noted in the RFI, digital asset use cases and related activities may fall into one or more broad categories:

- Technology solutions, such as those involving closed and open payment systems, other token-based systems for banking activities other than payments (*e.g.*, lending), and acting as nodes in networks (*e.g.*, distributed ledgers).
- Asset-based activities, such as investments, collateral, margin lending, and liquidity facilities.
- Liability-based activities, such as deposit services and where deposits serve as digital asset reserves.
- Custodial activities, such as providing digital asset safekeeping and related services, such as secondary lending, as well as acting as a qualified custodian on behalf of investment advisors.
- Other activity that does not align with the others above. Examples could include market-making and decentralized financing.

A small number of IDIs currently play a significant role in supporting digital asset-related activities. Most notably, IDIs hold dollar-denominated accounts for digital asset market participants (exchanges, hedge funds, proprietary trading firms, etc.) as well as the dollar deposits underlying stablecoins and facilitate dollar-denominated payments related to digital asset transactions (*i.e.*, the dollar leg of a digital asset purchase or sale). IDIs may provide loans to funds and other entities secured in whole or in part by digital assets. These IDIs are providing traditional banking services to digital asset market participants, but typically do not hold digital assets on their balance sheet or otherwise have direct exposure to digital assets.

Some IDIs have begun offering credit cards with digital asset rewards programs. In these instances, the role of the bank is largely the same as issuing any rewards card, with the digital

asset-related operations managed by a third-party partner and the rewards held in a third-party wallet.

The RFI asked about activities and use cases related to digital assets that IDIs are currently engaging in or considering. From ADAM’s point of view, IDIs along with other financial institutions have historically provided custodial services for non-bank financial services firms engaged in the securities business, such as investment advisers and broker-dealers, and that as regulatory frameworks evolve, IDIs will also be the most natural partners to provide digital asset custody services to non-bank financial services firms. By increasing clarity on the standards, IDIs should meet in providing these services, the FDIC can play a key role in ensuring that consumers and others seeking custodial services for their digital assets can work with well-regulated entities.

With respect to investment advisers, IDIs routinely act as “qualified custodians” as contemplated in Rule 206(4)-2 of the Investment Advisers Act of 1940 (Advisers Act). Under Rule 206(4)-2 (Custody Rule), which governs the custody practices of investment advisers (RIAs) registered with the Securities and Exchange Commission (SEC), RIAs that have custody of client funds or securities must have and maintain controls to protect those assets from being lost, misused, misappropriated or subject to exposure to claims of the RIA’s creditors. Part of this framework requires that RIAs custody their client assets with qualified custodians, which are defined to include, among others, banks as defined Section 202(a)(2) of the Advisers Act,<sup>11</sup> and savings associations as defined in Section 3(b)(1) of the Federal Deposit Insurance Act (FDI Act) that have deposits insured by the FDIC under the FDI Act.

With respect to broker-dealers, such firms often use “banks,” as defined in Section 3(a)(6) of the Securities Exchange Act of 1934 (Exchange Act) to serve as “good control locations” for customer fully-paid securities. In brief, Rule 15c3-3 under the Exchange Act— known as the Customer Protection Rule – is designed to give more specific protection to customer funds and securities, in effect forbidding broker-dealers from using customer assets to finance any part of their businesses unrelated to servicing securities customers (*e.g.*, a firm is precluded from using customer funds to buy securities for its own account). To meet this objective, Rule 15c3-3 requires a broker-dealer that maintains custody of customer securities and cash (a “carrying broker-dealer”) to take two primary steps to safeguard these assets. The steps are designed to protect customers by segregating their securities and cash from the broker-dealer’s proprietary business activities.

The first step required by Rule 15c3-3 is that a carrying broker-dealer must maintain physical possession or control over customers’ fully paid and excess margin securities.

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<sup>11</sup> That provision defines a bank to include (A) a banking institution organized under the laws of the United States or a Federal savings association, as defined in section 1462(5) of title 12, (B) a member bank of the Federal Reserve System, (C) any other banking institution, savings association, as defined in section 1462(4) of title 12, or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks or savings associations, and which is not operated for the purpose of evading the provisions of this subchapter, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

Physical possession or control means the broker-dealer must hold these securities in one of several locations specified in Rule 15c3-3 and free of liens or any other interest that could be exercised by a third party to secure an obligation of the broker-dealer. Permissible locations include a bank, as defined in section 3(a)(6) of the Exchange Act.

The second step is that a carrying broker-dealer must maintain a reserve of cash or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers, including cash obtained from the use of customer securities. The account must be titled “*Special Reserve Bank Account for the Exclusive Benefit of Customers.*”

As the regulatory framework and customer protection protocols associated with digital assets mature, we believe that IDIs and other financial institutions will seek to provide custodial services to non-bank financial firms. Indeed, ADAM believes IDIs and other financial institutions must be able to fully continue providing custody services to non-bank financial institutions as contemplated under the Custody Rule and the Customer Protection Rule. To this end, ADAM believes that it is vitally important for the FDIC – when considering the custodial services provided to non-bank financial institutions – to discuss the framework with other interested regulators, such as the SEC, to further the seamless ability of IDIs and other banks to provide these services.

With respect to digital assets and IDIs’ balance sheets, some IDIs provide access to loans collateralized by digital assets such as bitcoin, and several other IDIs are considering similar offerings. With the growth of NFTs, we expect that loans secured by NFTs will be a natural extension of many IDIs’ businesses of making loans against artworks, particularly when serving ultra-high net worth customers. As a result, these IDIs will have indirect exposure to digital assets on their balance sheet. IDIs already in this space typically manage this exposure with high margin requirements and robust collateral management (provided by digital asset partners, such as custodians and analytics firms). ADAM believes that digital asset-backed lending has the potential to be highly automated and ensure secure collateral management through the use of smart contracts.<sup>12</sup>

### ***Supervision and Activities***

The RFI asked for the ways in which the custody of digital assets differed from the custody of traditional assets. ADAM’s view is that in the context of securities, the custody of digital assets differs from the current framework under which securities are custodied in that there may be fewer intermediaries involved in the clearance, settlement, and custody chain. In this respect, the current clearance, settlement, and custody process for traditional securities is best described by the SEC in its statement regarding special purpose broker-dealers that custody digital asset securities.<sup>13</sup> In that statement, the SEC stated that:

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<sup>12</sup> We note that lending collateralized by digital assets is one of the key mainstays of “decentralized finance”. While ADAM strongly supports innovation in the lending area, we also recognize the important alternative role IDIs can provide in providing more traditional financing to investors, traders and others who seek to borrow against their digital asset holdings.

<sup>13</sup> Custody of Digital Asset Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 90788 (Dec. 23, 2020) 86 Fed. Reg. 11,627 (Feb. 26, 2021) (SEC Broker-Dealer Custody Statement).

Traditional securities transactions generally are processed and settled through clearing agencies, depositories, clearing banks, transfer agents, and issuers. A broker-dealer's employees, regulators, and outside auditors can contact these third parties to confirm that the broker-dealer is in fact holding the traditional securities reflected on its books and records and financial statements, thereby providing objective processes for examining the broker-dealer's compliance with the Customer Protection Rule. Also, the traditional securities infrastructure has established processes to reverse or cancel mistaken or unauthorized transactions. Thus, the traditional securities infrastructure contains checks and controls that can be used to verify proprietary and customer holdings of traditional securities by broker-dealers, as well as processes designed to ensure that both parties to a transfer of traditional securities agree to the terms of the transfer.

Digital assets that are issued or transferred using distributed ledger technology may not be subject to the same established clearance and settlement process familiar to traditional securities market participants. The manner in which digital assets, including digital asset securities, are issued, held, or transferred may create a greater risk that a broker-dealer maintaining custody of this type of asset, as well as the broker-dealer's customers, counterparties, and other creditors, could suffer financial harm. For example, the broker-dealer could be victimized by fraud or theft, could lose a "private key" necessary to transfer a client's digital assets, or could transfer a client's digital assets to an unintended address without the ability to reverse a fraudulent or mistaken transaction. In addition, malicious activity attributed to actors taking advantage of potential vulnerabilities that may be associated with distributed ledger technology and its associated networks could render the broker-dealer unable to transfer a customer's digital assets.<sup>14</sup>

ADAM believes that the SEC's concerns in this respect can be greatly alleviated by fully integrating IDIs and other financial institutions into the clearance and settlement system for digital asset securities. In this vein, ADAM believes that the FDIC may view the recent actions by the Office of the Comptroller of the Currency (OCC)<sup>15</sup> with respect to the custody of digital assets as a useful framework for evaluating and gaining comfort with IDIs increasing their roles and responsibilities with respect to facilitating transactions in, and providing custody for, digital assets.

IDIs can also play an important role in the digital asset ecosystem by acting as node operators, validating digital asset transactions taking place on blockchain-based networks. In Interpretative Letter 1174 dated January 4, 2021, and entitled "OCC Chief Counsel's Interpretation on National Bank and Federal Savings Association Authority to Use Independent Node Verification Networks and Stablecoins for Payment Activities the Office of the Comptroller of the Currency"<sup>16</sup> the Office of the Comptroller of the Currency (OCC) confirmed that National banks and Federal savings associations may use

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<sup>14</sup> Id. at 68 Fed. Reg. at 11628-29.

<sup>15</sup> See, e.g., Anchorage Digital N.A. Approval Letter, <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-6a.pdf> (granting Anchorage Digital N.A. a charter to custody digital assets).

<sup>16</sup> See <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2a.pdf>.

new technologies, including independent node verification networks and related stablecoins, to perform bank-permissible functions, such as payment activities. ADAM strongly supports the OCC's position in this letter and encourages the FDIC to consider taking a similar position with respect to IDIs subject to its supervision.

### **Regulatory Processes and Dialogue Moving Forward**

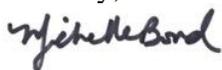
ADAM appreciates the FDIC's recent interest in the digital asset regulatory space, including its creation of a Chief Innovation Officer and its participation in the "Interagency Sprint on Crypto" with the Federal Reserve and the OCC. These steps can help provide clarity on the regulation of digital assets, so firms can plan to develop and execute on future lines of business. To this end, however, ADAM encourages the FDIC to coordinate with financial markets regulators such as the SEC and the CFTC. Such coordination will be essential when cross-cutting issues such as deposit insurance for stablecoins or custody proposals for tokenized money funds are brought to the regulators' attention. As such, with any formal guidance or rulemaking process, ADAM asks that the FDIC and the other regulators it works with follow the steps put forward in the Administrative Procedure Act to engage in a transparent and rigorous public process.

ADAM recognizes that the technological use applications in the digital assets space are constantly evolving, which continually presents new questions to be addressed. Often times, these questions can be addressed through the application of novel technological solutions. However, such responses require clear outlines of the relevant problems and sufficient time to focus on developing a solution. As such, ADAM and its members welcome an ongoing dialogue with the FDIC on all areas of the digital asset industry. The dialogue could take place in a traditional format, or through collaborative areas ranging from trainings to the development of compliance manuals--subject to limited resources.

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ADAM appreciates the FDIC's considerations of the comments above. ADAM and its members stand ready to answer any questions on the industry or the Code that the FDIC may have.

Sincerely,



Michelle Bond  
Chief Executive Officer  
Association for Digital Asset Markets (ADAM)