

Special Purpose Depository Institution (SPDI) Legislation

Cryptocurrency businesses are advocating for the creation of a Special Purpose Depository Institution (SPDI) charter in select state legislatures. Granting a charter of this nature will introduce new risks to consumers, banks and the payment system, as well as require a significant investment by the state to properly regulate. The ultimate goal of the new charter is to gain direct access to the Federal Reserve and the U.S. payments system, without being subject to the same federal regulatory and supervisory framework with which banks must comply. Indeed, the business model behind the charter is to intentionally sidestep this important framework.

The SPDI charter would allow cryptocurrency businesses to take *uninsured* U.S. dollar deposits from consumers, convert them to “digital assets,” conduct payments, connect them to lending and investment platforms, or provide custody services for digital assets. While this business model encompasses a large swath of the services already provided by traditional depository institutions, a new cryptocurrency payments charter would not have access to the same federal protections as commercial banks, such as deposit insurance and other federal backstops, nor would they be subject to the same regulations and supervision mandated for all other depositories.

Consistent oversight across all depository institutions is essential to safeguarding consumers and preventing regulatory arbitrage that could introduce new systemic risks to the U.S. financial system. In addition:

- **A new charter is unnecessary.** It is unclear what is achieved by a new charter with limited oversight. Banks can already serve as custodians for digital assets, and serve as important intermediaries between cryptocurrency companies and the U.S. payments system.
- **This new charter would enable money laundering.** The Financial Crimes Enforcement Network (FinCEN), a department of the U.S. Treasury charged with safeguarding the U.S. financial system from illicit use, has identified convertible virtual currencies held in un-hosted wallets as an “illicit finance threat” and is currently in the process of establishing appropriate recordkeeping and reporting requirements to “close loopholes that malign actors may exploit.”¹ Until that robust reporting framework is in place and functioning effectively, these SPDIs would create a vulnerable entry point into the U.S. financial system for bad actors.
- **This charter would create significant consumer and market confusion.** Because the SPDI lacks federal deposit insurance and other protections, the failure of an SPDI will almost certainly result in the loss of depositors’ money. However, it is likely that many consumers of the SPDI will not fully understand that the entirety of their deposit is exposed. This confusion also will likely introduce reputational and other risks into the banking industry, as consumers and others will only see that a failed “bank” lost its depositors’ money.

¹ <https://home.treasury.gov/news/press-releases/sm1216>

- **Supervision and examinations would be the sole responsibility of the state banking commission.** States, as the sole provider of oversight for these entities, will need to absorb the substantial costs associated with creating rules, hiring and training examiners, and ensuring compliance with consumer protection, anti-money laundering, and other regulatory requirements for a complex and evolving financial product and marketplace.

- **Introducing crypto currency into the U.S. backed currency and payments system is untested.** Wyoming passed similar legislation in 2019, but the two entities that have received charters under that law are not yet operational, and how the model will function in practice remains unseen. Serious concerns about the ability of the Wyoming Department of Banking to provide sufficient supervision to this industry remain.²

- **This charter is unlikely to attract jobs to the state.** The proposed state charter is billed as a job creator that will attract innovative new “fintech” firms, but the reality is that these firms that include cryptocurrency exchanges and digital wallet providers operate primarily online and are unlikely to establish a significant physical presence in-state.

Access to the payment system would lower transaction costs for a crypto-company since they would no longer need to work through a regulated bank. This benefits the crypto-company, while introducing unmitigated risks to the U.S. banking and payments systems.

² <https://www.forbes.com/sites/jasonbrett/2020/10/02/an-inside-look-at-wyoming-state-regulators-prepping-for-first-crypto-bank-examinations/?sh=70089c369d9d>