



Regulatory Alert for Financial Services

Regulatory Insights

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Crypto & Digital Assets: FSOC, NY Fed Reports on Financial Stability Implications

KPMG Insights. *The reports on the financial stability risks of digital assets, which follow on from multiple other recently released reports (see KPMG Regulatory Alert, [here](#)), show the ongoing focus of regulators and standards setters in the U.S. and globally to understand and assess the risks associated with these novel assets, and to appropriately build a regulatory and supervisory framework. As in other reports, these reports reiterate recommendations that regulatory and law enforcement agencies continue to use their existing authority to address current and emerging risks and recognize that legislation may be required in areas related to stablecoins and central bank digital currencies (CBDCs).*

The Financial Stability Oversight Council (FSOC) and the New York Federal Reserve Bank have both published detailed reports on the financial stability risks and implications of digital assets. At a high level, the reports:

- Encourage agencies to use their existing regulatory and enforcement authorities, even as market regulation evolves.
- Identify regulatory gaps, which they recommend be addressed through Congressional action.
- Call for coordination among regulators.

Separately, the Basel Committee on Banking Supervision (Basel Committee) released its first dataset on digital asset exposures at banking institutions. The reports and dataset are discussed below.

FSOC Report

The FSOC released a [report](#) on crypto-assets pursuant to the March 2022 [Executive Order 14067](#) on “Ensuring Responsible Development of Digital Assets.” The report identifies key financial stability risks, vulnerabilities, and regulatory gaps as

well as recommendations for both regulators and Congress to address them.

The report notes that many of the identified vulnerabilities are independent but could raise financial stability risks should they interact to exacerbate or amplify shocks, particularly if the *scale* of crypto-asset activities and their *interconnectivity* with the traditional financial system continue to grow. Likewise, the report provides a non-exhaustive list of potential sources for these shocks, including malicious acts, technology breakdowns, or governance or decision-making breakdowns.

FSOC recommendations. The report states that large parts of the crypto-asset ecosystem are already covered by the existing regulatory structure, but also notes that growth in overall scale or interconnectivity should be paired with appropriate regulation and enforcement. Therefore, it proposes the following ten recommendations to its agency members and Congress to address the financial stability risks posed by increasing crypto-asset activity and “ensure appropriate regulation” of those activities.



Regulatory Principles	
1	<p>Consider the following general regulatory principles when deliberating the applicability of current authorities</p> <ul style="list-style-type: none"> — Same activity, same risk, same regulatory outcome — Technological neutrality — Leveraging existing authorities where appropriate — Transparency in technology — Addressing financial stability risks before they impair the economy — Monitoring mechanisms through which crypto-assets could become more interconnected with the traditional financial system or increase in overall scale — Bringing transparency to opaque areas (disclosures and documentation) — Prioritizing timely and orderly transaction processing and legally binding settlement — Facilitating price discovery and fostering market integrity — Interagency crypto-asset market data-sharing
Enforcement	
2	Continue to enforce existing rules and regulations
Regulatory Gaps	
3	Regulate the spot market for non-security crypto-assets by passing legislation including rulemaking authority over a range of subjects, including but not limited to conflicts of interest, consumer and investor protection, disclosure and reporting requirements, governance standards, capital and margin, custody, settlement, and clearing, transparency, and any necessary anti-fraud authorities
4	Limit opportunities for regulatory arbitrage by coordinating and aligning regulatory and supervisory efforts
5	Create a comprehensive federal prudential framework for stablecoin issuers through legislation that addresses market integrity, investor and consumer protection, and payment system risks
6	Create authority that gives regulators visibility into, and supervision of, the activities of all affiliates and subsidiaries of crypto-asset entities , through legislation in cases in which regulators do not already possess such authority
7	<p>Use existing authorities to review services provided to banks by crypto-asset service providers and other entities in the crypto-asset arena, and evaluate whether existing authorities provided FRB, OCC, FDIC, and state bank regulators are sufficient</p> <p>Pass legislation to ensure that NCUA and FHFA have adequate examination and enforcement authority for such entities and third-party service providers</p>
8	Assess the impact and appropriateness of vertical integration (direct access to markets by retail customers) on conflicts of interest and market volatility
Regulation Informed by Appropriate Data	
9	Coordinate a government-wide approach to data, collection, analysis, monitoring, supervision, and regulation of crypto-asset activities
Regulatory Capacity and Expertise	
10	Build capacity to analyze and monitor crypto-asset activities and allocate sufficient resources to do so, as well as prioritize investments and efforts to build out related enforcement capacity

NY Federal Reserve Bank – Financial Stability Implications of Digital Assets

Like the FSOC report, a recent [report](#) from the New York Federal Reserve Bank also describes emerging vulnerabilities that could present risks to financial stability if the digital asset ecosystem becomes more systemic, including run risks among stablecoins, valuation pressures in crypto-assets, and growing interconnectedness.

The report identifies three regulatory challenge areas, including:

- **Risks from outside of the regulatory perimeter** stemming from currently unregulated or under-regulated portions of the digital asset ecosystem, including connections beyond U.S. jurisdictions.
- **The regulatory scope and novel digital assets**, where novel technologies may challenge regulatory oversight, such as in the case of smart contracts, which act as counterparties and intermediaries despite being unalterable pieces of code, or decentralized finance (DeFi) protocols, which are controlled by “Decentralized Autonomous Organizations” (DAOs).
- **Efforts related to stablecoins**, as many are designed to be used as a means of payments and are exposed to many of the same risks as traditional payments systems, such as credit risk, liquidity risk, operational risk, and settlement risk. The report reiterates recommendations of the President’s Working Group on Financial Markets (PWGFM) in its November 2021 report of the Regulation of Stablecoins (see KPMG Regulatory Alert, [here](#)), which outlines legislative proposals to address run risk, payment system risk, and concerns about systemic and concentration risk.

Basel Committee Dataset

Banks’ exposures to crypto-assets. The Basel Committee on Banking Supervision published the first [dataset](#) in a collection to support its work on prudential treatment of banks’ crypto-asset exposures. Highlights from the data submitted by 19 global banks:

- Crypto exposures remain a small (0.14 percent) portion of total exposures but are not evenly distributed across the reporting banks.
- Crypto exposures are primarily concentrated in Bitcoin (31 percent), Ether (22 percent), or derivatives of the two (35 percent).
- Reported crypto-related activities included custody, wallet, and insurance services (50.2 percent), clearing, client, and market-making services (45.7 percent), and direct holdings and lending (4.2 percent).

Please refer to:

- [Press Release: FSOC Releases Report on Digital Asset Financial Stability Risks and Regulation](#)
- [Remarks \(Yellen\): Financial Stability Oversight Council Meeting October 3, 2022](#)
- [Statement \(Gensler\): FSOC’s Report on Digital Asset Financial Stability Risks and Regulation](#)
- [Staff Report: The Financial Stability Implications of Digital Assets](#)
- [BIS – Basel Committee Report: Banks’ exposures to cryptoassets – a novel dataset](#)

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