Commissioner Russell C. Weigel, III

Guidance to Florida State-Chartered Financial Institutions Regarding the Provision of Virtual Currency and Digital Asset Custody Services
January 2022

The use of virtual currency (also known as "digital currency or "cryptocurrency") and digital assets has become more commonplace as technology continues to rapidly evolve. There is growing demand for safe places, such as financial institutions, to hold unique cryptographic keys associated with virtual currencies and digital assets on behalf of customers and to provide related custody services. As such, the Florida Office of Financial Regulation would like to offer guidance on this topic to its regulated financial institutions. The remainder of this document includes the term "digital assets" within the term "virtual currency."

Florida's Financial Institutions Codes do not prohibit state-chartered financial institutions from providing virtual currency services to their customers. As is the case with any other product or service, the institution must ensure that adequate policies and procedures are in place to effectively monitor, manage and mitigate any associated risks and must comply with applicable laws and regulations. The board of directors and management must conduct due diligence and carefully examine the risks involved in offering virtual currency custodial services as they would any other product, through a methodical and comprehensive risk assessment process.

While virtual currencies have certain commonalities with traditional money, the mechanism by which it is exchanged is unique. Virtual currency is an electronic representation of value intended to be used as a medium of exchange, unit of account, or store of value. Virtual currencies do not exist in a physical form. Instead, they are an intangible form of property and exist only on the blockchain or distributed ledger associated with that virtual currency. The owner of the virtual currency holds cryptographic keys in the form of a code associated with the specific unit of virtual currency in a digital wallet. The keys enable the rightful owner of the virtual currency to access and utilize it further. Providing virtual currency custody services would involve the provision of some type of storage and security services for virtual currencies.

Virtual currency custodial services can take many forms. Just as cash or credit cards can be kept in a physical wallet, virtual currency can be stored in a "digital wallet". The digital wallet can be hardware based or web based. Every wallet contains a set of private keys without which the owner cannot access the virtual currency.

- **Hot wallets** are online wallets that run on internet-connected devices such as computers, phones or tablets. These wallets generate the private keys to virtual currency on these devices. While this can be very convenient and provide easy access for transactions, they also come with more risk.
- **Cold wallets** are not connected to the internet and are also known as offline or hardware wallets. These wallets store a user's address and private key on something that is not connected to the internet, such as a USB drive device, and therefore stands a far less risk of being compromised than those connected to the internet. However, they do not offer the accessibility and convenience of a hot wallet.

Custodial services have been an integral part of the financial institution industry from its inception, and the concept can be extended to include virtual currency, within the realm of safety and soundness. If a financial institution is contemplating the addition of virtual currency custodial services for its customers, the institution should first analyze how the offering of such services would fit into its overall strategic business plan, what level of expertise financial institution management and staff have in the subject matter, and how the offering of such products would align with the financial institution's desired risk profile.

The risks associated with virtual currency can include value volatility; the possibility of theft arising from the failure to secure the currency; the possible use of the currency in criminal activities; and the evolving regulatory structure. Any financial institution contemplating providing virtual currency custodial services to its customers should be aware of these and any other risks and at a minimum should:

- Perform adequate customer due diligence;
- Review the virtual currency and custodial program for legal compliance;
- Ensure adequate administrative, technical and physical controls specific to the virtual currency are in place prior to providing virtual currency custody services;
- Ensure compliance with anti-money laundering obligations for cryptocurrencies;
- Ensure compliance with any OFR, SEC, CFTC, FinCEN, or U.S. Treasury requirements for record keeping and confirmations; and
- Have adequate knowledge of the assets and the ability to properly manage them.

In providing virtual currency custodial services in a non-fiduciary capacity, the financial institution takes possession of the customer's asset for safekeeping while legal title to that asset remains with the customer. The extent of the institution's duties regarding the asset depends on the custodial agreement between the two parties, but generally, the institution owes its customer the duty to use proper care to keep the asset safely and to return it unharmed upon request.

A financial institution may only offer custody services in a fiduciary capacity if it has active trust powers. In its fiduciary capacity, an institution with active trust powers has the authority to manage virtual currency assets as it would any other type of asset held in such capacity.

Due to the complexities and technological evolution related to virtual currency, the financial institution may choose to utilize a third-party vendor relationship in order to capitalize on the service provider's expertise and experience. Strong service provider oversight is key in any such relationship. Information on outsourcing technology services can be found in the Federal Financial Institutions Examination Council's IT Examination Handbook for Outsourcing Technology Services. Information related to due diligence and management of potential financial technology third party relationships can be found in the Conducting Due Diligence on Financial Technology Companies, A Guide for Community Banks, issued by the FDIC, Federal Reserve and OCC.

The Office of Financial Regulation stands ready to answer any questions regarding the provision of virtual currency custody services. Please reach out to your primary regulatory contact, or contact the office at (850) 410-9509 or Jeremy.Smith@flofr.gov.