

Crypto Banks Threaten Americans' Savings and the Main Street Economy

By Phillip Basil | *Director of Economic Growth and Financial Stability*

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The Office of the Comptroller of the Currency's (OCC) finalization last week of its [weak and irresponsible rule](#) governing stablecoins was another major step by the administration to force crypto and its huge risks into the financial system. This will only benefit the crypto industry and its army of lobbyists, who are all making huge sums of money for a product the American public never asked for and, in fact, are [nearly all concerned about its risks](#).

Those concerns are quickly becoming reality within the banking system. All three federal banking agencies—the OCC, the Federal Reserve (Fed), and the Federal Deposit Insurance Corporation (FDIC)—are taking actions that collectively will create crypto-based banks with all of the benefits of being a bank but without any of the rules that keep our banking system safe. This short-sighted, profit-seeking policymaking undermines our community banks, hurts economic growth, and unnecessarily brings the huge risks of crypto into our banking system, threatening widespread bank failures and bailouts.

What makes a bank a bank?

Basically, a bank takes deposits and uses them to make loans and facilitate payments. Banks are essential to a healthy economy, keeping the savings of households and businesses safe; providing inexpensive, durable credit that fuels economic growth and wealth building; and facilitating fast and secure payments that make commerce efficient. This special role in our economy is recognized with a special status for banks in our laws and rules. In fact, banks must receive a special charter to do business from the OCC or a state banking agency.

Because those activities are so important, banks receive unique support from the government, also a big component of what makes a bank a bank. Banks receive deposit insurance from the FDIC that helps prevent bank runs. They also have access to the services of the central bank (the Fed), including central bank deposit accounts, facilitation of payments between banks, and emergency lending for when banks have cash shortfalls.

That government support and special role in our economy comes with government-enforced risk management standards that minimize bank failures and the associated costs to the economy and taxpayers.



So, to summarize, a bank:

- Has a special charter from the OCC (or a state bank agency)
- Takes deposits, makes loans, facilitates payments
- Has deposit insurance through the FDIC
- Has access to Fed-provided deposit accounts, payment systems, lending facilities

And is subject to risk management standards through:

- Requirements for minimum amounts of loss-absorbing capital funding
- Requirements for minimum amounts of readily accessible funding for stress periods
- Oversight of bank risk management and operations.

New Rules Allow Crypto Companies To Do the Activities of a Bank without Risk Management

The OCC modified its trust charters to allow for crypto banks to exist

Historically, a bank charter from the OCC meant a bank could engage in the combination of deposit-taking, lending, and payments. Over time, there was a need for fiduciary activities—primarily meaning the management of assets in the best interest of clients—to be formally added as an approved practice, and authority was given in law for the OCC to provide so-called trust charters specifically for fiduciary activities.

The trust charter is the only charter crypto companies can apply for, because their businesses primarily involve taking dollars from clients and providing stablecoins in exchange. That is, the companies do not take deposits and so cannot receive a traditional bank charter. So far, the OCC has approved over a dozen trust charters for crypto companies. However, historically, a trust charter would limit crypto banks to fiduciary activities, an outcome crypto banks don't like because that would prevent them from conducting the basic activities of a stablecoin issuer, like holding assets under custody or facilitating payments.

That's why this year the OCC [reinterpreted the law without basis](#) and expanded the activities allowed under its trust charter. In fact, the OCC left the interpretation wide open and did not specify which activities are allowed, simply stating that the trust charter is not limited to fiduciary activities. This recklessly provides a back door for crypto banks to engage in essentially all the activities of a traditional bank with a charter that, under the law, was intended to be strictly limited. Better Markets will watch the evolution of crypto trust banks' activity, which may migrate from traditional fiduciary activities now that the OCC has permitted an expansion of business lines.

The OCC asserted that state laws don't apply to its banks



Prior to this crypto-friendly administration, crypto companies had not obtained federal trust charters from the OCC. Therefore, a big issue in the crypto industry has been the need to comply with the laws and rules of all 50 states, each of which can have its own framework. However, a federal charter allows banks to mostly follow federal laws and rules and ignore nearly all state laws, a concept known as federal preemption. This would create a huge efficiency and profit boost for crypto companies.

Now that crypto banks have federal charters, the issue of where and how federal preemption of state laws applies is still battled in the legal system. Nonetheless, the OCC ignored this battle and used its rulemaking authority to [assert—again without basis—federal preemption](#) on a very specific but consequential issue, essentially showing that the OCC is asserting its federal preemption more generally, an action that states would have to challenge in the courts.

The Fed will provide crypto banks with direct access to its payment services and deposit accounts

Because nobody actually uses crypto to pay for real-world, non-crypto goods and services, crypto customers must have their funds transferred out of crypto and back into the banking system to engage in economic transactions. Right now, crypto companies partner with traditional banks for access to the Fed's payments systems, which easily and cheaply allow the transfer of funds from one bank to another. But they want direct access to the Fed to reduce costs and simplify operations.

The Fed is [giving them exactly what they want](#) with its recent proposal to create a special type of account that would give companies, including crypto banks with OCC trust charters, direct access to the Fed's payments systems. Also, even though the Fed says the accounts are "limited" to payments, the accounts would allow crypto banks to deposit significant amounts of money in the special Fed accounts. Crypto banks therefore would be able to cut out having to use banks as an intermediary with the Fed, creating huge cost savings.

The Fed is also providing a back door for crypto banks to its lending facilities

Banks often have cash shortfalls due to a constant in-and-out flow of funds, and banks often use the Fed's lending facilities to address those shortfalls. Even though the Fed says it will not provide lending to users of the special payments accounts, crypto banks would still have indirect access to the Fed's lending facilities simply by depositing funds at traditional banks.

That is, if a crypto bank maintains large deposits at a traditional bank, when it is experiencing large-scale withdrawals by customers, the crypto bank could simply in turn withdraw deposits from the traditional bank to pay back its customers. Then the traditional bank likely would have cash shortfalls, and would face the burden of borrowing from the Fed's lending facilities. As crypto banks grow, large-scale withdrawals would result in bank runs throughout the banking system and put pressure on the Fed's lending facilities.

The FDIC is providing deposit insurance to crypto banks despite the huge risks

Crypto banks don't take deposits, but they do deposit large amounts of customers' funds at traditional banks. So, although crypto companies are unable to directly offer deposits with their trust charters (although the expanded definition of trust charters discussed above may allow this), they can indirectly provide deposits by immediately depositing customer funds at a bank. Those deposits are eligible for deposit insurance from the FDIC.

Recently, the FDIC has taken this one step further by approving deposit insurance for a bank whose only stated purpose is to provide banking services to crypto companies, including taking their deposits. Considering the run dynamics discussed above and the weak regulations detailed below, the FDIC could soon be on the hook to insure a large number of deposits, potentially ultimately putting the burden on the taxpayer.

Nearly All the Benefits with None of the Rules

Putting it all together, the changes being made by the banking agencies provide crypto banks with nearly all the same benefits as traditional banks with none of the rules.

Benefits

Traditional Banks	Crypto Banks
Ability to take deposits and make loans and payments	Ability to make loans and payments, potential to take deposits
Federal preemption for OCC charters	Federal preemption for OCC charters
Direct deposit insurance from FDIC	Indirect deposit insurance from FDIC
Direct access to Fed's payments systems	Direct access to Fed's payments systems
Ability to deposit funds in Fed accounts	Slightly limited ability to deposit funds in Fed accounts
Interest paid on deposits in Fed accounts	No interest paid on deposits in Fed accounts
Direct access to Fed lending facilities	Indirect access to Fed lending facilities

Rules and Oversight

Traditional Banks	Crypto Banks
Risk-based capital requirements: minimum of 4.5 percent with a 2.5 percent buffer; additional buffers for larger banks	Issuers self-assess capital based on their risk profile and operating history, subject to supervisory review.
Leverage-based capital requirements: minimum of 4 percent for most banks	Issuers self-assess capital based on their risk profile and operating history, subject to supervisory review.
Liquidity requirement for larger banks to cover 30 days of stressed outflows	Reserve asset value must equal or exceed outstanding issuance value, i.e., no buffer required.
Liquidity requirement for larger banks to have a minimum amount of stable funding	Reserve asset value must equal or exceed outstanding issuance value, i.e., no buffer required.

Regular supervisory oversight through examinations	TBD
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Crypto Banks Undermine the Banking System and Economy

Significant growth in crypto banks would slow the economy and starve borrowers of much-needed credit by drawing deposits out of the banking system and into the crypto ecosystem. Deposits are vital to the banking system and the real economy because:

1. Banks fund their loans almost entirely with deposits and
2. Banks are the safest, cheapest, and best source of lending.

So, fewer bank deposits means less of the bank lending that is highly beneficial to households and businesses. This would be very problematic and, depending on the amount of deposits banks lose, potentially catastrophic, especially to Main Street small businesses and households.

Economists at the Fed Bank of Kansas City estimate that an increase in stablecoins to just \$900 billion would result in a [reduction in bank lending of \\$325 billion](#). Using the same assumptions, if stablecoins grow to \$2 trillion or more, as [some have estimated](#), bank lending would be reduced by at least \$450 billion to \$1 trillion, or 5 to 10 percent of current bank lending to the real economy. Furthermore, more limited availability of bank credit would drive up costs for all borrowers because less supply of loans and the same demand for borrowing means a higher cost of borrowing. The entire economy would suffer the consequences, but Main Street small businesses and households would be hurt the most.

Conclusion

Banking is supposed to be a safe activity that supports economic growth. Unfortunately, the GENIUS Act allowed crypto and its huge risks into our banking system, threatening to undermine it. The banking agencies should be protecting the banking system from those risks. Instead, they are choosing to ignore their statutory responsibility to maintain the safety and stability of our banking system by implementing a set of rules that provides a free pass to stablecoin issuers to do the activities of banks without any of the protections that keep our banking system safe. When stablecoins and the crypto banks that issue them start to fall apart—as they have repeatedly in the past—Americans, including those who do not even know what a stablecoin is, will pay the price. Regulators serious about financial stability must revisit their framework of rules and impose the capital, liquidity, reserve, and supervisory safeguards that should have been adopted today.



Better Banks | Better Businesses
Better Jobs | Better Economic Growth
Better Lives | Better Communities

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

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2000 Pennsylvania Avenue NW | Suite 4008 | Washington, DC 20006 | 202-618-6464 | www.bettermarkets.org
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