

Diving into Digital Currency: What You Need to Know About Crypto

by Matt Herren

The digital currency environment is a space that traditional financial institutions should watch in order to stay competitive. There is much to gain from understanding and staying ahead of digital currency trends, including cryptocurrencies.

As they navigate this new digital currency landscape, bankers should consider customer demands and how to best position themselves for success.

What is a Cryptocurrency?

Cryptocurrencies are digital or virtual currencies protected by encryption, making counterfeiting and double-spending practically impossible. Many cryptocurrencies use blockchain technology, a distributed ledger enforced by a network of computers.

In short, cryptocurrencies leverage advanced mathematical formulas to create digital assets. The value of these digital assets ebbs and flows, much like traditional currencies or stocks. Sophisticated cryptography prevents counterfeiting and fraudulent transactions.

Cryptocurrencies have also become more popular in recent years. [Time reported](#) the world's cryptocurrency as worth more than \$3 trillion globally, and consumers transact trillions of dollars in value each year. While there has been much debate over the true "value" of cryptocurrencies, these digital assets have undoubtedly made headlines—both positive and negative—for the value the marketplace has placed upon them.

It's important to remember that volatility is part of any emerging market and has been a part of the crypto space since its inception, though the general trend has consistently been upward. More established crypto assets have gained additional certainty from a regulatory perspective, making them more attractive offerings as banks begin to explore this space.

The volatility in the crypto space has caused some to question if consumers should participate, but this creates even more demand for banks to serve as a trusted partner that can guide consumers to safer, more established options like Bitcoin.

Why Should Your Bank Consider Entering the Cryptocurrency Marketplace?

In short: Banks should care about cryptocurrencies because many of their customers are showing interest and competitors are getting there first. Capitalizing on this trend could ensure that customers engage in the space safely and deepen their connection with their institution.

According to [Visa](#), 32% of crypto-aware consumers own cryptocurrency, with 21% being active owners who have transferred crypto or used it in a transaction. Despite the difficulties banks have implementing digital currency services, there's no reason they can't dip their toes in the water. A recent [Cornerstone Advisors survey](#) found that 60% of crypto owners would use their bank to invest in cryptocurrencies, and another 32% might.

Customers are interested in digital assets, and banks can use this interest to further their position at the center of their financial lives. As with previous innovations like digital banking, the capacity to control customer experience and truly drive strategy depends upon how quickly a bank adopts.

Financial institutions have an opportunity to maintain their role as financial advisors regarding crypto. Many consumers want to participate but need a trusted partner, such as their bank, to better understand how. In addition to offering education, allowing customers to try their hand in the crypto space could generate additional revenue.

What Do the Regulators Say About Crypto Assets?

As the space evolves, regulations governing digital currencies are updated on an ongoing basis. Financial institutions should stay up to date on regulations and instructions from federal regulators regarding decentralized cryptocurrencies.

[Recent guidance](#) from the Federal Reserve, FDIC and OCC has focused on the need for greater clarity, with tentative guidance around:

- Crypto-asset custody
- Facilitation of customer purchases and sales of crypto assets
- Loans collateralized by crypto assets
- Activities involving payments
- Activities that may result in crypto-asset holding on an institution's balance sheet

Institutions should look for additional clarity from the agencies throughout 2022 and beyond to best understand policies, potential gray areas and what might come next. Looking ahead, it's wise to keep an eye on the Federal Reserve and additional regulatory changes. Keep in mind that while there may be risk in emerging spaces, inaction could pose risk as well.

What is Crypto Custodial Management?

Bankers needn't worry about the ins and outs of crypto to offer custodial management services. [Banks can simply become channels](#) through which customers engage. A bank's role in working with a custodial management system is to remove some of the risks and act as a trusted vault of information. The implications are straightforward:

- A bank partners with a technology provider to offer Bitcoin wallets through [digital banking](#).
- Customers buy, sell and hold Bitcoin as an asset rather than currency.
- Banks generate fee revenue, gaining a certain percentage for each transaction amount.
- The technology partner facilitates tax filings and offers downloadable tax forms.

Effective custodial management uses best practices to safeguard crypto assets and the keys to access them. These safeguards require avoiding hot wallets, whose keys are still connected to the internet and therefore vulnerable. Another best practice is breaking keys into parts so that no one person has access.

Getting Ahead of Digital Currency Trends

The adoption of digital banking, bank apps and self-service options shows that financial institutions can adapt to new trends in technology. Banks must now continue to innovate to meet consumer needs in an increasingly competitive landscape.

This space deserves continued attention by all financial institutions, and it is time to craft a strategy before someone else does it for you. Listen to CSI's [Fintech Focus](#) podcast for additional insight into cryptocurrencies and how financial institutions should move forward in this space.

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