

**EXAMINING THE PRESIDENT'S WORKING GROUP
ON FINANCIAL MARKETS REPORT ON
STABLECOINS**

HEARING
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
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ON

EXAMINING THE PRESIDENT'S WORKING GROUP ON FINANCIAL
MARKETS REPORT ON STABLECOINS

FEBRUARY 15, 2022

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TUESDAY, FEBRUARY 15, 2022

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD-538, Dirksen Senate Office Building, Hon. Sherrod Brown, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN SHERROD BROWN

Chairman BROWN. The Senate Banking, Housing, and Urban Affairs will come to order.

Under Secretary Liang, welcome. Glad you are here. Thank you.

Our witness is in person. Members have the option to appear either in person or virtually, so thank you.

Let me start out by talking about the Federal Reserve for a moment. This afternoon at 2:15, we will be meeting in SVC-200, the Visitors Center at the bottom of the steps, to mark up five Federal Reserve nominees and one for the FHFA. We need a full Federal Reserve Board of Governors to bring down prices and put workers first. It will be the first time in a decade we have seen a full complement of Governors once we confirm in Committee and on the floor, these five nominees.

Ranking Member Toomey and I agreed on the dates. Three weeks ago, we agreed on the dates for the hearing and markup. Americans are depending on us to get these people on the job as soon as possible. If my colleagues are as concerned about inflation as they claim to be in this Committee and beyond, they will not slow down this process, which will only hurt workers, their families, and our recovery.

If you watched the Super Bowl on Sunday, you saw ad after ad for a product that most Americans have heard of, but almost nobody knows what it really is. Even many of the people who have bought it often do not really understand it. Big cryptocompanies are looking to make big profits, are desperate to reach as many Americans as they can. They brought in celebrities and gimmicks to make crypto sound exciting and daring and profitable.

But the ads left a few things out. They did not mention the fraud, the scams, and the outright theft. The ads did not point out that you can lose big in crypto's huge price swings. They did not tell you about the high fees pocketed by the cryptocompanies. They

sure did not explain that cryptomarkets lack basic investor protections and oversight.

Just a few weeks ago, hackers stole \$300 million of people's investments from a cryptoplatfrom. The fact that these companies felt the need to advertise at all is a bit of a giveaway about one of their major claims. If this were actually meant to be used as currency, why would you need to buy ads? I do not think I have ever seen in 40 years of Super Bowl watching, the Federal Reserve buy a multimillion-dollar commercial for U.S. dollars. That is because crypto is not money. It is designed for speculation.

Watching those ads reminded a lot of us of some asset bubbles we have been before. The 2000 Super Bowl featured 21 ads from 14 different dot-com startups. The internet may have been the next frontier, but these companies surely were not. Many of them were defunct within a year or two. Only 4 from those 14 are still around.

We are here today because, once again, real people's real money is at risk. We need to look beyond the unproven promises, protect Americans and our entire financial system.

In a hearing last July, this Committee examined the risks of cryptocurrencies to our economy. In December, we looked closely at the mechanics behind stablecoins and stablecoin companies.

Today we are joined by Treasury Under Secretary Liang to look at the risks stablecoins pose and how regulators and Congress can protect consumers.

Last fall, the Treasury Department led a team of our financial regulators to conduct a report on stablecoins. This report makes it clear that without regulation, stablecoins can endanger our economy, our payments systems, our hard-earned money. And while stablecoins suggest they are like money, good luck trying to use one at the store. Their main purpose today is to make it easier to trade, to speculate, and in some cases, unfortunately, especially, even hide assets in crypto and digital markets.

In just a few years, stablecoins have mushroomed into a 175 billion—"billion" with a B—dollar market. They are asking us to believe that what they have built is as good as real money and that it works the way these startups say it does. Americans and this Committee should look carefully at those promises. The companies claim that a stablecoin is backed by real dollars invested in a reserve account; that is what makes it stable.

But our financial regulators have tested that claim by a giant stablecoin issuer. That issuer ended up paying nearly \$60 million in fines because it lied about its reserves. It turns out that for over 2 years, the stablecoin was really backed 28 percent of the time.

Stablecoin companies say that you can, quote, "redeem" a stablecoin whenever you want, exchanging it back into dollars from the stablecoin's reserve, but the fine print in the agreements of some of the biggest companies says that ordinary consumers cannot actually redeem their stablecoins for dollars from the company that issues them. Only institutions like hedge funds can, and even then, many stablecoin issuers can delay redemptions or refuse them entirely.

So, if you saw a Super Bowl ad, you would figured out you would give this a try. You change your mind and want to exchange your

stablecoin for dollars? You might be out of luck. The website could be down. Your money could be trapped.

Stablecoin issuers also promise that their product will serve people who have been left behind in the financial system. Their interest in helping the unbanked, they always start with that. But, as we have established, crypto does not actually function as real currency in any traditional sense that Americans for decades have understood. Allowing more people to trap their money in risky, speculative investments is not the kind of financial inclusion that people seek. It is not going to do anything to help Americans working hourly jobs who do not put their paychecks in the banks because of abusive fees.

Finally, stablecoin companies say that if you hand them your money, your money will be safe. They tell us that they structure their reserves so that people's money is protected, that their businesses will weather any kind of crisis.

Now, maybe the stablecoin companies are right. Maybe we should just close our eyes and trust that a product called "Magic Internet Money" run by an outfit called "Abracadabra," that is a safe place for your money. I am not sure working Americans want to take that risk.

Remember in 2007 and '08 when the banks said homes prices would only go up and mortgages would never be underwater? Do you remember those days? Then, as now, it is workers and their families whose homes and hard-earned savings are being used as gambling chips. They are the ones always, always, always, often because of the actions of this House and Senate in this conservative-too-often Committee, they are the ones who pay the price.

I understand the appeal of crypto. Americans have been burned over and over again by Wall Street. The 2008 crisis, abusive fees, a stock market that is just detached from reality, of course, people do not trust big banks. They figure, how could putting my money in one of these new products be any worse than the scams I have seen in the banking system? Maybe they are thinking I will finally get in on the kinds of deals that have been making investment bankers wealthy for a generation.

Some of those Super Bowl ads were pretty compelling television. They make vague allusions to innovation and the future, and who could be against innovation? But we have ignored warnings like the report we are talking about too many times before. Before the crisis, Congress and regulators ignored warnings about the risky bets and the increasing leverage and over-the-counter derivatives on Wall Street. Then the banks got a bailout. Again, working people paid the price. That is why I want Congress and regulators to work together to tackle these issues now before it is too late.

I urge my colleagues to listen carefully to Under Secretary Liang's testimony and to the warnings in the PWG, the President's Working Group report. We need a strong, proactive approach from regulators and Congress to limit stablecoin risks for working Americans.

As our economy continues to recover from COVID-19, as workers finally, finally, finally are starting to see higher wages and more bargaining power in the workplace, the last thing we need is for a risky new financial product to cause disaster.

This is not the first hearing that the Banking, Housing, and Urban Affairs Committee has had on stablecoins. It will not be the last.

Ranking Member Toomey.

OPENING STATEMENT OF SENATOR PATRICK J. TOOMEY

Senator TOOMEY. Thank you, Mr. Chairman, and, Ms. Liang, welcome. Thank you for coming to the Committee. Thanks for taking the time to chat recently. I enjoyed our conversation.

It was about 2 months ago that this Committee held its first hearing on stablecoins, and I was encouraged to hear from our witnesses about the essential role that stablecoins play in the larger cryptocurrency trading ecosystem. But it also important to note the tremendous potential stablecoins have to be adopted as a common medium of exchange in the broader, ordinary goods and services economy.

Unlike cryptocurrencies that fluctuate in value, stablecoins are designed to maintain a one-to-one value relative to some reference asset, typically a fiat currency such as the U.S. dollar. Put simply, one stablecoin is meant always to be worth one dollar.

Because of this price stability, stablecoins have the potential to serve all the traditional functions of money by acting as a medium of exchange, unit of account, as well as a store of value.

Stablecoins can also improve upon traditional forms of money by increasing payment speed, especially cross-border transfers, reducing transaction costs, and helping to combat illicit finance through the creation of an immutable and transparent transaction record.

Stablecoins can also be programmed to execute payments automatically upon the occurrence of some predesignated, verifiable event. This capability in particular has the potential to transform finance and, in time, much of our economy.

Any regulatory regime for stablecoins will inevitably focus on consumer protections and systemic stability, but at least as important will be preserving the tremendous, unimagined benefits that will flow from future innovations.

As stablecoin usage has grown significantly, regulators have increasingly taken interest. Last November's report from the President's Working Group on Financial Markets, spearheaded by Ms. Liang, appropriately recommended Congress pass legislation to establish a Federal regulatory framework for stablecoins. The PWG report recommends Congress address three perceived prudential concerns: first, stablecoin runs; second, payment system risks; and third, systemic risk and concentration of economic power.

Now, the principal recommendation is that stablecoin issuance be limited to insured depository institutions. I commend the contribution of the public discussion that the PWG has contributed, but I strongly disagree with that recommendation. I think we can protect against concerns such as run risk through a less restrictive and more appropriately tailored approach.

So, to accomplish those objectives, I released a set of guiding principles for stablecoin legislation. These principles recognize that stablecoin issuers have significantly different business models than banks, and they present different risks. For example, stablecoin issuers typically neither make loans nor take deposits. They may

choose not to transform maturity or intermediate credit risk. As such, stablecoin issuers using cash or cash equivalents to back its coin is likely safer than most existing financial institutions. Because of these differences, it would be inappropriate to subject stablecoin issuers to the full range of bank regulations meant to address risks posed by the fractional reserve, deposit and lending banking system.

So I was encouraged that Ms. Liang has recognized these differences and sensibly agreed there should be regulatory flexibility for stablecoin issuers not engaged in traditional banking, but that does raise the natural question: Why require all stablecoin issuers to become insured depository institutions then?

My legislation will take a different approach. It will provide regulatory treatment that is flexible and adaptable to future technological innovation. It will also promote competition in the stablecoin market by allowing at least three types of regulated entities to issue stablecoins.

First, my legislation would preserve the regime to which the majority of stablecoin issuers are currently subject as State-registered money service businesses and money transmitters. To disrupt this regime would both introduce unnecessary burdens to an emerging technology and unwisely diminish the success of States with experience and expertise in this area. Rather than discard this regime, we should build on it to ensure the public has the right disclosures about stablecoin reserves to make an appropriately informed decision about whether to use any particular stablecoin.

Second, my legislation will clarify that insured depository institutions are actually in fact permitted to issue stablecoins. The former head of the OCC, Brian Brooks, pioneered work to give banks clarity on digital asset activities, but the current OCC has created confusion regarding permissible activities.

Finally, my approach will establish a new stablecoin charter with regulatory requirements designed specifically for stablecoin issuers. The requirements will address the risks identified by the PWG report, but will not force stablecoin issuers into a one-size-fits-all system created for traditional banks.

Ms. Liang's recent testimony indicates to me that I think she agrees with the idea of a tailored approach for such issuers. Rather than just rely on the flexibility of the existing framework for depository institutions, which leaves full discretion to bank regulators, however, I think it is the responsibility of Congress to design this approach.

So these three paths would allow each stablecoin issuer to choose the regulatory framework most appropriate for its own business model.

Now, under this legislation, each stablecoin issuer would be required to meet certain minimum requirements, regardless of its charter or license. For example, all would be required to disclose the assets that back the stablecoin. All would be required to adopt and clearly disclose redemption policies, and they would have to undergo third-party audits. These requirements would ensure that consumers have sufficient information to choose which stablecoin they use.

Ms. Liang's thoughtful comments on stablecoin regulation lead me to believe there are many issues on which we can find common ground. So I look forward to developing legislation with my Senate colleagues and working with the administration to establish a regulatory framework for stablecoins that addresses potential risks while also encouraging innovation and competition. Thank you.

Chairman CRAPO. Thank you, Ranking Member Toomey.

Today's witness, we will hear from Nellie Liang, the Under Secretary of the Treasury for Domestic Finance.

Madam Under Secretary, please proceed with your testimony. Thank you.

STATEMENT OF JEAN NELLIE LIANG, UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Ms. LIANG. Chairman Brown, Ranking Member Toomey, and other Members of the Committee, thank you for the opportunity to testify this morning on stablecoin report by the President's Working Group on Financial Markets.

The PWG is chaired by the Secretary of the Treasury and composed of the Federal Reserve Board, the SEC, and the CFTC. It was formed by a Presidential Executive Order in response to the 1987 stock market crash and regularly produces reports on financial market issues for the President, which may include recommended legislative changes. For the stablecoin report, the PWG was joined by the FDIC and the OCC.

Stablecoins are part of an emerging set of digital assets, activities, and services that could have profound implications for the U.S. financial system and economy. The distinguishing feature of stablecoins as compared to other digital assets is that they are designed to maintain a stable value relative to a reference asset, often the U.S. dollar.

Stablecoins have grown rapidly from a market capitalization of roughly \$5 billion at the start of 2020 to approximately \$175 billion today.

The PWG report focused on stablecoins because the offer of a stable value means they have the potential to be used widely as a means of payment by households, businesses, and financial firms. This potential use could create significant benefits for stablecoin users and payment transactions, but it could also pose risks.

The PWG report focused on three prudential risks associated with the use of stablecoins for payments: first, run risk, a scenario in which loss of confidence in a stablecoin triggers a wave of redemptions, which could have spillover effects for the broader financial system; second, payment risk, including operational issues that could interfere with the ability of users to store stablecoins or use them to make payments; and third, concerns related to concentration of economic power, for example, if a stablecoin provider scaled up quickly and gained market power as a provider of payment services.

The PWG report found significant gaps and authorities that would address these prudential risks. Some of the largest stablecoin issues operate with limited regulatory oversight, raising significant questions about whether their stablecoins are adequately backed. Even where a stablecoin issuer is subject to over-

sight, supervisors may not have sufficient visibility into the broader operations that support the use of stablecoins, which may be distributed across multiple entities.

Neither State money transmitter nor securities law requirements were designed to address the financial stability payment system risks for a payment instrument based on new distributed ledger technology. To fill this regulatory gap, the PWG report recommended legislation to ensure that stablecoins are subject to a consistent and comprehensive framework that is proportionate to the risks posed. Such legislation would complement existing authorities with respect to market integrity, investor and consumer protection, and illicit finance.

Specifically, the report recommended limiting issuance of stablecoins to ensure depository institutions, giving supervisors of stablecoin issuers visibility into the broader stablecoin arrangements and authority to set risk management standards for critical activities related to the use of stablecoins for payment, and certain measures to reduce concerns related to concentration of economic power.

In developing the recommendation for stablecoin issuers to be insured depository institutions, the PWG report relied upon the flexibility that banking agencies would have to adjust for differences between stablecoin issuers and traditional commercial banks and to adjust to new products and structures that may emerge over time.

As noted at the beginning of my testimony, stablecoins are a subset of the large and quickly evolving digital assets market. The Treasury Department supports responsible innovation from digital assets but is also committed to protecting against risk to users, the financial system, and the broader economy.

The Biden administration continues to work across the agencies to develop a comprehensive strategy for all digital assets with the goals of ensuring that cryptocurrency is not used for illicit finance, addressing risk related to financial stability in consumer and investor protection, and furthering financial inclusion and our continued leadership of the global financial system.

We look forward to working with Congress on these critical issues as we make progress and appreciate the Committee's leadership in this area.

Thank you for the opportunity to testify this morning. I would be happy to answer your questions.

Chairman BROWN. Thank you, Madam Under Secretary.

Stablecoins are, as we know, only a few years old. We know most Americans have never bought one. Commercials in Silicon Valley just tell us stablecoins are an innovation.

I want to be clear, though, Madam Under Secretary, about the stakes here. How important is it we act now to regulate stablecoins before they can hurt our economy? How could stablecoins hurt working families if Congress and regulators do not reign in the risks of these products?

Ms. LIANG. Thank you for your question, Senator Brown.

As I mentioned, the crypto, the digital asset market is growing very rapidly. The fundamental change is this new innovation that can allow for new provision of financial services and could radically change the way financial services are provided. This provides a lot

of benefits, could bring efficiencies, especially to the payment system when we are speaking of cryptocurrencies.

It also raises some of the concerns, of course, that you raised earlier on illicit finance, tax evasion, and fraud. So it is important to address those issues.

My view is, given these risks and the growth of the market, it is for our regulators and policymakers to take some actions to protect users and ensure the resilience of the financial system.

Stablecoins are a subset of this digital asset space. The prospect of stable value gives them the potential to be used for payment transactions, a store value, a medium of exchange. That raises a different set of risks. They have the ability to provide payments on 24/7, to reduce the costs of payments in a substantive way. I think it has the potential to be part of the future payment system.

So I think it is important to assess the stability of stablecoins. Are they stable? Can they provide the services that they offer themselves to? The Secretary of the Treasury convened the PWG to evaluate whether they can be stable and to address whether this new product has an adequate regulatory framework, and the PWG report recommended that there should be additional authorities provided to regulators for this product.

Chairman BROWN. Thank you.

The stablecoin companies assure us they are transparent. They tell us they follow the law. They even say they like to say they are built on trust, but of course, they say that. They want to suggest if you buy stablecoins with dollars, your dollars will be safe, that you will be able to exchange stablecoins back for dollars without a problem.

Madam Under Secretary, is there any risk that people with stablecoins will not always be able to exchange stablecoins for dollars? If so, do these companies make that clear to consumers?

Ms. LIANG. There is risk that stablecoins cannot deliver a dollar. This is the—they ought—they say they are stablecoins. The assets backing the stablecoins may not be able to deliver a dollar under stress periods, and in fact, if you look at stablecoins, they do fluctuate.

In addition, there are issues around redemption as well as there could be fees that may not be disclosed. So I do think there are features of stablecoins that create run risk, which is the first risk that the PWG report identified.

Chairman BROWN. Are those companies informing potential purchasers of stablecoin that there is that risk?

Ms. LIANG. They are not required to by any regulators because they are not regulated.

Chairman BROWN. I understand that, but are they doing that, in your experience?

Ms. LIANG. So there are probably 50 or 60 different stablecoins at this point in time. I imagine the practices vary quite a bit.

Chairman BROWN. I think it is more worth knowing that the answer to that are most of them. If there are 50 or 60, do they disclose the risk at all? I am not asking right now—I am asking right now, but I think it is something important to know.

Last question. For a long time in this country, we have prevented commercial companies from partnering with financial companies. In some ways, we built a wall between the two.

There have been reports that companies like Walmart think about issuing a stablecoin. Is anything right now stopping Amazon or Walmart or another big company from starting their own stablecoin, and if so, what are the risks if they do that?

Ms. LIANG. So, currently, I do not believe—because stablecoin issues are licensed by State money transmitter responsibilities, there is nothing that stops a commercial company from wanting to issue a stablecoin.

The PWG proposal for an IDI for the issuer would preclude a commercial company from being an issuer. The PWG recommendations also are to consider whether—for Congress to consider whether the custodial wallet providers or other service providers related to the stablecoin arrangement could be commercial or should be limited to financial, but this is an issue that Congress—the separation of banking and commerce has been a long—has been an issue that Congress has grappled with over many times in different periods, and this is another area where it should issue—it is an area for them to consider carefully.

Chairman BROWN. Thank you, Madam Under Secretary.

Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman.

Ms. Liang, so, as I said, I appreciate the work that the PWG has done. I disagree with some of the conclusions, but it was a constructive addition to this ongoing public discussion.

One of my criticisms is I do not think that the PWG report took sufficient account of the existing state-based regulatory framework, and as you just pointed out, stablecoin issuers do operate as State-based money transmitters, also trust companies. And it occurs to me that a stablecoin issued by a trust company, if it is backed solely by cash and cash equivalents, could very well be safer than many existing financial institutions, including many banks.

It seems that it would be sensible for a trust company that issued such a safe, fully backed stablecoin ought to be subject to a different regulatory regime than a traditional bank because its business model is so different.

So my question for you, if Congress were to authorize a well-defined charter that was specific to stablecoins for, let us say, this type of institution, a trust company that issues a stablecoin fully backed, do you think that that could be designed in a manner that is consistent with safety and soundness?

Ms. LIANG. Thank you for the question.

So I believe that the regulation for stablecoin should be flexible, should reflect the risks of the stablecoin activity, and stablecoin issuers that issue only stablecoins do not extend credit, should not need to be subject to the sort of full set of banking regulations that relate to credit provision. So flexibility, I agree, is very important.

The trust charters—and this may vary across States—are designed more for—have been developed for fiduciary responsibilities. They may not be as currently structured, have the authority to reach in and see how the whole stablecoin arrangement that is needed to be a payment service is conducted, and so I think, as we

have talked to State supervisors—and we have learned a lot from the experience they are building—they have less insight into the overall arrangement than at times they might like.

Senator TOOMEY. Yeah. And I guess that goes to the point that I was trying to make. I am not suggesting that the existing State-based regime is perfect and we are finished and there is no work to be done here, but I am suggesting that it might serve as a part of a regulatory framework, an option that would be available, with the overlay that would address some of the concerns that you just raised.

Now, I appreciate you just, once again, reiterated a point that I think you have made before that the full set of bank regulations really should not need to apply if the issuer is not engaged in the full range of traditional banking. I think that is a really important distinction.

And I think one of the things that we ought to consider is creating—some people call it “narrow bank,” you know, a narrowly defined charter that would be well suited for stablecoin issuers. Do you think a narrow bank could be consistent with the goals of the PWG report?

Ms. LIANG. On a specific type of charter, I guess I could be more comfortable with the issues it is trying to address. So I think staying flexible within an IDI framework, which I believe is flexible, to better match the activities and risks with the regulation, it does not need—the PWG report did not necessarily recommend deposit insurance, for example. So that would be consistent with a narrow bank, but it did require—it would like financial firms to be issuers. And for other parts of the stablecoin arrangement, it could be commercial, but that would be something for Congress to consider.

So I think in terms of a narrow bank, that can be defined separately. I think it is within the IDI charter with lots of flexibility to match the risks of the activities.

Senator TOOMEY. So where I think there is common ground here is a recognition that we both have that the nature of stablecoins and their issuers is very distinct from traditional banking, and therefore, a different regulatory approach makes sense.

Where we might have—I am not sure, but we might have somewhat different views is how clearly Congress should prescribe what that looks like. My own preference is not—I acknowledge there is a lot of regulatory discretion. I do not think that is the optimal way to proceed. I think it is better for Congress to provide some guide points.

I want to make one last point, and I see I am out of time. This is not a criticism of you. This is not an observation about Ms. Liang at all, but it is a general observation that Congress and regulators should remember our mission is not to make it impossible for a financial institution to fail. It is not to make it impossible for an investor to lose money. It is, in my view, to ensure that investors are well informed about the risks that they choose to take and to make sure that if there is a financial institution that fails, it does not have catastrophic, systemic consequences. I hope we will keep that in mind as we go down this road.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Toomey.

Senator Menendez from New Jersey is recognized from his office, I believe.

[No response.]

Chairman BROWN. Senator Warner is recognized from Virginia from his office.

[No response.]

Senator WARNER. Thank you, Mr. Chairman. You got me a little bit quicker there.

Chairman BROWN. Sorry. Let me just allow a second or two.

Senator WARNER. I appreciate again you having this hearing, Mr. Chairman. This is an issue I think we all need to learn a little more about.

I have got a twofold question. One is I want to reiterate. I think maybe you and the Ranking Member already raised this. Can we check on a real-time basis that there is sufficient backing on these stablecoins? And let us assume for a moment there is, but I would like to get a reiteration of that from the Under Secretary.

But the bigger question I had is, assuming there is this backing and you have got, in a sense, potentially billions and billions of assets having that one-to-one backing, how is there a viable business model here for these stablecoins unless they are charging exorbitant amount of fees and other add-on costs?

I know the idea behind oftentimes stablecoins is that there is less friction. You can transfer these resources from dollars here to currencies that may be unstable in second- and third-world Nations, but still, if you have got a one-to-one backing and that kind of capital basically set aside, other than large transaction fees, how do these entities make any money? Under Secretary Liang?

Ms. LIANG. Sure. Thank you for your question.

So, in terms of real-time backing, some of the—

Senator WARNER. I have got no volume, Mr. Chairman, here. I do not hear the—

Ms. LIANG. Yeah. I seemed to have lost the camera.

Senator WARNER. All right.

Ms. LIANG. I am not sure if you can hear me. Some stablecoins do provide audits of their assets and post them. They are not—there are no regulations, and there is no regulator to confirm those statements.

In terms of the stablecoin business model, it strikes me as there is probably several, and they probably vary. One is the backing for the stablecoin of a dollar. Those assets could be invested in, say, longer-term securities, even safe securities, and there would be some spread. But I think as you point out, certainly, there are fees that are charged to help to provide some revenue.

It is an area that is changing very rapidly. New products are being introduced every day. So I think the business model will evolve over time.

Senator WARNER. Madam Under Secretary, one thing I had reported to me from an expert in this field is if we look at these tokens on a bigger basis, not just in terms of stablecoins, we have got about 7,000 publicly traded stocks in this country with the attendant regulations that are in place. If you look at the crypto exchanges, there are about 17,000 tokens that are being traded on

these crypto exchanges with, again, varying levels of backing, many of them not even claiming to be stablecoins.

An area that I know the Ranking Member and I have discussed—and we have got some legislation to make sure that people are not unfairly penalized, but in the world of DeFi, decentralized finance, there have been estimates. And I do not think there is an accurate number yet, but there could be upwards, literally, of a million different coins or different tokens out in that field, all of them potentially moving to some of these cryptocurrency exchanges. Should we be concerned about this and the lack of transparency and the volume simply of these items that are being traded?

Ms. LIANG. Yeah. So I think what you are referring to is the rapid increase in the digital assets market and new products and new services that are being provided, and there are concerns about lack of transparency, fraud, potential for manipulation, misleading advertising. Those are areas that are of great concern to regulators and believe that there needs to be important investor and consumer protections put in place for that, and that is an area that SEC and the CFTC are working actively in that space.

Stablecoins, just again to emphasize, are a subset, a small subset of that smaller space of digital assets, and they purport to have stable value. Their prices are not nearly as volatile as the prices of digital assets more broadly, but it is because of that promise of stable value, they become the possibility used for payments on a wide basis in the non-crypto world. So, in that sense, it raises a whole different set of risks, these potential risks that the PWG report highlighted: the run risk, the payment system risk, and concentration of economic power.

Senator WARNER. Well, Mr. Chairman, I appreciate you holding the hearing, and I think there is great potential in digital assets, but, boy, I think we have got a lot of education to go on.

Thank you.

Chairman BROWN. Senator Rounds from South Dakota is recognized.

Senator ROUNDS. Thank you, Mr. Chairman, and I think this is an excellent time to have this particular hearing as well.

Under Secretary Liang, I am just curious. In South Dakota, we have a number of different licensed cryptocustodians. They have been licensed through the State of South Dakota and, in some cases, federally.

Just to give you an example, we have Anchorage. This company received their charter from South Dakota Division of Banking in July of 2019. Anchorage Trust Company received its OCC charter in early 2021, becoming the first federally charter digital asset bank in history, and although a bank, it does not offer deposit or lending services.

BitGo. In September of 2018, BitGo was approved by the South Dakota Division of Banking to act as a qualified custodian for digital assets and created the BitGo trust company, Kingdom Trust. Kingdom Trust serves as an independent qualified custodian for the assets of clients of registered investment advisors, broker-dealers, and investment sponsors, as well as their individual retirement accounts, nonqualified plans, and qualified defined contribution

401(k) plans. Kingdom Trust platform was the first to allow self-directed retirement accounts holding digital currency investments directly.

Now, in each of these cases, these are custodians. They do not issue a stablecoin, but they act as a custodian for digital assets. Stablecoins, as you indicated, were just a small part of what could be used out there in terms of different cryptos—or cryptocurrencies.

I am just curious. I think that stablecoins definitely have a future, and I am concerned that if we do not put in appropriate but measured regulatory—a system in place here that we may very well fall behind other Nations that do. If we want to continue to be the reserve currency of choice, I think we have to allow options for very efficient ways in which to make payments.

I think stablecoins can fit into that. If they are a viable payment mechanism, then it means that a regulatory environment that promotes that. And just the fact that all of these have occurred in just the last few years means that there is probably a lot more innovation to come in the future, and we most certainly do not want that innovation to be unnecessarily stymied by a one-size-fits-all regulatory environment here in the United States.

Do you believe—after your review, do you believe that stablecoins have this capability of assisting and competing on an international basis if we put in a limited regulatory environment here in the United States?

Ms. LIANG. Thank you, Senator Rounds.

So the PWG recommendations were designed to promote innovation that is responsible and protects users and the economy at the same time while addressing some of the risks that it can pose as stablecoins is used for payments, so agree with the principles and believe that a stable stablecoin would go far in preserving the global reserve currency. The dollar is the global reserve currency. I think there is no conflict there. I think it is actually important.

It is part of, in my view, the future of the payment system. It serves a purpose. It may not be the only payment mechanism or the only payment option, but it could be an important part.

Senator ROUNDS. Thank you.

Can the development of both a central bank digital currency and private stablecoins coexist?

Ms. LIANG. I see no reason why they could not coexist.

Senator ROUNDS. In looking at the report in its entirety, where do you believe that the regulatory framework should exist after reviewing it? Where should it exist within the Federal Government?

Ms. LIANG. So the PWG report came down on the view that a consistent, less fragmented regulatory framework is preferable to one that is inconsistent, that less fragmentation will spur innovation more than a very fragment system.

When we reached out when developing the report, we were hearing from firms, developers that they would like more regulatory clarity. Currently, States do issue charters. They are learning a lot from this experience, but they do differ across States. State money transmitter licenses are across 49 different States. They vary quite a bit in terms of what they cover. They usually address consumer protection, but they are not designed for modern payment systems.

The PWG came out on the side of a less fragmented, more consistent, more comprehensive framework.

Senator ROUNDS. My time has expired. Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Rounds.

Senator Menendez, I believe, is now with us from New Jersey from his office.

Senator MENENDEZ. Thank you, Mr. Chairman.

The defining feature of stablecoins versus other types of cryptocurrencies is that they claim to be backed by reference assets such as the dollar and other currency. However, without proper transparency, this only provides the illusion of stability for stablecoin investors.

Madam Under Secretary, are market participants able to verify the portfolio of holdings backing what stablecoins they invest in?

Ms. LIANG. Stablecoin issuers, perhaps under pressure from investors and regulators, are providing self-audited statements. Some of the major ones are providing self-audited statements on their holdings, but regulators are not in place to confirm those or to set the standards for them.

Senator MENENDEZ. Well, I look at Tether, which is the world's largest stablecoin, which was created with a promise of a one-to-one backing with the dollar, and instead, a reporting from Bloomberg found that many Tether stablecoins are backed by risky loans to Chinese real estate companies.

So it seems to me that transparency is a cornerstone of our economy. Consumers and investors make the best decisions when they have the necessary information, and that is why I have always advocated for robust disclosure rules in different areas of the financial system.

How does the Treasury intend to—do you propose to increase transparency to ensure market participants properly disclose the value of the assets backing stablecoins so that investors can have a true understanding of the risks associated with such assets?

Ms. LIANG. Yes. The PWG report would—is in favor of transparency of the assets. I think that is an important element in reducing run risk.

I would highlight—I would mention, however, that transparency and disclosure are not sufficient to address run risk, that there still needs to be a certain about the backing and the ability to actually deliver to an investor if they redeem their stablecoin. So it probably requires more than disclosure and transparency.

Senator MENENDEZ. OK. I am for that.

As stablecoins become more broadly used both as a payment method and as an investment vehicle, Congress and the financial regulators need to address their more illicit uses, including money laundering, fraud, and sanctions evasion.

As the working group noted in its report, criminals often use the most common and liquid forms of value. So stablecoins could be a particularly attractive vehicle for money laundering and terrorist financing. And that report also noted that effective international implementations of AML standards is critical.

So the Financial Action Task Force published updated guidance on virtual currencies in October. What is your understanding of the

level of effective implementation by our global partners? Who is doing well, and who is not?

Ms. LIANG. Yeah. The illicit finance issues are of serious concern to Treasury. Treasury has been leading the work in the Financial Action Task Force, as you mentioned. They issued a report. They are continuing to work on this.

As I understand, implementation of standards is not even across jurisdictions. There are concerns about lack of implementation, consistency in some, and they are working on that, those issues specifically.

I think, certainly, my colleagues in FinCEN would be happy to follow up with you if you had additional questions.

Senator MENENDEZ. Well, I would like to.

What are Treasury's priorities over the next 6 months with reference to increase that implementation?

Ms. LIANG. So, as I mentioned, they are leading the Financial Action Task Force and focus specifically on implementation, especially exchanges that are operating in some foreign jurisdictions.

I would mention the broader administration effort on digital assets is ongoing, and I understand there will be some more details announced in the next few weeks. So that can also provide some additional information, and again, we would be happy to follow up with you on that.

Senator MENENDEZ. Well, let me close by saying, you know, as Chairman of the Foreign Relations Committee, I am particularly concerned that countries like Venezuela, Russia, Iran will continue to use digital currencies to evade sanctions, which would weaken one of our most effective policy tools in terms of foreign policy. The anonymity touted as a major benefit of stablecoins and other cryptocurrencies is inherently very useful for facilitating all kinds of illegal activity, and it is imperative that Treasury prioritize achieving concrete progress on this issue in the near term as the technology becomes a key part of the financial system. And we look forward to working with you on that.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Menendez.

Senator Hagerty of Tennessee is recognized.

Senator HAGERTY. Chairman Brown, thank you, and Ranking Member Toomey. I appreciate you holding this hearing.

Before I get to questions, I would just like to reflect the fact that I also serve on the Foreign Relations Committee with Senator Menendez, and I share the concerns that he raised in terms of illicit activity, and I very much appreciate the ongoing work and your keeping us posted as to how you address that.

At the same time that many of us are concerned about illicit activity, though, we see great promise in this industry, and some of the comments that you mentioned have raised some concerns with me, your interchange with Senator Rounds, for example, talking about how the President's Working Group report has interpreted integrating States' rights and States' regulatory authorities in the grand scheme of things.

I have approved of the innovation that occurs at a State level, and I would be very interested in your view on how you would in-

tend to incorporate State perspectives, or is this going to be a heavy-handed, one-size-fits-all approach?

Ms. LIANG. So I think the recommendations of the PWG report are building on the State frameworks that currently exist. The first recommendation that stablecoin issuers be an IDI, an insured depository institution, given the flexibility within that framework is still that the IDI can be a State or Federal charter.

Senator HAGERTY. Mm-hmm.

Ms. LIANG. Second, it is building on the State money transmitter licenses. It was not a recommendation to replace. I do think some of the State money transmitter licenses requirements probably need to be updated for digital assets, for example, and they were not designed for the kind of new emerging modern payment system. But it would—the recommendation is that you be able to require some higher risk management standards but not to replace the existing framework.

Senator HAGERTY. I appreciate your desire not to replace it.

I hail from Tennessee. We have a wonderful State system there and I think one that is agile and capable of incorporating recommendations but, at the same time, solving in an agile way for new innovation. So I encourage that you continue to incorporate the State's perspective.

I would also like to touch on another notion that you discussed with Senator Menendez regarding the risk of runs on a given stablecoin, and here, just on a theoretical level, would a fully reserve stablecoin pose a substantial risk of experiencing a run, or would that risk be higher or lower than, say, a fractional reserve bank, the risk of a run on a fractional reserve bank?

Ms. LIANG. The fractional reserve bank is backed by either deposit insurance or lender of last resort, discount window facilities that can—with regulation of the assets and the fractional reserve can prevent runs.

Fully reserved, for example, a money market fund fully reserves, 100 percent, high-quality assets have limited reserve—run, but for payment—so the difference between stablecoin and, say, a money market fund is that a money market fund, in my view, is purchased for the purpose of earning yield. You purchase a stablecoin to be able to use it as a payment mechanism. So they are slightly different. So I think the redemption features will distinguish a stablecoin from, say, a money market fund, a Government money market fund.

Senator HAGERTY. I think as we look at this, we should be just particularly careful to accommodate the great potential that this shows, to recognize that we want to keep America a competitive market, that that is the interest of our economy security.

We also need to take our national security interest into account, but I hope that we do so in a way that it continues to make America a desired jurisdiction to do this, rather than pushing this activity, which is very jurisdictionally movable. We would rather do it here than push it to another market where we would have much less control and visibility on it.

Ms. LIANG. So I would agree with your comment. Stablecoins that are stable, stablecoins that are tied to the U.S. dollar that are

stable, I think, would be an important component of preserving a global reserve currency.

Senator HAGERTY. Yeah. I think we should work together to make certain that our vital concerns, our vital national security concerns are addressed as we try to make this market the leader, and I think we have every potential to do so. We have great innovators here, but I have had some very disturbing conversations with those in the industry about trying to decide which jurisdiction is going to be best. And I think the work that you are undertaking to provide clarity, again, incorporating States' perspectives, we can do that. We can take the lead, but I also would underscore the times of the essence here because these markets are highly competitive.

Ms. LIANG. Yes.

Senator HAGERTY. And a tremendous amount of capital is moving around the globe right now trying to search for a reason there.

I would like to turn my ability for just a minute, my last question, regarding the FSOC's ability to address designating financial market utilities as systemically important under Title VIII of the Dodd-Frank Act. If you were to take this market and address the utilities here as systematically important—the stablecoin market is much smaller than many of the systemically important financial market utilities—how would you go about making this determination, and would this be the first time that such a designation has been made under Title VIII?

Ms. LIANG. Yes. The short answer to your question about Title VIII for this would be yes under the payment clearing settlement, but FSOC—

Senator HAGERTY. It would be the first?

Ms. LIANG. Yeah. The council has a responsibility to look for and identify risks to financial stability. It has been focused on digital assets more broadly and looking, for example, especially at whether the extent to which leverage may be raising the value of the prices of crypto assets.

On stablecoin, I think it is a little early to prejudge how they could use their authorities. They certainly have a responsibility to think about how to use their authorities, but it is new. And it would require—it would depend on the facts and circumstances of the case.

Senator HAGERTY. I am running out of time, but I would just encourage you to keep in close contact with us because, again, I want to maintain—

Ms. LIANG. Yes.

Senator HAGERTY. —a competitive market here—

Ms. LIANG. Yes.

Senator HAGERTY. —rather than put such heavy-handed regulatory perspective on this that we are going to shove this to another jurisdiction.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator.

Senator Warren from Massachusetts is recognized.

Senator WARREN. Thank you, Mr. Chairman.

And before I start, I just want to echo the Chairman in stressing the importance of voting on our Federal Reserve nominees this

afternoon. This is our job, and we should not be playing games in order to delay this. So I hope we can get that vote done today.

I want to talk about the cryptocurrencies here. Some cryptocurrencies like bitcoin are not backed by anything but hype, but stablecoins are different. They claim to be pegged to a fixed asset like the dollar. One stablecoin is supposedly backed up by one dollar or a dollar equivalent. Even though boosters claim that stablecoins represent the future of the payment system, they are not really being used to pay for real-world goods and services.

Even so, stablecoins have taken off. Their market cap is now 35 times bigger than it was just 2 years ago, and instead of being used to pay for goods and services, those billions of dollars worth of stablecoins are used to lubricate speculation in the shadiest part of the crypto ecosystem where people are lending, trading, and leveraging with no laws and no sheriff anywhere.

The President's Working Group on Financial Markets recently identified a long list of risks posed by stablecoins: run risk, payment system risk, concentrated economic power, illicit finance, investor protection. Or to state that in slightly less fancy terms, it found that stablecoins run the risk of helping cheaters steal people's money; financing terrorism, cyberattack ransoms, and the drug trade; causing a run on the financial system, like we saw in 2008; and allowing big stablecoin users to dominate market and harm consumers.

Now, Secretary Liang, do you agree that these kinds of risks mean that stablecoins are not just an emerging threat to our financial system but a threat that could become systemic if this market continues to grow rapidly?

Ms. LIANG. So, Senator Warren, thank you for the question.

So I do think there is some urgency to considering stablecoins and applying the appropriate regulations to reduce run risk and the potential for them to scale up quickly.

Senator WARREN. Let me remind you what my question is: Do they pose the threat of becoming a systemic risk?

Ms. LIANG. Of becoming a systemic risk, yes.

Senator WARREN. Yes, they do. I agree that the stablecoin market poses significant risk and that Congress and our regulators need to contain these risks.

And that is where you come in. You advise the Financial Stability Oversight Council, FSOC, and you sometimes sit in these meetings as Secretary Yellen's substitute. FSOC's job, according to Treasury's website, is, quote, "identifying emerging threats to financial stability and coordinate regulatory actions to address them," end quote.

So, Under Secretary Liang, if you believe that stablecoins are a serious emerging threat to our financial system, then have you advised FSOC to use the tools that Congress gave it specifically to mitigate threats before they get out of hand?

Ms. LIANG. So FSOC, as you say, has the responsibility to identify risk to financial stability. It is discussing these issues. It does convene the regulators. They have been discussing consumer protection and investor protection, illicit finance, and taking steps to assess what risks and what authorities regulators have.

The PWG was recommended, which is a subset of the FSOC, with most tangible interests to assess whether there are existing regulatory gaps, however, in assessing to address the risks of stablecoins as a use for payments and identified some gaps and made some recommendations.

Senator WARREN. So you are moving at least in that direction? Is that what you are telling me? I want to make sure I just understand your technology here today.

Ms. LIANG. Yes. The PWG is making recommendations, and the complement the existing authorities that regulators have—the SEC, the CFTC—and the banking regulators are issuing guidance carefully about how banks—

Senator WARREN. Well, I understand about the other regulators. I am asking about FSOC—

Ms. LIANG. Mm-hmm.

Senator WARREN. —because I do not want monitoring to be a way to just avoid doing your job.

In your testimony before the House Financial Services last week, you suggested that FSOC should not and would not act ahead of Congress. That is something the crypto industry might find comforting, but it is not consistent with FSOC's mission. Did you misstate something last week?

Ms. LIANG. So I—what I intend to say—intended to say—I did see that—is FSOC has the responsibility to look at the tools it has—

Senator WARREN. Well, not just to look—

Ms. LIANG. —and whether it—

Senator WARREN. —but to use.

Ms. LIANG. —they can apply, and the situation is developing very quickly. And so how different tools would apply, it is a big difficult to prejudge how they would be used, but I would—

Senator WARREN. OK. But you are willing to use them ahead of Congress?

Ms. LIANG. If that is the case and it is assessed that they are a systemic risk that needs to be addressed, and I—

Senator WARREN. Well, not that they are a systemic risk. Remember what it says on the website: before that risk has reached fruition.

You know, I worry that you are approaching the cryptomarket with blinders on. You talk a lot about the benefits of the stablecoins, benefits that have been promised for years and that have still not materialized, and all the while, you are not talking about the risks that are flashing bright red in our faces here.

Congress needs to put guardrails around crypto, and I am writing a bill to do just that. But there is no reason to delay. Pointing a finger at Congress does not give you or FSOC the right to ignore your current statutory responsibilities.

Thank you. I apologize for running over, Mr. Chairman.

Chairman BROWN. Senator Lummis from Wyoming is recognized from her office.

Senator LUMMIS. Well, thank you, Mr. Chairman, and, Under Secretary Liang, thank you for appearing here today.

I want to follow on the line of questioning that Senator Hagerty had begun a few minutes go and ask about the recommendation in

the President's Working Group report on stablecoin issuers that it should only be limited to insured depository institutions.

With respect to the insurance requirement, is it the case that the FDIC and NCUA have found that stablecoins and their assets are insurable, and have these agencies committed to provide deposit insurance to newly chartered, de novo institutions that issue a stablecoin?

Ms. LIANG. Thank you for that question, Senator Lummis.

The proposal for stablecoin issuers to be insured depository institutions, given the flexibility of that supervisory and regulatory regime, is not—does not necessarily mean that stablecoin need deposit insurance. I think that would depend on the circumstances of the backing and the functionality of the stablecoin that is being provided. So the proposal is not, and the PWG did not recommend necessarily that stablecoins be backed by deposit insurance.

Senator LUMMIS. And what other types of backings would you believe adequately protects the consumer?

Ms. LIANG. So I think the consumers can be protected with reserve assets that are truly high quality, that will provide some—reduce the risk of runs by investors.

There is also the protections provided by oversight of the—all the entities that go into providing supporting stablecoin as a payment. So the custodial wallets, the custody, the other ways of trans—of liquidation of the redemption of the stablecoin that can be provided. So I think all those go into protecting consumers when they want to use stablecoin for payments.

Senator LUMMIS. So since there are alternative ways of bringing stablecoins inside the banking perimeter, like 100 percent reserve bank with tailored holding company supervision, is that something you discussed and are willing to consider?

Ms. LIANG. Yes. I think bringing stablecoins into an IDI framework that is adjusted for the risks of the stablecoin issuer, which would include solid backing of the stablecoin, one for one, would certainly be an option.

Senator LUMMIS. Well, I am so pleased to hear that that is your approach, because without it, I think the type of competition that Senator Hagerty wants to protect would be at risk if someone already has deposit insurance and can issue a stablecoin like JPMorgan's JPM coin. That would seem to limit competition in that marketplace to only the very, very largest banks in our country, and there may be other options that other institutions could explore. And it sounds like you are willing to discuss that with them.

So I am going to conclude with a different question: Does Treasury have a timeline for issuance of the guidance on the definition of broker for digital assets under the infrastructure bill? I know we were promised some public guidance on this a few months ago, and we have yet to see it.

Ms. LIANG. I know Treasury is working very actively on that. The principle of the tax provisions is, you know, for those who owe taxes should pay their taxes. It is not designed to crimp the activities of crypto assets.

Senator LUMMIS. Well, I am also very pleased to hear that because some of the provisions in the definition, as you know, in-

cluded people who would not know the ultimate customer of a digital asset, the ultimate customer being the one who owes the taxes as opposed to the inventor of the software or the hardware.

So thanks very much. We look forward to that guidance coming out as soon as possible and appreciate, again, your testimony today.

Mr. Chairman, I yield back.

Chairman BROWN. Thank you, Senator Lummis.

Senator Van Hollen of Maryland is recognized.

Senator VAN HOLLEN. Thank you, Mr. Chairman and Ranking Member Toomey.

I know there is some discussion about moving forward on the vote on the Fed nominations today. I hope we will move forward on all five this afternoon.

Ms. Liang, I have been monitoring some of the testimony. Welcome. And we do want to encourage innovation. I suppose that, but we also want to make sure that we protect consumers. You would agree?

Ms. LIANG. Absolutely.

Senator VAN HOLLEN. And I do want to focus on some of the things that could happen when things go wrong, where there are protections under our existing financial arrangements that do not apply to stablecoins, even though stablecoins are intended to be tied to a stable base.

As you know, when it comes to the deposits in banks, we have the Federal Deposit Insurance Act that makes sure that consumers are protected up to some amount of their deposits, right? Is there any protection if the stablecoin issuer was to go belly up for consumers?

Ms. LIANG. There currently—the protection would be provided by the quality of the assets that are held in reserve against the stablecoin, but there is not deposit insurance. But it would be—

Senator VAN HOLLEN. But are they—let me ask you this, then.

Ms. LIANG. But they are not regulated.

Senator VAN HOLLEN. Are there any standards with respect to—

Ms. LIANG. There are no standards.

Senator VAN HOLLEN. —what the reserves have to be?

Ms. LIANG. No. There are no standards at this point.

Senator VAN HOLLEN. Right. So, currently, if the issuer were to go belly up, in other words, if they were to go out of business and they did not have reserves to cover the deposits, the depositors—the holders of stablecoin would just be out of luck, right?

Ms. LIANG. That is correct.

Senator VAN HOLLEN. OK. There are also protections that apply to consumers when it comes to transactions and things like credit cards or debit cards, right?

Ms. LIANG. Yes.

Senator VAN HOLLEN. And for example, if there are payment errors, fraud, or unauthorized transactions, then consumers have existing protections when they are dealing with credit cards or debit cards, right?

Ms. LIANG. Correct.

Senator VAN HOLLEN. And when it comes to stablecoins, if there is some error, if there is some kind of fraud or unauthorized transaction or a hacking, are there any protections for the consumers of stablecoins?

Ms. LIANG. So stablecoins are licensed under State money transmitter regimes, and there are consumer protection laws in those. They vary by State. They may apply to stablecoins. In some States, they may not.

Senator VAN HOLLEN. So right now, it is hit or miss, depending on whether you are in a State that provides some protection and the extent of that protection. Is that right?

Ms. LIANG. As I understand it, yes.

Senator VAN HOLLEN. So just to pick up on the question from Senator Warren, in terms of the work group, the Presidential work group that was put together, clearly, you identified some of the risks that we are talking about right now. Is that correct?

Ms. LIANG. Correct.

Senator VAN HOLLEN. And do you believe that the executive branch currently has the authority to move forward to protect consumers, for example, in the two areas that I mentioned, right? With respect to some kind of stablecoin equivalent of depository insurance or national rules that protect consumers from errors or fraud, do you believe that the administration, the executive branch, has the authority to regulate in that area, or is that an area that would require legislation?

Ms. LIANG. I believe that is an area that would require legislation, that the risk of runs and the risk of payment system disruptions, including protections to consumers, is a gap in the current regulatory system.

Senator VAN HOLLEN. And in response to Senator Warren, you indicated that there may be some areas where FSOC could move. If not these areas, can you describe some of the areas where you think you may have the authority to move at the executive branch level?

Ms. LIANG. Yeah. I do not—I think each—you know, each agency will take actions consistent with their mandates, but it is not sufficient for the gap, for the risks of runs and payment system.

FSOC has some tools, but it is not a substitute. It would not provide a consistent, comprehensive framework. It could address particular risks as they arose, depending on the facts that circumstances, but it is not a comprehensive, consistent framework that legislation could provide.

Senator VAN HOLLEN. And I hope you will work with those of us on this Committee who are interested in providing that kind of consumer protection regime and standards in this area.

Ms. LIANG. Absolutely. We would be very happy to work on it.

Senator VAN HOLLEN. Thank you.

Thank you, Mr. Chairman.

Chairman BROWN. Thanks, Senator Van Hollen.

Senator Daines from Montana is recognized.

Senator DAINES. Chairman Brown, thank you.

As I said in our previous hearing on stablecoins, I think it was about 2 months ago, I do believe the stablecoin policy is an area where there should be, there can be, hopefully there will be some

broad bipartisan agreement and compromise. I do believe that we should pursue a light-touch approach to regulation.

But I also believe a bipartisan legislative framework on stablecoins is possible and I do believe necessary. Bipartisan legislation will also help provide users as well as market participants with the certainty they need to let innovation flourish without fear that regulators will overreach using authority in existing statutes that in no way contemplated the emergency of stablecoins.

I would urge my colleagues to avoid any partisan solution and instead seek consensus on truly something that is bipartisan. There is a moment here that we need to seize.

It would provide certainty needed for private industry to grow as well as to prosper. I think this will help provide the best pathway for this technology to grow in a way that benefits the folks back home in Montana, all Americans, and the global financial system.

Furthering the use of stablecoins would help to increase the speed of payments and lower cost in the financial system, and I believe these are results we should all agree are worth pursuing.

I turn to my questions. Under Secretary Liang, absent legislation from Congress, can you provide us a sense as to which Federal agencies would be most likely to issue regulations relating to stablecoins and on which statutes they would derive their authority?

Ms. LIANG. So, Senator Daines, thank you for the question.

I would need to defer to the individual agencies as to what—how they would interpret their authorities and their strategies.

I would say, currently, the SEC and CFTC are approaching crypto assets more broadly to prevent fraud, to prevent manipulation, to protect investors and consumers.

The banking agencies are taking actions to—are taking—issuing guidance to advise banks about their activities in crypto, but currently, I do not think there is the authority for any agency to address the risks of stablecoins, to prevent runs, and to prevent disruptions in the payment system should stablecoins be used widely as payments.

Senator DAINES. So I think hearing you answer that question, it leads me to follow up in terms of your thoughts around the need for adopting a clear regulatory framework that would be established through bipartisan legislation. Might that be a catalyst for a more widespread adoption of digital assets?

Ms. LIANG. I think a consistent comprehensive framework could be a catalyst for innovation as well. I think developers need clarity on how they can operate, how they can develop their business that will be viewed as permissible in the marketplace, to serve customers, to protect customers as well as to provide a product that they think can deliver faster payment—faster payments, cheaper payments. So I do think more regulatory clarity can actually promote innovation.

Senator DAINES. And I think why we need bipartisanship here and, in my opinion, a lighter touch is we have an opportunity where we could actually put the right kind of framework in place that could accelerate innovation.

Ms. LIANG. Mm-hmm.

Senator DAINES. The wrong framework and, in my opinion, too much of a heavy hand could certainly stifle innovation. So this is a moment we could actually accelerate it, I believe, with the right regulatory framework.

Ms. LIANG. Yes, I agree. And we are seeing stablecoin issuers pursuing bank-like charters and talking to the banking regulators. So they do believe that this is an area—this is a path, possible path forward.

Senator DAINES. And anytime we look at a situation like this, an issue like this, I always come back to the question of global competitiveness, what this means certainly around the world. If the U.S. does not clearly define this landscape, would it be unreasonable to expect a large portion of this activity to perhaps migrate overseas to countries with more favorable and clear regulatory structures?

Ms. LIANG. I think businesses would tend to migrate where regulations are more clear. I would absolutely agree with that.

There is an incentive to want to tie to the value of the dollar because the dollar is the global reserve currency, and so I think there is a pull from the strong dollar and all that stands behind a strong U.S. dollar. Technology can help that, but the dollar itself is—you know, the value of the global status of the dollar is supported by the rule of law and the governance of the country and the economic potential. But the technology will want to—you know, is incentivized to move to be backed by the dollar because of that, and it will help it, I think, if we can provide a good framework.

Senator DAINES. Thank you.

Chairman BROWN. Thank you, Senator Daines.

Senator Cortez Masto from Nevada is recognized from her office.

Senator CORTEZ MASTO. Thank you, Mr. Chair.

Under Secretary, welcome. Thank you so much for being here.

Let me just say I agree with Senator Daines that this issue really is bipartisan always when it comes to the needs of the regulatory system, and in that spirit, that is why I look forward to voting for the five Federal Reserve nominees this afternoon. We need a full Federal Reserve Board to bring down prices and promote full employment and wage gains, and we really should be playing politics with that.

Let me say, Mr. Chairman, thank you for this hearing. It is such an important issue. I also appreciate the Ranking Member putting—laying out these principles to talk about developing a legislative framework for stablecoins. It is such an important area, and I think it is an area we need to focus on.

So, Under Secretary, let me start with a couple of questions, and I am going to follow up on Senator Daines' questions to you about which agencies are responsible for the oversight right now of stablecoins. Are there any Federal agencies that are responsible right now to ensure that stablecoin issuers are adequately backed?

Ms. LIANG. Currently, stablecoin issuers are backed by either State money—are regulated by State money transmitter licenses or State charters.

Senator CORTEZ MASTO. So right now, there is no Federal agency looking at whether they are adequately backed. It is State agen-

cies; that is, if the States have some sort of regime for that. Is that correct?

Ms. LIANG. That is correct.

Senator CORTEZ MASTO. OK.

Ms. LIANG. That is correct.

Senator CORTEZ MASTO. Yeah. And it goes back to what Senator Van Hollen had said. Some States have it; some do not. So there is some patchwork there.

Let me ask you this. With respect to stablecoin and cryptocurrency, do they always have to register as a money services business under FinCEN's Federal regime?

Ms. LIANG. Yes.

Senator CORTEZ MASTO. Yeah. And thank you, because, you know, the last Congress, I worked on the FinCEN Improvement Act. I led that bill, and it is important that we gave FinCEN the authority over cryptocurrencies and other technical reliance on financial payments for this very reason.

Do you feel that FinCEN has a robust framework to prevent and sanction illicit finance when it comes to stablecoins or any cryptocurrency?

Ms. LIANG. Yes. Yes, FinCEN—so registering as a money service business under the State transmitter license triggers a number of FinCEN regulations: AML, BSA, AML/CFT regulations. They have been working on this for many years. Some of the initial guidance on what was called virtual assets came out in 2014. They lead some of the international work. This is an area of strong focus. They understand and want to enforce stronger—have a stronger implementation and enforcement.

As I understand it, some of the issues are related to activities abroad, exchanges abroad, and with the Financial Action Task Force, they are working globally to try to improve implementation.

This is an area also for the administration more broadly, which they are working on and will be announcing more work on in the coming weeks.

Senator CORTEZ MASTO. Great. Thank you for that.

Let me go back to the report that the working group put out. In some of the prudential concerns, one of the areas that you talked about is to address additional concerns about systemic risk and concentration of economic power, and then in there, it states supervisors should have authority to implement standards to promote interoperability among stablecoins. Can you discuss the interoperability piece of it and elaborate a little bit more on that?

Ms. LIANG. Yeah. So one of the three prudential risks is this possibility of increased concentration of economic power. This has to do with the network externalities of a payment system, where everyone—there are greater benefits if everyone is part of the same payment system. So, if you have large firms, the ability to scale up a payment system could potentially increase market power.

One way to diminish or to offset some of that unwanted increase in market power would be to promote interoperability among stablecoin issues, and that just allows for consumers to exchange one stablecoin for another, so to speak, and allow them to interact with each other so you do not create a number of different sort of closed-loop systems.

Senator CORTEZ MASTO. And I know my time is up, but I would imagine that there is going to be issues with respect to the standardization of that interoperability that we would have to address.

Ms. LIANG. Absolutely. Absolutely. It is a complicated issue of which more discussion would definitely need to be taking place.

Senator CORTEZ MASTO. Thank you. Thank you very much.

Chairman BROWN. Thank you, Senator Cortez Masto.

Senator Ossoff is recognized from his office from Georgia.

[No response.]

Chairman BROWN. Senator Sinema from Arizona is recognized from her office.

Senator SINEMA. Thank you, Mr. Chairman, and thank you to our witnesses for being here today.

As you know, Mr. Chairman, I cochaired the Senate's Financial Innovation Caucus alongside my friend, Senator Lummis of Wyoming. So I am very glad that we are holding this hearing today.

As we discuss new financial technologies, I want to ensure that we balance commonsense protections for everyday Arizonans while creating an environment where innovation can thrive.

Under Secretary Liang, it is great to speak with you today and to discuss this important topic. The President's Working Group report on stablecoins calls for Congress to pass a solution to avoid runs on stablecoins and to ensure that users have commonsense protections to safeguard stablecoins' stated value. These objectives align with some of the concerns I raised in our last stablecoin hearing.

There is general agreement that this is a noble goal, but it is important to be thoughtful about the solution that we propose. I am interested in ensuring there are adequate consumer protections to give Arizona consumers confidence in the value of stablecoin, but I also want to make sure that regulatory requirements are not overly onerous. We do not want to discourage innovation or limit consumer choice.

Can you elaborate on how the report balances these competing priorities?

Ms. LIANG. So thank you for that question. So I think that was the underlying principles of the report to balance innovation and competition for payment systems and while at the same time protecting consumers.

So our view is that a more clear, consistent, comprehensive regulatory framework goes a long way to promoting innovation and providing choices for consumers.

It does require that stablecoins actually be stable, and so there are some recommendations about how to achieve stability in a stablecoin. It requires that stablecoins be able to provide the payment services that it offers in a reliable way, and we want the payment system to be resilient. So it makes a number of recommendations in that space.

Senator SINEMA. Well, thank you, Under Secretary Liang.

I am encouraged to see this discussion of decentralized finance and Web3 evolve. I think it has the potential to make everyday transactions faster, safer, simpler, and more affordable for everyday Arizonans.

With any new groundbreaking technology—the internet in particular comes to mind—the technology itself is quite promising, though many of the early use cases ultimately do not work and do not make it. The technology, however, ensures, and the next group of entrepreneurs improve on or disrupt what came before them. So that is the nature of innovation, and I am committed to ensuring we have an innovation ecosystem that is a win-win for Arizona entrepreneurs and consumers alike.

I see decentralized finance and Web3 in this way. Our job is to think through what works and what does not, what helps consumers and what does not, and to create commonsense rules of the road that provide certainty for everyone. It is important to me that we address some of the short-term challenges with these technologies while also not losing sight of the long game when it comes to the potential benefits of decentralized finance and Web3.

Are you and the Administration aligned in that thinking on this issue?

Ms. LIANG. So I agree that DeFi is growing rapidly. There are many different range of products and services being offered, and the potential for benefits are there.

Innovation is—responsible innovation is absolutely supported with the—alongside of making sure that investors and consumers are protected through actions by the market regulators, the Consumer Financial Protection Bureau, or the State regulators where appropriate, so agree with your assessment.

Senator SINEMA. Thank you.

Finally, I received a letter from Assistant Secretary Davidson in response to a bipartisan letter I sent in December with Senators Portman, Warner, Crapo, Toomey, and Loomis. Our letter requested that the cryptocurrency provision, included in our bipartisan Infrastructure Investment and Jobs Act, is implemented in accordance with congressional intent. I am not encouraged by aspects of a letter we received, including but not limited to an acknowledgment that congressional intent is that cryptocurrency providers, bankers, and those solely engaged in the business of selling hardware or software, to allow individuals to control private keys. They should not be considered brokers for the purpose of this action.

Providing certainty to these groups and ensuring that a future rulemaking aligns with congressional intent is a priority for me, and I believe it is possible to help close the tax gap while also ensuring that the rules are clear and fair so that innovators are not inadvertently or unintentionally subjected to these requirements.

So my question of you is we submit that the Department will work closely with me and the other authors of the letter to consider development of a Notice of Proposed Rulemaking to ensure that the law is executed as Congress intended.

Ms. LIANG. I believe the Treasury Department's principle is to not to squash crypto assets but to collect taxes from those who owe taxes.

Senator SINEMA. So just to clarify—and I know my time has expired, Mr. Chairman—Under Secretary, would you be willing to work with the authors of our bipartisan letter to ensure that Congressional intent is honored?

Ms. LIANG. I am sure Treasury and my colleagues in the Office of Tax Policy would be very happy to work with you.

Senator SINEMA. All right. Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Sinema.

Senator Ossoff from Georgia is recognized from his office.

Senator OSSOFF. Thank you, Mr. Chairman, and thank you, Ms. Liang, for joining us and for your service and for the report that the President's Working Group has submitted.

Could you please restate briefly what are the principal risks that you assess to be posed by the growth of the stablecoin market?

Ms. LIANG. So, briefly, stablecoins have been growing, and their potential to be used for payments in the ordinary world, the non-crypto world, has been increasing. So the risks that we included and identified in the PWG report are, one, the risks that investors could run on a stablecoin, perhaps because investors lose confidence in the value of the assets that are behind it; two, the risk of disruptions to the payment system, if they—the payment—the operations are not held as standards that ensure that payments can be made as promised; and then, third, the increased risk from higher market concentration if some stablecoins were to scale up very quickly and increase market share. So those are the three risks that were identified in the PWG report for which the report—the PWG believed current regulations do not address.

Senator OSSOFF. Thank you, Ms. Liang.

The report states that stablecoins, depending on context, could be considered derivatives or commodities or securities. Why are existing regulatory authorities, in your opinion, insufficient?

Ms. LIANG. So, currently, stablecoins could be—you know, I leave it to my colleagues at SEC and CFTC as to whether stablecoins are securities or commodities, but as a payments mechanism, to be used by households and businesses to facilitate payment transactions, that, I think, is a separate consideration, and that is what the PWG report focused on.

Senator OSSOFF. And what regulatory actions might you recommend be undertaken for which the Department currently lacks statutory authority?

Ms. LIANG. So, currently, stablecoin issuers are authorized—they are licensed by State money transmitter laws, some trust banks in some States. There is not a Federal agency. The principal recommendation is that stablecoin issuers register, be required to be insured depository institutions where the regulation and supervision of these institutions would be matched to the risks and activities of a stablecoin issuer, so that if it does not make loans or extend credit, it is not subject to the same set of rules that other traditional commercial banks might be.

Senator OSSOFF. What are the most common mechanisms by which issuers peg the value of the stablecoin to the U.S. dollar, and which of those mechanisms, in your view, present the most risk or may most require some form of prudential regulation at the Federal level?

Ms. LIANG. There are many different stablecoins issuers right now. I think the predominant is tied to the value of the U.S. dollar, and they do that by holding reserve assets in U.S. dollars that are—on redemption request would be able to be converted to a dol-

lar, to one dollar. So that is the primary, by far, the largest stablecoin issuers.

The issue at question is whether the issuer, the stablecoin issuer could actually provide a user a dollar on request, and the IDI framework, the insured depository institution framework, would be an important step to ensuring that stablecoins, in fact, deliver the dollar when asked.

Senator OSSOFF. And in your view and in the analysis of the working group and a relevant law, Ms. Liang, you do not believe that currently regulatory authorities have adequate statutory authority to, for example, impose reserve requirements or other prudential requirements on such issuers to ensure that they can maintain the peg if there is a sudden increase in demand for redemption?

Ms. LIANG. I do not think there is any regulation that requires them to do that. No.

Senator OSSOFF. Thank you for your testimony, Ms. Liang.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Ossoff.

Thank you, Madam Under Secretary, for joining us today.

Senators who wish to submit questions for the record, those questions are due 1 week from today, Tuesday, February 22nd. Witnesses—you, Madam Under Secretary—have 45 days to respond to any of those questions.

Thank you again. The Committee is adjourned.

[Whereupon, at 11:41 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN SHERROD BROWN

Let me start by talking about the Federal Reserve.

This afternoon at 2:15 we will be meeting in SVC-200 to markup five Federal Reserve nominees and one for the FHFA.

We need a full Federal Reserve Board of Governors to bring down prices and put workers first.

Ranking Member Toomey and I agreed on the dates for the hearing and markup over 3 weeks ago.

Americans are depending on us to get them on the job as soon as possible.

If my colleagues are as concerned about inflation as they claim to be, they will not slow down this process, which will only hurt workers, their families, and our recovery.

If you watched the Super Bowl on Sunday, you saw ad after ad for a product that most Americans have heard of, but almost nobody knows what it is. Even many of the people who've bought it often don't really understand it.

Big cryptocompanies are looking to make big profits, and are desperate to reach as many Americans as they can. They brought in celebrities and gimmicks to make crypto sound exciting and daring and profitable.

But the ads left a few things out.

They didn't mention the fraud, scams, and outright theft.

The ads didn't point out that you can lose big in crypto's huge price swings. They didn't tell you about the high fees pocketed by the cryptocompanies.

And they sure didn't explain that cryptomarkets lack basic investor protections and oversight.

Just a few weeks ago, hackers stole more than \$300 million of people's investments from a cryptoplatform.

The fact that these companies felt the need to advertise at all is a bit of a giveaway about one of their major claims—if this were actually meant to be used as currency, why would you need to buy ads? I've never seen the Federal Reserve buy a multimillion dollar commercial for "U.S. dollars."

That's because crypto isn't money. It's designed for speculation. And watching all those ads reminded a lot of us of some asset bubbles we've been before.

The 2000 Super Bowl featured 21 ads from 14 different dot com start-ups. The internet may have been the next frontier, but those companies weren't—many of them were defunct within a year or two, and just four are still around today.

We're here today because once again, real people's real money is at risk. We need to look beyond the unproven promises, and protect Americans and our entire financial system.

In a hearing last July, this Committee examined the risks of cryptocurrencies to our economy. In December, we looked closely at the mechanics behind stablecoins and stablecoin companies.

Today, we're joined by Treasury Under Secretary Liang, to look at the risks stablecoins pose, and how regulators and Congress can protect consumers.

Last fall, the Treasury Department led a team of our financial regulators to conduct a report on stablecoins. The report makes it clear that without regulation, stablecoins can endanger our economy, our payments systems, our hard-earned money.

And while stablecoins suggest they're like money, good luck trying to use one at the store. Their main purpose today is to make it easier to trade, speculate, and in some cases even hide assets in crypto and digital markets.

In just a few years, stablecoins have mushroomed into a 175 billion dollar market. Now they're asking us to believe that what they've built is as good as real money, and that it works the way these start-ups say it does.

Americans—and this Committee—should look carefully at those promises.

The companies claim that a stablecoin is backed by real dollars, invested in a reserve account—that's what makes it "stable."

But our regulators tested that claim by a giant stablecoin issuer. That issuer ended up paying nearly \$60 million in fines because it lied about its reserves. It turns out that for over 2 years, the stablecoin was only really "backed" 28 percent of the time.

Stablecoin companies say that you can, quote, "redeem" a stablecoin whenever you want, exchanging it back into dollars from the stablecoin's reserve.

But the fine print in the agreements of some of the biggest companies says that ordinary consumers can't actually redeem their stablecoins for dollars from the company that issues them. Only institutions like hedge funds can. And even then, many stablecoin issuers can delay redemptions, or refuse them entirely.

So if you saw a Super Bowl ad and figured you'd give this a try, and you change your mind and want to exchange your stablecoin for dollars, you might be out of luck. The website could be down. Your money could be trapped.

Stablecoin issuers also promise that their product will serve people who have been left behind in the financial system.

But as we've established, crypto doesn't actually function as real currency in any traditional sense. Allowing more people to trap their money in risky, speculative investments isn't the kind of financial inclusion we need. It's not going to do anything to help Americans working hourly jobs who don't put their paychecks in the bank because of abusive fees.

Finally, stablecoin companies say that if you hand them your money, your money will be safe. They tell us that they structure their reserves so that people's money is protected, and that their business will weather any kind of crisis.

Now, maybe the stablecoin companies are right. Maybe we should just close our eyes and trust that a product called "Magic Internet Money"—run by an outfit called "Abracadabra"—is a safe place for your money.

But I don't think working Americans can take that risk.

Remember in 2007 and 2008, when the banks said homes prices would only go up and mortgages would never be underwater?

And then, as now, it's workers and their families whose homes and hard-earned savings are being used as gambling chips. They're the ones who will pay the price.

I understand the appeal of crypto. Americans have burned over and over again by Wall Street. The 2008 crisis, abusive fees, a stock market that seems detached from reality—of course people don't trust the big banks. And they figure, how could putting my money in one of these new products be any worse? Maybe I'll finally get in on the kinds of deals that have been making investment bankers wealthy for years.

And some of those Super Bowl ads were pretty compelling television. They make vague allusions to innovation and the future—and who could be against innovation?

But we have ignored warnings like the report we're talking about today too many times before.

Before the financial crisis, Congress and regulators ignored warnings about the risky bets, increasing leverage, and over-the-counter derivatives on Wall Street. Then the banks got a bailout, and working people paid the price.

That's why I want Congress and regulators to work together to tackle these risks now, before it's too late.

I urge my colleagues to listen carefully to Under Secretary Liang's testimony today, and to the warnings in the PWG report.

We need a strong, proactive approach from regulators and Congress to limit stablecoins' risks for working Americans.

As our economy continues to recover from COVID-19—as workers are finally starting to see higher wages and more bargaining power in the workplace—the last thing we need is for a risky new financial product to cause disaster.

This isn't the first hearing this Committee has had on stablecoins, and it won't be the last.

PREPARED STATEMENT OF SENATOR PATRICK J. TOOMEY

Thank you, Mr. Chairman. And Ms. Liang, welcome.

Two months ago, this Committee held its first hearing on stablecoins. I was encouraged to hear from our witnesses about the essential role stablecoins play in the larger cryptocurrency trading ecosystem.

It also important to note the tremendous potential stablecoins have to be adopted as a common medium of exchange in the broader, ordinary goods and services economy. Unlike cryptocurrencies that fluctuate in value, stablecoins are designed to maintain a 1-to-1 value relative to reference asset, typically a fiat currency, such as the U.S. Dollar. Put simply, one stablecoin is meant always to be worth one dollar.

Because of this price stability, stablecoins have the potential to serve all the traditional functions of money by acting as a medium of exchange, unit of account, and store of value. Stablecoins can also improve upon traditional forms of money by increasing payment speed, especially cross-border transfers, reducing transaction costs, and helping to combat illicit finance through an immutable and transparent transaction record.

Stablecoins can also be programmed to execute payments automatically upon the occurrence of some predesignated, verifiable event. This capability in particular has the potential to transform finance and, in time, much of our economy.

Any regulatory regime for stablecoins will inevitably focus on consumer protections and systemic stability. But at least as important will be preserving the tremendous, unimagined benefits that will flow from future innovations.

As stablecoin usage has grown significantly, regulators have increasingly taken interest. Last November's report from the President's Working Group on Financial Markets—spearheaded by Ms. Liang—appropriately recommended Congress pass legislation to establish a Federal regulatory framework for stablecoins.

The PWG report recommends Congress address three perceived “prudential concerns”: stablecoin runs, payment system risks, and systemic risk and concentration of economic power. The principal recommendation is that stablecoin issuance be limited to insured depository institutions (IDIs).

While I commend their contribution to the public discussion, I strongly disagree with that recommendation. And I believe we can protect against concerns such as run risk through a less restrictive and more appropriately tailored approach.

To accomplish those objectives, I released a set of guiding principles for stablecoin legislation. These principles recognize that stablecoin issuers have significantly different business models than banks and present different risks.

For example, stablecoin issuers typically neither make loans nor take deposits. They may choose not to transform maturity or intermediate credit risk. As such, a stablecoin issuer using cash or cash equivalents to back its coin is likely safer than most existing financial institutions.

Because of these differences, it would be inappropriate to subject stablecoin issuers to the full range of bank regulations meant to address risks posed by the fractional reserve, deposit, and lending banking system.

I am encouraged that Ms. Liang has recognized these differences and sensibly agreed there should be regulatory “flexibility” for stablecoin issuers not engaged in traditional banking. But that raises the natural question: why require all stablecoin issuers to become insured depository institutions?

My legislation will take a different approach. It will provide regulatory treatment that is flexible and adaptable to future technological innovation. It will also promote competition in the stablecoin market by allowing at least three types of regulated entities to issue stablecoins.

First, it will preserve the regime to which the majority of stablecoin issuers are currently subject as State-registered money service businesses and money transmitters. To disrupt this regime would both introduce unnecessary burdens to an emerging technology and unwisely diminish the success of States with experience and expertise in this area. Rather than discard this regime, we should build on it to ensure the public has the right disclosures about stablecoin reserves to make an appropriately informed decision about whether to use any given stablecoin.

Second, it will clarify that insured depository institutions are in fact permitted to issue stablecoins. The former head of the OCC, Brian Brooks, pioneered work to give banks clarity on digital asset activities, but the current OCC has created confusion regarding permissible activities.

Finally, it will establish a new stablecoin charter with regulatory requirements designed specifically for stablecoin issuers. The requirements will address the risks identified by the PWG report, but will not force stablecoin issuers into a one-size-fits-all system created for traditional banks. Ms. Liang's recent testimony indicates to me that she agrees with a tailored approach for such issuers.

Rather than rely on the “flexibility” of the existing framework for depository institutions, which leaves full discretion to bank regulators, it is the responsibility of Congress to design this approach. These three paths would allow each stablecoin issuer to choose the regulatory framework most appropriate for its business model.

And under this legislation, each stablecoin issuer would be required to meet certain minimum requirements regardless of its charter or license. For example, all would be required to disclose the assets backing the stablecoin, adopt and clearly disclose redemption policies, and undergo third-party audits. These requirements would ensure that consumers have sufficient information to choose which stablecoin they use.

Ms. Liang's thoughtful comments on stablecoin regulation lead me to believe there are many issues on which we can find common ground. I look forward to developing legislation with my Senate colleagues and working with the Administration to establish a regulatory framework for stablecoins that addresses potential risks while also encouraging innovation and competition.

PREPARED STATEMENT OF JEAN NELLIE LIANG
 UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY
 FEBRUARY 15, 2022

Chairman Brown, Ranking Member Toomey, and other Members of the Committee, thank you for the opportunity to testify this morning on stablecoins.

Stablecoins are part of an emerging set of digital assets, activities, and services that could have profound implications for the U.S. financial system and economy. Treasury supports responsible innovation that helps meet the evolving needs of users and the financial system. But stablecoins also raise policy concerns, including those related to illicit finance, user protection, and systemic risk. To mitigate these risks while supporting the potential benefits from innovation, Treasury believes that regulation of stablecoins should be clear and consistent.

In November, the President's Working Group on Financial Markets, along with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, took an important step in this direction with the publication of a stablecoin report (PWG Report). The PWG was formed by Executive order in response to the 1987 stock market crash. The group is chaired by the Secretary of the Treasury and composed of Federal financial regulators. The PWG regularly produces reports on financial markets issues for the President, which may include recommended legislative changes.

As described in the PWG Report, stablecoins are a type of digital asset designed to maintain a stable value relative to the U.S. dollar or other reference asset. Today, stablecoins are used primarily to facilitate trading in digital assets. But, because stablecoins are designed to maintain a stable value, they could potentially be used more widely as a means of payment by households, businesses, and financial firms. There are no standards regarding the composition of assets used to support the value of stablecoins (reserve assets), and information made publicly available regarding stablecoin reserve assets is not consistent across stablecoin arrangements in either its content or the frequency of its release.

Stablecoins are growing and developing rapidly and are not subject to a statutory or regulatory framework that mitigates the risks they present in a consistent and comprehensive manner. Currently, regulators have authorities that can be used to address illicit finance and investor protection concerns in the context of stablecoins. However, as described in the PWG Report, regulatory gaps exist regarding certain prudential risks. The PWG Report recommends legislation to ensure that stablecoins are subject to appropriate Federal prudential oversight. Such legislation would complement existing authorities with respect to market integrity, investor and consumer protection, and illicit finance. The PWG's specific recommendations included: limiting issuance of stablecoins to insured depository institutions (IDI); giving supervisors of stablecoin issuers authority to set risk management standards for critical activities related to use of stablecoin as a means of payment; and certain measures to reduce concerns related to concentration of economic power.

As mentioned, stablecoins are part of the much larger and quickly evolving market for digital assets. The Biden administration continues to work across the agencies to develop a comprehensive strategy for all digital assets, with the goals of ensuring that cryptocurrency is not used for illicit finance; addressing risks related to financial stability and consumer and investor protection; and furthering financial inclusion and our continued leadership of the global financial system.

Prudential Risks of Stablecoins

Given their potential to be used as a means of payment, as well as the design mechanisms that they rely on to maintain a stable value, stablecoins present risks that are similar to some of the prudential risks traditionally associated with bank deposits and other forms of private money. History has shown that, without adequate safeguards, bank deposits and other forms of private money have the potential to pose risks to consumers and the financial system. These prudential risks include the risk of stablecoin runs; payment system risks related to the mechanisms that are used to store or transfer stablecoins; and broader concerns related to concentration of economic power.

"Run risk" refers to the potential for a scenario in which a loss of confidence in a stablecoin sets off a wave of stablecoin redemptions, which could then be followed by distressed sales of the stablecoin's reserve assets. Such distressed sales of assets could negatively affect critical funding markets and broader financial conditions. Runs could also spread contagiously from one stablecoin to another, or to other types of financial institutions that are viewed as having a similar risk profile. The dynamics of a run, as well as the harm that runs can inflict on the broader system, are amply demonstrated by the history of runs on banks and shadow banks—including

ing those that occurred in 2007–2008 and, more recently, at the start of the COVID–19 pandemic in March 2020. The first stablecoin run is believed to have occurred in June 2021, when a sharp drop in the price of the assets used to back the stablecoin set off a negative feedback loop of stablecoin redemptions and further price declines.

“Payment system risks” refer to a disruption in the mechanisms used to store or transfer value, which could interfere with the ability of users to make or settle payments. Payment system risks distinguish stablecoins from certain investment products that are not designed to serve as a means of payment. Custodial wallet providers—meaning wallet providers that hold stablecoins on behalf of users—are one locus of payment system risk, as the failure or disruption of such a wallet provider could deprive users of access to their stablecoins. More generally, use of stablecoins depends on a range of activities that are often distributed across multiple entities within a stablecoin arrangement.¹ Depending on the particular design of a stablecoin, these activities include: governance of the stablecoin arrangement; stablecoin issuance and redemption; management and custody of stablecoin reserve assets; distributed ledger operation, validation, and settlement; and interfacing with stablecoin holders. Even if a stablecoin itself is adequately protected against run risk, problems related to the activities or entities that support the stablecoin could still interfere with its use as a means of payment, harming stablecoin users and resulting in a loss of payments efficiency.

Finally, I would highlight two concerns related to concentration of economic power. First, connections between a stablecoin (or stablecoin wallet provider), on one hand, and a commercial company, on the other, could be used to give the commercial company an unfair competitive advantage. These policy concerns are analogous to those traditionally associated with the mixing of banking and commerce, such as advantages in accessing credit or using data to market or restrict access to products. Second, the issuer of a stablecoin that becomes sufficiently widely adopted as a means of payment could become a dominant provider of payment services. Market power with respect to payments could reduce incentives for further investment in payments innovations or lead to higher prices for payment services.

Regulatory Gaps

Current statutory and regulatory frameworks do not provide consistent and comprehensive standards for the risks of stablecoins as a new type of payment product. Certain regulatory schemes may have the flexibility to address some issues presented by stablecoins, such as illicit finance. However, stablecoins are not subject to standards to address concerns about run risk, payment system risk, or concentration of economic power. Some of the largest stablecoin issuers operate with limited regulatory oversight, raising significant questions about whether these stablecoins are adequately backed and other aspects of their operations. The regulatory frameworks that apply to stablecoin issuers and service providers are inconsistent, creating opportunities for regulatory arbitrage and uncertainty among stablecoin users. Even where the issuer of a given stablecoin is subject to oversight, the number of different key parties that may be involved in an arrangement, and the operational complexity of these arrangements, may pose substantial challenges for supervisors. The exponential growth of stablecoins—from a market capitalization of roughly \$5 billion at the start of 2020 to approximately \$175 billion today—increases the urgency of ensuring that an appropriate regulatory framework is in place.

Having described the regulatory gaps at a high level, I would like to discuss in more detail several frameworks that have featured prominently in discussions of stablecoins: State money transmitter laws, securities laws, and commodities laws. While Treasury and the PWG fully support efforts by State and Federal agencies to use existing authorities in support of their statutory mandates, we do not believe existing authorities provide a sufficient basis for comprehensive and consistent oversight of stablecoins.

Money Transmitter Requirements

In many States, stablecoin operators are licensed or registered as money transmitters and money services businesses, and are subject to standards that include minimum net worth requirements, surety bond and other security requirements, and restrictions on permissible investments. These standards are generally designed to address consumer protection concerns. They are not meant to address the financial stability and payment system concerns that would arise if stablecoins become widely

¹The term “stablecoin arrangement” refers to a stablecoin together with the functions and activities that allow the stablecoin to be used as a means of payment.

adopted by households, corporations, and financial institutions as a means of payment.

Securities Regulation

Some have suggested that stablecoins could be regulated either as securities or as money market mutual funds (MMFs). Certain legal academics have raised a threshold question as to whether stablecoins qualify as securities or MMFs under existing laws. Assuming that stablecoins satisfy the definition of securities or MMFs, there is a further question as to whether these regimes would effectively address the prudential risks of stablecoins. Requirements that apply generally to issuers of public securities are not designed to address concerns about run risk, payment system risk, or concentration of economic power. MMF regulations do not focus on payment system risks or concerns about concentration of economic power.

Commodities Regulation

Under the Commodity Exchange Act, the CFTC has the authority to police fraud and manipulation in commodities spot markets, which the CFTC has indicated include digital assets.² In addition, derivatives products on commodities and leveraged retail transactions are subject to jurisdiction of the CFTC. These are important tools for ensuring the integrity of these markets and protecting investors, but they are not intended to address prudential risks.

Recommendation Regarding Stablecoin Issuers

The PWG Report recommends requiring stablecoin issuers to be IDIs because IDIs are subject to a regulatory and supervisory framework that would help to mitigate the prudential risks the report identifies. Run risk would be reduced by features including capital, liquidity, and other prudential standards, as well as access to the Federal Reserve as lender-of-last resort. Payment system risk would be mitigated through the establishment of risk-management standards for entities that conduct critical activities within stablecoin arrangements. Concerns about concentration of economic power would be addressed by prohibiting stablecoin issuers from conducting commercial activities, or affiliating with commercial companies, and by allowing supervisors to establish interoperability standards. In short, IDI regulation provides a tested regulatory model that would protect against the prudential risks of stablecoins and help to support confidence of stablecoin users.

In developing this recommendation, the PWG relied upon the flexibility that the banking agencies would have to calibrate supervision and regulation of stablecoins based on risk. Banking agencies currently use existing authorities to adjust supervision and regulation in the context of overseeing IDIs with a diverse range of business models (e.g., commercial banks, trading banks, custody banks) and systemic risk footprints (e.g., community banks, mid-size banks, regional banks, large banks). The fact that some prominent stablecoin issuers are already seeking IDI charters provides additional reason to think that IDI regulation is a feasible regulatory model for stablecoin issuance.

Since the publication of the PWG Report, some have asked whether stablecoins issued by an IDI would be covered by FDIC insurance, or its equivalent. The PWG Report does not take a position on this issue. While insuring stablecoins would protect users against the risk of loss, it would also introduce certain policy and technical challenges. For this reason, Congress (or the banking agencies) might want to consider alternative measures to protect stablecoin users.³

Finally, the Financial Stability Oversight Council (FSOC) continues to evaluate potential systemic risks related to stablecoins and other digital assets, and the steps that may be available to the FSOC to mitigate such risks. These may include designation of certain activities conducted within a stablecoin arrangement as, or as likely to become, systemically important payment activities.

Digital Assets and Distributed Ledger Technology

As I stated at the beginning of my testimony, Treasury supports responsible innovations that meet the needs of users, the financial system, and the economy. The Administration continues to evaluate the broader set of issues and opportunities posed by digital assets and distributed ledger technology, and welcomes the opportunity to continue to work with Congress.

To date, much of the public policy discussion of digital assets has focused on regulatory questions about digital assets themselves. I would identify two additional sets of issues that merit focus as policy is developed in this area:

² <https://www.cftc.gov/media/4636/VirtualCurrencyMonitoringReportFY2020/download>

³ For example, there could be a requirement for stablecoins issued by an IDI to be fully backed by safe assets—consistent with how many stablecoins currently purport to be backed.

The first relates to the regulation of intermediaries that participate in digital asset markets. Some of these intermediaries are banks, investment companies, and other traditional financial actors that are increasingly expanding into digital assets. Other intermediaries—such as stablecoin issuers, custodial wallet providers, and digital asset exchanges—are native to the digital asset ecosystem, but provide financial services similar (and sometimes identical) to those provided by traditional financial services providers. For both traditional and digital native intermediaries, it is critical to ensure that regulatory frameworks are in place that appropriately address risks to businesses, consumers, and investors, as well as the broader financial system. The banking agencies’ recent “crypto sprint,” the Securities and Exchange Commission and Commodity Futures Trading Commission’s assessment of authorities over digital exchanges, and the PWG’s work on stablecoins are important steps in this direction. But clearly, much work remains to be done.

The second set of issues relates to potential for systemic risk that could result from the build-up of leverage against digital assets. As we saw in the 2007–2008 financial crisis (and most that preceded it), leverage can play a key role in catalyzing and accelerating financial instability. To address these risks, the Administration is building its knowledge and understanding of the role that leverage plays in digital asset markets and of the implications of that leverage for the rest of the financial system. We would be pleased to discuss this set of issues further with the Committee as our understanding deepens.

Conclusion

I want to thank the Committee for its leadership on these important issues and for inviting me here to testify today. I am happy to answer any questions from the Committee. I also look forward to additional conversations regarding broader issues raised by digital assets and distributed ledger technology.

**RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN BROWN
FROM JEAN NELLIE LIANG**

Q.1. Stablecoin issuers claim that stablecoins can be used for payments and can promote financial inclusion. Please discuss whether, at present, stablecoins play a meaningful role in retail payments or in expanding financial inclusion, including as compared to their use in facilitating speculation in digital asset markets. What risks do retail consumers face in attempting to use stablecoins for payments?

A.1. Today, stablecoins are used primarily to facilitate trading in digital assets, and, because stablecoins are intended to maintain a stable value, they have the potential to be used as a means of payment by households, businesses, and financial firms. This transition to a broader use for payment could occur rapidly due to network effects or relationships between stablecoins and existing user bases or platforms. Currently, because stablecoins are not subject to prudential regulation and supervision on a consistent or comprehensive basis, consumers that use stablecoins may be put at risk. Consumer risks could include an unexpected risk of loss due to significant and unexpected declines, for instance due to a decline in the value of the assets backing their stablecoins or as a result of failure in mechanisms for storage or transfer of their stablecoins.

Q.2. Your testimony discussed the use of stablecoins in buying and trading crypto assets, including complex cryptoderivatives. It also mentioned the risk of increasing leverage in digital assets. Experts believe stablecoins make it easier for leverage to build up in cryptomarkets. What are the risks of leverage accumulating in the crypto ecosystem, and how could those risks affect traditional financial markets outside the digital asset space?

A.2. As we saw in the 2007–2008 financial crisis (and many preceding examples of financial crises), leverage can play a key role in catalyzing and accelerating financial instability. Treasury is concerned that similar dynamics may increase the likelihood that stress in digital assets affects other financial markets and is actively working with the Administration and interagency partners to build its knowledge of the role that leverage plays in digital asset markets and of the implications of that leverage for the rest of the financial system. The potential for spillovers into traditional financial markets would likely depend on a range of factors, including the amount of leverage involved, the sorts of assets being used as collateral, as well as the duration and other features of the arrangements used to take on leverage.

Q.3. Stablecoin companies frequently claim that their products are safe because reserves are invested in low-risk, highly liquid assets, such as bank deposits. Very low-risk assets, however, have low or even nominal returns. If stablecoin reserves are invested in these assets, doesn't the stablecoin business model then rely on generating revenue from stablecoin users in other ways, such as by cross-selling DeFi investments or charging transaction fees? Is there evidence in the market so far that firms face these incentives?

A.3. There are several potential business models that could support the issuance of stablecoins. These include generating revenue from (a) the spread between interest received on reserve assets and that paid to stablecoin holders; (b) transaction or other kinds of fees, as you note; (c) data from transactions involving the stablecoin; and (d) cross-selling of stablecoins with other products. Consistent with the emphasis in the Digital Assets EO, this Administration is committed to protecting consumers and the broader financial system by implementing appropriate guardrails for digital assets. That, of course, applies here: Treasury, in its capacity, is committed to ensuring that whatever business model a stablecoin issuer pursues, it is consistent with protection of consumers and the broader financial system.

Q.4. Digital asset “wallets” play a key role in the crypto ecosystem by allowing consumers to store their stablecoins. Please identify the major consumer protection or other risks associated with stablecoin wallets. Are any significant consumer protection rules currently applicable to stablecoin wallets? In your view, what would be the most important elements of a consumer protection framework for wallets?

A.4. As you observe, many customers rely on third parties, including custodial wallets, to store and facilitate the transfer of their stablecoins and other digital assets. In so doing, custodial wallets may be critical to the functioning of a stablecoin as a means of payment.

Relying on a third-party to hold or transfer stablecoins may improve functioning and customer experience, but it also can put customers at risk of loss or theft if the custodial wallet fails or misuses customer assets. In some cases, custodial wallets may be taking risks with customer assets—for example, by lending or borrowing them in an inappropriate or high-risk manner. Today, custodial wallets are not subject to consistent and comprehensive standards to protect against these risks. By comparison, other intermediaries that hold or transfer customer financial assets are subject to requirements—often at the Federal level—aimed to protect consumers. These requirements often include segregation of customer and firm assets, limits on certain activities or investments, supervision, financial resource requirements, protections against conflicts of interest, and disclosure of potential liquidity risks depending on the type of underlying assets.

Q.5. Please describe the risks that you believe are presented by smart contracts. How could smart contracts create systemic risks? As compared with traditional contracts, are smart contracts useful in consumer or small business contexts, and what risks do they pose?

A.5. A “smart contract” is a self-executing contract with the terms of the contract written into code, typically supported by distributed ledger technology. Like other financial innovations, smart contracts have both potential benefits and potential risks. When well-designed, smart contracts could be highly transparent and reduce risks of manipulation and arbitrary intervention. But, smart contracts without appropriate controls and protections also face risks, including execution risk, operational risk, illicit finance risks, and

dependencies on crypto assets or platforms that may be susceptible to failure.

Q.6. When stablecoin issuers preclude retail users from redeeming directly, consumers can convert stablecoins into fiat currency by selling the tokens for dollars on exchanges. But major crypto exchanges have been prone to outages and malfunction. Please discuss how exchange outages or errors can affect stablecoin markets and stablecoin holders. Are there scenarios involving exchange failures that give rise to particular concern?

A.6. Currently, many stablecoin users do rely on the ability to convert stablecoins into cash by trading the stablecoins on an exchange. Where stablecoin users do not have right to redeem their stablecoins directly, exchange outages may prevent users from converting their stablecoins into cash. An important benefit of extending key tools like prudential oversight and clear disclosures to stablecoin issuers is that it would give supervisors and regulators the ability to ensure that user redemption rights are well-defined and that stablecoin issuers have the financial means to meet redemption requests.

Q.7. In Senator Toomey’s proposed stablecoin framework, he suggested that some stablecoin issuers could, “based on their business models,” choose to be regulated by “[r]egister[ing] as a money transmitter under the existing State regime and as a money services business under FinCEN’s Federal regime.” Are State money transmitter and Federal MSB rules adequate for managing the risks to consumers and the economy created by stablecoins? Please describe what you perceive to be the risks of a State-based approach to stablecoin regulation as compared to a Federal approach.

A.7. State money transmitter rules do not provide an adequate framework for regulation of stablecoins. These regimes do not adequately address the financial stability risks, payment system risks, and concerns about concentration of economic power that would arise if stablecoins become a widely used means of payment. There is also considerable variation among money transmitter rules across States, with money transmitter rules in certain States not applying to stablecoins (or other digital assets) at all. In States where money transmitter rules do apply to stablecoin issuers, financial resource requirements are often significantly lower than for other prudentially regulated entities.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JEAN NELLIE LIANG

Q.1. White supremacy is an existential threat for our country. According to the Department of Homeland Security, domestic violent extremism is now the greatest terrorism threat to the U.S., and cryptocurrency is increasingly funding these domestic terrorists. The data analytics firm Chainalysis found certain alt-right groups that participated in the January 6th insurrection received over \$500,000 in Bitcoin from a single donor a month prior. According to other reporting, the founder of a neo-Nazi website has taken in at least 112 Bitcoin since January 2017—worth over \$4.7 million today. According to the Southern Poverty Law Center, it is more

difficult now to track these hate groups and domestic terrorists because of their use of virtual money.

Does Treasury have the tools and resources it needs to track domestic terrorists' use of virtual currencies?

A.1. Tracking and disrupting the flow of funds to terrorists is an integral part of Treasury's counterterrorism efforts. In some instances, foreign-based racially or ethnically motivated violent extremist (RMVE) groups and some domestic violent extremists (DVEs) have sought to solicit or transfer funds in virtual assets or expressed interest in using virtual assets to move funds pseudonymously or through anonymity-enhancing technologies. For some groups, the use of virtual assets represents an opportunity to evade transparency compared to other financial services. For others it is an alternative to online payment platforms that will no longer permit them to use their services. Additionally, some of these groups make extensive use of social media and encrypted applications to reach potential supporters and rely largely on online solicitations. As virtual asset penetration in the overall economy increases, we assess the usage by terrorists is also likely to increase.

Identifying and disrupting financial facilitators of DVEs has already been a priority in Treasury's work to ensure financial institutions meet their anti-money laundering/countering the financing of terrorism (AML/CFT) obligations. For example, in 2020 Treasury assessed a \$60 million civil money penalty against the virtual asset mixing service Helix. Among Treasury's findings, which are publicly available on its website, was that Helix failed to implement policies, procedures, and internal controls to prevent the service from being exploited by White nationalist/neo-Nazi groups.¹

Existing laws and regulations sufficiently support Treasury efforts to address this threat, although we will continue to reassess our authorities in light of its evolving nature. The additional resources requested in the President's FY 2023 Budget to hire staff and provide technical training would enhance our capabilities in this area.

Treasury, alongside interagency partners, is currently addressing vulnerabilities posed by virtual assets in several ways:

- Treasury is encouraging and supporting foreign jurisdictions in addressing significant weaknesses in implementing international standards on AML/CFT regulation and supervision for virtual assets and related service providers.
- Treasury is also working to ensure foreign-located virtual asset service providers (VASPs) doing business in whole or substantial part in the United States register with the Financial Crimes Enforcement Network (FinCEN) and implement AML/CFT requirements.
- Investigators and regulators have significant visibility into financial transactions involving virtual assets, such as cryptocurrency, due to the frequent use of assets operating on transparent blockchains. The United States continues to invest in technology and training to help investigators, analysts, and

¹ See, "Harmon Helix-Assessment and Statement of Facts" ([fincen.gov](https://www.fincen.gov)).

regulators benefit from the transparency of public blockchains for AML/CFT purposes.

- Treasury also continues to engage with the domestic and international private sector to enhance their understanding of existing obligations. At this time of rapid growth in the virtual asset sector, it is imperative that the United States lead on establishing the global model for supervision, examination, and private sector compliance with existing regulatory obligations.
- Working through the Financial Action Task Force (FATF) and its global network, Treasury has assisted financial institutions and authorities in identifying terrorist use of virtual assets. This includes producing several reports that examine specific aspects of how terrorist groups and individuals raise, move, and use funds. The FATF also drafted and recently updated a set of risk indicators that financial institutions and authorities can use to identify terrorist financing activity through virtual assets.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK
FROM JEAN NELLIE LIANG**

Q.1. Under Secretary Liang, with regard to communities that are traditionally underserved by banking institutions, including low- and moderate-income households, communities, and color, and rural communities, what has been the adoption and use patterns of stablecoins?

A.1. While data in this area is sometimes difficult to come by or verify, some survey data suggests that Black Americans and Hispanic Americans may be more likely to own cryptocurrencies than White Americans.

We know that today's financial system does not work for many Americans, particularly Americans of color and low-income Americans, who are disproportionately likely to lack access to bank accounts and other financial tools. Innovations like stablecoins, and other digital assets, may have the potential to increase the inclusion of these people in the financial system. But digital assets are not subject to consistent regulatory safeguards—meaning they pose an elevated risk to consumers and investors, and might even raise risks to financial stability.

These are issues that we are following closely, including by launching a new working group as part of the interagency Financial Literacy and Education Commission, which will assess the risks and benefits that adoption could present for communities that have traditionally not been well served by banking institutions, and produce resources for consumers and investors to more fully understand this set of products.

Q.2. Is it accurate to say that the expanded use of digital currencies like stablecoins would help these underserved communities, or would it exacerbate existing disparities in access to financial products?

A.2. Treasury supports responsible innovations that could contribute to a more efficient, resilient, and inclusive payments system. It is possible that well-designed and appropriately regulated

stablecoins could serve as a useful means of payment for some unbanked and under-banked individuals. At the same time, we should be mindful that lack of access to technology, as well as other factors that now keep people out of the financial system, could also be barriers in the context of stablecoins.

Q.3. Would prudential oversight over stablecoins issuance and custodial wallet providers reduce the run risk of stablecoins?

A.3. Yes. Requiring issuers to be insured depository institutions reduces these risks. Failure of stablecoins to maintain a stable value could harm stablecoin users and lead to stablecoin runs that could damage financial stability. The status quo is simply not adequate to address the prudential risks posed by stablecoins, and the best way to address these risks is through legislation. In the PWG report, we recommended to the President a legislative solution that would comprehensively address all of the prudential risks identified in the report, which are risk of runs, payment system risks, and risks of concentration of economic power.

Q.4. When examining systemic risks for stablecoins, how much exposure currently lies with low- and moderate-income households who may be invested in stablecoins?

A.4. Please see my answer to Question 1.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM JEAN NELLIE LIANG

Q.1. The New York Fed recently published a blog post entitled, “The Future of Payments is Not Stablecoins”. The authors note that bank-issued stablecoins—backed by cash or similar reserves and issued by a bank—“necessarily” tie up liquidity at the bank, presumably money that could be deployed in communities in South Carolina and around the country.

Are there other methods, such as the use of tokenized deposits, which are not stablecoins, that could be used by banks to increase transaction speed and security, without freezing capital that could otherwise be lent to deserving borrowers?

A.1. As described in the blog post by staff of the Federal Reserve Bank of New York, the basic distinction between stablecoins and tokenized deposits is that whereas stablecoins would be backed 1:1 by high-quality liquid assets, tokenized deposits could be backed by loans and other bank assets. As discussed in the blog post, there are important considerations that inform adoption of stablecoins relative to other existing or future payments products. Currently, stablecoins are growing rapidly and, as discussed in the PWG Report, are not subject to a consistent and comprehensive regulatory framework to address the risks that they present.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGERTY FROM JEAN NELLIE LIANG

Q.1. Undersecretary, during your testimony before the Committee, you made some blanket statements in response to questions about the lack of regulatory oversight on reserves of stablecoins. In particular, when asked if market participants are able to verify port-

folio holdings backing stablecoins, you stated that “some issuers, perhaps under pressure from investors and regulators, are providing self-audited statements on their holdings but regulators are not in place to confirm those or set those standards for them.”

You further stated, in response to a question about the disclosures of risks to customers, “they are not required to by any regulators because they are not regulated”.

Is this true of issuers that are regulated as State-chartered trust companies?

A.1. Today, information regarding stablecoin reserves is inconsistent. Some issuers provide this information on a voluntary basis, but these disclosures are not uniform or at regular intervals across issuers. It is also important to note that, while disclosure is an important tool, it is not alone sufficient to address the risks identified by the PWG. In particular, these risks include (1) risk of destabilizing runs, (2) risk due to disruptions in payments, and (3) risks of concentration of economic power.

Q.2. During the hearing, you and I had an exchange about existing State regulatory structures and not foreclosing their use.

Isn't it true that there are stablecoin issuers that are trust banks and that do, in fact, have regulators in place to confirm and set standards for reserves and have primary prudential regulation over those companies?

A.2. Typically, State-chartered limited-purpose trust companies are permitted to act as fiduciaries, trustees, grantees and provide other safekeeping and custody services. State chartering and oversight of trust companies is designed for these purposes.

Q.3. Such statements certainly feed into the findings and recommendations of the PWG report that all stablecoins should be issued by insured depository institutions, but they do not tell the whole story.

A.3. See response to Question 4.

Q.4. Would you please explain why the PWG report as well as your testimony fails to properly acknowledge that there are State and Federal regulatory structures that exist that do provide oversight over reserves and business activities and that at least some companies have chosen to organize themselves under those structures that provide the very oversight you claim is needed in the market?

A.4. As part of the development of the PWG report and its recommendations, the PWG engaged with a broad range of stakeholders, including with some State regulators. We appreciate the experience of State regulators in supervising and regulating digital assets and digital asset intermediaries and look forward to continued discussions with them. The PWG recommendations seek to establish clear, consistent, and comprehensive rules for stablecoin wallet providers and stablecoin issuers. As discussed in the report, these rules can and do build on State-based regulation and Federal frameworks. For example, “insured depository institutions” include both State-chartered and federally chartered banks and thrifts.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

STATEMENT SUBMITTED BY ICBA



The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing titled: "Examining the President's Working Group on Financial Markets' Report on Stablecoins."

We appreciate the Committee's examination of fundamental issues related to stablecoins and are pleased to share the community bank perspective. To ensure that innovation is undertaken safely, ICBA advocates for a comprehensive, coordinated regulatory approach for the reasons described below.

Community Banks and Digital Assets

Wider adoption of digital assets, including stablecoins and other cryptocurrencies, is altering global digital commerce and the global financial system. Community banks keep pace with innovation to remain viable, relevant and continue to serve their communities. Numerous financial service providers, including financial technology companies, now offer consumers and businesses access to cryptocurrency-related activities, such as investments, lending, and custodial services. Although stablecoins and other cryptocurrencies are still not widely used for payments, several crypto companies are developing solutions to enable crypto payments for consumers and businesses. Community banks are beginning to explore offering digital assets services to meet customer demand and want to ensure they can do so safely.

ICBA is working with community bankers to educate their staffs on all forms of digital assets, follow market and regulatory developments, and evaluate their exposure to these assets through customer activities. Community bank involvement, as regulated financial institutions, will help mitigate risks presented by stablecoins and other cryptocurrencies, provided it can be done under a rigorous and thoughtful regulatory framework.

Community banks have a strong interest in ensuring that digital assets such as stablecoins do not create systemic, investor, or consumer risk. As described below, ICBA is concerned with stablecoins' potential risks to end-users, the financial system, and national security. These risks must be addressed by appropriate safety and soundness requirements.

Stablecoins

Stablecoins are digital assets that are issued and transferred using distributed ledger technologies and are purported to maintain a stable value relative to a national currency or other reference asset or assets. ICBA is concerned that stablecoins, including those backed by fiat currencies, may erode monetary authority, threaten financial stability, and risk community bank disintermediation. This is particularly true of privately issued stablecoins.

The President's Working Group on Financial Markets (PWG) report on digital assets rightly reflects ICBA concerns that continued, rapid stablecoin growth creates accelerating risks for consumers, the financial system, and the broader economy. In addition, the November 2021 Financial Stability Report of the Board of Governors of the Federal Reserve, quoted below, identifies the following risks associated with stablecoins:

- "Certain stablecoins, including the largest ones, promise to be redeemable at any time at a stable value in U.S. dollars but are, in part, backed by assets that may lose value or become illiquid. **If the assets backing a stablecoin fall in value, the issuer may not be able to meet redemptions at the promised stable value.**"
- "Accordingly, these stablecoins have structural vulnerabilities similar to (...) certain money market funds and are susceptible to runs.



- “These vulnerabilities may be exacerbated by a lack of transparency and governance standards regarding the assets backing stablecoins. **The potential use of stablecoins in payments and their capacity to grow can also pose risks to payment and financial systems.**”

To amplify the analysis of the Federal Reserve, stablecoins create the risk of a destabilizing run on redemptions which could ripple through the financial system. This risk is compounded by a lack of transparency into reserves backing stablecoins, which is needed to reassure investors in times of uncertainty. Moreover, the dramatically increasing scale of stablecoins in circulation represents a concentration of economic power and risk, potentially distorting American finance and commerce.

Policy Recommendations

ICBA encourages policymakers to harmonize regulations to ensure strong, clear, and consistent oversight of all cryptocurrency providers, including those that deal in stablecoin.

- Congress should act to ensure that stablecoins are subject to appropriate federal prudential oversight. Any regulatory regime applied to cryptocurrency, including stablecoin, should be comparable to the same regulations applicable to traditional, functionally similar payments products and services offered by the banking system.
- The scope of regulation should include capital adequacy and reserves; activity restrictions; due diligence; information security and privacy; business resiliency; ownership and control of data; anti-money laundering and anti-terrorist financing; reporting and maintenance of books and records; consumer protections; safeguarding customer information; vendor and third-party management; and ongoing examination.
- A more comprehensive, coordinated regulatory approach by banking and market regulators, including the Securities and Exchange Commission and the Commodity Futures Trading Commission, could help address risks, dispel confusion in the marketplace, and prompt more community banks to explore digital asset products and services to address customer needs. Stablecoin companies are not subject to comprehensive consolidated supervision, which allows for risks to multiply and creates an unequal playing field with banks.
- The harmonization of regulations will not only address risk—the additional clarity can level the playing field and create opportunities for more community banks to consider offering digital products and services, including stablecoin. Without such information, many banks may choose not to engage in digital asset activities.
- Collaboration can also help to ensure that the development of digital assets will not harm the integrity of the U.S. financial system by disintermediating community banks. Without harmonization among all the banking regulators, community banks that are not regulated by the OCC may find they are at a competitive disadvantage relative to their OCC-regulated peers and non-bank digital asset companies.
- Stablecoins must be brought within the regulatory perimeter. Appropriate federal oversight is needed to close regulatory gaps and mitigate the risk of regulatory arbitrage regardless of how these digital assets are classified by policy makers. The regulatory framework should address risks posed by any entity within a stablecoin arrangement that participates in the creation, transfer, or storage of stablecoins. Unregulated entities should not be permitted to issue stablecoins.



- A consistent federal regulatory framework for stablecoins should balance their benefits and risks and preserve the separation of banking and commerce.

Decentralized Finance

A further reason for regulation of stablecoins is their role in enabling the rise of a shadow banking system known as decentralized finance (DeFi). DeFi is a growing ecosystem of financial applications that run on public blockchains, such as Ethereum. DeFi applications, known as dApps, rely on smart contracts – or complex automated programming most consumers would find difficult, if not impossible, to evaluate and understand – to execute specific functions in an effort to replicate traditional products and services like payments and lending. However, DeFi is designed to deliver this variety of financial services without the use of centralized parties, such as banks, insurance companies, or brokerages. DeFi relies on stablecoins to function.

Policymakers must recognize that DeFi threatens to disintermediate community banks and create a shadow banking system filled with unregulated platforms that pose risks to consumers, the financial system, and U.S. national security. DeFi protocols are also frequent targets of hacks and other malicious activity that result in substantial losses for users. Last August, [\\$600 million was stolen from Poly Network](#) in a hack, though the funds were later recovered, and just last week, [\\$320 was stolen from Wormhole](#). Between October 2020 and April 2021, [nearly 7,000 consumers](#) filed complaints with the Federal Trade Commission reporting crypto scam losses exceeding \$80 million.

For these reasons, ICBA encourages regulators to collaborate on a comprehensive approach to DeFi to address the significant risks it poses as a shadow banking system.

Special-Purpose Bank Charters

ICBA strongly opposes granting special-purpose bank charters to stablecoin or other cryptocurrency companies that do not fully meet the requirements of federally insured chartered banks. These novel charters for non-banks firms raise a number of regulatory concerns—such as violation of the long-standing principle of the separation of banking and commerce, lack of application of traditional banking statutes and regulations governing safety and soundness and consumer protection, and the potential introduction of systemic risk into the payments system. We welcome the choice of certain stablecoin companies to pursue a standard bank charter.

Closing

ICBA and community bankers look forward to continuing to work with policymakers to balance the benefits of innovation in digital assets with their safety and soundness risks.

Thank you for your consideration of the community bank perspective.

STATEMENT SUBMITTED BY ABA

Statement for the Record¹*On Behalf of the***American Bankers Association***Before the***United States Senate***Committee on***Banking, Housing, and Urban Affairs****February 15, 2022**

Chairman Brown, Ranking Member Toomey, and distinguished Members of the Committee, the American Bankers Association (ABA)¹ appreciates the opportunity to submit a statement for the record for the hearing titled "Examining the President's Working Group on Financial Markets Report on Stablecoins." The topic of today's hearing is an important one.

The origins of cryptocurrency were driven by the desire to build a "trustless" financial system, where parties can transact directly with each other without the need for intermediaries. But the trust inherent in our regulated banking system is important to consumers and as interest in cryptocurrencies and other digital assets such as stablecoins continues to grow, consumers engaging with digital assets most often seek out trusted financial institutions to act as financial intermediaries.² ***ABA believes that customers who choose to access digital asset markets, including stablecoins, will be best served when they can do so through fully regulated banks where they are afforded robust consumer protection.*** To accommodate this customer demand, banks are actively developing ways to safely and responsibly allow their customers to buy, hold, and sell digital assets through their existing banking relationships, as well as become involved in stablecoin arrangements. We have encourage regulators to acknowledge that such digital asset activities are generally permissible for banks, as

¹ The ABA is the voice of the nation's \$23.3 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$19.2 trillion in deposits and extend \$11 trillion in loans.

² See, e.g., NYDIG, *Survey: Bitcoin + Banking* (Jan. 2021), https://assets-global.website-files.com/614e11536f66309636c98688/616db2743df0d03cf3824093_NYDIG-Survey-Bitcoin-Banking.pdf.

functions incidental to the permissible banking activities, when conducted in a safe and sound manner, notwithstanding the novel technology involved.³

Recently, the President's Working Group on Financial Markets, together with the FDIC and OCC, released a report on stablecoins that are pegged or linked to the value of fiat currencies (**Report**).⁴ Given the risks these products pose to consumers, the payments system, and the broader financial system, the Report recommends that Congress act promptly to enact legislation to ensure that stablecoin arrangements are subject to a consistent and comprehensive federal prudential regulatory framework. The Report also identifies certain interim measures detailing how financial and banking regulators can address stablecoin risks falling within their respective jurisdictions. In addition, in the absence of Congressional action, the Report recommends that the Financial Stability Oversight Council (FSOC) consider steps to address the risks outlined in the Report. ***ABA agrees that action is urgently needed to address the gaps in the federal regulation of the stablecoin market and urges Congress to enact the Report's recommendations.***

Stablecoins are unique among digital assets in that their stable value positions them as a functional alternative to a traditional deposit account. This introduces a new set of risks that banking regulations are well positioned to address. Stablecoins often seek to maintain their stable value by holding reserve assets and offering to redeem a stablecoin one-to-one for its fiat counterpart. When offered through a bank, these assets are subject to oversight that ensures the reserves are sound and there is appropriate liquidity to pay outstanding claims. That oversight is also critical to assure that the responsible party can and will deliver the reserve asset according to the terms of the stablecoin arrangement upon redemption. Even if stablecoins remain outstanding and unredeemed, their usefulness in payments transactions depends upon this degree of stability. However, many stablecoins today are issued by non-banks which are not subject to the same oversight designed to mitigate the risks they pose to consumers and the financial system.

The lack of regulation for nonbanks is particularly concerning as the rapidly evolving uses of stablecoins is fueling significant market growth. To date, stablecoins have primarily been used to facilitate digital asset trading and lending activities, but

³ See ABA Comment Letter on FDIC RFI on Digital Assets (July 15, 2021), <https://www.aba.com/advocacy/policy-analysis/aba-comment-letter-on-fdic-rfi-on-digital-assets>; see also OCC Interpretive Letter No. 1179, Chief Counsel's Interpretation Clarifying: (1) Authority of a Bank to Engage in Certain Cryptocurrency Activities; and (2) Authority of the OCC to Charter a National Trust Bank (Nov. 18, 2021), <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdf> <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1172.pdf>.

⁴ President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins* (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

increasingly they are being used as a store of value and means of payment for real-world goods and services (e.g., Facebook/Meta's new digital wallet using stablecoins, called "Novi Wallet").

While enthusiasts claim that stablecoins have the potential to support faster and more efficient payments options, any innovations come from a position of strength. The United States has one of the most efficient, safe, and modern payments systems in the world. Banks have invested significant resources in expanding faster, safer, more inclusive options, including P2P, real-time payments systems (e.g., The Clearing House Real Time Payment Network (RTP) and the Federal Reserve's FedNow), and upgraded Automated Clearing House (ACH) products.

In contrast, many non-bank stablecoins are designed to circumvent this established regulatory architecture and pose a number of unmitigated risks including harm to consumers, the potential for stablecoin runs, and payment system risks, the latter of which could spill over into the broader financial system. The possibility that some stablecoins may rapidly scale, particularly as affiliates of commercial entities, also raises additional issues related to the concentration of economic power and concerns that transactions through unregulated entities may compromise protections against money laundering and terrorist financing.

Existing regulation of stablecoin arrangements is neither comprehensive nor sufficient to address these nonbank risks. The Securities and Exchange Commission (**SEC**) and the Commodity Futures Trading Commission (**CFTC**) exercise jurisdiction over certain aspects of stablecoin activity. At the state level some states subject virtual currencies, including stablecoins, to money transmission laws, but other states are undecided in their approaches. While these state laws are often aimed at a range of policy goals, including consumer protection and prevention of payment instrument default, they are not consistently applied and lack rigorous supervision and enforcement. This has resulted in a patchwork of guidance at a state and federal level that fails to ensure that all stablecoin arrangements are subject to appropriate prudential oversight on a consistent and comprehensive basis and that consumer financial protection laws are rigorously enforced.⁵ This is particularly troubling in the case of stablecoins that may pose systemic significance once scaled.

Accordingly, ABA supports appropriate regulatory and legislative actions to provide a comprehensive federal regulatory framework for stablecoins. While Congressional action is pending, we encourage regulatory agencies to use their existing authorities to identify and address the risks of nonbank stablecoin arrangements, as well as FSOC to

⁵ Accepting and transmitting activity denominated in stablecoins does make a person a money transmitter under the Bank Secrecy Act (**BSA**). As a result, administrators of stablecoins, and potentially other participants in stablecoin arrangements, are required to register as money transmitter businesses (**MTBs**) with the Financial Crimes Enforcement Network (**FinCEN**) and become subject to AML and sanctions requirements. However, FinCEN has delegated its supervisory authority to a variety of different entities.

engage in a determination of whether certain activities conducted within a stablecoin arrangement are, or are likely to become, systemically important payment, clearing, and/or settlement activities.

In connection with this, ABA wishes to emphasize that any regulatory or Congressional action should:

- Provide a clear and comprehensive definition of “stablecoin” that avoids creating loopholes or permitting regulatory arbitrage and that clearly differentiates stablecoins from other types of digital assets. This would also ensure the regulatory treatment of stablecoins is appropriately calibrated to their risks;
- Recognize that nonbank stablecoin arrangements can pose *both* systemic risks *and* consumer and investor protection concerns, making it critical to regulate not just stablecoin issuers, but also other participants in the stablecoin ecosystem, including custodial wallet providers and parties engaged in the business of stablecoin trading and/or brokerage;
- Encourage banking and financial regulators to collaborate on and coordinate a comprehensive approach to prevent the rise of unregulated (or under-regulated) stablecoin issuers and platforms that could pose risks to consumers, investors, the financial system, and the general economy; and
- Provide consistent treatment of banks and non-banks that engage in similar stablecoin activity to prevent regulatory arbitrage and ensure all customers are protected equally.

* * *

ABA Assessment of Legislative Recommendations in the PWG Report	
Legislative Recommendations	ABA Assessment
Stablecoin Runs: Require stablecoin issuers to be insured depository institutions, subject to appropriate supervision and regulation at the depository institution and the holding company level, and require them to be subject to standards and regulations aimed at managing liquidity risk.	ABA supports this recommendation. A key risk related to the use of stablecoins is the possibility for loss of value. The design of Stablecoins sets them up as a store of value that can be used as an alternative to bank deposits. To protect stablecoin users and prevent stablecoin runs it is critical to maintain trust in the value of a stablecoin. The PWG report identifies the following factors that could undermine this confidence: (1) use of reserve assets that could fall in price or become illiquid; (2) a failure to appropriately safeguard reserve assets; (3) a lack of clarity regarding the redemption rights of stablecoin holders; and (4) operational risks related to cybersecurity and the collecting, storing, and safeguarding of data. Banking regulation is designed to address exactly these risks and requiring stablecoin issuers to be insured depository institutions is the most effective way to address them while guarding against stablecoin runs. This would provide for supervision on a consolidated basis; prudential standards; and, potentially, access to appropriate components of the federal safety net. Furthermore, insured depository institutions, which include both state and federally chartered banks and savings associations, have deposits that are covered, subject to legal limits, by deposit insurance, and have access to emergency liquidity and Federal Reserve services, unlike stablecoin issuers that are not insured depository institutions.
Payment System Risk: Require custodial wallet providers to be subject to appropriate federal oversight.	ABA supports these recommendations. Custodial wallet providers play a key role in the stablecoin ecosystem and should be

Provide the federal supervisor of a stablecoin issuer with the authority to require any entity that performs activities that are critical to the functioning of the stablecoin arrangement to meet appropriate risk-management standards.	subject to appropriate federal oversight to address payment system risk. This should include, among other things, requirements for clear and complete disclosures and protections against fraud, manipulation, and related risks, as well as appropriate risk management standards. Oversight at the federal level is critical because there is a patchwork of guidance at the state and federal level that fails to ensure that all stablecoin arrangements are subject to appropriate prudential oversight on a consistent and comprehensive basis and that consumer financial protection laws are rigorously enforced, and that the entities issuing stablecoins are subject to rigorous supervision and enforcement.
Systemic Risk and Concentration: Require stablecoin issuers to comply with activities restrictions that limit affiliation with commercial entities. Supervisors should have authority to implement standards to promote interoperability among stablecoins. In addition, Congress may wish to consider other standards for custodial wallet providers, such as limits on affiliation with commercial entities or on use of users' transaction data.	ABA supports imposing activities restrictions that limit the affiliation of stablecoin issuers with commercial entities to prevent inappropriate concentrations of economic power and to address additional concerns about systemic risk. Interoperability among stablecoins and between stablecoins and other payment instruments is critical in order not to disrupt existing payments systems. Appropriate restrictions that limit affiliation of custodial wallet providers with commercial entities and the use of users' transaction data will help to prevent concentration of economic power.

LETTER SUBMITTED BY THE CLEARING HOUSE



February 11, 2022

Via Electronic Submission

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Patrick J. Toomey
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: Statement for the Record – Senate Banking Committee Hearing, “Examining the President’s Working Group on Financial Markets Report on Stablecoins”

Chairman Brown, Ranking Member Toomey & Distinguished Members of the Committee:

The Clearing House Association, L.L.C. (“The Clearing House”)¹ appreciates the Senate Banking Committee’s efforts to examine the opportunities and risks presented by stablecoins and stablecoin arrangements, and welcomes the opportunity to submit this statement for the record for the hearing: “Examining the President’s Working Group on Financial Markets Report on Stablecoins” (the “Hearing”).² This statement focuses on the explosive growth of stablecoins, the significant and diverse risks presented by stablecoins/stablecoin arrangements, and the inadequacy of state money transmitter licensing regimes as a regulatory framework for addressing those risks.

Growth of Stablecoins/Stablecoin Arrangements

Stablecoin issuers and arrangements have proliferated in the eight years since the first stablecoin was issued,³ and Stablecoins are growing at a remarkable pace. According to the

¹ The Clearing House Association, L.L.C., the country’s oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S., clearing and settling more than \$2 trillion each day. See The Clearing House’s web page at www.theclearinghouse.org.

² See U.S. Senate Committee on Banking, Housing, and Urban Affairs, “Hearings” page, listing the hearing “Examining the President’s Working Group on Financial Markets Report on Stablecoins” for Feb. 15, 2022.

³ Tether, the first “blockchain-enabled platform to facilitate the digital use of traditional currencies [as] a familiar, stable accounting unit,” was launched in 2014. See Tether, “What is Tether?” (available at: <https://tether.to/facts/>).



November report on stablecoins issued by the President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, as of October 2021, "[t]he market capitalization of stablecoins issued by the largest stablecoin issuers exceeded \$127 billion" – a "nearly 500 percent increase over the preceding twelve months";⁴ and according to research conducted in connection with a House Financial Services Committee hearing on stablecoins held last week, "[a]s of February 3, 2022, stablecoins reached an estimated \$174 billion in market capitalization."⁵ Private estimates show a similar, if not more rapid, rate of increase – suggesting as much as a 600 percent increase from 2020 to 2021;⁶ and the rate of growth is even faster when looking at specific stablecoins.⁷ One of the most popular stablecoins, Binance USD, has experienced a 1000% increase in the past year.⁸

With respect to specific stablecoins, just three of them – Tether, USD Coin, and Binance USD – collectively represent more than a \$143 billion in market capitalization. As of the end of January 2022, Tether's market capitalization was estimated to be approximately \$78.2 billion, USD Coin (the stablecoin offered by Circle) was estimated to have a market capitalization of \$49.8 billion, and Binance USD was estimated to have a market capitalization of \$15.3 billion.⁹ Additionally, stablecoin arrangements under development from firms with global footprints, such

⁴ President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, "Report on STABLECOINS" (Nov. 2021), p. 7 (available at: https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf).

⁵ Majority Committee Memorandum, "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins" (Feb. 3, 2022), p. 2 (available at: <https://financialservices.house.gov/uploadedfiles/hhrg-117-ba00-20220208-sd002.pdf>). Information on the full hearing is available at: <https://financialservices.house.gov/events/eventsingle.aspx?EventID=409026>. See also Senate Banking Committee, "Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?" Full Committee Hearing (Dec. 14, 2021) (available at: <https://www.banking.senate.gov/hearings/stablecoins-how-do-they-work-how-are-they-used-and-what-are-their-risks>).

⁶ See Timothy G. Massad, "Regulating stablecoins isn't just about avoiding systemic risk," Brookings (Oct. 5, 2021) (available at: <https://www.brookings.edu/research/regulating-stablecoins-isnt-just-about-avoiding-systemic-risk/>) (estimating that as of August 2021 market capitalization of stablecoins was approximately \$120 billion); and Andrew Ross Sorkin, et al., "Here Come the Crypto Rules," The New York Times (Sept. 24, 2021) (available at: <https://www.nytimes.com/2021/09/24/business/dealbook/stablecoin-crypto-regulation.html>) (estimating that as of mid-September 2021 dollar-tied stablecoins in circulation had a value of \$125 billion) (a September 2021 market capitalization of stablecoins between \$120 and \$125 billion represents a 600% increase from 2020 (see "Report on STABLECOINS," *supra* note 4, at p. 7, footnote 20 (noting that the Stablecoin supply in October 2020 was approximately \$21.5 billion))).

⁷ See, for example, CoinMarketCap, "Binance USD," at one year Market Cap (available at: <https://coinmarketcap.com/currencies/binance-usd/>) (showing a 1000% increase in market capitalization for Binance USD) (Jan. 31, 2022), and "USD Coin," at one year Market Cap (available at: <https://coinmarketcap.com/currencies/usd-coin/>) (showing a more than 800% increase in market capitalization for USD Coin).

⁸ CoinMarketCap, "Binance USD," at one year Market Cap (available at: <https://coinmarketcap.com/currencies/binance-usd/>) (showing a 1000% increase in market capitalization for Binance USD) (Jan. 31, 2022).

⁹ See CoinMarketCap at Tether, USD Coin, and Binance USD, respectively (available at: <https://coinmarketcap.com/currencies/tether/>; <https://coinmarketcap.com/currencies/usd-coin/>; and <https://coinmarketcap.com/currencies/binance-usd/>, respectively) (Jan. 31, 2022).



as global technology companies, or social media platforms, have the potential for immense scale and significant, if not systemic, importance immediately upon release into the marketplace.¹⁰

Risks Presented by Stablecoins

The emergence of stablecoin issuers and explosive growth of stablecoin arrangements pose a bevy of significant risks. These risks are not merely theoretical.¹¹ For example, stablecoin issuers have abruptly decided to shut down operations;¹² stablecoin arrangements have suffered massive, sudden shocks due to internal and external manipulation and attack, including cyber-attack;¹³ stablecoin issuers have been found to have made material misrepresentations about backing/reserve status;¹⁴ and stablecoin arrangements have suffered from developmental

¹⁰ See Sergio Goschenko, “Facebook’s Novi Launches Pilot Program in Guatemala and US Using Pax Dollar,” Bitcoin.com (Oct. 20, 2021) (available at: <https://news.bitcoin.com/facebook-novi-launches-pilot-program-in-guatemala-and-us-using-pax-dollar/>) (noting that Facebook’s digital wallet Novi will be initiating a pilot program using the Pax Dollar, with Coinbase serving as a custodian, and that although Diem is not being used as a transactional asset for the pilot the intention is for Diem to be used by Novi in the future), and Bank for International Settlements, “Stablecoins: risks, potential and regulation,” BIS Working Paper No 905 (Nov. 2020) (available at: <https://www.bis.org/pub/work905.pdf>), pp. 9-13 (discussing the potential significance of a global technology company issuing a stablecoin), but see Peter Rudegeair and Liz Hoffman, “Facebook’s Cryptocurrency Venture to Wind Down, Sell Assets: Diem Association is selling its technology to crypto-focused bank Silvergate for \$400 million,” The Wall Street Journal (Jan. 27, 2021) (reporting that Facebook (now Meta Platforms Inc.) has a deal in place to sell assets associated with its planned stablecoin, Diem).

¹¹ The G20, for example, has undertaken a study of the risks to the international monetary system presented by stablecoins. See G20, “Assessing the impact of stablecoins on the international monetary system: G20 and IMF to study the impact of Facebook’s Libra project,” G20 Insights (Dec. 10, 2020) (available at: https://www.g20-insights.org/policy_briefs/assessing-the-impact-of-stablecoins-on-the-international-monetary-system-g20-and-imf-to-study-the-impact-of-facebooks-libra-project/).

¹² See, for example, “Cryptocurrency project Basis to shut down and return funding to investors,” Reuters (Dec. 13, 2018) (noting that a project to launch a stablecoin called “Basis” was shutting down after soliciting over \$133 million in investments), and Tomio Geron and Yuliya Chernova, “‘Stablecoin’ Project Basis Is Shutting Down After Raising \$135 Million,” The Wall Street Journal (Dec. 13, 2018) (available at: <https://www.wsj.com/articles/stablecoin-project-basis-is-shutting-down-after-raising-135-million-11544730772>).

¹³ See Emily Nicolle, “Crypto.com suspends withdrawals after ‘unauthorized activity,’” Los Angeles Times (Jan. 17, 2022) (available at: <https://www.latimes.com/business/story/2022-01-17/crypto-com-suspends-withdrawals-unauthorized-activity>) (noting that cryptocurrency and stablecoin wallet provider crypto.com stopped all deposits and withdrawals while investigating “unauthorized activity” and that Coinbase, Binance, and Kraken all experienced outages in 2021), Arjun Kharpal and Ryan Browne, “Hackers return nearly half of the \$600 million they stole in one of the biggest crypto heists,” CNBC (Aug. 11, 2021) (noting that \$33 million of Tether was part of a successful hacking of Poly Network, a platform that connects different blockchains together), and Yael Bizouati-Kennedy, “Stablecoin SafeDollar Crashes to \$0 Following Cyberattack,” GOBankingRates.com (June 29, 2021) (available at: <https://www.yahoo.com/news/stablecoin-safe-dollar-crashes-0-following-122357249.html>). See also U.S. Securities and Exchange Commission, “Investor Alert: Bitcoin and Other Virtual Currency Investments” (May 7, 2014) (available at: <https://www.sec.gov/oiaa/investor-alerts-bulletins/investor-alert-bitcoin.html>) (noting the risk that cryptocurrency exchanges may stop operating or permanently shut down due to fraud, technical glitches, hackers or malware).

¹⁴ See “In the Matter of Investigation by Letitia James, Attorney General of the State of New York, of iFinex Inc., BFXNA Inc., BFXWW Inc., Tether Holdings Limited, Tether Operations Limited, Tether Limited, Tether International Limited,” settlement agreement (Feb. 18, 2021), pp. 3-13 (available at: https://ag.ny.gov/sites/default/files/2021.02.17_-_settlement_agreement_-_execution_version-b-t-signed-e2_oag_signed.pdf) (finding that material misrepresentations had been made about the backing of Tether). See also



difficulties and design challenges.¹⁵ Additionally, the absence of comprehensive and consistent supervision and examination of stablecoin issuers and arrangements means that matters routinely addressed in the supervision and examination processes of regulated financial institutions – matters such as capital and liquidity, operational risk, third party risk management, data security, data privacy, and anti-money-laundering and sanctions compliance – may be left unaddressed, resulting in stablecoin end-users being exposed to the resulting risks.¹⁶ The protection of consumers and the financial system from the risks associated with stablecoins is too important to leave to a patchwork of state money transmitter laws that may or may not even apply depending on the vagaries of state statutes and individual state interpretations, discussed *infra*. Finally, stablecoins/stablecoin arrangements present a host of anti-money laundering and countering the financing of terrorism risks (“AML/CFT”). The growth and reach of stablecoins, the degree to which stablecoin arrangements permit anonymity, the usability of stablecoins, the exchangeability of stablecoins for fiat currency, and other characteristics of stablecoins all present AML/CFT risks that this Committee has previously identified, and which must be addressed.¹⁷ The Clearing House is currently evaluating ways in which the U.S. Department of the Treasury, including the Office of Foreign Asset Control and the Financial Crimes Enforcement Network (“FinCEN”), might act to address anti-money laundering, terrorist financing and proliferation risks associated with stablecoins, such as through the adoption of certain recommendations of the Financial Action Task Force on Virtual Assets and Virtual Asset

Zeke Faux, “Anyone Seen Tether’s Billions?” Bloomberg (Oct. 7, 2021) (available at: <https://www.bloomberg.com/news/features/2021-10-07/crypto-mystery-where-s-the-69-billion-backing-the-stablecoin-tether/>) (examining Tether’s backing, as well key officers of Tether).

¹⁵ See Nivesh Rustgi, “Algorithmic Stablecoin Crashes 50% as Devs Scramble for a Fix,” Crypto Briefing (Apr. 7, 2021) (available at: <https://cryptobriefing.com/algorithmic-stablecoin-crashes-50-devs-scramble-fix/>) (noting that the algorithmic stablecoin FEI suffered price instability due to a protocol mishap, forcing holders to choose between a reduced value holding (a “lower peg value”) and accepting a penalty of 50% for exchanging their FEI). See also Dr. Ryan Clements, “Built to Fail: The Inherent Fragility of Algorithmic Stablecoins,” 11 Wake Forest L. Rev. Online 113 (Oct. 25, 2021) (available at: <http://www.wakeforestlawreview.com/2021/10/built-to-fail-the-inherent-fragility-of-algorithmic-stablecoins/>) (noting that algorithmic stablecoins have inherent design flaws that make them unstable).

¹⁶ Tellingly, although some proponents of stablecoins suggest that state money transmitter licensing regimes are sufficient to address the risks presented by stablecoins, they were not sufficient to protect consumers from any of the actual risks that are detailed above.

¹⁷ Majority Committee Memorandum, “Digital Assets and the Future of Finance: Understanding the Challenges and Benefits of Financial Innovation in the United States” (Dec. 8, 2021), at pp. 3-4 (noting money laundering, terrorist financing, sanctions evasion, illicit finance, kleptocracy, and other risks of digital assets (including stablecoins) and related service providers); and President’s Working Group on Financial Markets, “Statement on Key Regulatory and Supervisory Issues Relevant to Certain Stablecoins” (Dec. 23, 2020) (available at: <https://home.treasury.gov/system/files/136/PWG-Stablecoin-Statement-12-23-2020-CLEAN.pdf>) (noting AML/CFT risks associated with stablecoins, stablecoin issuers, and stablecoin arrangements). See also “OCC’s Hsu: Stablecoins Can Boost Innovation If Regulated Like Banks,” Pymnts.com (Jan. 15, 2022) (available at: <https://www.pymnts.com/cdn.ampproject.org/c/s/www.pymnts.com/crypto/currency/2022/occs-hsu-stablecoins-can-boost-innovation-if-regulated-like-banks/amp/>) (quoting Acting Comptroller of the Currency Michael Hsu on “the lack of standards and controls in the crypto space,” as risks associated with stablecoins); and Senate Banking Committee, “Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?” Full Committee Hearing (Dec. 14, 2021) (available at: <https://www.banking.senate.gov/hearings/stablecoins-how-do-they-work-how-are-they-used-and-what-are-their-risks>).



Service Providers that are not already part of the AML/CFT framework.¹⁸ The Clearing House anticipates submitting comments on this issue by February 14 in response to FinCEN's request for information on ways to streamline and modernize the AML/CFT regime in the United States.¹⁹

The PWG's, FDIC's & OCC's Report on Stablecoins

The November 1st "Report on STABLECOINS" (the "Report") issued by the PWG, FDIC, and OCC constitutes an important step toward identifying and addressing emerging risks related to stablecoins.²⁰ As the Report recognizes, key stablecoin-related risks include: (i) market integrity risks; (ii) investor protection risks; (iii) illicit finance concerns/money laundering risks; and (iv) prudential risks related to stablecoins used for payments purposes, which can be further classified by: (1) loss of value: risks to users and stablecoin runs; (2) payment system risk; and (3) risks of scale: systemic risk and concentration of economic power.²¹ However, stablecoin-related risks are not limited to those identified in the Report. For example, spillover from runs on stablecoin could easily impact the insured banking system or U.S. payment systems.²² In many instances, stablecoin issuers offer accounts that look like financial institutions' transaction accounts, and accept central bank money or commercial bank money in exchange for stablecoins. Depositors of insured financial institutions may not understand the difference between those systems that store value in, or enable transactions in, insured commercial bank money, versus systems utilizing uninsured stablecoins. Likewise, end-users of stablecoins often do not appreciate that stablecoin issuers and arrangements, depending on the vagaries of state application of money transmitter licensing regimes, discussed *infra*, may not be subject to any form of meaningful regulation and supervision.

The Clearing House encourages the Committee to view stablecoin-related risks not merely as a concern for markets and users, but as a challenge for administrative agencies and governmental actors, and a concern for the continued safe and sound operation of the U.S. financial system.

¹⁸ See Financial Action Task Force, "Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers" (Oct. 20, 2021) (available at: <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets-2021.html>).

¹⁹ Financial Crimes Enforcement Network, "Review of Bank Secrecy Act Regulations and Guidance," 86 Fed. Reg. 71,201 (Dec. 15, 2021).

²⁰ See "Report on STABLECOINS," *supra* note 4.

²¹ *Id.* at pp. 12-15.

²² Although the Report addresses run risks, the likelihood of spillover and contagion is generally not addressed (*but see* "Report on STABLECOINS," note 4, pp. 12 & 14 (observing that there could be "implications" for the financial system of stablecoin runs and that "[t]he perception of the safety of insured depository institutions relative to stablecoins could also shift during times of stress, with large and sudden inflows or outflows of deposits possible")). (The Report addresses stablecoin run risk in detail (*see* pp. 12 & 15).)



State Money Transmitter Licensing Laws

Although some have suggested that state money transmitter licensing regimes provide an adequate regulatory and supervisory framework for stablecoin arrangements,²³ and while The Clearing House acknowledges that some state money transmitter laws may provide some regulatory and supervisory frameworks for stablecoin arrangements, there are significant gaps in such laws, particularly when applied to the unique issues presented by stablecoin arrangements.²⁴ State money transmitter licensing schemes, which largely pre-date the development of stablecoins, are often not fit for purpose, and may not even cover stablecoin arrangements at all.²⁵ While some states have addressed this issue by enacting specific regulations targeting digital currencies,²⁶ the vast majority of states have yet to do so, leaving the potential for significant coverage gaps across the U.S.

²³ Judith Rinearson, "What the President's Working Group got wrong about stablecoins," American Banker BankThink (Nov. 19, 2021) (available at: <https://www.americanbanker.com/opinion/what-the-presidents-working-group-got-wrong-about-stablecoins>).

²⁴ Unique issues presented by stablecoin arrangements include: (a) the potential use of settlement assets that are not liabilities of the money transmitter (i.e., are assets of the issuer) and might carry an additional financial risk; (b) the interdependencies between multiple stablecoin arrangement functions; (c) the degree of decentralization of operations and/or governance; and (d) a potentially large-scale deployment of emerging technologies such as distributed ledger technology. See Committee on Payments and Market Infrastructure & Board of the International Organization of Securities Commissions, "Application of the Principles for Financial Market Infrastructures to stablecoin arrangements," Consultative Report, pp. 4, 7, 9-10 & 19 (Oct. 2021) (available at: <https://www.bis.org/cpmi/publ/d198.pdf>) (noting these issues). See also David Mills et al., "Distributed ledger technology in payments, clearing, and settlement," Board of Governors of the Federal Reserve System, Finance and Economics Discussion Series, pp. 9 & 13 (Dec. 2016) (available at: <https://www.federalreserve.gov/econres/feds/distributed-ledger-technology-in-payments-clearing-and-settlement.htm>) (noting that distributed ledger technology can be utilized in a variety of ways, including as a protocol for an asset transfer).

²⁵ See Rinearson, Cohen & McLaughlin, "Trouble in Paradise: Florida Court Rules That Selling Bitcoin is Money Transmission," K&L Gates U.S. FinTech Alert (Feb. 13, 2019) (available at: <https://www.klgates.com/Trouble-in-Paradise-Florida-Court-Rules-that-Selling-Bitcoin-is-Money-Transmission-02-13-2019>) (noting that some states have "amended their money transmitter statutes to include or exclude virtual currencies explicitly"); California Department of Financial Protection & Innovation, "Re: _____-Opinion Request" letter (Oct. 4, 2019) (available at: <https://dfpi.ca.gov/2019/10/14/virtual-currency-2-10-4-2019/>); and Pennsylvania Department of Banking, "Money Transmitter Act Guidance for Virtual Currency Businesses" (2017/2018) (available at: <https://www.dobs.pa.gov/Businesses/Non-Bank%20Licensees/Money%20Transmitters/Pages/default.aspx>) (posted by the department as of Dec. 29, 2021, and noting that because virtual currency is not "currency or legal tender" it is not covered by Pennsylvania's Money Transmitter Act). See also Montana Department of Administration, "Money Services Businesses" notice (available at: <https://banking.mt.gov/moneytransmitters>) (posted by the department as Dec. 29, 2021, and noting that money services businesses do not need to be licensed with the Montana Division of Banking and there is no legislation in Montana providing for the licensing and supervision of money services businesses).

²⁶ Some states, like New York, Wyoming, and Rhode Island, have addressed the issue by enacting specific regulations targeting digital currencies, but the vast majority of states have yet to do so, leaving significant coverage gaps across the U.S. See, for example, New York State Department of Financial Services, "Virtual Currency Businesses" (available at: https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses) (providing information on New York State's BitLicense).



Reliance on state money transmitter laws to provide a regulatory framework for stablecoins would, in most cases, leave consumer protection up to the vagaries of individual state interpretations of their licensing schemes. For example, in a letter issued in October of 2019, the State of California Department of Business Oversight noted that the operation of a payment network platform that allows consumers to use digital assets to pay for goods and services was not required to be licensed and supervised under California's state money transmitter law.²⁷ Similarly, the Pennsylvania Department of Banking has noted that, "[to] date, bitcoin and other virtual currencies have not been designated by federal law as legal tender" and therefore, "are not 'money,' and their transmittal is not subject to the licensing requirements of [Pennsylvania's Money Transmitter Act]."²⁸ Delaware also ties its licensure requirement to "the transmission or payment of money."²⁹ (5 Del. C. 1953, §§ 2301 - 2319.) While the Office of the State Bank Commissioner and state courts of Delaware do not appear to have opined on application of Delaware's Sale of Checks and Transmission of Money code to cryptocurrencies or stablecoins, if the Delaware code is interpreted the same as in Pennsylvania, the code would not apply. Finally, some states, like Massachusetts and Montana, do not have a licensing scheme that regulates domestic money transmitters and consumers in those states would be left completely unprotected from the risks associated with stablecoins.²⁹

The protection of consumers and the financial system from the risks associated with stablecoins is too important to leave to a patchwork of state money transmitter laws that may or may not even apply depending on the vagaries of state statutes and individual state interpretations. Even if state money transmitter laws apply to stablecoins, they are likely inadequate in numerous ways. For example, state money transmitter laws lack supervision at the holding company level, which is important given that the stablecoin arrangements that could scale the fastest would likely be associated with an already existing fintech platform.³⁰ Many

²⁷ California Department of Financial Protection & Innovation, "Re: _____-Opinion Request" letter (Oct. 4, 2019) (available at: <https://dfpi.ca.gov/2019/10/14/virtual-currency-2-10-4-2019/>), and Rineason, Cohen & McLaughlin, "Trouble in Paradise: Florida Court Rules That Selling Bitcoin is Money Transmission," K&L Gates U.S. FinTech Alert (Feb. 13, 2019) (available at: <https://www.klgates.com/Trouble-in-Paradise-Florida-Court-Rules-that-Selling-Bitcoin-is-Money-Transmission-02-13-2019/>) (noting that some states have "amended their money transmitter statutes to include or exclude virtual currencies explicitly.") Note that stablecoins are a subset of virtual currency.

²⁸ Pennsylvania Department of Banking, "The Quarter" newsletter, Vol. 6, No. 1, at "Bitcoin Update," p. 11 (Oct. 2014) (available at:

<https://www.dobs.pa.gov/Documents/Newsletter/Newsletter%20Volume%206/Quarter2Vol6FINAL.pdf>). See also

Pennsylvania Department of Banking, "Money Transmitter Act Guidance for Virtual Currency Businesses"

(2017/2018) (available at: <https://www.dobs.pa.gov/Businesses/Non-Bank%20Licensees/Money%20Transmitters/Pages/default.aspx>) (posted by the department as of Dec. 29, 2021, and

noting that because virtual currency is not "currency or legal tender" it is not covered by Pennsylvania's Money

Transmitter Act).

²⁹ See, e.g., MGL, CH. 167F, § 4, which applies only to the "selling, issuing or registering checks or money orders."

See also, Montana Department of Administration, "Money Services Businesses" notice (available at:

<https://banking.mt.gov/moneytransmitters/>) (posted by the department as Dec. 29, 2021, and noting that money

services businesses do not need to be licensed with the Montana Division of Banking and there is no legislation in

Montana providing for the licensing and supervision of money services businesses).

³⁰ See "Report on STABLECOINS," note 4, pp. 2 & 14 (noting that the potential for an individual stablecoin to scale

rapidly raises distinct policy concerns), see also "Facebook pilots Novi, but without Diem," Finextra (Oct. 19, 2021)

(available at: <https://www.finextra.com/newsarticle/39054/facebook-pilots-novi-but-without-diem>), and Chaim



state money transmitter laws and regulations promulgated under them do not impose third-party and vendor risk management requirements.³¹ This is particularly significant given that functionality across a stablecoin arrangement may be fractionalized among various distinct legal entities and therefore the licensee under state money transmitter regimes may not be the entity actually engaged in stablecoin issuance or redemption.³² Some state money transmitter laws fail to impose portfolio restrictions or restrictions on the use of customer funds and may not contain capital or liquidity requirements, important factors given that the value of stablecoins must be backed by highly liquid assets in order to protect consumer investments.³³ Finally, state money transmitter laws do not provide access to lender of last resort facilities. This is important to preserve financial stability in the event that the assets underlying a stablecoin arrangement become devalued in times of stress.³⁴ For these reasons, The Clearing House encourages the Committee to not view state money transmitter licensing regimes as an adequate regulatory and supervisory framework for stablecoin arrangements, or as an alternative to a federal prudential framework.

Concluding Comments

The Clearing House appreciates the important work that the Committee is doing to examine the opportunities and risks presented by stablecoins and stablecoin arrangements, and we hope that the Committee will take the points made in this statement into consideration. The rapid growth of stablecoin arrangements, their use as a payments vehicle, the transfer and issuance functions associated with them, inadequate capital and reserve requirements, and the lack of a

Gartenberg, "Facebook's digital wallet final launches... without Diem cryptocurrency," The Verge (Oct. 19, 2021) (available at: <https://www.theverge.com/2021/10/19/22734487/facebook-novi-digital-wallet-pilot-program-payments-diem-cryptocurrency>) (noting that Facebook has launched a stablecoin-based pilot using the Novi wallet and USDC stablecoin, and that Facebook has larger ambitions, including providing remittance transfer services, and integrating the Diem stablecoin into Novi-based applications). Many state money transmitter laws, however, provide only for supervision and examination of the licensee (*See, e.g., Ala. Code* § 8-7-1 *et seq.*; *Colo. Rev. Stat.* § 11-110-101 *et seq.*; 5 *Del. Code* § 2301 *et seq.*; *Miss. Code Ann.* § 75-15-1 *et seq.*; *Mo. Rev. Stat.* § 361.700 *et seq.* (providing for evaluation and examination / supervision of the applicant / licensee only)).

³¹ *See, e.g., Colo. Rev. Stat.* § 11-110-101 *et seq.*; *Miss. Code Ann.* § 75-15-1 *et seq.*; *Mo. Rev. Stat.* § 361.700 *et seq.* (lacking robust third-party-risk / vendor management requirements, and putting critical, interdependent functionality outside of the regulatory perimeter by expressly providing only for the examination of licensees).

³² *See* "Report on STABLECOINS," note 4, pp. 13 & 17 (noting that the supporting infrastructure in a stablecoin arrangements may be beyond the control of any one organization and there may be no clear entity to regulate, and that issuance may be separate from critical functionality). State money transmitter laws, however, may only capture the entity performing the transfer function as the licensee and therefore may lack direct authority over other entities that are performing critical functionality, including actual issuance of the stablecoin. (*See, e.g., Colo. Rev. Stat.* § 11-110-101 *et seq.*; *Miss. Code Ann.* § 75-15-1 *et seq.*; *Mo. Rev. Stat.* § 361.700 *et seq.* (expressly providing only for the examination of licensees)).

³³ *See, e.g., Ga. Code Ann.* § 7-1-680 *et seq.* (imposing no portfolio restrictions around the use of customer funds); and *Wi. Code* § 217.01 *et seq.*; and *Mo. Stat.* § 361.700 *et seq.* (providing no ring-fencing of permissible investments within a statutory trust). And *see* "Report on STABLECOINS," note 4, pp. 4, 6, 12, 16 & footnote 21 (noting that there are no standards regarding the composition of stablecoin reserve assets, publicly available information about issuers' reserve assets is inconsistent, and that reserve assets held varies).

³⁴ *See* "Report on STABLECOINS," note 4, p. 16 (noting the importance of providing access to the federal safety net.)



comprehensive federal prudential framework all present risks that warrant further attention from Congress in determining what an appropriate regulatory framework for stablecoins should look like.

Thank you for the opportunity to provide a statement for the record. If you have any questions, please do not hesitate to contact the undersigned by phone at (646) 709-3026 or by email at Robert.Hunter@theclearinghouse.org.

Respectfully submitted,

/s/

Robert C. Hunter
Deputy General Counsel and Director of Regulatory and Legislative Affairs
The Clearing House Association L.L.C.



LETTER SUBMITTED BY NAFCU



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National Association of Federally-Insured Credit Unions

February 14, 2022

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Patrick Toomey
Ranking Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Re: Tomorrow's Hearing Examining the President's Working Group on Financial Markets Report on Stablecoins

Dear Chairman Brown and Ranking Member Toomey:

I write to you today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts on issues of importance to credit unions ahead of tomorrow's hearing on the President's Working Group (PWG) Report on Stablecoins. NAFCU advocates for all federally-insured not-for profit credit unions that, in turn, serve over 127 million consumers with personal and small business financial service products.

NAFCU appreciates the continued work of the Committee in examining the integration of digital assets into traditional financial products. Recent years have seen increased interest in cryptocurrencies, with prices reaching new highs as well as experiencing pullbacks. Notwithstanding these fluctuations, distributed ledger technology and other technologies that support a broad ecosystem of digital assets offer an array of potential operational efficiencies. For example, the ability to facilitate payment transactions that support smart contracts, either through use of stablecoins or other digital assets, may help members with specific business needs and potentially reduce credit unions' operational costs. Most importantly, digital asset technologies can be designed with strong auditability features, which can enhance regulatory compliance and reduce instances of human error, fraud, and other misconduct. However, the absence of a clear regulatory environment and appropriate supervisory framework poses risks to the adoption of these otherwise promising technologies.

The PWG on Financial Markets Report on Stablecoins (the Report) was an important first step towards bringing rules and regulation to emergent stablecoin adoption. The Report recommended Congress enact legislation requiring all payment stablecoin issuers to be insured depository institutions. In later describing American depositors' access to federal deposit insurance and their financial institutions' access to emergency liquidity and Federal Reserve services, the Report adopts and cites the limited *Federal Deposit Insurance Act* definition of an insured depository institution that does not include credit unions. By adopting this narrow definition, which includes banks and savings associations but not credit unions, the Report risks legislators and other regulators interpreting the Report as recommending that Congress enact legislation requiring a

The Honorable Sherrod Brown, The Honorable Patrick Toomey
February 14, 2022
Page 2 of 2

stablecoin issuer have a bank charter – not either a bank charter or a credit union charter. We hope that this was just an oversight by the PWG.

This arbitrary approach, if left unchecked, will result in competitive disadvantages, market distortions, and reduced innovation by excluding an entire class of federally insured and comprehensively supervised depository institutions from new markets for innovative products and services. Establishing barriers to credit union engagement with digital assets would also undercut many of the financial inclusion benefits that may be realized through related technologies given that the credit union industry has a long history of prioritizing the needs of underserved and low-income communities. Accordingly, we urge Congress to explore ways to provide regulatory certainty and parity across the financial services system and ensure a level playing field for all. We urge you to ensure the needs of credit unions are considered in any legislative approach you consider in the future.

We thank you for the opportunity to share our thoughts and look forward to continuing to work with you on including emerging technologies into financial services. Should you have any questions or require any additional information, please contact me or Lewis Plush, NAFCU's Associate Director of Legislative Affairs, at (703) 258-4981 or lpush@nafcuhq.org.

Sincerely,



Brad Thaler
Vice President of Legislative Affairs

cc: Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs

LETTER SUBMITTED BY CUNA



Jim Nussle
President & CEO

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99 M Street SE
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February 14, 2022

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Brown and Ranking Member Toomey,

On behalf of the Credit Union National Association (CUNA), I am writing about the hearing entitled, "Examining the President's Working Group on Financial Markets Report on Stablecoins." CUNA represents America's credit unions and their 130 million members.

The topic of today's hearing is President's Working Group on Financial Markets' Report on Stablecoins. We appreciate the Committee's examination of this report and its recommendations because cryptocurrency and digital assets and platforms created through blockchain technology are poised to create major disruptions in the delivery of financial services. We have significant concern with the potential for regulatory arbitrage and consumer harm if these technologies and platforms are not subject to substantial regulation.

As you know, credit unions are subject to significant consumer protection and safety and soundness regulation. However, the crypto and digital currency sectors operate largely outside of the traditional financial safeguards and generally without the stabilization and protections that financial intermediaries generally provide. In fact, the fundamental innovation of cryptocurrency is the elimination of the financial intermediary. Unfortunately, when there is no financial intermediary, the functions that they provide also are lost, presenting users of this technology with significant risk: just ask bitcoin owners who have lost or forgotten their digital wallet password.

The digital ledger technology (DLT) underpinning digital currency will allow many industries to innovate but we see no reason why innovation should change the government's role in overseeing an industry that uses DLT. The fundamental issue with DLT as applied to the delivery of financial services is that it disintermediates financial services providers and this is where the government regulates financial services. Eliminating or weakening the backbone of the U.S. and global economy will have consequences and we think that these consequences should be understood before consumers and the economy are harmed.

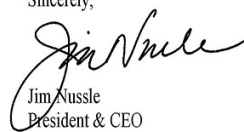
Congress should explore ways to regulate the delivery of financial services using digital currencies to ensure that consumers are protected in the same way if they received financial services from a financial institution. Furthermore, Congress should look for ways enable credit unions and other financial

cuna.org

institutions to provide digital asset related services, so that these services can be properly overseen by Federal regulators.

On behalf of America's credit unions and their 130 million members, thank you for your consideration of our views and for holding this important hearing.

Sincerely,



Jim Nussle
President & CEO

STATEMENT SUBMITTED BY BPI



Statement by the Bank Policy Institute

Before the U.S. Senate Committee on Banking, Housing and Urban Affairs
 'Examining the President's Working Group on Financial Markets Report on Stablecoins'

Feb. 15, 2022

Chairman Brown, Ranking Member Toomey and members of the U.S. Committee on Banking, Housing and Urban Affairs:

The Bank Policy Institute appreciates the opportunity to submit comments to the Committee on today's hearing titled "Examining the President's Working Group on Financial Markets Report on Stablecoins."

Innovation is occurring at a rapid pace within the financial services sector. BPI members support innovation and welcome competition when it is conducted responsibly and in a way that ensures that customers are protected through consistent regulation and oversight.

To date, much of the innovation in cryptocurrencies — including stablecoins — has occurred outside the regulated banking sector, largely in nonbank fintech firms subject to little to no government oversight. Now that these innovations are well past proof-of-concept stages, gaining steam and becoming more widely understood and accepted by consumers, many banks are becoming more and more interested in finding ways to give their customers the ability to access, invest and transact in them. As banks enter this space, ordinary consumers will benefit by being able to access these innovations through trusted intermediaries. Banks are subject to an extensive federal regulatory and supervisory framework that allows policymakers to ensure consumers are protected and that the banking and financial system remains resilient. That framework does not apply equally to the nonbank fintech providers, leaving consumers more exposed to potential harm.

U.S. banking regulators should move swiftly to finalize long-promised guidance about supervisory expectations for banks that choose to engage in broader digital assets, including crypto and stablecoin, activities. Absent such guidance, the highly regulated banking sector will be left on the sidelines as digital asset innovations continue to advance unchecked in the unregulated sectors, with little to no government oversight to ensure the safety and soundness of our financial system and the protection of ordinary American consumers.

BPI has long argued that both consumers and the U.S. financial system are put at risk when entities operating outside the federal bank regulatory perimeter offer banking products and services without adhering to appropriate consumer and prudential regulatory protections and with far more limited — if any — onsite supervision to determine compliance with those protections. By way of example, BPI has repeatedly identified significant risks posed by stablecoins and stablecoin issuers, both of which exist almost entirely outside the regulated financial system. Many of these risks have been identified by members of this Committee, domestic and international regulatory bodies and members of the President's Working Group — whose recent report is the focus of today's hearing. Most notably, BPI has expressed serious concern about issuers of stablecoins that market their products as being "backed 100% by reserves" when that is in fact false.

In banking, “reserves” refers to vault cash and deposits at the Fed, both of which are short-term loans, highly-liquid and whose values experience inconsequential fluctuation. Many of the leading stablecoins — including the two largest stablecoin issuers that together represent 77% of all stablecoins in circulation¹ — claimed up until recently to hold 100% reserves while also applying a broad definition to “reserves” to count commercial paper (i.e., short-term corporate debt that can be volatile in periods of stress), including in the case of Tether investing in Chinese commercial paper of dubious value. Thus, it’s a risk to consumers and potentially also financial stability when these products are called “stablecoins” and the assets that back them are anything but stable. In substance, they are actually more like 2008-style prime money funds that contributed to the destabilization of the financial sector during the Global Financial Crisis. Some stablecoin issuers have committed to greater transparency. However, this transparency has not fully materialized, and oversight of these activities has largely been confined to state-level money transmitter rules that may not be sufficiently robust to address the run risk of these products.

BPI is encouraged by the Committee’s attention to this important topic. It is critical that Congress and other policymakers pursue measures that would address the risks posed by stablecoin issuers and further ensure that they adhere to existing consumer protections.

The attached note delves deeper into the aforementioned concerns. Thank you for considering our perspective.

¹ Nelson, B., & Paridon, P. P. (2021, December 10). Stablecoins are backed by ‘reserves’? give us a break. American Banker. <https://www.americanbanker.com/opinion/stablecoins-are-backed-by-reserves-give-us-a-break>



Liquidity Transformation Always Finds the Path of Least Regulation

Bill Nelson | September 23, 2021

Banking is inherently unstable. The business of banking in a nutshell is borrowing deposits and using the funds to make loans. If too many depositors ask for their money back at the same time, the bank will default because it doesn't have the money on hand, it has lent it out. So if you are a depositor and you think other depositors are going to demand their money back, it makes sense to withdraw your money first before the bank fails. Since each depositor knows this, a deposit run can develop simply because there is fear of a deposit run. That's unstable.

The instability has been well understood for as long as there have been banks. In modern times, bank regulation and deposit insurance have reduced the instability. Capital regulations require a bank to have a lot more assets than liabilities so that even if the bank suffers losses, it still has assets to cover its borrowings (including the deposits owed to customers). Liquidity regulations require banks to hold safe and highly liquid assets—basically short-term loans to the federal government—so that each bank has funds on hand to cover deposit withdrawals (or other demands on its funds) for long enough for the bank to sell or borrow against its other assets, if necessary, to generate cash to meet ongoing deposit withdrawals. Lastly, banks are required to purchase federal insurance for their deposits, so that most depositors are assured their money is safe no matter what happens to the bank.

Banking is also profitable. People like to deposit their cash at a bank because they know it is safe and its value is stable: every dollar deposited will still be worth a dollar when it is withdrawn. Plus, they can withdraw their cash at any time (as long as they don't all try to withdraw their cash at once). People also value the transaction services that a bank provides (i.e., the ability to pay and receive payments from others). Deposit rates are lower than interest rates on other short-term investments to reflect the value of these money-like features. On the other side of the balance sheet, loan-making requires expertise and extensive due diligence to make sure the borrower is credit-worthy—loans are “informationally intensive”—and loan rates cover those added costs. Loan rates also include risk premiums and liquidity premiums and often term premiums because loans are risky, illiquid and often longer-term. Due to these characteristics of deposits and loans, banks are engaging in what is called “liquidity” or “maturity transformation” when they fund loans with deposits—funding long-term or illiquid assets with short-term liabilities. For all these reasons, loan rates are generally above deposit rates. Banks earn the spread.

Regulations and deposit insurance reduce bank profitability. Capital is more expensive than deposits as a source of funding. Liquid assets yield less profit than bank loans. And deposit insurance is costly.

It is profitable for *any* institution, not just banks, to fund itself with deposit-like liabilities (liabilities where the creditor is seemingly guaranteed to get at least a dollar back for every dollar invested) and invest in risky and illiquid assets. And it is even more profitable if the intermediation avoids costly regulations and deposit insurance. As a result, there is always an incentive for maturity and liquidity transformation to take place outside of regulated, federally insured banks. But when that happens, the result is always increased instability in the financial system.

It isn't unstable right away. Usually, the institutions claim to have found a new, innovative, and safe way to take in deposit-like investments and turn a profit. People that raise concerns are accused of not understanding how things are different this time and being "anti-innovation."

We saw this dynamic in the years before the Global Financial Crisis. Prime money funds promised investors that every dollar they invested would be worth a dollar, plus they'd earn interest. The money funds invested in, among other things, asset-backed commercial paper that was supposedly perfectly safe because it was backed by large amounts of asset-backed securities. The asset-backed securities were safe because they were backed by large amounts of subprime mortgages. The mortgages, which were made by mortgage brokers, not banks, were safe, or at least safe enough, because they'd only go bad if housing prices fell and a lot of people became unemployed. Between 2002 and 2007, credit intermediation through the shadow banking system grew by about 75 percent.

In the end, it was all just a complicated way to fund loans with deposits without regulation or insurance. And, of course, it proved unstable. Once "investors" in prime money funds realized that they might not all get their money back, they all headed for the exit at once, and the darkest days of the Global Financial Crisis began. Since then, prime money funds have no longer been allowed to treat investments like deposits; instead of the value of a share being pegged to a dollar, the value moves up and down as the funds' investments fluctuate in value.

Liquidity transformation outside the banking system is starting up again. This time, it is FinTech that makes everything different. This time, digital dollars and uninsured deposits at FinTech banks really will be perfectly safe. The new digital crowd has it all figured out. Anyone doubting it either doesn't understand or is afraid of competition or innovation or both.

This time, we are told, stablecoins and uninsured deposits at FinTech banks are safe because they aren't used to fund loans, they are invested 100 percent in "reserves." And that does sound safe. In banking, "reserves" means vault cash and deposits at the Fed, both of which are very short-term loans to the government that don't fluctuate in value and are perfectly liquid. Moreover, many remember from their college money and banking courses that we have a "fractional reserve banking system" where banks "magically" – and some would say recklessly or perhaps even unconstitutionally – create money by loaning out deposits while only holding a fraction as reserves. Being backed 100 percent by "reserves" then, as stablecoin issuers and FinTech banks assert they are, must be the opposite. It's not only safe, it's an act of defiance against the whole evil banking system.

Those of us that have seen this show before, who spent years cleaning up the pieces from the Global Financial Crisis, who have worked to make the financial system safer, are not surprised at all to learn those "reserves" aren't at all perfectly safe and liquid assets. No, they are once again risky and illiquid assets.

Consider the two largest stablecoin issuers in the United States, Tether and USDC. Together they have issued about \$100 billion in coins. In both cases, people who buy a stablecoin using real money are told that they can get all their money back whenever they want it. In that sense, these stablecoins are just like a demand deposit at a bank. Recently, however, they've been forced to provide information on the "reserves" that they have invested in using the dollars people have given them in exchange for their stablecoins, and the reserves don't look anything like the "reserves" that banks hold.

Table 1		
Tether's Reserve Disclosure as of June 2021		
Cash & Cash Equivalents & Other Short-Term Deposits & Commercial Paper:		
	\$billions	percent
Commercial Paper & Certificates of Deposit ²	30.8	49
Cash & Bank Deposits ³	6.3	10
Reverse Repo Notes ⁴	1.0	2
Treasury Bills ⁵	15.3	24
Subtotal		
Secured Loans (none to affiliated entities)	2.5	4
Corporate Bonds, Funds & Precious Metals	4.8	8
Other Investments (including digital tokens)	2.1	3
² Commercial paper & certificates of deposit comprises commercial paper (short-term debt issued by corporations) and certificates of deposit (negotiable short-term deposits issued by financial institutions). The average duration of items in this category is 150 days and the average rating is A-2.		
³ Cash & bank deposits comprises: cash deposits at financial institutions and call deposits, i.e., deposits that may be withdrawn with two days' notice or less; fiduciary deposits, i.e., deposits made by banks on behalf of and for the benefit of members of the consolidated group; and, term deposits, i.e., deposits placed by members of the consolidated group at its banks for a fixed term.		
⁴ Reverse repo notes comprises reverse-repurchase agreements that have been entered into by means of the purchase of structured notes or fund vehicles whose ultimate issuer or guarantor has a rating of A-2 or better.		
⁵ Treasury bills comprises U.S. Treasury bills with a maturity of less than 90 days.		

As shown in Table 1, More than half of Tether's "reserves" are invested in commercial paper and certificates of deposit.¹ When Tether invests in commercial paper, it gives a company money and at some later time, from the next day to a year later, the company gives Tether back the money plus interest. Sounds like a loan, doesn't it? That's because there is no meaningful difference. Plus, more than half of Tether's commercial paper is so risky that even prime money funds can't hold it. Another 10 percent of Tether's "reserves" is bank deposits, and yet another 10 percent is corporate bonds, precious metals, digital tokens, and "other" assets. Less than a quarter of Tether's reserves consists of Treasury bills, the short-term loans to the federal government of the sort that most people mean when they use the term "reserves."

Until earlier this summer, USDC stablecoin, which is issued through a partnership between Coinbase and Circle, was marketed as being backed by U.S. dollars. Circle, too, recently provided additional information on its reserves (Table 2). As of last month, Circle states that nearly all (92 percent) of its reserves are cash and "cash equivalents" and only 2 percent commercial paper.² That sounds pretty good until you read the fine print. "Cash Equivalents" includes *any* security with a maturity less than or equal to 90 days, which includes most commercial paper. The

¹ See Independent Accountant's Report by Moore Cayman, dated 6 August 2021, available at https://tether.to/wp-content/uploads/2021/08/tether_assuranceconsolidated_reserves_report_2021-06-30.pdf

² See Independent Accountant's Report by Grant Northam, dated September 20, 2021, available at <https://www.centre.io/hubfs/pdfs/attestation/2021%20Circle%20Examination%20Report%20August%202021%20Final.pdf?hsLang=en>

"commercial paper" line listed separately only includes CP with maturity between 91 days and 13 months. So some unknown fraction of that 92 percent in "cash & cash equivalents" is actually invested in commercial paper.

Table 2		
Circle's Reserve Disclosure as of August 2021		
USDC Reserve Breakdown	\$billions	percent
Cash & Cash Equivalents ¹	25.3	92
Corporate Bonds ²	0.4	1
Yankee CDs ³	1.3	5
Commercial Paper ⁴	0.5	2
Total ⁶	27.5	100
¹ Cash and cash equivalents include U.S. dollar deposits at banks and short-term, highly liquid investments that are readily convertible to known amounts of cash and have a maturity less than or equal to 90 days from purchase, as consistent with generally accepted accounting principles (US GAAP).		
² Unsecured debt obligations of corporations and financial institutions with a maturity of less than or equal to 3 years. Minimum S&P rating of BBB+; maximum maturity of 3 years.		
³ USD denominated Certificates of Deposit issued in the US by branch(es) of Foreign Banking Organizations. Minimum S&P rating of S/T A1; maximum maturity of 13 months.		
⁴ Unsecured debt obligations of corporations and financial institutions with maturities between 91 days and 13 months. Minimum S&P rating of S/T A1; maximum maturity of 13 months.		

At present, Tether, Coinbase, and Circle are earning the interest being paid on their "reserves" while paying no interest on the funds that they received for their stablecoins. But as soon as any of the risky assets that they have invested in go bad, they will not have the wherewithal to repay all those stablecoin holders because they don't have sufficient capital cushions to absorb investment losses nor enough liquidity to meet massive outflows immediately. Those holding stablecoins – all stablecoins – will all demand their real dollars back at the same time, and the house of cards will collapse again.

Indeed, as discussed in a recent interview of Tether's CTO and General Counsel on CNBC, there are rumors that Tether has invested in the commercial paper of Chinese companies.³ While Tether has issued a statement that it is not holding any of Evergrande's (a large, financially troubled Chinese financial institution) commercial paper, if it is holding the commercial paper of other Chinese financial institutions, it would be exposed to losses should any of those firms default.⁴

Liquidity transformation outside the traditional banking system may also soon begin at Wyoming's Special Purpose Depository Institutions (SPDIs). SPDIs can accept deposits, offer payment services and provide debit cards, but their deposits are not insured. They are not insured because the state of Wyoming requires that the SPDIs invest

³ See <https://www.youtube.com/watch?v=Z8FqyIO3ScQ>.

⁴ See "Stablecoin Tether says holds no Evergrande commercial paper," Reuters, September 16, 2021.

<https://www.reuters.com/business/finance/stablecoin-tether-says-holds-no-evergrande-commercial-paper-2021-09-16/>.

only in “reserves,” thus rendering deposit insurance unnecessary.⁵ The deposits are no different than ordinary bank deposits: they are marketed as safe and stable, and they are available on demand. Except “ordinary” bank deposits are insured.

It is not clear what “reserves” means, though. The regulation provides a list of allowable assets that includes reserves balances and Treasury securities (which qualify as level 1 High Quality Liquid Assets (HQLA), a category of assets that can be used to satisfy federal liquidity regulations), as well as other things that do not count as level 1 HQLA (like munis and most agency MBS).⁶ However, the regulation then states that only level 1 HQLA is allowed except for any other asset consistent with “safe and sound banking practices” approved by the Wyoming Banking Commissioner. Any asset a bank is legally allowed to hold that hasn’t gone bad – boat loans, construction loans, etc. – is consistent with “safe and sound” banking practice. The Wyoming Banking Commissioner has not indicated what assets he would allow.

Nor have any of the SPDIs, which have not yet opened for business, stated unambiguously what they will invest in. Kraken, for example, the first institution to get an SPDI charter, acknowledges in a website FAQ on deposit insurance that a customer’s investments will not be FDIC-insured and then goes on to say:

However, Kraken Bank will be fully reserved (i.e., no fractional reserve banking or associated re-hypothecation and lending activities). All assets will be kept on hand and available as cash or the least risky, most liquid cash equivalents. We will also maintain significant capital reserves and surpluses of our own capital to cover the full balance of all clients, even in the event of a “bank run.”⁷

Because Kraken does not publicly disclose the assets into which customer deposits will be invested, or otherwise substantiate its claim that they are “the least risky, most liquid cash equivalents,” we contacted Kraken customer service and asked what “Cash Equivalents” means. We were told “stocks, bonds, and mutual funds.”⁸

Is this beginning to sound familiar? Offer a deposit-like product that is going to be so ultra-safe that it doesn’t need insurance, using a new technology that makes everything so different the institution doesn’t need to be subject to insured-commercial-bank-level regulations. Use the funds received to invest in assets that turn out not to be safe and liquid. Earn the spread.

WHY NOT BE TRANSPARENT?

All the parties involved – the stablecoin issuers, the SPDIs, the Wyoming Banking Commissioner – have every incentive to be completely transparent. The stablecoin issuers want customers to be confident that their coins are safe. The SPDIs want customers to know that their deposits are safe. The Wyoming Division of Banking wants SPDIs to be seen as so safe that they don’t need FDIC insurance.

⁵ For example, Kraken states that it “is required by Wyoming law to maintain 100% reserves of its deposits of fiat currency at all times.” <https://blog.kraken.com/post/6241/kraken-wyoming-first-digital-asset-bank/>. Avanti states that it offers “full-reserve requirement for dollar deposits”. <https://avantibank.com/>.

Also see Wyo. Stat. 13-12-105: “At all times, a special purpose depository institution shall maintain unencumbered liquid assets valued at not less than one hundred percent (100%) of its depository liabilities.”

⁶ Wyoming SPDI Rules (05-21), section 9, available at https://drive.google.com/file/d/1EVLJkvGv3-gWnie72fIwn_9VwVaiLC/view.

⁷ <https://www.kraken.com/en-us/bank>.

⁸ Our exchange with Kraken customer service is available on request. It is, of course, possible that the customer service representative was incorrect.

The only reason to be anything but fully transparent is to be able to invest in higher-yielding assets that are inconsistent with the message that the stablecoins or uninsured deposits are backed by vanilla, ultra-safe, highly liquid assets. There are no trade secrets involved in investing in Treasury bills.

Nevertheless, not only does the lack of transparency persist, Tether is taking legal action to avoid being transparent. Tether recently petitioned the New York Supreme Court to block a Freedom of Information Law request from the publication CoinDesk for documents detailing the composition of Tether's reserves over the past few years.³ Tether states that releasing the documents would put it at a disadvantage relative to its competitors.

Similarly, there is no reason for the Wyoming regulations to define liquid assets as anything the Banking Commissioner says they are. Such ambiguity and unfettered secret discretion is generally not present in federal banking regulations. When the Fed requires a bank to hold a certain quantity of reserves against deposits, it is completely clear that reserves are defined as vault cash and deposits at a Federal Reserve Bank. There is no "other things the Fed defines" category, secret or not. The banking agencies have been unambiguous about what assets count as level 1 HQLA for the purposes of satisfying liquidity requirements or equity for the purposes of satisfying capital requirements. Will the Commissioner decide that Wyoming state or local municipal debt is liquid, or investments in equity mutual funds, or deposits at a Wyoming bank? Has the Commissioner already approved some assets – will those decisions be made public? Why not provide a definitive list now?

OUTLOOK

There is reason to be optimistic that a financial crisis will be avoided this time. All the U.S. financial regulators appear deeply concerned about the financial stability and other risks that are building. In July, the President's Working Group on Financial Markets met to discuss the rapid growth of stablecoins and the possible risks they present to end users, the financial system and national security. The Secretary of the Treasury underscored the need for government to act quickly to ensure that there is an appropriate U.S. regulatory framework in place, and the PWG indicated that it expects to issue recommendations for such a framework in the coming months. In addition, Fed Chair Powell has stated that the Fed will be issuing a research paper this month discussing crypto currency, including stablecoins. Finally, stablecoins and their issuers have been the recent target of the attention of the SEC. Chairman Gensler has said that he believes many are operating illegally as unregistered investment securities, and just recently, Coinbase revealed that the SEC is investigating the crypto exchange's planned offering for crypto holders to lend out stablecoins and earn interest as constituting an unregistered investment.

Disclaimer: The views expressed do not necessarily reflect those of the Bank Policy Institute's member banks, and are not intended to be, and should not be construed as, legal advice of any kind.

³ In the Matter of the application of iFinex Inc. et al against State of New York, Office of the Attorney General, regarding Freedom of Information Law Requests G000260 and G000261, filed August 30, 2021. See also "Tether Asks Court to Block NYAG From Releasing Documents to CoinDesk," CoinDesk, August 31, 2021. <https://www.coindesk.com/policy/2021/08/31/tether-asks-court-to-block-nyag-from-releasing-documents-to-coindesk/>

LETTER SUBMITTED BY ETA



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February 15, 2022

The Honorable Sherrod Brown
Chairman
Senate Committee on Banking,
Housing, and Urban Affairs
Washington, DC 20510

The Honorable Patrick Toomey
Ranking Member
Senate Committee on Banking,
Housing, and Urban Affairs
Washington, DC 20510

Dear Chairman Brown and Ranking Member Toomey:

On behalf of the Electronic Transactions Association (ETA), we appreciate the opportunity to submit this statement for the record before the Committee's hearing, "Examining the President's Working Group on Financial Markets Report on Stablecoins."

As the trade association that represents the breadth of the payments industry,¹ the Electronic Transactions Association (ETA) has deep expertise in payments technology, including the use of cryptocurrencies, blockchain, and other crypto-related technologies to facilitate payment transactions (cryptoassets). At ETA, we are engaged in ongoing conversations within the industry and with policymakers about the promise and challenges of cryptoassets, and we believe there is a common set of principles against which any proposed governmental policies should be measured. In this regard, the payments industry has been a leader in developing industry best practices for mitigating risk and protecting the payments ecosystem.

As policymakers consider new laws and regulations for cryptoassets, they should carefully consider the following principles and ensure that any proposal best serves the needs of consumers and businesses, furthers financial inclusion, preserves and strengthens the financial system, minimizes fraud and money laundering, and ensures that consumers and businesses continue to have access to a robust and innovative array of secure banking and payment options.

1. **Properly Defining Cryptoassets:** Developing appropriate and functional definitions of cryptoassets is a critical first step in ensuring clarity about the regulatory requirements that are applicable to the technology. Given that new technologies can be deployed in many different ways, and that new use cases are constantly being developed, cryptoassets should be defined and regulated based on the underlying activity or use case. Adopting tailored definitions for specific activities and use cases will balance the need to appropriately regulate activity against the harms that might arise from sweeping definitions that inadvertently regulate other activities and use cases, while encouraging innovation that benefits consumers, businesses, and the economy.

¹ ETA is the world's leading advocacy and trade association for the payments industry. ETA's members include banks, mobile payment service providers, mobile wallet providers, money transmitters, and non-bank financial technology companies (fintech) that provide access to credit, primarily to small businesses, either directly or in partnership with other lenders. ETA member companies are creating innovative offerings in financial services and are revolutionizing the way commerce is conducted with safe, convenient, and rewarding payment solutions and lending alternatives – facilitating over \$22 trillion in payments in 2019 worldwide.





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2. **Tailoring Regulations to the Risk Profile of the Participant/Activity:** Appropriate regulation of cryptoassets is key to unlocking their potential while ensuring the safety and soundness of the payments ecosystem. Entities engaging with cryptoassets should be subject to regulation that is tailored to the risks that they or the activity in which they are engaged poses to the payments ecosystem. Appropriate regulation of cryptoassets should consider potential harm to consumers as well as safety, soundness, and financial stability risks.
3. **Ensuring Consumer Protection:** The public policy governing cryptoassets should include a framework of standards and rules that appropriately safeguard the privacy and security of every transaction, protect consumers' interests, and give consumers confidence to use the technology for in-person and online transactions. Policymakers should also ensure that consumers understand those protections and how they may differ from those offered by other payment methods. The ability to identify and reduce fraud is critical and should be part of the regulatory framework.
4. **Harmonizing With Existing Regulatory Frameworks:** The payments industry is heavily regulated, and the adoption of any new laws or regulations governing cryptoassets should be designed to fit within this established, robust, regulatory framework. This framework includes federal and state laws relevant to anti-money laundering, economic sanctions, and other anti-fraud and consumer protection requirements. New public policies for cryptoassets should complement, and not conflict with, existing laws and regulations as well as private sector rules and practices.
5. **Encouraging Responsible Innovation:** Continual investment in innovation is at the heart of past, present, and future improvements to the financial ecosystem. Our financial system has benefited greatly from the development of new technologies and capabilities, which serve to strengthen cybersecurity and consumer protection, increase efficiencies, and expand access to financial services. As a technology, cryptoassets have the potential to further many of these developments and promote new innovation and developments. Accordingly, any regulation of cryptoassets should consider the technology's promise to improve existing capabilities while serving as a catalyst and platform for continued innovation.

We appreciate the opportunity to submit this letter for the record and the Committee's leadership on this topic. If you have any questions, please contact me or ETA's Senior Vice President of Government Affairs, Scott Talbott, at stalbott@electran.org

Sincerely,

Jeff Patchen
Senior Manager of Government Affairs
Electronic Transactions Association

