

**PUTTING THE “STABLE” IN “STABLECOINS”:
HOW LEGISLATION WILL HELP STABLECOINS
ACHIEVE THEIR PROMISE**

HEARING
BEFORE THE
SUBCOMMITTEE ON DIGITAL ASSETS,
FINANCIAL TECHNOLOGY,
AND INCLUSION
OF THE
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U.S. HOUSE OF REPRESENTATIVES
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**PUTTING THE “STABLE” IN
“STABLECOINS”: HOW
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STABLECOINS ACHIEVE
THEIR PROMISE**

Thursday, May 18, 2023

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DIGITAL ASSETS,
FINANCIAL TECHNOLOGY,
AND INCLUSION,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:02 a.m., in room 2128, Rayburn House Office Building, Hon. French Hill [chairman of the subcommittee] presiding.

Members present: Representatives Hill, Davidson, Rose, Steil, Timmons, Flood, Houchin; Lynch, Foster, Gottheimer, Torres, Sherman, Green, Casten, and Nickel.

Ex officio present: Representative Waters.

Chairman HILL. The Subcommittee on Digital Assets, Financial Technology, and Inclusion will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, “Putting the ‘Stable’ in ‘Stablecoins’: How Legislation Will Help Stablecoins Achieve Their Purpose.”

The Chair notes that votes are expected at 10:10, and it is only one vote, so we will adjourn for that vote, and then come back and continue our work.

I will now recognize myself for 4 minutes to give an opening statement.

I want to thank all of you for joining our second stablecoin hearing in the new Subcommittee on Digital Assets, Financial Technology, and Inclusion. And although this is only the second stablecoin hearing for the subcommittee, Member-level conversations have been going on since 2021, and the committee has worked significantly with our Members on both sides of the aisle and with the President's Working Group on Financial Markets' report on stablecoins. Both sides of the aisle have discussed key guideposts for an effective regulatory framework for payment stablecoins, which were incorporated into the stablecoin proposal in the last Congress, and into the two proposals that were noticed for today's hearing.

For example, Treasury Under Secretary Liang made it clear that any regulatory framework for stablecoins must have strict requirements in place around reserves and capital to guard against potential runs, so we included those requirements in both of the proposals. The Under Secretary also made it clear that disclosures and attestations are critical for creating enhanced transparency among stablecoin issuers, and those were included as well. To echo the Under Secretary, and the title of today's hearing, we want stablecoins to be used as a payment mechanism, which they really are not today. And also, the only way we can do that is by passing the appropriate regulatory framework legislation.

In 2022, we made extensive progress on bipartisan stablecoin legislation, and we have continued to build on those efforts by taking feedback from members and stakeholders, and the legislation noticed today reflects that feedback. There are clearly many areas where Members have different views, and you can see that from the two proposals. But from my seat as chairman of this subcommittee, I remain convinced that Members on both sides of the aisle are actively working in good faith to find agreement on these key points. We also agree on the basic protections that must be included in any stablecoin legislation—consumer investor protection—which is at the heart of our bill.

So, I want to be clear that while we notice two different legislative proposals today, we are not starting from scratch. To do so would have ignored all of the effort that has been made and the common ground that was found during the negotiations on the previous proposal. In fact, Ranking Member Waters' proposal is substantially similar to the September draft that we noticed at the April hearing, apart from three key changes. Not only that, but Republicans made the exact same change in our proposal as well for one of those. So, while there is still work to be done, and we should use today's hearing to discuss those key areas, I want to emphasize that the similarities between the two proposals are strong, and that we are not that far apart.

Without action from Congress, however, offshore and opaque projects will continue to thrive, and stablecoin issuers will not feel confident to seek opportunities in the United States, and to echo the hearing title, stablecoins will not be stable. Thus, opposing legislation is not a vote in favor of consumer protection. Rather it is a vote for putting consumers at risk by allowing a regulatory environment that pushes stablecoins further away from appropriate U.S. regulatory oversight. We have the power to reverse this trend and cement the U.S. as the leading place for safe payments innovation.

I look forward to the discussion today. I look forward to hearing our witnesses' views on the two proposals, and to ultimately bringing legal clarity and consumer protection to the stablecoin ecosystem.

And with that, I now recognize the ranking member of the subcommittee, Mr. Lynch of Massachusetts, for 4 minutes.

Mr. LYNCH. Thank you, Mr. Chairman, for holding this hearing as we consider legislative options for regulating stablecoins. I want to welcome all of the witnesses, and thank you for attending to help this subcommittee with its work.

Last Congress, this committee came close to reaching a bipartisan agreement led by then-Chair Waters. While the bill was far from perfect, we had come to an agreement on some key issues on stablecoins. Since then, however, much of the digital assets space—including many stablecoin companies—has collapsed. The recent bank failures have also taught us some important lessons. It is clear that we need to ensure that future legislation addresses the cracks that have deepened.

It appears that we have shifted further apart from a bipartisan agreement and are now considering two different pieces of proposed legislation. One is led by the Chair of the Subcommittee, Chairman Hill, and the other by Ranking Member Waters of the full Financial Services Committee. Ranking Member Waters' bill and Mr. Hill's bill each address different issues with stablecoins, taking various approaches. My hope is that we can use this hearing to further discussion and to find some alignment.

My concern with stablecoins remains the same as the last time we held the hearing on this topic: stablecoin issuers claiming their products are pegged to reserve assets and used for the purpose of payments when we know that is not correct. Eighty percent of stablecoin volume is dedicated to facilitating the trading of cryptocurrencies and are instead used as speculative instruments. I also continue to worry that the stablecoins contain structural fragilities that make them vulnerable to runs and pose risks to monetary policy, national security, and financial stability. As we consider the recent bank failures and threats to economic stability, we need to ensure that any proposal provides adequate safeguards to our financial system.

I do acknowledge and appreciate that my Republican colleagues have attempted to address some of those issues that we raised last time, such as disallowing non-bank issuer access to Federal Reserve services, including master accounts and access to the discount window. However, I still have concerns about custody, the lack of acknowledgement of the SEC as primary regulator, a lack of adequate consumer protection, and the removal of exploration of a central bank digital currency (CBDC).

Ranking Member Waters' bill gets us a step closer to addressing some of those newer issues that have emerged. For example, Ms. Waters' bill includes specific rules that require issuers to protect assets they hold in custody from customers and restricts the commingling of customer and company assets.

There are still a number of outstanding questions and issues I would like to address. We need to reach an agreement on the role of the States and of Federal regulators. I have concerns about giving sole authority to States, because it risks the possibility of States engaging in a race to the bottom, and crypto companies seeking out jurisdictions with the weakest regulation, which has been their practice.

I am going to take all 5 minutes, Mr. Chairman.

Chairman HILL. Sure.

Mr. LYNCH. Yes. This also creates a moral hazard for States wishing to attract crypto businesses. I believe it is also important that all regulators weigh in and have a specific role. We should ensure that there is alignment between the Administration and finan-

cial regulators, and there needs to be a specific role for the SEC and for the Consumer Financial Protection Bureau (CFPB). While I understand there is some agreement to allow non-bank companies to issue stablecoins, I continue to have major concerns about access to deposit insurance.

We must consider the lessons we have learned in recent months regarding bank runs and losses. I must also reiterate the need to separate digital assets from our banking system to avoid the risk of exposure to our banking core. I am confident that through discussions and input from regulators, advocates, and banking experts, we can find alignment to address many of the issues I have mentioned. Mr. Chairman, I yield back the balance of my time.

Chairman HILL. The ranking member yields back.

We now welcome the testimony of our witnesses. First, Mr. Matt Homer. Mr. Homer is the managing member of The Department of XYZ, an early-stage venture capital firm focusing on blockchain. He is also the former executive deputy superintendent for research and innovation at the New York State Department of Financial Services.

Second, Mr. Robert Morgan. Mr. Morgan is the CEO of the USDF Consortium, an association of insured depository institutions working to build a blockchain network to support interoperable bank minute tokenized deposits.

Third, Mr. David Portilla. Mr. Portilla is a partner at Davis Polk & Wardwell, where he specializes in a range of policy matters related to financial institutions.

Fourth, Ms. Fennie Wang. Ms. Wang is the founder and CEO of Humanity Cash, which helped launch the community stablecoin in Berkshire County, Massachusetts.

And finally, Ms. Delicia Reynolds Hand. Ms. Hand is the director of financial fairness at Consumer Reports.

We thank each of you for taking the time to join us today. Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Mr. Homer, you are now recognized for 5 minutes.

STATEMENT OF MATTHEW HOMER, MANAGING MEMBER, THE DEPARTMENT OF XYZ, AND FORMER EXECUTIVE DEPUTY SUPERINTENDENT FOR RESEARCH & INNOVATION, NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES (NYDFS)

Mr. HOMER. Good morning, Subcommittee Chairman Hill, Subcommittee Ranking Member Lynch, and members of the subcommittee, and thank you for the opportunity to participate in this hearing. My name is Matt Homer. I was previously the executive deputy superintendent for research and innovation at the New York State Department of Financial Services (NYDFS), where my responsibilities included overseeing the Department's licensing supervision and examination of digital asset-related companies. Earlier in my career, I was a Federal bank regulator in the FDIC's Division of Depositor and Consumer Protection. And today, I am an investor advisor to startup companies, and the managing member of The Department of XYZ, a venture capital firm that invests in

early-stage companies building the next generation of financial systems.

I first became familiar with stablecoins through my experience regulating these products at the NYDFS. As this committee is aware from prior testimony, New York State was one of the first jurisdictions in the world to regulate the digital asset space generally, as well as stablecoins specifically. My experience as a regulator taught me that fiat-backed stablecoins represent an important but incremental improvement in the concept of money. In some ways, stablecoins are not so different from the stored-value products many people already use and are familiar with, such as gift cards or prepaid cards.

The question of how to effectively regulate stablecoins has a more clear and straightforward answer than one may find in considering how to regulate other parts of the digital asset ecosystem. New York's experience shows that it is possible to effectively regulate stablecoins using common sense and time-tested regulatory practices.

For example, New York's regulatory framework for stablecoins includes three major prongs: first, reserve requirements to ensure the assets backing stablecoins are held on a segregated basis on behalf of customers, are fully reserved on a one-to-one basis, and are comprised of cash deposits or other cash equivalents; second, redemption rights, ensuring that stablecoin users have the right to redeem their stablecoins on a one-to-one basis for U.S. dollars in a timely manner; and third, public transparency requirements, including monthly attestations from independent CPAs. The stablecoin issuers covered by these standards are also subject to robust supervision and examinations.

I believe there are eight important principles that should guide legislation on this topic and help payment stablecoins achieve their promise. I will discuss three of these for which my background offers unique insight.

First, stablecoin legislation and implementing regulation should recognize the dual banking system as an inherent feature of the American economy that benefits consumers, innovators, and markets. The parallel system of State and Federal regulations supports economic growth by providing innovators and founders optionality that can reduce barriers to launching new products on a small scale, before rolling them out at a national scale. It benefits consumers by providing access to financial services tailored to local needs, and protects them because States are able to move more quickly to fill regulatory gaps.

Finally, it benefits markets by encouraging healthy competition. The legislative drafts I have seen preserve this dynamic. It would establish a Federal floor in the form of a national standard, but would allow States to license and supervise stablecoin issuers and set even tougher rules within their own jurisdictions.

Second, stablecoin legislation should promote competition and the competitiveness of the U.S. system. The stablecoin market so far has trended toward oligopoly. Today, two issuers alone make up over 80 percent of the market for U.S. dollar-denominated stablecoins. Legislation should promote competition by providing pathways for new players to enter the space and challenge incum-

bents. One idea would be to create a safe harbor for new entrants to test new products or services at limited scale, and with limited customers, before requiring comprehensive regulation, in order to expand to the general public at greater scale.

I would also like to touch on competitiveness as a distinct concept from competition. It is in the American interest to ensure that issuers of U.S. dollar-backed stablecoins remain in the U.S. so that we can regulate stablecoins on our own terms. One way to promote this objective would be to add competitiveness to the official mandates of Federal regulators and to the set of criteria to be used by Federal regulators when considering whether to license a stablecoin issuer.

Third, regulatory capabilities need to keep pace with developments in the market. One of the aspects of regulating digital assets that most intrigued me when I was at NYDFS is the possibility of supervising the space more effectively using digital tools and technologies. For example, I previously mentioned monthly attestations of stablecoin reserves, but we could conceivably move towards more real-time or near real-time dashboards that provide insight into the backing assets of a stablecoin, or even into the financial condition of the entire issuing firm at any given moment in time.

I want to thank you again for the opportunity to be here, and I look forward to your questions.

[The prepared statement of Mr. Homer can be found on page 41 of the appendix.]

Chairman HILL. The gentleman yields back.

Mr. Morgan, you are now recognized for 5 minutes.

STATEMENT OF ROBERT MORGAN, CEO, USDF CONSORTIUM

Mr. MORGAN. Chairman Hill, Ranking Member Lynch, and members of the subcommittee, thank you for the opportunity to join you to represent the USDF Consortium and our member banks. My name is Rob Morgan, and I am the CEO of the USDF Consortium, which represents a group of community, mid-sized, and regional banks that have come together to build blockchain infrastructure for the responsible delivery of traditional banking services.

Today's hearing comes at a critical moment. Distributed ledgers hold tremendous promise to improve financial services by offering faster, cheaper, and more-efficient products that can help promote financial inclusion, drive growth in our communities, and support the role of the U.S. dollar as the global reserve currency. To date, most blockchain innovation has occurred outside of the regulated banking sector, in novel cryptocurrency markets. These markets have provided testing grounds that have proven the efficiency and stability that blockchain technology can deliver.

However, financial services only deliver value when they facilitate real-world activity, such as helping small businesses invest and grow, or helping families purchase a home. To leverage blockchain for real-world transactions, you first need a trusted form of digital money that exists natively on blockchain. This is what led to the rise of stablecoins and has driven the policy discussion around the creation of a central bank digital currency (CBDC). The debate on how to digitize the dollar is too often pitched as a binary choice between these two options. We believe there is a

third path that leverages the way money already exists in our economy.

The U.S. dollar is already largely digital and exists primarily in the form of bank deposits. Today, bank deposits represent 73 percent of money in our economy. At its core, blockchain is a ledger technology. Banks have long relied on ledgers to record value and facilitate transactions. Over the years, this technology has evolved from paper-based ledgers, to on-premise servers, and now the cloud. We believe that blockchain is the next evolution in ledger technology. By recording a traditional bank deposit on blockchain, we can bring many of the benefits of stablecoins to the real economy while maintaining the numerous benefits and protections that our two-tier banking system provides today.

Unlike stablecoins, tokenized deposits are not designed to connect the broader crypto ecosystem to the real world. Tokenized deposits are backend technology designed to improve the delivery of traditional banking services. They will not trade on exchanges, and in many cases will not be held directly by the public. Like all bank deposits, they are a liability of an insured depository institution.

Bank deposits are a cornerstone of our monetary and financial systems that support the dominance of the U.S. dollar around the world. They play a critical role in supporting a bank's ability to lend into the communities they serve, driving economic growth, and promoting social mobility. The value of bank deposits is supported by stringent regulation and proactive oversight, which includes capital and liquidity requirements as well as technology risk management designed to control for the risks associated with deposit taking.

Tokenizing deposits facilitates the creation of a real-time blockchain-based payments infrastructure that can significantly improve the delivery of banking services. It can facilitate faster, cheaper payments, programmable payments, and atomic settlement. We can only realize these benefits when innovation is delivered responsibly and regulatory guidelines are clear, certain, and consistently applied.

Legislation like that being discussed today is an important step to ensuring stablecoins are delivered responsibly and that consumers remain protected. It is important that these efforts do not inhibit the adoption of blockchain for other applications like tokenized deposits. To that end, we were pleased to see that the draft legislation makes the critical distinction between stablecoins and tokenized deposits, and that it affirms a bank's ability to leverage blockchain for traditional banking applications.

Unfortunately, there is not currently a clear regulatory path for banks to adopt blockchain. Today, banks require formal regulatory approval for any such project. We would encourage Congress to work with the banking agencies to ensure there is a clear and credible path for banks to adopt blockchain technology. Competition breeds innovation, and we believe there is a role for many forms of money, both novel and traditional. We look forward to working with Congress to ensure there is an appropriate regulatory framework for novel assets like stablecoins, and to ensure there is regulatory clarity for banks to adopt new technologies that benefit the customers and communities that they serve.

Thank you for the opportunity to testify today. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Morgan can be found on page 49 of the appendix.]

Chairman HILL. Thank you, sir.

Mr. Portilla, you are now recognized for 5 minutes for your oral presentation.

STATEMENT OF DAVID L. PORTILLA, PARTNER, DAVIS POLK & WARDWELL LLP

Mr. PORTILLA. Thank you, Chairman Hill, Ranking Member Lynch, and members of the subcommittee. It is a pleasure to have the opportunity to speak before you today. I commend all of your diligent efforts and the progress that has been made to develop stablecoin legislation. I believe a bipartisan substantive consensus should be achievable.

These types of financial products are special because they pose well-known risks, such as the risk of a run, that is, request for redemption and loss that cannot be met due to a mismatch in the liquidity of reserve assets. We can and should proactively mitigate these risks by establishing a regulatory framework now before the risks grow larger and scale makes that change more difficult.

I cannot say with certainty whether stablecoins represent a part of the future of payments, yet I feel quite confident that the current legal framework is ill-suited to comprehensively regulate payment stablecoins. Correspondingly, legislation that enables fit-for-purpose regulation would help foster an environment where this technology can develop and scale.

Some of the potential that payment stablecoins offer include the programmability of money and additional means for mobile-based, real-time payments for consumers, and the creation of an additional payments infrastructure in which further innovation can occur. If realized, all of these developments may amplify the potential for building a more efficient, competitive, and resilient payment system.

Legislation should establish privileges and responsibilities along a spectrum. Greater privileges from the government should be coupled with more-stringent regulatory oversight; a more-tailored regulatory approach, on the other hand, should be coupled with appropriately-calibrated privileges from the government.

The remainder of my remarks will focus on what I believe are the key outstanding issues that should be addressed in any legislation.

One, who should be permitted to issue payment stablecoins? Nonbanks should be permitted to issue payment stablecoins. Within a banking organization, it makes the most sense for a stablecoin to be issued by a non-bank entity within the corporate group. The reason is that the common conception of a payment stablecoin business, the issuance and redemption of an instrument backed by a discrete pool of high-quality liquid assets, is distinct from the traditional banking business model.

Two, who should regulate payment stablecoins? Federal regulation of stablecoin issuers would offer more uniform, consistent rules, where a State regulation could promote more diversity and

innovation in regulation and supervision. The answer to this question need not be binary. Many of the legislative proposals released by Members of Congress to date have followed the model of our dual banking system. That is, they would establish a framework in which stablecoin issuers could be regulated either directly at the Federal level, or primarily at the State level with an overlay of Federal oversight. There are many options, including providing Federal regulation as a backup to State regulation, or an approach that toggles based on the scale of an issuer.

Three, should non-bank payments stablecoin issuers be provided access to the Federal Reserve's payment system or discount window? Granting non-bank payment stablecoin issuers access to master accounts could help them provide more-efficient services to their customers. Perhaps legislation could grant non-bank stablecoin issuers access to Federal Reserve Bank services, but limiting those services in both scale and scope, or access to Federal Reserve Bank services could be available as an option or based on the scale of an issuer.

Four, to what extent, if at all, should payment stablecoins be subject to, "deposit insurance?" Whether some form of insurance is ultimately needed for stablecoins may turn on the nature of the reserves that backed them, and relatedly, the degree to which consumers expect their stablecoins to be redeemable on demand at par.

Five, what insolvency standard should be applicable to payment stablecoins? To the extent payment stablecoins are designed or perceived to be effectively free of credit risk, it would be prudent to provide stablecoin holders with structural priority over an issuer's other creditors. In addition, customers should know that the companies that help them hold stablecoins do so in a safe way. Existing Federal and State laws provide standards for custodians and should be useful in this context.

Six, what other legal regimes should apply to payment stablecoins and related products and services? Well, I focused primarily on prudential issues. Payment stablecoins and related products also present other common regulatory concerns such as those related to consumer protection and illicit finance. All of these considerations should be thoughtfully explored, but this does not mean that the securities laws should apply to payment stablecoins nor does it mean that we should be vexed to paralysis in trying to answer questions that, frankly, permeate traditional finance, such as how to regulate any service provider that is adjacent to a regulated firm. Ultimately, consumers in our financial system more broadly will be best-served by focusing on the issues I outlined, where I believe we can find common ground.

Thank you.

[The prepared statement of Mr. Portilla can be found on page 59 of the appendix.]

Chairman HILL. Thank you, sir.

Ms. Wang, you are recognized for 5 minutes for your oral presentation.

**STATEMENT OF FENNIE WANG, FOUNDER AND CEO,
HUMANITY CASH**

Ms. WANG. Good morning. Thank you, Chairman McHenry, Chairman Hill, and Ranking Members Lynch and Waters for giving me this opportunity to testify.

People like me rarely have this opportunity. I do not represent a large corporation or an industry organization. I am an independent lawyer and entrepreneur working with grassroots organizations. While in my past life, I have worked for a Wall Street bank and Wall Street law firms, the work I do now is a labor of love, working with community organizations to design local currencies that make money work harder for local communities. Indeed, my company is called, “Humanity Cash,” because we want to make money personal again.

During the pandemic, I studied the history of community currencies, which are not legal tender, but they complement national currencies as a local medium of exchange to ensure more money circulates and stays within local communities. In the United States, where we enjoy the world’s reserve currency, one downside is that the U.S. dollar sometimes works minimally for local communities, with most of that money benefiting big banks and large corporations. Therefore, the goal of a local currency may be to promote patronage of small businesses and local banks, which recirculate deposits back into the local economy in the form of productive loans, creating a money multiplier effect. This is the model of a local currency in The Berkshires, Massachusetts.

During the pandemic, small businesses were under and continue to be under pressure. The pandemic also accelerated the shift towards contactless payments, which means that more money is leaking out of local economies. Even if you shop locally, if you pay with a credit card, the local economy loses out on the money multiplier effect of that dollar being put to work by local banks, as well as the 3- to 4-percent transaction fees that are taken off the top. I saw this as an opportunity to address a real-world problem for which blockchain was suited. By digitizing a local currency, we can better compete with credit cards, and reduce transaction fees, while ensuring that the underlying dollar reserves remain deposited and, therefore, invested in the local economy via local banks.

During the process of designing and launching additional local currency, I interviewed small business owners, community bankers, and ordinary citizens, whether in The Berkshires or across the United States, from Puerto Rico to Hawaii to Indiana. The people I have met are not interested in crypto as a speculative investment, and neither is anyone in this room. We are all deeply passionate about making money work for our communities—that, “we,” includes a concrete mixer driver, a retired accountant, community organizers who support Black-owned businesses, and a small business owner who produces Massachusetts-made ukuleles.

As grassroots entrepreneurs and community innovators, we need risk-appropriate regulations that will not be cost-prohibitive, while providing guardrails to protect us from bad actors. Chairman McHenry’s stablecoin proposal strikes a good balance between these two needs. Importantly, it provides space for local initiatives in innovation through State regulators in a clear roadmap for im-

plementation. This proposal also provides the groundwork for community financial institutions as well as non-bank institutions, such as Economic Development Organizations, to staunch the flight of deposits from local communities.

Payment stablecoins enable higher-quality deposits, as we can transact amongst each other without needing to withdraw the underlying dollars. The urgency of keeping deposits local is more important than ever in light of the regional banking crisis. The community banks we work with in Massachusetts recirculate 70 cents of every dollar back into the local economy, compared to just 20 cents for large banks.

Long term, blockchain technology can replace outdated banking and payments infrastructure, which is currently limiting the ability of smaller banks to innovate and compete effectively against big banks and fintechs. With the right policies, starting with the stablecoin proposals, we can enable our financial system to be more competitive and more responsive to local economies, a benefit that ordinary Americans deeply desire. Thank you.

[The prepared statement of Ms. Wang can be found on page 67 of the appendix.]

Chairman HILL. Ms. Reynolds Hand, you are now recognized for 5 minutes for your oral presentation.

**STATEMENT OF DELICIA REYNOLDS HAND, DIRECTOR,
FINANCIAL FAIRNESS, CONSUMER REPORTS**

Ms. HAND. Thank you. Good morning, Chairman McHenry, Ranking Member Waters, Subcommittee Chairman Hill, Subcommittee Ranking Member Lynch, and members of the subcommittee, and thank you for this invitation to testify. My name is Delicia Reynolds Hand, and I serve as the director of financial fairness at Consumer Reports, where I lead the organization's work in digital finance. At Consumer Reports, we examine what fintech products and services actually do for consumers and how they rate alongside each other. Do they actually live up to what they promise?

As I testified recently, the convergence of new technologies and new forms of assets have made cryptocurrencies particularly appealing for consumers whom traditional finance has never appropriately served. In a volatile and stressed economic environment, consumers and investors are at an even greater risk in the absence of rules and noncompliance with regulations to protect them and prevent the misuse or exploitation of these assets. Since the last conversation on stablecoins, Europe has succeeded in bringing crypto assets, crypto asset issuers, and crypto assets service providers under a regulatory framework, and today, we have two bills under consideration. I hope we can land in a good place for consumers.

Consumer Reports urges this committee to work together to achieve effective and comprehensive regulation of stablecoins. This is especially important for responsible innovation, financial stability, and financial inclusion. Appropriate regulation, supervision, and oversight needs to be implemented before stablecoins become a greater risk to financial stability, safety, and soundness, and the smooth functioning of payment system.

To be clear, this space will be regulated, and new frameworks will be developed. The question is, whether the development will be driven by crisis or collaboration? We support updates to the committee draft which include Federal regulatory review to ensure the safety and soundness of stablecoin issuers. And we encourage the adoption of provisions in the bill granting the Federal Reserve Board authority to reject State licenses. Not including these provisions creates regulatory arbitrage, which could drive a race to the bottom instead of a race to the top. These are lessons we have failed to learn from the past. Keeping with the tradition of congressional implication of the commerce clause, the law should be the same across all 50 States.

The committee draft could also go further to include specific key requirements which parallel requirements for traditional banking. While both drafts retain some equivalent requirements to provide information about the organizers, senior management teams, and capital adequacy, we urge the committee to also retain requirements to promote diversity and inclusion in the compromise bill. We support the addition of requirements for Federal regulators to issue rules related to risk management infrastructure.

Second, while the committee bill outlines a role for Federal oversight, it does not require entities that become stablecoin issuers to be insured depository institutions. The compromise bill, however, makes it clear that issuers shall not represent stablecoins as insured depositors. We would encourage adoption of this language. We are most concerned about the removal of key text in the committee draft, maintaining separation of banking and commerce, prohibiting non-financial commercial businesses like Facebook or Walmart from owning a payment stablecoin issuer. Additionally, we would encourage the adoption of stronger consumer protections.

The bill sets up a regime to prove issuers of payment stablecoins, but it doesn't outline adequate consumer protections for payment activities conducted or facilitated by issuers or their coins. We urge the committee to move forward with the provisions in the compromise bill that require stablecoin payment regulation to additionally be technology-neutral, to promote interoperability and to ensure stablecoin arrangements share common features with the traditional financial system.

We also request that the committee adopt language associated with strong oversight of custodial wallets, as the committee draft does not cover all assets held by custodial wallets. We do not need another Lehman Brothers. And in the event of another insolvency, a bankruptcy court could reasonably view, as they have in Celsius, that commingled funds are grounds for giving the company and its creditors priority access to those funds rather than stablecoin holders, the rightful owners. Lastly, we urge explicit clarification on how and when the SEC can and should regulate in this space.

Thank you again for the opportunity to testify.

[The prepared statement of Ms. Hand can be found on page 36 of the appendix.]

Chairman HILL. Thank you for your testimony. And we appreciate all of the testimony from our witnesses. We will now turn to Member questions.

The Chair recognizes himself for 5 minutes.

Mr. Homer, those were interesting comments you made about validation of the reserves for a stablecoin, and you referenced the ability to do that on an intraday basis versus the way the bill is drafted. Is that technology readily available for a stablecoin issuer to provide an intraday valuation of their reserves and transparency on that?

Mr. HOMER. Thank you for the question, and, yes, the technology is available. I think there will be two aspects of it. One is the number of stablecoins that you have issued, which is available publicly through the blockchain, and then, the second aspect of it would be technology to show that the backing assets match that on a one-to-one basis. And both of those things can be accomplished,

Chairman HILL. Right. And that would obviously be backed up by the attestation and monthly financial reporting, and then audits. Yes. Thank you. That is a good comment you made.

In our last hearing, we heard testimony from NYDFS Superintendent Harris on the role of State regulators. She described how State regulators can regulate payments, stablecoin issuers, and how a regulatory regime could be built on a well-established dual banking system that we have in our country. I think it is important as we work through the drafts that we strike the right balance there. I think it is a key, effectively, a difference between these two drafts, and the one that we are going to try to figure out between both sides of the aisle as we work through this. And naturally, it is an area that the Federal Reserve cares a lot about since they would be the primary regulator for federally-qualified nonbanks. And in our Republican draft, we have the Comptroller of the Currency as the primary Federal regulator for national trusts.

Our September bill, from last fall, the Maxine Waters-Patrick McHenry bill, would require a State-chartered issuer also registered with the Fed.

Mr. Homer, striking a balance there, what is your view on making sure we get that balance right?

Mr. HOMER. Yes. As you pointed out, I think that balance is very important to get right for a number of reasons, most importantly, that we want a competitive marketplace. I have been a Federal regulator, and I have been a State regulator, and I think both regulatory systems are important to the stability of our financial system. But I will say with certainty that State regulators are much closer to the ground. They know their local constituents much better. They are much more able to effectively calibrate a regulatory environment that meets local requirements. The State pathway is important, because if you are someone who is starting a financial services company, that is where you go to get licensed or chartered for the first time.

Chairman HILL. But you know the ranking member's concerns about a race to the bottom, right? You have been a State regulator and an FDIC employee. Can we strike that balance with the way we have approached it in the Republican bill, do you think?

Mr. HOMER. I think so. I think in both of these bills, there is a strong Federal floor. I would argue that a race to the bottom is not possible.

Chairman HILL. Okay. Good. Thank you.

Let me turn to you, Mr. Portilla, on the issue of the OCC charters. The Comptroller of the Currency had two digital asset firms that they had given conditional approval to act as a trust. And those conditional approvals now have lapsed, like so many things, around our lack of a regulatory framework, adding to the frustration here. The Republicans on the subcommittee sent a letter to the Agency pointing out its inconsistent approach in reviewing national trust bank charter applications. Could you discuss the benefits of allowing the OCC to serve as the primary regulator for any stablecoin issuers that receive an OCC national trust charter, please?

Mr. PORTILLA. Yes. Thank you for the question. I think the main benefit of having the OCC serve as the primary Federal regulator for a stablecoin issuer that has a national trust charter is that you avoid multiple Federal regulators of the same entity. And in addition, the OCC is at heart a supervisor and an examiner of banks and trust companies, and so they are well-qualified to do that.

Chairman HILL. That is helpful. Let me yield back the balance of my time, and call on my friend from Massachusetts, the ranking member of the subcommittee, Mr. Lynch, for his 5 minutes of questions.

Mr. LYNCH. Thank you, Mr. Chairman. Mr. Homer, how many stablecoins are registered in New York State?

Mr. HOMER. There are, I believe, currently three companies that have been chartered to issue—

Mr. LYNCH. How many stablecoins are there?

Mr. HOMER. I believe it is five.

Mr. LYNCH. No, no. How many stablecoins are in existence right now?

Mr. HOMER. There are probably—

Mr. LYNCH. 20,000, I think, yes.

Mr. HOMER. That would claim they are stablecoins.

Mr. LYNCH. Yes. So, 5 out of 20,000 are registered in New York. I think that is evidence of a race to the bottom right there, where stablecoins are trying to and crypto companies are trying to go to the areas with the least amount of regulation. I also worry, and I know you have done extensive work in New York. We had Ms. Harris in yesterday, and I know people have done a lot of good work in New York around this issue.

But the practice—a race to the bottom is not possible. A race to the bottom is the practice, is the custom of this industry, to go offshore and seek areas of least regulation. I compliment the State of New York for the work that they have done. However, my feeling is that if we directed this to the 50 States and the Territories, perhaps that practice would continue, and cryptocurrencies would seek out those areas, those jurisdictions that offer the best opportunity for them to maximize their profit and avoid cumbersome and costly regulation and disclosure. That is what I worry about here, that we are not engaged in that type of practice where New York would be penalized for having a robust regulatory system. They would run elsewhere. There are other States that are in the game here. We all know who they are, that are offering themselves as safe havens, that offer us some real concerns.

But anyway, I do appreciate you all being here and helping us. This is a learning process, and we are all trying to understand this in a better way so that we can craft this legislation and come to a meeting of the minds. I deeply respect the chairman, Mr. Hill, and I know he is a good man, and we are trying to get to a good situation on this. But, Ms. Reynolds Hand, back in February of this year, the Fed Board of Governors offered guidance on member banks regarding the use of digital assets within the Federal banking ecosystem, and they said they are offering this guidance because of rampant fraud.

The rule that they promulgated covered two directives. One was to presumptively prohibit holding crypto assets out of safety and soundness concerns, and the rule also noted significant risks associated with the cryptocurrency sector, including fraud, legal ambiguity and volatility. They also said—and this really got me—that in the absence of a fundamental use case, the value of most crypto assets is driven largely by sentiment and future expectations, and not by cash flows from providing goods or services outside the crypto asset ecosystem.

So in light of so many of these stablecoins breaking the buck, becoming de-pegged, wreaking havoc for those who hold this because of the inability of depositors and investors to get their money back in redemption, is this something that we want to tie to a traditional financial system and give access to the Federal Reserve discount window or access to Federal Reserve services?

Ms. HAND. I would say we certainly shouldn't start there, with so much volatility and disruption occurring. We shouldn't open up the Federal purse, frankly, until industries are proven to be safe and we cut down on rampant fraud and other abuses. We should start first with clear rules of the road and strong protections for consumers. Then, once proven, we should add the additional programs in which companies are interested.

Mr. LYNCH. That is great. Thank you. Mr. Chairman, I yield back.

Chairman HILL. The ranking member yields back.

I now recognize Mr. Davidson of Ohio, who is the vice chairman of this subcommittee, and the chairman of our Housing and Insurance Subcommittee, for 5 minutes.

Mr. DAVIDSON. I thank the chairman. Thanks for our witnesses, and, frankly, for the colleagues who are here to help make good policy. I will try to stay calm and measured in my responses here. But the whole point that we are trying to do is provide a clear legal framework for the entire country so that no one State can game the system or, frankly, so that people aren't driven offshore, out of our capital markets and our regulatory framework. Often, they are fleeing our markets to find certainty, so it would be great if we would provide some. I have been working on this for a long time, as have many of you.

Speaking of efforts, people say, oh, there is a lack of stability, that a lot of the same people are working to create a lack of stability.

Mr. HOMER. This year it has become fairly apparent to many people in a bipartisan way that the traditional banking industry has started taking a hostile position with digital asset companies in the

space in which they operate. When Silicon Valley Bank failed, some people pointed to digital asset companies, one of which was a stablecoin issuer, and said they held too much of their capital at one bank, Silicon Valley Bank. When Signature Bank failed, people claimed that maybe it had something to do with digital assets.

Barney Frank, a former chairman of this committee, said it didn't have anything to do with that. The director of the New York State Department of Financial Services, who was there for the whole thing, said it didn't have anything to do with digital assets. So, where are they going to go for banking? Could you speak to the harm that comes with deep banking, the industry, and the damage, and, frankly, the lack of stability that it has caused?

Mr. HOMER. Yes. Thank you for the question. I think it is something that has been a challenge, and it has become much more difficult for companies in the space to find banking services, even for the most basic of services, to find an account for payroll, for example. I think, unfortunately, what that will lead to is people looking for alternatives that are, in some instances, offshore.

Mr. DAVIDSON. If you can't deposit your cash in America, you are probably going to deposit your cash somewhere, right?

Mr. HOMER. Right.

Mr. DAVIDSON. So then, they will point to that and say, see, they are offshore. Well, you drove them there, on purpose, I might add. Let me just address this. Could a stablecoin go to zero, a regulated stablecoin that is backed by high-quality liquid assets, or, frankly, commodities, physical custody of commodities, would that really go to zero?

Mr. HOMER. Under this proposal, it would be very difficult to foresee a scenario.

Mr. DAVIDSON. There would have to be complete fraud. They didn't have the assets, right? Could somebody in that case, where you had full custody of the assets that you say you have, whether they are level-one, high-quality assets or physical custody of a commodity that backs it, could it possibly go to less than the value unless there was actual fraud?

Mr. HOMER. It would be very difficult.

Mr. DAVIDSON. I think that is the case, and that is the whole goal of the regulatory regime we are trying to put in place here with stablecoins. As we confront the debt ceiling and the fact that this town spends way more money than we collect in revenue for a long, long period of time, we are spending more money than anyone will even lend us, there seems to be a shortage of demand for Treasuries, given that the most frequent backing for a stablecoin so that it really is fully backed is Treasuries.

Mr. Portilla, could you talk about the important linkage that stablecoins would create for demand for U.S. dollar-denominated Treasuries?

Mr. PORTILLA. Right, yes. Thank you for the question. I think you are right. If stablecoins are required to hold their reserves and high-quality liquid assets, which of course includes short-term Treasuries, there would inherently be increased demand for those assets from those issuers. So, I think that is right.

Mr. DAVIDSON. Yes. I think it could actually help us solve a number of problems. And then the last thing in terms of the payment

space, frankly, for a lot of people, is they look at a stablecoin as in many ways superior to a fiat currency, because while the fiat currency is backed by the full faith and credit of the United States, and we could just print more money, you have a hard time guaranteeing that it will buy the same amount of goods. But in the case of a stablecoin, it is fully backed and could be backed by physical custody of assets as well.

My time has expired. I hope we land on something in a completely bipartisan way and that we can get this done. I yield back.

Chairman HILL. I thank the gentleman. Mr. Foster, who is the ranking member on our Financial Institutions and Monetary Policy Subcommittee, is now recognized for 5 minutes.

Mr. FOSTER. Thank you. Mr. Homer, you mentioned real-time monitoring of reserve balances versus tokens issued. Wouldn't it be actually easiest and safest to simply require as part of the minting process that digital attestation for the Federal Reserve, that the amount of deposit in the relevant account at the Fed exceeds the amount of tokens that are proposed to be in circulation following any proposed minting operation? So basically, that any proposed minting operation would not be cryptographically valid until it was accompanied by a Fed attestation that the assets are actually there on reserve. Do you understand where I am going? It seems like this is a very unburdensome operation to require for both the Fed and the issuer.

Mr. HOMER. I think they could be complementary. If we are thinking about trust in the market and how do we produce trust, I think real-time dashboards could assist with that. But of course, attestations from a regulator or required by a regulator are important and probably not in addition to that. I don't think they are mutually exclusive.

Mr. FOSTER. I am worried about the sort of abuses that we saw with flash loans and things where even, for a fraction of a second, you can have weird things happening, and all of a sudden, a giant fraud has taken place, whereas if you would have simply said the minting is not valid until the Federal Reserve says, yes, they are there, before, during, and after the minting operation, you have some excess buffer of reserves. It seems like that should be an absolutely solid way of guaranteeing.

Also, that approach, it seems to me, really eliminates all of the worries about monetary effects, because there is a one-to-one ratio in which you emphasize fraudulent issuance, runs on stablecoins, and that would all just disappear if we adopted that approach. So, I think there is a lot to be said for it.

Ms. Wang, in your testimony regarding Humanity Cash projects, I see that you have kind of independently discovered and implemented the two principles that I believe must be included to have the controlled privacy and security that will be needed to avoid fraudulent and criminal use of stablecoins.

First, in your testimony you state that the use of a blockchain ledger can also cost-effectively and in transparency meet part of the public reporting requirements under the proposed stablecoin bill. For example, you can show in real time that the number of tokens on a chain compared to the U.S. dollar reserve balances is what we have just been talking about.

But second, I was very pleased to see that you have also attached what amounts to be automobile license plates on each digital wallet, something that I have been advocating in this committee for quite some time.

Then, in your testimony, you state that at the point of wallet creation, we collect information regarding username and contact information associated with each wallet, not available to the public on a public ledger to preserve user confidentiality, and then go on to explain why it would be to the advantage of that system.

So, let us spend a moment looking through the privacy implications of this to see if it is a comfortable place to land. For example, if a person uses Humanity Cash to buy a secret gift for their secret lover with no criminal activity involved, can they expect that it will remain anonymous and secret?

Ms. WANG. Yes. The blockchain itself doesn't show any personal identifying information, but we can also design systems that preserve the balance between preserving your privacy versus law enforcement needs. One of the other areas that I have done work on is around digital identity. You can, for example, have the DMV or a bank issue a digital token that represents like KYC credential, right? So, your identity

Mr. FOSTER. Yes. The so-called mobile ID or digital driver's license?

Ms. WANG. Right. And a wallet can hold that digital identity token to signal that it has been checked, and then, you are going to have safe transactions without needing to actually know who that person is, unless there was a compliance reason to reveal the underlying information.

Mr. FOSTER. I know that. I am a huge fan of mobile ID as well. Now, on the other hand, if there is a ransomware attack, say attempting to use Humanity Cash as a payment and someone's screen locks up and says that in order to decrypt your computer files, we want you to transfer this much Humanity Cash to this wallet, then I presume you can go to some judge somewhere, prove a crime has been committed, and de-anonymize the owner of that wallet. How does that take place? What is the mechanism for control of de-anonymization?

Ms. WANG. In our specific case, I think the chances of that are pretty low because you would only be able to suspend it—

Mr. FOSTER. I understand, but we are talking about systems at a scale.

Ms. WANG. Right, but at a systems level, there will be ways to prevent that. Instead, you would know exactly where the money has been transferred. But you can freeze, for example, compromised tokens and so they would no longer be transactable after the point of attack. And then, you still have the underlying real-world assets, the deposits in the bank, and all of that remains safe, so we can then—

Mr. FOSTER. Thank you. I think my time is up. Your project may be small, but I think you have seen the future pretty clearly.

Ms. WANG. Thank you.

Chairman HILL. Thank you, Dr. Foster. We now turn to the gentleman from Tennessee, Mr. Rose, for 5 minutes.

Mr. ROSE. Thank you, Chairman Hill and Ranking Member Lynch, for holding this hearing, and thank you to all of our witnesses for your time today. I would like to also thank the chairman for noticing Ranking Member Waters' stablecoin draft to this hearing to give us the opportunity to discuss some of the bad policies that it includes. For instance, it would require each stablecoin issuer to disclose so-called diversity statistics, which have nothing to do with the financial stability of the issuer. Additionally, the Waters draft proposes to push forward with a study on a central bank digital currency, which has been called the single greatest assault to financial privacy since the creation of the Bank Secrecy Act.

Since my time is limited, I want to dive directly into my questions. Mr. Morgan, the U.S. dollar is the world's reserve currency, accepted all around the world because it is backed by the full faith and credit of the U.S. Government. In that sense, it is the original utility token. I see the value in U.S.-based stablecoins to facilitate payments. So, Mr. Morgan, if we are going to use blockchain technology and crypto rails to facilitate payments, is it essential to have a less-volatile asset, like a U.S.-backed stablecoin, than, say, Bitcoin or an Ethereum-based token?

Mr. MORGAN. Congressman, thank you for the question. We think that stable asset is a critical piece of facilitating real-world value. In particular, we believe tokenized deposits are one path to do that. Today, bank deposits are 73 percent of money in the U.S. economy. Stablecoins are separate and apart from that, but we believe that competition from well-regulated parties for the form of that money can only benefit the economy.

Mr. ROSE. Thank you.

Mr. Portilla, the McHenry bill does not include a requirement for a report on financial inclusion, which was included as part of an earlier draft. It also does not require regulators to consider financial inclusion when evaluating a stablecoin issuer's application, which is also required in the earlier draft. Mr. Portilla, does information pertaining to diversity and financial inclusion have any bearing on whether the stablecoin issuer is capable of operating a stablecoin in a safe and sound manner?

Mr. PORTILLA. Yes. Thank you for the question as well. No, I think the safety and soundness factors in the proposed legislation, both of the proposed pieces of legislation, are different than what you might call the community benefit or the financial inclusion standards. I think the financial inclusion or community benefit standards are not going towards safety and soundness. They are addressing other policy goals.

I think those are borrowed from our banking laws, where those factors are required to be considered under the banking statutes for mergers and acquisitions, for example, for different reasons. For example, classic banking is taking deposits and making mortgage loans, and Congress in the past has worried about banks making decisions about whom they are lending to. To me, that is not relevant to the business of a stablecoin. They are not making those types of decisions. So, I think there is a question of if that is the right piece of the banking statutes to draw from for stablecoin legislation.

Mr. ROSE. Thank you. I agree.

Mr. Morgan, tokenized deposits have a role to play in utilizing the benefits of the blockchain in our payment systems. Can you address the benefits of tokenized deposits and how they differ from traditional stablecoins?

Mr. MORGAN. Congressman, thank you for the question. We believe that this is a critical distinction. Unlike stablecoins, tokenized deposits are not designed to connect that broader crypto ecosystem to the real world. Tokenized deposits will not trade on exchanges, and in most cases, will not be held by the general public. They are simply backend infrastructure that can bring the innovations associated with blockchain technology into the traditional banking space.

Mr. ROSE. Thank you.

Mr. Homer, how do we ensure that stablecoin issuers work with their regulator to utilize an appropriate amount of on-balance sheet liquidity and concentration limits to offset the risk of withdrawals in a stress scenario based on their risk profiles?

Mr. HOMER. Thank you, Congressman, for the question. It is a great question, and it really speaks to the importance of a prudential supervisor being the primary regulator of stablecoins. And that is the balance the stablecoin issuers have to strike, a balance between stability and liquidity, and prudential supervisors have an important role to play there in helping them think through scenario planning to get that right.

Mr. ROSE. Thank you. I see my time is expiring, so I yield back.

Chairman HILL. The gentleman yields back. The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. I am here to channel Nancy Reagan. Just say no to crypto and to so-called stablecoins, the biggest oxymoron in the American language. Mr. Rose points out that the other way to go here is with the digital dollar, and the reason he opposes that is he wants to have financial privacy. That is right. If you want to be a drug dealer, you need financial privacy. If you want to evade our sanctions laws, you need financial privacy. But the big market is the tax evaders. The IRS has testified that we have a trillion dollars of uncollected taxes, chiefly from billionaires, in this country. That means they have to hide \$3 trillion of income every year. That is the big market for this.

I first got involved in crypto because it blows a giant hole in what has been the most effective element of national power, and that is our ability to impose sanctions. We differed on the Iran nuclear deal, but we were able to order every country in the world to not buy Iranian oil in excess of the amount we specified for that country because of the role of the U.S. dollar. Some would say that got us a great nuclear deal, some would say it should have gotten us a better nuclear deal, but if this works, we are not going to have that power anymore. You can build a couple more aircraft carrier groups at great expense, but it isn't going to give you the power that we had at that time.

My concern is what happens if this works as a payment system. It is designed to compete with the U.S. dollar. I think Mr. Davidson had it right. Here in Congress, we spend money like we are Democrats, we impose taxes like we are Republicans, and we have a fis-

cal deficit that would make Argentina blush. If we didn't have the U.S. dollar playing the role that it does, our economy would be worse than that of Argentina, so if this works, it is a problem. We have people here concerned with either helping billionaires make money or maybe helping consumers not get ripped off. All of the billionaires make the money, but we don't have anybody on our panel concerned with the power of the United States through its U.S. dollar.

Now, we have the McHenry bill, which allows you to go to any one of the 50 States and make them your regulator. So, you supposedly have one-to-one backing for your money, but you pick your auditor out of any one of the 50, so it certainly gives you the opportunity to have less oversight, and eventually not to have support. Mr. Davidson points out that the inflation means that the dollar is worth less. That doesn't mean these stablecoins preserve value because these stablecoins are tied to the value of the U.S. dollar. They are never worth more than one-to-one. They can be worth less if you have fraud and you invite fraud by saying, go to the State that has the least-effective audits.

Finally, there is the use of private wallets. Now, those who talk about fiat currencies will say, hey, I have a private wallet. You can't conveniently put a million dollars in this. The Federal Government doesn't regulate it, but how much money can you put in it? In contrast, we are going to have a stablecoin system that is like an iceberg. Some will be above the water and will see it, but then you will have private wallets below the water that will be a lot more efficient for tax evaders, drug dealers, and sanctions evaders.

I can't believe I still have an additional 40 seconds.

I will also point out that this stablecoin is not some hip new thing. It is as hip as John Quincy Adams. We already had this in the 1820s. Banks would issue their own currency, similar to what Ms. Wang was talking about. I want to add one more thing, and that is, we already have money market funds. They work much better than stablecoin as a payment system now, and we can make them much better than they are now. You can tie them to a debit card. The only problem is they have Know Your Customer (KYC) rules, and that means they are not good for tax evaders and sanction evaders. I yield back.

Chairman HILL. The gentleman yields back, and the Chair reminds all Members that there is no loss of prestige by yielding back in less than 5 minutes.

The Chair now recognizes the gentleman from Wisconsin, Mr. Steil, for 5 minutes.

Mr. STEIL. Thank you very much, Mr. Chairman. Thanks for holding today's hearing. I think it is a really important topic.

Mr. Homer, one of the things I think a lot about is how we make sure that the development of these products isn't overseas, but rather, in the United States. A lot of times, I think about the challenges that I have with Big Tech, but if I look at all of the challenges that I have with Big Tech, I think I can't even fathom to wrap my head around the challenges that we would face if, instead of having U.S.-domiciled companies at the forefront, if all of our Big Tech companies were like TikTok and were developed outside

the United States, the challenges that we would face or the infancy in some ways of this technological revolution.

I want to make sure it remains and is developed here in the United States with our values rather than internationally, as well as the jobs and value that will come from that. And so, as I look at that, do you believe that the proposed McHenry legislation will provide innovators with the certainty they will need to invest here in the United States?

Mr. HOMER. I do, and I can—

Mr. STEIL. No, no, no. That is good. Okay. Straightforward answer then. Singapore has enacted a regulatory framework for stablecoins, so let's examine Singapore's experience as we craft our own framework here in the United States. Is there anything specifically we can learn from the Singapore experience?

Mr. HOMER. Sure. I think one thing that is important now is that stablecoins will happen regardless of whether we want them to happen or not. The U.S. dollar dominates stablecoins. There is nothing stopping offshore entities from doing this already. We should have it done in the U.S. so we can regulate it on our own terms.

We can learn a lot from stablecoin frameworks being proposed in other countries like Singapore and the European Union. In some ways, they mirror much of what is reflected in this proposal regarding reserve requirements. I think one feature that is different that you see in other markets is a tiering. Under this proposal, someone who issues \$5 of stablecoins is regulated in the same way as someone who issues \$5 billion worth of stablecoins, and in other country's proposals, we see a tiering in terms of regulatory requirements.

Mr. STEIL. That is helpful. Thank you very much. Let me stay with you, Mr. Homer, but let me shift gears somewhat dramatically. The SEC recently issued a, "Wells notice," to Paxos that alleges the stablecoin, BUSD, is a security. We all know one of the key prongs to the Howey test is that there will be an expectation of profit. Could a purchaser of a stablecoin have an expectation of profit?

Mr. HOMER. It is hard to understand how a user of a stablecoin could have an expectation of profit.

Mr. STEIL. So, you would agree that stablecoins are not securities, based on your answer, correct?

Mr. HOMER. Correct.

Mr. STEIL. Thank you. I think that is important for the record. Let me shift gears, if I can, to you, Mr. Portilla. I am assuming you have had an opportunity to review the ranking member's alternative proposal ahead of this hearing?

Mr. PORTILLA. I have.

Mr. STEIL. Did you review the section of the legislation entitled, "Risk Management for Contracted Services," which requires Federal regulation of payment stablecoin issuers, affiliates, and subsidiaries?

Mr. PORTILLA. I did.

Mr. STEIL. And would you agree that the legislation requires an entity without an existing Federal regulator to be regulated by the Federal Reserve?

Mr. PORTILLA. That is correct.

Mr. STEIL. So is it fair to say that entities that may not issue stablecoins, but instead engaged in other market activities, would end up being regulated by the Fed?

Mr. PORTILLA. Correct, if they provide the services in that section.

Mr. STEIL. And you agree that this is outside the scope of the Fed's normal regulatory activities?

Mr. PORTILLA. It would be a new responsibility for them, right.

Mr. STEIL. Is this even in the Fed's area of expertise?

Mr. PORTILLA. I don't want to speak for them, but to my knowledge, no.

Mr. STEIL. It appears to me to be a bit of a question as to why we would look for the Fed to engage in a regulatory oversight role that is outside their area of expertise, so I appreciate your feedback. I think it is broadly problematic. I think it would further cause market confusion and potentially conflict with other regulators. I appreciate your time.

Mr. Chairman, since you noted I could yield back time with no disgrace, I will yield back to the Chair. Thank you.

Chairman HILL. The gentleman from Wisconsin yields back in a most gracious manner.

The Chair now recognizes the ranking member of the Full Committee, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. Mrs. Reynolds Hand, the Democratic compromise draft that I posted for today's hearing includes several critical provisions that are missing from the Republican draft. One of them would give the Federal Reserve Board the option to decline any registration of a State-approved stablecoin issuer. This aligns bank and non-bank stablecoins issuers with the current process we have for State-chartered banks and would ensure a strong Federal floor for registration. This means that stablecoin issuers could not engage in regulatory arbitrage. Can you elaborate on the importance of giving a Federal agency, like the Fed, a role to approve payment stablecoins before they are issued?

Ms. HAND. Thank you for the opportunity, Ranking Member Waters. In this country, there is a strong role for Federal regulators in approving all banks, the backbone of consumer finance, and the cryptocurrency and the Fed overlap when banks hold cryptocurrency as an asset on their balance sheets. And in the last couple of years, we have seen that when the traditional banking system and decentralized finance (DeFi) begin to intersect, it can create significant questions and structural issues. For example, although stablecoins may peg their value to the same real-world asset, stabilization mechanisms vary greatly.

This is one of the reasons payment stablecoins can impact the monetary system, and why we need a role for the Fed in the same way that there is the role for Federal regulators to approve State-chartered banks. There has to be a role for the Fed to review applications and reject them if they don't meet certain requirements.

Ms. WATERS. Thank you. That is an important issue that we are dealing with, with stablecoins. Let me move on. One of the most devastating impacts of the FTX collapse resulted from the inten-

tional lack of customer asset segregation. The assets of FTX's customers were used to fund personal loans for senior FTX staff, and funneled into FTX founder, Sam Bankman-Fried's, trading from Alameda Research. Customer funds were commingled with the firm funds. When the exchange collapsed, commingled customer assets largely vanished, and to this day are difficult to recover. Some are unlikely to be recovered at all. However, this is a different experience compared to FTX's Japanese customers, who were largely made whole because Japan passed strong regulations against the commingling of funds. Unfortunately, only a few months after the FTX collapse, the Republican stablecoin draft allows for the creation of stablecoins but has no oversight of the wallets where they would hold them.

Can you describe the importance of customer protections, like the complete segregation of customer assets by issuers, exchanges, wallet providers, and other entities? What are the dangers presented by firms commingling customer assets with the firm's own assets?

Ms. HAND. Briefly, custodial structures help protect consumer funds, and it is important because if a firm goes bankrupt, then consumers need to have a clear pathway to be able to recover their funds. And as we saw in the court rulings in Celsius, there is a clear gray area there, and we need clear rules of the road, particularly around custodial wallets. We need a segregation of consumer funds in these instances.

Ms. WATERS. So, commingling is a serious issue. Again, we have seen it with FTX, and we should be aware of that, and that is one of the issues we have to resolve in this legislation. Thank you, and I yield back the balance of my time.

Chairman HILL. The gentlewoman yields back. The gentleman from Illinois, Mr. Casten, is recognized for 5 minutes.

Mr. CASTEN. Thank you, Mr. Chairman. Mr. Homer, I want to just run through some hypotheticals with you as I think about some of the mechanics of this bill. If I am a broker-dealer of conventional equities, am I legally allowed to unilaterally halt trades on a volatile security, or do I need to have the regulator's approval for that?

Mr. HOMER. I don't have the answer to that question right now.

Mr. CASTEN. It is a, "yes." I hope you would agree that we would not want to give broker-dealers that power, give them the conflicts of interest. I asked the question, because from March 10th to March 12th, Coinbase made a unilateral decision. Coinbase was registered as a broker-dealer, and made a unilateral decision to pause USDC conversions after Circle disclosed that they had \$3.3 billion in exposure to Silicon Valley Bank and they lost their peg. So, exchanges that are registered as broker-dealers in the crypto space, is there something unique about crypto? Should they have authorities that we do not give to other broker-dealers because of the conflicts of interest? It is not a super-complicated question.

Mr. HOMER. I think that anyone who is registered as a broker-dealer should experience a consistent set of regulatory requirements.

Mr. CASTEN. Okay. That is great, because the implication of that is that cryptocurrency exchanges should comply with securities laws and be registered with the SEC.

Second question. Mr. Homer, I was trying to read your background, and I don't know how long you have been at this firm, but you are the managing member of a venture capital fund. Is that right?

Mr. HOMER. That is correct.

Mr. CASTEN. And does your fund invest in crypto firms?

Mr. HOMER. In companies, yes. Not in tokens.

Mr. CASTEN. Okay. Do you receive or buy cryptocurrency tokens in connections with those investments?

Mr. HOMER. We have not.

Mr. CASTEN. Would you be open to that possibility with the right deal and the structure?

Mr. HOMER. I would not preclude it.

Mr. CASTEN. Okay. So if you did, once your contractual lockout ends, however long that is, you are then allowed to sell those tokens to the public immediately, right?

Mr. HOMER. It depends on how it is structured, but in your scenario, it sounds like yes.

Mr. CASTEN. I am just saying, legally; I am not saying how you might structure it. I am just saying, just as a venture fund, when your lockout period is over, you can sell that back, because if you were subject to SEC registration, those would first have to comply with Section 5 of the Securities Act and be registered with the Commission, right?

Mr. HOMER. I am guessing the answer is yes.

Mr. CASTEN. And furthermore, if you are getting paid in these crypto tokens, you don't have to comply with Section 12(a)(1), which would allow individuals who might feel that they had been defrauded, to sue you if there was something that they thought was a fraudulent conveyance or something else, right?

Mr. HOMER. I am following.

Mr. CASTEN. I raise all this because this lack of regulation in the crypto space—and I am not saying anything about you personally; it is just that you are the only venture capital guy up here—allows crypto startups to bypass regulations so that you could exit your position quicker even if it is defrauding investors. I am not saying that is your intent, but I am saying there are a whole lot of problems here with this lack of regulation, and I, frankly, don't think that either of these bills go far enough to address that.

The next piece is, do non-bank stablecoin issuers have a fiduciary obligation to meet customer demands for redemption?

Mr. HOMER. Yes, they would.

Mr. CASTEN. Okay. When Circle saw that SVB was going under, they tried to pull the \$3.3 billion out. They were meeting their obligations to their customers, right?

Mr. HOMER. Yes.

Mr. CASTEN. Okay. Now in the case of SVB, \$3.3 billion wasn't going to make a difference in the overall troubles that they were facing. But it is really easy to imagine that money being in a smaller bank or stablecoin succeeding the way we are talking about, and it all of a sudden being a massively destabilizing event on our fiscal system if you have this obligation to pull, right?

Mr. HOMER. Yes. This is why I think prudential supervision is important and prudential supervisors are the best set of regulators.

Mr. CASTEN. No, I think there is a different issue here. There is a good case for blockchain. There is a good case for Web3. There is a good case for distributed ledger. Why are we creating a currency within that mix that has access to our financial system? If you want to buy this pen for three magic ponies, we can do that. That is a barter transaction. Why are we connecting this to our financial system?

And Ms. Reynolds Hand, I guess I will just end with you, if you have any final thoughts on what risks we expose ourselves to?

Chairman HILL. The gentleman's time has expired. I am just sensitive to it since we have votes on the Floor, and I want to get to Mr. Green. So, I yield to Mr. Green for 5 minutes, and at the end of Mr. Green's questioning, the hearing will be adjourned.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the witnesses for appearing. Let me just start by indicating to you that I am very much concerned about the stability of our currency. There is a war for currency supremacy. This war for currency supremacy is one that involves countries that don't always have our best interests at heart, and our reserve currency is preeminent. It is something that we treasure, but opposition in the world is dependent, to a certain extent, on the validity of our currency. People trust us because of the validity of our currency. They invest in our country and our Treasury because of the validity of our currency.

So, my concern emanates from this belief that we must proceed with caution. And as we proceed with caution, we must keep in mind that the system we have, has some flaws, but it isn't bad, it isn't the worst system in the world, and I want to be very careful about how we do things to impact a system that is fairly efficacious. It seems to be something that others would love to have. In fact, they try to create it on a daily basis.

Here is my concern for you non-bank financial companies. Non-bank financial companies can issue stablecoins. What kind of power are we giving to non-bank financial companies when they can issue stablecoins? In a sense, someone might say they are issuing currency of a sort.

Why don't we just start with you, Ms. Reynolds Hand? Could you kindly comment on what we will be doing when we do this?

Ms. HAND. Congressman, I completely share your concern. I was on the Hill as a staffer during the last financial crisis, and since then, we have continued to see the proliferation of non-bank financial services, i.e., fintech, explode and eclipse, in some parts, the traditional banking system. And that is a primary reason why we do need some clear rules of the road. Unfortunately, via the mobile phones that consumers walk around with, consumers now have access to these digital assets, but they severely lack protections. And that is the only reason why there is a need for legislation and clear rules of the road in this space, but I do share your concern about how we proceed forward.

We have a strong financial system. We have some solid principles around which that system is based, and yet, because there are clear vagaries and gaps in terms of regulation and rules, new entrants are always entering the space and engaging with consumers without adequate protections.

Mr. GREEN. Thank you.

Ms. Wang, just an additional predicate before you respond. Our fiat currency is the envy of the world. Everybody wants the dollar. If we allow circumstances to continue unabated without the legislation, what can happen? Give me your opinions as to how this can metamorphose into something.

Ms. WANG. Thank you, Congressman, for the question. I think, on a global level, countries want to de-dollarize. They want to have the dollar be less influential in international trade. So if there are competing stablecoin legislations elsewhere, they are going to promote their own national currency and de-emphasize dollar-denominated stablecoins, so having this bill would allow us to stay competitive.

And as you said, the U.S. dollar is the reserve currency. I believe that, and I understand the concerns you have, but don't paint all of us with the same brush, because there are those of us who may be non-bank financial institutions, but we are community organizations. We are grassroots organizations. We support the work of local community banks. And we are doing that work to ensure that the U.S. dollar works harder, and by allowing us an opportunity to also—

Mr. GREEN. Let me recede. The chairman has been very generous. Thank you, Mr. Chairman. Mr. Chairman, I am a supporter of Ms. Waters' bill, and I am going to do what I can to help us to have a good piece of legislation.

Chairman HILL. I thank the gentleman from Texas. And I thank our witnesses, and I appreciate your patience. We have two votes on the House Floor. We have other Members who do have some questions. It won't be that many. We ask your indulgence. And the committee will stand in recess until after votes.

[recess]

Mr. TIMMONS. [presiding]. The committee will come to order. I now recognize myself for 5 minutes.

My colleagues across the aisle have asserted that all stablecoin issuers must register with Federal regulators before conducting business, including those that are regulated on the State level.

Mr. Homer, although stablecoin issuers that go through the State pathway are not also required to register with the Federal Reserve under the McHenry proposal, would there still be a significant role for the Federal Reserve to play, and what would that role be under the McHenry proposal?

Mr. HOMER. Thank you for the question, Congressman. There would be a significant role for the Federal Reserve to play in that scenario, namely, in two ways, the first being backstop supervision. The Federal Reserve would have access to the books and records of the companies that are regulated by the States and would have the ability to step in if they felt they were not being properly regulated, and also would be able to take enforcement actions.

Mr. TIMMONS. Thank you for that. Both proposals noticed to this hearing establish a list of factors that Federal regulators must utilize when considering an application for a given stablecoin issuer. Again, Mr. Homer, would you discuss the factors in the McHenry proposal and how they provide the bounds for what the banking regulators may and may not consider?

Mr. HOMER. Yes. Thank you for the question. The factors include the financial requirements, including reserve assets, etc. It includes character and fitness of management and includes an analysis of risks and benefits.

Mr. TIMMONS. And what are the consequences of including more open-ended or subjective factors, as contemplated in the Waters proposal?

Mr. HOMER. There are tradeoffs associated with doing that. For companies/applicants in the space, it makes it more difficult to understand your requirements and to put together a complete application, and for regulators, it would give them significant discretion to reject applications based on a potentially unlimited set of reasons.

Mr. TIMMONS. And if our objective is to provide certainty and a framework from which the market can operate, would the McHenry or the Waters proposal accomplish that objective?

Mr. HOMER. Yes. I think that the first noticed proposal would provide greater certainty.

Mr. TIMMONS. Thank you. One risk identified in the President's Working Group report on stablecoins was a lack of transparency.

Mr. Portilla, would you describe how the draft legislation attached to this hearing could help provide transparency and how that transparency will in turn give consumers confidence in stablecoins?

Mr. PORTILLA. Yes, for sure. Thank you for the question. I think both of the proposals noticed for the hearing include provisions that would enhance transparency for stablecoin issuers. In particular, there is a requirement to disclose the issuers' redemption policy, to establish procedures for timely redemption, to publish the monthly composition of the reserve assets, and to provide attestations of the accuracy of the report of those disclosures to the relevant regulators. And there are, in fact, criminal penalties associated with false attestations, which should provide significant incentive for management to make sure those attestations are correct and provide accountability for when they are not.

Mr. TIMMONS. Thank you for that. Some claim that the State regulatory framework under Chairman McHenry's legislation will be insufficient to address anti-money laundering and financial crime issues with stablecoins.

First of all, the bill requires all stablecoin issuers to be treated as financial institutions for purposes of the Bank Secrecy Act, which levels a number of requirements including registering with the Financial Crimes Enforcement Network (FinCEN) and submitting suspicious activity reports (SARs). States may add additional enhanced requirements under their framework.

Mr. Homer, again, can you describe how the New York DFS considers anti-money laundering compliance when determining whether to approve the application of a stablecoin?

Mr. HOMER. Yes. Thank you for the question, Congressman. It is one of the most significant factors. New York is a leading regulator in the space, but it is not an easy regulator, and it is still very challenging for companies to get approval in New York, and rightfully so. This risk area is one of the most-significant areas, I would say, where it takes companies a while to really adequately meet those requirements. The requirements in New York are incredibly

robust, and look at the policies and procedures a company has related to this issue, including ensuring that adequate KYC is being done at the time of issuance and at the time of redemption of stablecoins.

Mr. TIMMONS. Thank you for that. I yield back.

And the Chair now recognizes Representative Nickel from North Carolina for 5 minutes.

Mr. NICKEL. Thank you so much, and I want to thank Chairman Hill and Ranking Member Lynch for holding today's hearing, and thanks so much to our witnesses for being with us here today. I am hopeful that we can come to a bipartisan agreement on stablecoin legislation as the status quo is both risky for consumers and stifling for innovation. We also have the opportunity with stablecoins to reinforce the dominance of the U.S. dollar as the global reserve currency, all while making it stronger, more accessible, and more competitive.

We are already seeing challenges to the dollar's influence with the share of dollars in global currency reserves decreasing from 66 percent to 58 percent since 2015. If the dollar were to lose its status, there would be negative impacts across our economy, in addition to national security concerns. The dollar is the asset underlying 98 percent of stablecoin transactions. If stablecoin use increases, the dollar will only get stronger. By passing bipartisan stablecoin legislation to provide regulatory clarity and improve the infrastructure on which the U.S. dollar travels, we can ensure it remains the global reserve currency.

Mr. HOMER, I would like to start with you. Can you please describe the role of stablecoins in supporting U.S. dollar-dominance?

Mr. HOMER. Thank you for the question, Congressman. I believe stablecoins are the most significant way in which the U.S. Government can ensure continued dollar dominance in a digital era. We are seeing a transformation of money from analog to digitized, and we are moving toward a digital native era which stablecoins represent, and we see that in the form of users in other countries wanting to hold U.S. dollar-denominated stablecoins. If we want to maintain our ability to engage in economic statecraft and use tools like sanctions, having stablecoins be issued from the U.S. is essential to that objective.

Mr. NICKEL. And you kind of touched on this in your answer here, but I would like to hear more about the national security implications of the dollar losing its status as the global reserve currency. How would this impact the effectiveness of our sanctions, having stablecoin legislation?

Mr. HOMER. Yes. Sanctions tools are only effective to the extent to which payment instruments or payment systems are denominated in dollars or involve U.S. leadership. And if significant stablecoin issuance were to happen outside of the U.S., it would lessen our ability to use sanctions tools in the future.

Mr. NICKEL. I think we are really close on a lot of the different forms of legislation that I am seeing, but I am concerned about the Federal Reserve Board having a very broad veto authority to decline registrations by State-regulated issuers of stablecoins. Are there certain scenarios where you think the Fed should have this veto? How can we narrow this to keep a strong Federal floor while

also preserving North Carolina's ability to regulate stablecoins in our dual banking system? Mr. Homer?

Mr. HOMER. I think we can look at some of what has happened in other countries, places like the EU or even Singapore, where there is a tiered approach, where issuers who are below a certain threshold can be subject to subnational regulation or a different regulatory regime. But once you have reached a systemic or significantly-important level, then I certainly think enhanced oversight would make sense.

Mr. NICKEL. Thank you so much, and I yield back.

Mr. FLOOD. [presiding]. The gentleman yields back. And I now recognize myself for 5 minutes. First of all, I want to thank all of the witnesses who are here today.

My number-one concern on stablecoins is ensuring that there is a robust State pathway for stablecoin issuers. Much like the dual banking system, there should be an opportunity for stablecoin issuers to be regulated at both the State and the Federal level. This is important for a few reasons. First, it makes it possible for States like Nebraska to come up with our own regulatory frameworks for stablecoins. Over time, States will learn from each other and adopt best practices from their neighbors, reaching consensus on common issues and, ultimately, better regulation across-the-board.

The problem with only Federal regulation is that it doesn't undergo that natural iterative process. Instead, you have this top-down approach that might be more difficult to change over time, and that is not a system that fosters innovation. And it is hard to argue that America's financial system built on this two-tier Federal and State approach to regulation of banks hasn't yielded great results for the United States. In the case of stablecoins, we are talking about something that we may very well have to revisit periodically as blockchain technology and its use cases continue to develop. It is much better to have several State regulators working in this area than just one or two Federal regulators, who may require an act of Congress to make technical changes.

Additionally, it creates opportunities for States to develop specialization. Regulators can establish a reputation as knowledgeable on a particular set of issues. Such a reputation can then become a reason for a business to locate in that State. My hope was to develop precisely that kind of environment in Nebraska when, as a State senator, I wrote and passed the Nebraska Financial Innovation Act.

Ms. Wang, in your testimony, you compared the State regulatory pathway for stablecoins to the, "laboratories of democracy," that Constitutional scholars write about. Can you elaborate on this point and on the importance of allowing States to write some of their own rules?

Ms. WANG. I think that the State regulatory pathway is absolutely critical for grassroots innovation, without which we would not be able to have true bottom up diversity and inclusion of our financial system. These grassroots innovators are for the community, of the community, and by the community, and we should be allowed to experiment and to fail safely.

Under Chairman McHenry's proposal, we would already be required to meet the minimum Federal guidelines for issuance under Section 4, backstopped by the Federal Reserve Board in the event of exigent circumstances. In my view, there is no constitutional reason to preempt State regulation in the case where not all stablecoins may necessarily implicate interstate commerce.

Mr. FLOOD. Thank you for that.

Mr. Homer, one of the claims we hear occasionally, and we heard it today about a State pathway for stablecoin issuers, is that it could lead to a so-called race to the bottom. As a former New York State Department of Financial Services executive deputy superintendent, would you mind just responding to that claim?

Mr. HOMER. Yes. I think under the proposal, it would be very hard to imagine a race to the bottom. A Federal standard is established, which is basically the New York standard. New York best practices that have been tried and tested and proven would be established as a Federal floor.

Mr. FLOOD. I would like to close by speaking just a little bit on the two drafts noticed for this hearing. I am glad that Ranking Member Waters and the Democrats have come forward with a stablecoin proposal. I am hopeful that we can take serious steps on this and lead because the United States needs to lead here, not just for our country, but for the world.

However, when I look at Ranking Member Waters' bill, the State pathway includes the following provisions: number one, State-issued stablecoins must register with the Federal Reserve, and the Fed is responsible for creating registration requirements; number two, the Federal Reserve is directly responsible for regulating and examining the State issuer; and number three, the Federal Reserve may, if it chooses, enter into a memorandum of understanding where it could delegate some of the regulatory enforcement obligations to the State regulator if they so choose.

To summarize, the Federal Reserve would be in charge of processing applications, regulation, examination, and enforcement. That is the whole ballgame. The Federal Reserve would be responsible for all of the nuts and bolts of regulating and overseeing State issuers, and they would delegate some of their responsibilities only if they so choose. To be frank, that is just not a State pathway in any meaningful sense. And my number-one focus as a member of this subcommittee is to maintain a State pathway, an opportunity for all of these laboratories in our democracy, all of the different States to be able to participate in a true two-tier system.

With that, I yield back. And I now recognize Mr. Torres.

Mr. TORRES. Thank you, Mr. Chairman. There has been a suggestion that State regulators cannot be trusted to regulate State-licensed stablecoins without parental supervision from the Federal Reserve. If State regulators can be trusted to regulate State-chartered banks, then why can they not be trusted to have analogous authority with respect to stablecoins? Regulating fractionally-reserved banks that take on credit risk strikes me as far more complicated than regulating a fully-reserved stablecoin that takes on no credit risk at all.

So, Mr. Homer, can you explain to me why there should be a strong State option for fractional reserve banking but no strong

State option for stablecoin issuance? Imagine you are ChatGPT, and I am a 5-year-old. Please explain the logic that underlies that criticism.

Mr. HOMER. It is really hard to make a rational argument for that. I think, as you point out, fully-reserved stablecoins and other forms of non-bank companies don't hold the same type of risk as fractional companies. And States like New York have really been the primary chartering entities or regulators for non-bank companies in the history of the United States.

Mr. TORRES. So, it certainly should be possible to set a Federal floor that prevents regulatory arbitrage that prevents a race to the bottom without subordinating State regulators, like DFS, to the Federal Reserve?

Mr. HOMER. Absolutely.

Mr. TORRES. Okay. And let's be crystal clear, State regulators, like DFS, have been more effective at crypto regulation than the Federal Government. The SVB collapse happened under the watch of the Federal Reserve. The FTX Ponzi scheme happened under the watch of the Federal Government. Federal regulators, like the SEC, spent more time targeting Kim Kardashian than Sam Bankman-Fried. So, the evidence is crystal clear that we have been poorly served by the SEC's regulatory ambulance chasing. As far as the lessons learned from FTX, those lessons should inform the development of a Federal framework for regulating stablecoins. A lesson learned, stablecoins should be fully reserved, and those reserves should consist of 100 percent cash or cash equivalents. Raise your hand if you agree.

[Hands raised.]

Mr. TORRES. I imagine all of you agree. Lesson learned, stablecoin reserves should be verified not only by self-attestation, but also by a third-party audit. Please raise your hand if you agree.

[Hands raised.]

Mr. TORRES. Customers should have the right to immediately redeem a stablecoin on a one-to-one basis. Please raise your hand if you agree.

[Hands raised.]

Mr. TORRES. And stablecoin issuers should be prohibited from lending, leveraging, or commingling customer funds. Please raise your hand if you agree.

[Hands raised.]

Mr. TORRES. A federally-licensed stablecoin issuer should have a single Federal regulator. Too many cooks in the kitchen creates regulatory confusion and duplication. If a stablecoin is a currency regulated by the Federal Reserve or trust regulated by the OCC, it should not simultaneously be a security regulated by the SEC. Do you agree with that, Mr. Homer?

Mr. HOMER. I do.

Mr. TORRES. There is a common misconception that crypto threatens the status of the dollar as the world's reserve currency, but the experience of stablecoins has shown the exact opposite. The fact that most stablecoins are pegged to the dollar reinforces rather than challenges the reserve status of the U.S. dollar.

Mr. Homer, you actually referenced competition. My understanding is that, in the realm of financial technology, China has

largely been now competing with the United States. The only fintech battleground on which the United States has been now competing, China has been the domain of digital currency, stablecoins. Dollar stablecoins have been far more successful than China's failed attempt at a CBDC. Is that a fair assessment?

Mr. HOMER. It is a fair assessment, and it is because that is what people throughout the world want. People want U.S. dollar-denominated stablecoins.

Mr. TORRES. And a common refrain heard from critics of crypto in Congress is that crypto has no use case. But it seems to me that blockchain enables real-time transactions, stablecoin tokenizes the dollar, and the ability of a tokenized dollar to move at the speed of the blockchain creates a better, cheaper, and faster payment system, which would include the potential for better, cheaper, and faster remittances for the lowest-income Americans. Is that a fair assessment?

Mr. HOMER. A very fair assessment, and we are already seeing that happen.

Mr. TORRES. Would anyone else like to comment on the use cases of stablecoins?

[No response.]

Mr. TORRES. The enthusiasm is overwhelming, I know. The 8 seconds you have, okay. Other than that, I yield back.

Mr. FLOOD. The gentleman yields back. I would like to thank all of our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that, this hearing is adjourned.

[Whereupon, at 11:18 a.m., the hearing was adjourned.]

A P P E N D I X

May 18, 2023



Testimony of Delicia Reynolds Hand, Director, Financial Fairness, Consumer Reports

**Before the United States House Committee on Financial Services
Subcommittee on Digital Assets, Financial Technology and Inclusion**

**“‘Putting the ‘Stable’ in
‘Stablecoins:’ How Legislation Will Help Stablecoins Achieve Their Promise.’”**

**Thursday, May 18, 2023
Rayburn House Office Building
Washington, DC**

Good morning Chairman McHenry, Ranking Member Waters, Subcommittee Chairman Hill, Ranking Member Lynch, members of the Subcommittee and Committee.

Thank you for this invitation to testify. I'm pleased to be back to participate in this important conversation about the overarching regulatory framework for stablecoins.

My name is Delicia Reynolds Hand, and I am the Director of Financial Fairness at Consumer Reports where I lead the organization's work in digital finance. Among other things, we evaluate and rate digital financial products and services. In an equitable digital economy, digitized financial products let consumers spend, save, borrow, and invest safely in ways that respect their privacy and data, provide the benefits they expect, protect them from discriminatory and predatory practices, and help them achieve their financial goals.

At Consumer Reports, we are beginning to demonstrate what fintech products and services actually do for consumers and how they rate alongside each other. Additionally, we are beginning to identify new norms and concrete best practices for industry and determine whether these products and services facilitate positive consumer outcomes, as some of them promise.

As I previously testified, the convergence of new technologies and new forms of assets have made cryptocurrencies particularly appealing for consumers whom traditional finance has never appropriately served. For the most vulnerable consumers, often underserved or ignored by traditional finance; there is added complexity and risk; and yet there is faith and trust by some in the promise of digital assets and financial products and services which make cryptocurrencies accessible to consumers. However, a 2022 Consumer Reports nationally representative survey of 3,208 U.S. adults reported that African Americans were significantly more likely than other racial/ethnic groups to say they had owned crypto in the past but don't anymore. In a volatile

Hand, 1

and stressed economic environment, consumers are at an even greater risk in the absence of rules to protect consumers and investors and to prevent the misuse of these assets.

Stablecoins and consumers

Even in the areas meant to usher in more stability, consumers can be caught in a vicious cycle of the boom and bust of crypto experimentation. Since this subcommittee's last conversation on stablecoins, Europe has succeeded in bringing crypto-assets, crypto-assets issuers and crypto-asset service providers under a regulatory framework. And, today we have two bills under consideration; one of which has stripped out important safeguarding principles and consumer protections. We must avoid repeating history in an area so volatile and potentially disruptive, at a moment where we verge on recession, interest rates are high, workers are being displaced and losing jobs to emerging technology, collapsing markets; and U.S. companies begin to chase lowest common denominator states and overseas as the places from which to drive innovation. We need the strongest federal floors to ensure a solid foundation upon which companies and consumers can safely and reliably participate in digital assets.

There continues to be no uniform and meaningful regulatory framework in the U.S., potentially creating significant risks for the entire country. While these new technologies may hold some promise, the potential risks are significant, including an unlimited supply of tokens and coins serving as collateral for loans, rigid self-executing smart contracts, non-existent reserve requirements, lack of interoperability requirements, lack of meaningful disclosures, and the creation of debtor-creditor relationships. These risks are simply too big to place on unsuspecting consumers, especially if this entire ecosystem continues to be meaningfully and uniformly unregulated. This very complexity tied to the state of these technologies - crypto adolescence - makes it hard to assess risk and dangerous for the most vulnerable communities

Common sense, consumer first, comprehensive regulation

Consumer Reports urges this committee to bridge the gap and to continue to work in a bipartisan manner to develop common sense legislation to achieve effective regulation of stablecoins. This is especially important for responsible innovation, financial stability, and financial inclusion. Appropriate regulation, supervision and oversight need to be implemented before stablecoins become a risk to financial stability and the smooth functioning of payment systems.

The presence of two draft bills published in advance of this hearing signals that instead of one conversation, we are potentially going down divergent paths. To be clear, this space will be regulated and frameworks will be developed. The question is what will drive the development of oversight. The question remains whether the driver will be crisis or collaboration. There are alas two bills; one of which seems to be a compromise on many issues. The other of which seems to have pared back prior areas of agreement. Both, as drafted, will introduce some important prudential standards into the regulation of the issuance and trading of payment

stablecoins. As previously emphasized, anything but the most comprehensive will be insufficient.

Strong regulatory process and federal oversight are needed

Consumer Reports supports the updates to the committee draft which include federal regulator review to ensure the safety and soundness of stablecoin issuers. While the committee draft would allow federal regulators to bring an enforcement action following the failure of a state regulator to do so, we encourage the adoption of provisions in the compromise bill granting the Federal Reserve Board authority to reject state licenses. Not including these provisions creates a regulatory gap which could drive a race to the bottom instead of a race to the top. In consumer finance, fiat currency payments are now 24/7 and borderless, which makes payments easier for consumers. These are lessons we have failed to learn from the past. On these basic matters for stablecoin payments, keeping with the tradition of congressional application of the Commerce Clause, the law should be the same across all 50 states.

For example, while the committee bill outlines an application process for becoming a stablecoin payment issuer for depository institutions and non-depository institutions, the bill should go further to include specific key requirements that parallel the requirements for traditional banking. Starting a new de novo bank is a long organization process, requiring permission from several regulatory authorities. While both drafts retained some equivalent requirements to provide information about the organizers, senior management team, and capital adequacy, we urge the committee to retain requirements to promote diversity and inclusion found in the compromise bill. We support the addition of requirements for federal regulators to issue rules related to risk management infrastructure.

Second, while the committee bill does outline a role for federal oversight, it does not require entities that become stablecoin issuers to be insured depository institutions (IDIs). While the bill does require that the parent companies of bank subsidiaries authorized as stablecoin issuers be IDIs, it provides no such requirement for non-bank issuers. Instead, the compromise bill draft attempts to make it clear that issuers shall not represent stablecoins as insured deposits while the committee draft does not even require this disclosure. Allowing deposit-like instruments to not only be uninsured, but issued by banks who insure other deposits, will inevitably create confusion for customers, especially during periods of financial distress, and may inevitably provide less protection for consumers that choose to purchase stablecoins that do not offer such insurance.

Last, in creating the regulatory framework for stablecoin payments, the administrative process outlined is insufficient and would hamstring regulators and prevent meaningful regulation of this space. Specifically, it requires collective interagency rulemaking for which the first set of rules need to be issued within 180 days of this bill becoming law. Interagency rulemaking can often be a long and complicated process, and especially so in newer areas of authority. Additional time or the ability of individual FIRREA regulators to promulgate rulemaking jointly or independently would increase the likelihood of these entities receiving meaningful regulation. Additionally, given the high risk nature of this space, there should be a clear role for the FSOC.

Strong consumer protections needed

While this bill sets up a regime to approve issuers of payment stablecoins, it does not outline how payment activities conducted or facilitated by the issuers or their coins will have adequate consumer protections. Currently, most blockchain technologies are built without the capacity to reverse transactions, as many are append-only digital ledgers. But, being able to prevent, cancel, replace, or override a transaction is a critical function necessary to ensure payment system operators are able to conduct chargebacks or facilitate disputes over payments. Additionally, the bill does not include stablecoins in the rules under the Electronic Funds Transfer Act.

We urge the committee to move forward with the provisions in the compromise bill that require stablecoin payment regulation to be technology neutral to promote interoperability and to ensure stablecoin arrangements share common features with the traditional financial system and are not walled off into each institution's specific system. They should be issued on interoperable technology protocols to prevent market concentration and potentially restrict data collection. The lack of interoperability would be an impediment to consumer access. Consumers who have come to rely on interoperability in fiat currency payment systems, should have the same benefits in stablecoin payments.

Related, we request the committee to adopt language associated with strong oversight of custodial wallets. The committee draft does not cover all assets held by custodial wallets - a key point of interaction that consumers have with stablecoins. While custodial wallets may help consumers keep track of their keys, this has created a legal gray area that should be clarified. The law should prevent a debtor-creditor relationship from being formed and this should be clear in required disclosures.

Further, this bill's consumer and investor protections should be improved, specifically to give stronger protections than continued reliance on outdated check the box notice and disclosure regimes like Gramm-Leach-Bliley Act (GLBA), require more than monthly looks into an issuer's reserve portfolio and provide stronger bankruptcy protections for consumers. The bill lays out protections for holders of stablecoins in the event of an issuer becoming insolvent. But other parts of the bill appear to undermine those protections. For example, the committee should include clarifying language that prohibits stablecoin issuers from co-mingling funds received by coin holders in omnibus accounts to withdraw or use those funds to cover various administrative costs. In the event of issuer insolvency, a bankruptcy court could reasonably view, and the Court in *Celsius* already has held, that those commingled funds and such use by the company as grounds for giving the company and its creditors priority access to those funds, rather than stablecoin holders, the rightful owners.

We encourage the committee to move forward with language in the compromise bill that imposes a timeline to allow consumers to redeem their stablecoins within 24 hours. We suggest adding clarifying language to specify that consumers should be able to redeem to be able to access their funds within a calendar day, and not just one business day, especially if a redemption were to occur after the close of business on a Friday.

Some additional key improvements we would like to see

1. Increased activity limitations. While the bill does restrict risky activities such as pledging, rehypothecation, or reusing reserve and custody assets, it does not clarify the position of consumers when a stablecoin payment provider becomes bankrupt. A consumer's use with any stablecoin issuer or provider must not create a debtor-creditor relationship.
2. There should be no exception to the prohibition of certain convicted individuals to participate in stablecoin payments. The committee draft being considered removed the prohibitions altogether.
3. This bill, while outlining a clear role for the Federal Reserve Board over stablecoin payment issuers, the FRB's authority would come second to that of the prudential regulators and consumer protection regulators.

Explicit Recognition of SEC authority is needed

Given the agency's active role and number of interventions brought on behalf of consumers, we are pleased to see that the compromise bill retains provisions that the SEC is not limited in its authority by the bill to regulate stablecoins but there is no further clarity. The compromise bill also requires the SEC to be consulted in a study of endogenously collateralized stablecoins, which are stablecoins backed by other crypto such as bitcoin or ether.

Many stablecoins function and have been marketed as investment products like swaps or function like money market funds (MMFs). The compromise bill contains a provision suggesting that the legislation shall not infringe upon the authority of other regulators to assert jurisdiction over stablecoins, but we believe that such language is insufficient protection for other agencies' regulatory authority. This bill needs more explicit clarity on how and when the SEC can and should regulate stablecoins. When these products mirror traditional finance products - like swaps and MMFs - and are traded on secondary markets, to assert jurisdiction over an issuer, asset or related party, the SEC would have to first establish jurisdiction in court, then seek enforcement action. Regulation by enforcement is expensive, inefficient, and is the antithesis of promoting good governance and capital formation. Not accounting for the SEC and market regulatory aspects of stablecoins is bad for consumers and will create additional regulatory uncertainties.

I urge the Committee to resume bipartisan efforts to achieve comprehensive oversight of stablecoin, that is as robust and consumer first as possible.

Thank you again for the opportunity to testify today.

WRITTEN TESTIMONY OF
Matthew Homer
Managing Member of the Department of XYZ
Former Executive Deputy Superintendent for Research & Innovation, New York State
Department of Financial Services

BEFORE THE
United States House of Representatives Committee on Financial Services
Subcommittee on Digital Assets, Financial Technology and Inclusion

IN A HEARING ENTITLED
Putting the “Stable” in “Stablecoins”: How Legislation Will Help Stablecoins Achieve
Their Promise

HELD ON
May 18, 2023

Good morning, Chairman McHenry, Ranking Member Waters, Subcommittee Chairman Hill, Subcommittee Ranking Member Lynch, and members of the Subcommittee on Digital Assets, Financial Technology, and Inclusion.

Thank you for the opportunity to participate in this hearing. It is an honor to offer my testimony on payment stablecoins, the role they play in the ongoing evolution of financial services from analog to digital, and principles to consider as you contemplate how best to regulate the space. Money and payments form the basic plumbing of our modern economy, so there is an obvious national interest in getting this right.

My name is Matt Homer. I was previously the Executive Deputy Superintendent for Research & Innovation at the New York State Department of Financial Services (NYDFS), where my responsibilities included overseeing the Department's licensing, supervision and examination of digital asset related companies. Earlier in my career, I was a federal bank regulator in the FDIC's Division of Depositor and Consumer Protection. Today, I am an investor and advisor to startup companies and the Managing Member of the Department of XYZ, a venture capital firm that invests in early stage companies building the next generation of financial systems. We help founders in the space build in a compliant manner.

I first became familiar with stablecoins through my experiences regulating these products at the NYDFS. As this Committee is aware through previous testimony, New York State was one of the first jurisdictions in the world to regulate the digital asset space generally, as well as stablecoins specifically, and as such it has confronted many of the same issues this Committee is exploring. Our work on stablecoins included evaluating the suitability of these instruments to be issued by regulated entities as new products, which ultimately led the Department to publish stablecoin

guidance in June 2022, following my tenure. I believe New York's approach provides a useful model for others to consider.¹

My experience as a regulator taught me that fiat-backed stablecoins represent an important but incremental improvement in the concept of money. They may also represent the first major real-world asset to be tokenized in a market that is moving in the direction of many different types of real-world assets becoming tokenized, meaning a right of ownership or entitlement being recorded on a public blockchain. In some ways, stablecoins are not so different from the stored value products many people already use and are familiar with, such as gift cards or prepaid cards. The question of how to effectively regulate stablecoins has a more clear and straightforward answer than one may find in considering how to regulate other parts of the digital asset ecosystem. Because of this, and because stablecoins are an entry point into the broader digital asset ecosystem, they represent a logical starting point for a federal framework to regulate the industry overall.

New York's experience shows that it is possible to effectively regulate stablecoins using common-sense and time-tested regulatory practices. For example, New York's regulatory framework for stablecoins includes three major prongs: (1) reserve requirements, to ensure the assets backing stablecoins are held on a segregated basis on behalf of customers, are fully reserved on a one-to-one basis, and are comprised of cash deposits and/or other cash equivalents; (2) redemption rights ensuring that stablecoin users have the right to redeem their stablecoins on a one-to-one basis for US Dollars in a timely manner; and (3) public transparency requirements including monthly attestations from independent CPAs certifying the value of reserves, their composition, the quantity of outstanding stablecoins, and whether the reserve is adequate to fully back the number of outstanding stablecoins. The stablecoin issuers

¹ https://www.dfs.ny.gov/industry_guidance/industry_letters/il20220608_issuance_stablecoins

covered by these standards are required to hold a license or charter, subjecting them to robust bank-like supervision and examinations from NYDFS to ensure they operate in a safe and sound manner. It is encouraging to see these requirements and practices generally reflected in the legislative drafts that have been circulated on this topic thus far.

As stablecoins increasingly come to represent an improved payment system, a number of real-world use cases are coming into focus. For example:

- Stablecoins as a store of value for individuals living in economies with high or volatile rates of inflation who prefer to hold their savings in US Dollars;
- Stablecoins for peer-to-peer payments for cross-border remittances, shopping, and other expenses; and
- Stablecoins for business payments for employees, vendors, and suppliers, including cross border.

Based on my experiences regulating stablecoins, as well as my more recent work with early-stage companies and founders in the broader digital asset space, I believe there are eight important principles that should guide federal legislation on this topic and which will help payment stablecoins achieve their promise. I will discuss three of these for which my background offers unique insights, and touch upon the remaining five later in my testimony.

First, stablecoin legislation should recognize the dual banking system as an inherent feature of the American economy that benefits consumers, innovators, and markets. The dual banking system refers to the parallel regimes under which state and federal banking regulation co-exist. In the case of insured depository institutions, a bank may receive a national charter from the OCC or be chartered by a single state. When chartered by a state, the bank will also have a

primary federal supervisor, either the FDIC or one of the Federal Reserve banks.

Non-depository institutions are not always subject to federal supervision, but are often supervised by multiple states if they intend to operate in more than one jurisdiction. Of course, all firms offering consumer financial products and services are subject to the federal consumer laws and the jurisdiction of the Consumer Financial Protection Bureau – regardless of the provenance of their license or charter. The parallel system of state and federal regulation supports economic growth by providing innovators and founders optionality that can reduce barriers to launching new products on a small scale before rolling them out at national scale. It benefits consumers by providing access to financial services tailored to local needs and protects them because states are able to move more quickly to fill regulatory gaps. Finally, it benefits markets by encouraging healthy competition.

The legislative draft I have seen preserves this dynamic, which has been so important in making the American financial system an engine of innovation and experimentation. It also provides a model for what digital-era dual regulation could look like, not only for stablecoins but other products and services as well. Importantly, it would establish a federal floor in the form of a national standard, but would allow states to license and supervise stablecoin issuers and set even tougher rules within their own jurisdiction. A federal baseline of standards and backup supervision means consumers can expect a consistent set of foundational protections regardless of where a stablecoin issuer has received their license or charter. It also avoids a race to the bottom whereby some states could seek to attract issuers by offering the lightest possible touch.

Second, stablecoin legislation and implementing regulation should promote competition in the market and the competitiveness of the US system. I'll start with competition. The stablecoin market has so far trended toward oligopoly. Today, two issuers alone make up over 80% of the

market for US Dollar-denominated stablecoins.² Legislation should promote competition by providing pathways for new players to enter the space and challenge incumbents. This could help address the risks typically associated with oligopolistic markets, including rent-seeking and systemic risks that emerge when activities are concentrated into only a few hands. In an environment where we are seeing community and regional banks consolidating or being acquired by mega-banks, it would be wise to think proactively about opportunities to promote a competitive system from scratch when it comes to novel developments in the industry. One idea would be to create a safe harbor for new entrants to test new products or services at limited scale and with limited customers before requiring comprehensive regulation in order to expand to the general public at greater scale.

I'd also like to touch on competitiveness as a distinct concept from competition. Here I am referring to the desirability of the US as the preferred jurisdiction from which to launch stablecoins. The stablecoin market will continue to evolve and grow globally, regardless of what approach our government chooses to take. Dollar-denominated stablecoins can be issued offshore, backed by US Dollars held in offshore bank accounts, from jurisdictions with lower regulatory barriers to entry. Therefore, it is in the American interest to ensure that issuers of US Dollar-backed stablecoins remain in the US so we can regulate stablecoins on our own terms. One way to promote this objective would be to add competitiveness to: (1) the official mandates of federal regulators as it relates to stablecoins; and also to (2) the set of criteria to be used by federal regulators when considering whether to license a stablecoin issuer. For example, regulators could be required to consider the risks associated with *not* granting a license, including the possibility that the same stablecoins could be issued offshore and therefore expose consumers to greater risks than if they were issued from the US.

² <https://www.theblock.co/data/decentralized-finance/stablecoins>

Third, regulatory capabilities need to keep pace with developments in the market. One of the aspects of regulating digital assets that most intrigued me when I worked at NYDFS was the possibility of supervising the space more effectively using digital tools and technologies.³ The digital nature of firms in this space provides an opportunity to further evolve the capabilities of regulators and create incentives for the market to self-correct through transparent public data. For example, I previously mentioned monthly attestations of stablecoin reserves, but we could conceivably move toward real-time or near-real-time dashboards that provide insight into the assets backing a stablecoin, or into the financial condition of the issuing firm, at any given moment in time. Such data could even be made publicly available, encouraging a race to the top among stablecoin issuers wanting to show they are the safest and most secure. This type of regulatory transformation would require new skill sets and new types of collaborations. One tool that some regulators have been using is the “techsprint,” in which regulators invite industry technologists and other experts to co-create new digitally-native supervision tools. Efforts like this could be helpful for standing up technologies and data-collection methods to allow regulators to monitor stablecoins and supervise their issuers.⁴

I’d like to now more briefly highlight five other principles that are just as important as the preceding three.

Fourth, legislation and regulation should provide predictability, reliability, and protection for users. The drafted legislation goes a long way toward achieving this, and it mirrors many of the best practices that have been tested in New York.

³ https://www.dfs.ny.gov/system/files/documents/2021/11/2021_techsprint_lessons_learned.pdf

⁴ <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/early-lessons-on-regulatory-innovation-to-enable-inclusive-fintech/>

Fifth, legislation and regulation should provide oversight and accountability for issuers. Here too the draft legislation provides opportunities for meaningful oversight of issuers, including through a backstop of federal regulators in the case of entities authorized at the state level. This will hold sub-national regulators accountable to standards of effective supervision in order to discourage market participants from engaging in regulatory arbitrage.

Sixth, legislation and regulation should ensure transparent and accountable government. The public should have confidence in our regulatory system, and this can be achieved through greater transparency and public engagement, such as by requiring that any regulations be developed through public notice and comment.

Seventh, legislation and regulation should establish national consistency. As already mentioned, this proposal would achieve this through a national floor, while also preserving the dual banking system.

And eighth, legislation and regulation should promote national security and advance the influence of the US Dollar. Compliance with rules related to the detection of illicit finance and money-laundering should be required. And the spread of US Dollar-backed stablecoins should be embraced as an important means of maintaining and growing the influence of the US Dollar as the world's reserve currency.

Thank you again for the opportunity to be here. I look forward to your questions.



Testimony
of the
USDF Consortium
for the hearing entitled
Putting the “Stable” in “Stablecoins”: How Legislation Will Help Stablecoins Achieve Their Promise
of the
Subcommittee on Digital Assets, Financial Technology and Inclusion
of the
House Committee on Financial Services
May 18, 2023

Introduction

Chairman Hill and Ranking Member Lynch, the USDF Consortium¹ welcomes the opportunity to testify at this hearing entitled “Putting the ‘Stable’ in ‘Stablecoins’: How Legislation Will Help Stablecoins Achieve Their Promise.”

Today’s hearing comes at a critical moment. Distributed ledgers leveraging blockchain technology hold tremendous promise to improve financial services, offering faster, cheaper, and more efficient products that can help promote financial inclusion, drive growth in our communities, and support the role of the U.S. Dollar as the global reserve currency.

To date, most blockchain innovation has occurred outside of the regulated banking sector in novel cryptocurrency markets. These markets have provided testing grounds that have proven the efficiency and stability blockchain technology can deliver. However, financial services only deliver value when they facilitate real-world activity such as helping small businesses invest and grow or helping families purchase homes.

To leverage blockchain for real-world transactions, you first need a trusted form of digital money that exists natively on blockchain. This need is what led to the rise of stablecoins and has driven the policy discussion around the creation of a central bank digital currency (CBDC). However, the debate on how to “digitize the dollar” is too often pitched as a binary choice between these two options.

¹ The USDF Consortium is a membership-based association of insured depository institutions. Our mission is to build a network of banks to further the adoption and interoperability of a bank-minted tokenized deposit (USDF™). We believe that blockchain technology can make payments more efficient and improve traditional banking, expanding access to safe and affordable financial services.

We believe there is a third option that leverages the way money already exists in our economy. While we tend to think of paper money, the reality is that most money in the U.S. is already digital and exists in the form of bank deposits. Today, bank deposits represent 73% of money in our economy.²

At the end of the day, blockchain is a ledger technology. Banks have long relied on ledgers to record value and facilitate transactions. Over the years, this technology has evolved from paper-based ledgers, to on-premises servers, to cloud infrastructure.

We believe blockchain is the next evolution in ledger technology. By recording a traditional bank deposit on blockchain, we can bring many of the benefits of stablecoins to the real economy while maintaining the numerous benefits and protections that our two-tier banking system provides today.

Unlike stablecoins, these tokenized deposits are not designed to connect the broader crypto ecosystem to the real world. Tokenized deposits are back-end technology designed to improve the delivery of traditional banking services. Tokenized deposits will not trade on exchanges, and in the case of USDF, will not be held directly by the public. Like all bank deposits, they are a liability of an insured depository institution.

Bank deposits are a cornerstone of our monetary and financial systems that support the dominance of the U.S. Dollar around the world. They play a critical role in supporting banks' ability to lend into the communities that they serve. Today these loans are an important funding source powering \$2.5 trillion in residential mortgages, \$2.5 trillion in business lending, and \$2 trillion in consumer lending.³ These loans are a critical driver of economic growth and social mobility.

Banks are subject to stringent regulation and proactive oversight. This includes bank capital and liquidity requirements as well as technology risk management regulation designed to control for the prudential and operational risks associated with deposit taking. Tokenized deposits also maintain the privacy protections associated with our two-tier banking system today.

Tokenizing deposits facilitates the creation of a real-time blockchain-based payments infrastructure that can significantly improve the delivery of traditional banking services. The use of blockchain infrastructure facilitates:

- Faster, cheaper payments, ensuring that consumers and businesses can have real-time access to their funds.
- Programmable payments, allowing for the automation of complex transaction flows that can reduce fraud and improve transparency.

² Money as measured by M1 ([Federal Reserve H.6](#)).

³ FDIC Quarterly Banking Profile 4Q 2022. <https://www.fdic.gov/analysis/quarterly-banking-profile/index.html>

- Atomic settlement, leveraging blockchain to record other traditional banking assets can break down silos between systems making it easier to buy and sell these assets. This added liquidity allows for new funding options that can lower the cost of credit, expanding access to affordable financial products.

We can only realize these benefits when innovation is delivered responsibly and regulatory guidelines are clear, certain, and consistently applied. Legislation like that being discussed today is an important step to ensuring stablecoins are delivered responsibly and that consumers remain protected.

It is important that these efforts do not inhibit the adoption of blockchain for other applications in traditional banking like tokenized deposits. To that end, we are pleased to see that the draft legislation makes the critical distinction between stablecoins and tokenized deposits, and that it affirms banks' ability to leverage blockchain for traditional banking applications.

Unfortunately, there is not currently a clear regulatory path for banks to adopt blockchain-based solutions. As highly regulated institutions, any new offering by banks is subject to scrutiny, but blockchain initiatives are held to a higher standard. Although they have clear authority to do so, any bank wishing to undertake a blockchain project must receive formal regulatory approval. This process does not exist when utilizing other technologies. We encourage Congress to work with the banking agencies to ensure that there is a clear and credible path for banks to adopt blockchain technology.

Competition breeds innovation and we believe there is a role for many forms of money, both novel and traditional. We look forward to working with Congress to ensure that there is an appropriate regulatory framework for novel assets like stablecoins and to provide regulatory clarity for banks to adopt new technologies.

Policymakers should distinguish blockchain from cryptocurrencies

Blockchain technology is flexible infrastructure that can support a variety of applications. Despite this, it is most commonly associated with novel assets like cryptocurrencies. It is important to clearly distinguish blockchain infrastructure from crypto assets as policymakers consider appropriate regulation for these novel technologies and assets. By analogy, we do not regulate the internet, but instead regulate the numerous industries that leverage the internet to deliver their services. Similarly, a one-size-fits-all approach to blockchain that seeks to address the risks that have emerged from novel crypto markets may limit its use in other industries.

Policymakers are right to focus on the risks that have emerged from these novel crypto markets. Blockchain facilitated the creation of new financial services products that fall outside the perimeter of existing regulatory and supervisory structures. Many of these services resemble traditional financial services products but are not supervised for the same risks because they are offered by new kinds of businesses that do not fit under traditional licensing

and supervisory regimes. Despite this, the risks presented by the use of blockchain are rarely novel. In many cases, existing banking regulation is well suited to manage these risks.

At its core, blockchain is a ledger technology that can facilitate a wide range of activities, each presenting a different risk profile. The risks associated with delivering a novel asset in an unregulated market are very different from the risks associated with a regulated financial institution offering a traditional product, like deposits.

In banking, we believe that blockchain technology can provide efficiencies that lower the cost of offering financial services, allowing banks to reach more Americans with safe, affordable, and inclusive products. Blockchain is not a silver bullet, but it has a unique ability to break down silos, facilitating real-time collaboration between financial institutions. In particular, we believe that blockchain can facilitate the following activities:

- **Faster, cheaper, safer payments.** As a shared system of record, blockchain can facilitate the near real-time transfer of value. USDF leverages a proof-of-authority model where trust is already established, eliminating the need for participants to undertake costly computing exercises to create skin in the game. This allows for rapid transactions at minimal cost. We believe this can be particularly valuable in supporting business-to-business transactions, which are still largely paper based today.
- **Programmable payments.** Blockchain can integrate smart contracts, enabling banks to automate the execution of complex payments based on real-world conditions. For example, smart contracts could be used to automate the payments process associated with buying a home. Today, a buyer sends money to escrow, and an escrow agent calls individual banks and confirms wires to all of the various parties that participated in the transaction. With a smart contract, we can deliver each payment to the right party the minute a contract is signed.
- **Atomic settlement.** Blockchain adds additional value when used as a system of record for other traditional banking assets (like loans). Today, banking infrastructure is a system of siloed proprietary databases. These silos create friction when a transaction requires moving assets in multiple systems at the same time. A buyer will not release funds until they are sure the asset has moved in a separate system of record.

Blockchain allows for both payments and assets to be recorded on the same system of record. This allows a buyer to trade their dollars for an asset in real time without settlement risk because the transfer of money and the purchased asset move in the same block.

Incorporating atomic settlement into traditional banking assets makes it easier to buy and sell those assets. By making these assets more liquid, we add new funding options that lower the cost of credit, expanding access to affordable financial products.

Blockchain also has potential to ensure the continued competitiveness of community banks. A key force driving industry consolidation is the large, fixed cost of technology investments. Large institutions have better ability to spread these investments over a large customer base. As shared infrastructure, blockchain changes this equation, promoting a focus on the value of individual customer relationships. This is similar to cloud technology, which helped level the playing field for small businesses by offering flexible and scalable infrastructure.

Bank deposits should play a central role in the creation of any digital dollar

Financial innovation adds value only when it helps facilitate real-world economic activity like buying capital goods, hiring employees, or purchasing a home. Before blockchain can make a positive impact on the real world, we need a safe, reliable, and trusted form of payment that exists natively on chain. This has led to demand for blockchain native “cash equivalents” that can be used as a means of payment and a store of value.

This demand led to the development of stablecoins and has driven a policy dialogue on whether the U.S. should issue a CBDC. While we believe there is room for many forms of digital money in a modern economy, commercial bank money (i.e., bank deposits) plays a critical role as the dominant form of money in our economy today.

Despite the recent turmoil, bank deposits are subject to a strong and tested regulatory regime and play a prominent role in supporting the availability of credit. These benefits are why bank deposits make up 73% of money in the U.S. economy today. We believe they will continue to play a dominant role as money is developed natively on blockchain.

The existing U.S. monetary and financial system provides numerous benefits to consumers and the broader economy, and supports the important role that the U.S. dollar plays around the world today. Tokenized deposits (sometimes referred to as deposit tokens or dollar tokens) allow us to bring the benefits of bank deposits on-chain by creating a representation of an existing bank deposit on blockchain. Tokenized deposits can take many forms; some might be held by the customers of the bank while others may only be used by financial institutions to create blockchain-native payments rails. In the initial implementation of USDF, no customers will engage directly with the blockchain just as they do not engage directly with existing payments rails today.

In a recent speech Sir Jon Cunliffe, Deputy Director for Financial Stability at the Bank of England, notes that tokenized bank deposits “might offer some or all of the functionality and efficiency claimed for stablecoins, allowing bank deposits to compete better with non-bank payment coins.”⁴ Given the important role that bank deposits play in our economy today, we believe it is critical that bank deposits are able to compete with novel forms of tokenized money.

⁴ Bank of England. “The Shape of Things to Come: Innovation in Payments and Money – Speech by Sir John Cunliffe,” April 18, 2023. <https://www.bankofengland.co.uk/speech/2023/april/jon-cunliffe-keynote-speech-at-the-innovate-finance-global-summit>.

Tokenized deposits have the following features which make them an attractive form of money in a digitized economy:

Banking regulation ensures that deposits are safe.

Bank deposits are backed by robust capital and are subject to a regulatory regime that ensures liquidity and solvency. For banks, the implementation of blockchain technology does not fundamentally change the nature of banking or how regulation controls for the risks associated with it. Banks are heavily supervised to ensure they deliver the numerous consumer protections associated with digital payments.

Moreover, the bank regulatory structure is designed to maintain important broader public policy objectives. For example, under the Community Reinvestment Act and other laws, banks have long demonstrated their unique ability to support underserved communities. These laws are directly tied to bank deposits.

Bank deposits support credit creation.

Banks play a critical role in our economy, engaging in maturity transformation. Banks take short-term assets in the form of deposits and use those funds to extend long-term assets in the form of loans.

When a bank makes a loan, it creates new money in the form of a deposit in the borrower's account that did not previously exist. That deposit in turn can be used to power additional lending. The amount of deposits that can be used to support additional lending is determined by the capital the bank must hold to support new loans. Today, the core capital (leverage) ratio for FDIC-insured institutions is near 8.7%.⁵ This system, called fractional reserve banking, means that a \$1 deposit can power more than \$10 of lending. These loans allow businesses to invest in new employees or capital goods that create jobs and drive economic growth.

The New York Federal Reserve staff reinforced the importance of this in a post, in which they argued in favor of tokenized bank deposits. The post notes, "In this post, we argue that if DLT [distributed ledger technology] platforms are the transfer mechanism of the future, then it seems worthwhile to find the best possible money that can be used on that transfer mechanism. We suggest that tokenized deposits might be a fruitful avenue to pursue."⁶

The only scalable way to bring traditional financial assets on-chain is to leverage the banking system to support that by tokenizing existing bank deposits.

⁵ FDIC Quarterly Banking Profile, FDIC QBP Graph Book, <https://www.fdic.gov/analysis/quarterly-banking-profile/graph-book/2022mar/QREGCAP.html>.

⁶ Federal Reserve Bank of New York, The Future of Payments Is Not Stablecoins (Feb. 7, 2022), <https://libertystreeteconomics.newyorkfed.org/2022/02/the-future-of-payments-is-not-stablecoins/>.

Bank deposits maintain privacy.

There exists an inherent tension between the need to protect the privacy of those conducting transactions with the need for the transparency necessary to combat illicit finance. Policymakers have the difficult task of determining the appropriate balance of these competing concerns.

Today, this careful balance is maintained through the two-tier banking system. Banks are trusted custodians of their customers' most sensitive data and are subject to enhanced regulatory requirements to designed to protect the privacy of financial data such as the Gramm-Leach-Bliley Act.

Banks also have an affirmative responsibility to combat illicit finance. The Bank Secrecy Act requires banks to implement a risk-based program to prevent money laundering and the financing of terrorism.

In certain instances, banks are required to share data with the government through the filing of Suspicious Activity Reports, Currency Transaction Reports, or similar programs. The instances where banks are required to share this data with the government is subject to important legal guardrails designed to protect privacy.

[Congress should ensure there is a clear, credible path for well-regulated institutions to offer responsible products](#)

As policymakers work to unlock the potential of blockchain they should focus on an approach that promotes innovation while maintaining critical protections. Banking regulation already provides a robust regulatory structure for the delivery of digital money. Congress should ensure that applicable protections are applied in novel markets while taking care that any legislation does not inhibit the adoption of blockchain for other applications that are already well-regulated.

The draft legislation is an important first step towards creating an appropriate regulatory structure for stablecoins

The legislation being discussed today is an important first step towards creating regulatory clarity that addresses the risks demonstrated by recent stablecoin failures. We offer the following feedback on the draft legislation and stand ready to work with Congress to advance policies that can promote responsible innovation:

1. A consistent theme of the legislation is ensuring that stablecoin issuers fully reserve against the stablecoins that have been issued. We believe this is a prudent step to ensure that stablecoins remain backed by high-quality assets.
2. The definition of "payments stablecoin" used in draft legislation is quite broad. Despite clarifications in the recent draft to distinguish tokenized deposits, there is a risk of capturing bank deposits recorded on blockchain. Banks are subject to stringent capital

and liquidity standards that allow them to use deposits to fund loans. If banks are required to fully reserve against tokenized deposits, it would limit banks' ability to lend into the communities they serve.

We were pleased to see clarifications in the text that recognize the critical distinction between stablecoins and tokenized deposits. We support language that ensures any legislation does not impede banks authority to engage in permissible activities including:

- accepting or receiving deposits and issuing digital assets that represent deposits;
- utilizing a distributed ledger for the books and records of the insured depository institution and to affect intrabank transfers; and
- providing custodial services for payments stablecoins, private keys of payments stablecoins, or reserves backing payments stablecoins.

We would respectfully urge Congress to strengthen this language by amending the definition of "payments stablecoin" to make explicit that the activities mentioned above would not be considered a payments stablecoin.

3. We also appreciate the clarification that any assets held in custody should not be recorded as a liability on a bank's balance sheet and should not be subject to additional capital charges.

Congress should urge the banking agencies to create a clear path for the approval of blockchain-based activities.

Banks are often slower to adopt new technologies than other industries. This is not for a lack of interest or skill but due largely to the fact that banks are so heavily regulated. Technology companies can bring nascent technologies directly to customers, iterating daily and fixing bugs after releases are made. Before releasing new products, banks must perform countless rounds of testing and ensure that their approach is aligned with regulatory expectations.

While caution is warranted given the important role that banks play, the standard for approval for blockchain-based activities is putting banks at a competitive disadvantage. Currently, banks must obtain formal approvals from their regulators prior to offering any blockchain product, a standard that does not exist for any other technology.⁷ To date, no clear set of expectations has been determined for regulatory approval and few approvals have been given.

⁷ The OCC's Interpretive Letter 1179 requires OCC-regulated banks to obtain supervisory non-objection prior to engaging in any permissible crypto-related activity. OCC Interpretive Letter 1179 (Nov. 18, 2021), <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdf>. The FDIC's FIL-16-2022 requires banks to notify the FDIC for supervisory feedback prior to engaging in any crypto-related activities. FDIC FIL-16-2022 (Apr. 7, 2022), <https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html>. The Federal Reserve similarly requires all its regulated banks to notify the Federal Reserve for supervisory feedback prior to engaging in any crypto-related activities. Federal Reserve SR 22-6 (Aug. 16, 2022), <https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm>.

Since creating these policies, the federal banking agencies have been careful to highlight that banks are “neither prohibited nor discouraged from providing banking services to customers of any specific class or type,” but have put out a series of statements, rules and reports highlighting the risks when banks engage in crypto-related activities.

- Joint Statement on Crypto-Asset Risks to Banking Organizations (1/3/23): Highlights safety and soundness risks of holding cryptocurrencies or dealing with crypto clients.⁸
- Federal Reserve Policy Statement and Final Rule (1/27/23, 2/7/23): The Federal Reserve issued a policy statement,⁹ which was later published as a final rule,¹⁰ clarifying that banks cannot hold crypto as principal. The Federal Reserve highlights that banks may be able to issue dollar tokens but that they do not believe banks can meet their obligations on a public, permissionless, or decentralized blockchain.
- The Administration’s Roadmap to Mitigate Cryptocurrencies’ Risks (1/27/23): The National Economic Council released a statement highlighting its plan to reduce crypto risk. In the statement, the Council discourages policy that would allow “mainstream institutions” to dive headlong into crypto.¹¹
- Joint Statement on Liquidity Risks to Banking Organizations Resulting from Crypto-Asset Market Vulnerabilities (2/23/23): Highlights heightened liquidity risks for deposits from crypto platforms involving customer funds or stablecoin reserves.¹²

These statements focus primarily on the risks associated with the broader crypto markets, but few address the use of blockchain for traditional banking. Despite this, the statements could be interpreted by the banking industry to set a tone that discourages banks from exploring these technologies.

We recommend that Congress engage to ensure that there is a clear path for regulated entities like banks to bring responsible blockchain innovation to market.

⁸ Federal Reserve, FDIC and OCC, Joint Statement on Crypto-Asset Risks to Banking Organizations (Jan. 3, 2023), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230103a1.pdf>.

⁹ Federal Reserve, Policy Statement on Section 9(13) of the Federal Reserve Act (Jan. 23, 2023), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230127a1.pdf>.

¹⁰ 88 Fed. Reg. 7,848 (Feb. 7, 2023), <https://www.govinfo.gov/content/pkg/FR-2023-02-07/pdf/2023-02192.pdf>.

¹¹ National Economic Council, The Administration’s Roadmap to Mitigate Cryptocurrencies’ Risks (Jan. 27, 2023), <https://www.whitehouse.gov/nec/briefing-room/2023/01/27/the-administrations-roadmap-to-mitigate-cryptocurrencies-risks/>.

¹² Federal Reserve, FDIC and OCC, Joint Statement on Liquidity Risks to Banking Organizations Resulting from Crypto-Asset Market Vulnerabilities (Feb. 23, 2023), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20230223a1.pdf>.

Conclusion

Blockchain technology holds tremendous potential to improve financial services. When delivered responsibly, it has the potential to promote financial inclusion and help ensure that the United States remains a global leader. Recent bank failures do not lessen this potential. We believe the bank regulatory structure is well-equipped to manage the risks associated with this novel technology and that tokenized deposits are the best way to realize these benefits.

The USDF Consortium was created as a venue for banks to collaborate as they design blockchain infrastructure that will power the future of financial services. We are committed to delivering these innovations responsibly, ensuring that our customers receive the world-class safety and protections inherent in U.S. banking regulation. We are committed to working with Congress to help ensure an appropriate regulatory framework to enable this critical innovation.

**Written Statement of
David L. Portilla**

**Before the
United States House of Representatives
Financial Services Committee
Subcommittee on Digital Assets, Financial Technology and Inclusion**

*Putting the 'Stable' in 'Stablecoins:' How Legislation Will Help Stablecoins
Achieve Their Promise*

May 18, 2023

David L. Portilla

I am a partner in the law firm of Davis Polk & Wardwell LLP in New York City, where I began my legal career in 2006. As a member of the firm's financial institutions group, I advise banking organizations and nonbank financial institutions on a range of M&A, regulation, policy, enforcement and governance matters – including the full gamut of the prudential regulatory framework. My practice includes a focus on the intersection of financial services laws with innovation and the future of banking and payments, including with respect to stablecoins.

I served as a senior policy advisor to the Treasury Department's Financial Stability Oversight Council office at its launch following the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I graduated with a degree in literature from Rutgers College and received my law degree from Rutgers Law School.

Today I am presenting my own views, and not those of my firm or any client of the firm.

Chairman Hill, Ranking Member Lynch, Chairman McHenry, Ranking Member Waters and members of the Subcommittee, thank you for the privilege to speak before you today.

Questions about the future of money have rightfully captured significant attention from Congress and other policymakers. As technological advances continue to push the boundaries of how we store, spend and conceptualize money, our regulatory framework also should evolve.

Among the innovations that have garnered attention and market share are products known as stablecoins. These digitally native “coins” are designed to maintain a stable value relative to a reference asset, typically the U.S. dollar.

As with other forms of money resulting from earlier innovations, stablecoins present both risks and opportunities for the financial system and for consumers. In November 2021, the President’s Working Group (PWG) on Financial Markets, together with the FDIC and OCC, published their examination of a class of stablecoins referred to as “payment stablecoins” (PWG Report).¹ The PWG Report identified prudential risks associated with payment stablecoin arrangements, such as: run risks; payment system risks; and competitive and financial stability risks. The report also noted various investor protection and illicit finance risks that may be implicated by stablecoin activities. The report recommended that Congress act promptly to pass legislation regulating payment stablecoins.

Following the release of the PWG Report, many legislative proposals have been introduced to regulate payment stablecoins. I commend Chairman McHenry, Chairman Hill, Ranking Member Waters and the other Republican and Democratic members of this Subcommittee for their diligent efforts and the progress that has been made. I believe a bipartisan substantive consensus on payment stablecoin legislation should be achievable.²

Why stablecoin legislation is important

Stablecoins represent the latest form of a class of financial products that have long been recognized as “special”³ and worthy of regulation: products that are (1) payable on demand at par, by their terms or by virtue of market expectations, and (2) readily transferable to third parties.⁴

¹ PRESIDENT’S WORKING GRP. ON FIN. MARKETS, THE FED. DEPOSIT INS. CORP., AND THE OFF. OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS 2 (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf (defining “payment stablecoins” as “those stablecoins that are designed to maintain a stable value relative to a fiat currency and, therefore, have the potential to be used as a widespread means of payment”). References to “stablecoins” throughout this written statement are intended to refer to “payment stablecoins” unless otherwise noted.

² For a discussion of the outlook for stablecoin legislation, as well as the broader context for crypto asset legislation, see Daniel E. Newman & Justin Levine, *The 2023 Outlook for Crypto Legislation: What’s In and What’s Missing from Current Proposals*, 31, 4 Mkt. SOLUTIONS, (Dec. 2022), https://www.davispolk.com/sites/default/files/2023-01/52887102_1.pdf.

³ I have written about what makes stablecoins special previously. See David L. Portilla & Will C. Giles, *The Stablecoins Debate*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Oct. 24, 2021), <https://corpgov.law.harvard.edu/2021/10/24/the-stablecoins-debate/#6b> (using E. Gerald Corrigan’s 1982 paper, “Are Banks Special?” as a framework for evaluating proper stablecoin regulation); E. Gerald Corrigan, ANNUAL REPORT 1982: ARE BANKS SPECIAL?, FED. RESERVE BANK OF MINNEAPOLIS, <https://fraser.stlouisfed.org/title/annual-report-federal-reserve-bank-minneapolis-473/annual-report-1982-18309>.

⁴ Academics often have focused on deposit taking when analyzing stablecoins. See, e.g., Gary B. Gorton & Jeffery Zhang, *Taming Wildcat Stablecoins*, 90 U. CHICAGO L.R. (Sept. 30, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3888752; Howell E. Jackson & Morgan Ricks, *Locating Stablecoins within the Regulatory Perimeter*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Aug. 5, 2021), <https://corpgov.law.harvard.edu/2021/08/05/locating-stablecoins-within-the-regulatory-perimeter/>. Others have focused on transforming such shorter-term obligations into longer-term assets like commercial paper. See Bill Nelson, *Liquidity Transformation Always*

These types of financial products are special because they pose well-known risks. Chief among them is the risk of a run – that is, requests for redemption *en masse* that cannot be met due to a mismatch in the liquidity of reserve assets. The ramifications of such a run, along with the potential need for government support, necessarily become more pronounced as stablecoins scale. We can – and should – proactively mitigate these risks by establishing a regulatory framework *now*, before these risks grow larger and scale makes change more difficult. Importantly, some form of appropriately calibrated prudential regulation can minimize the risk of needing to provide government support to stablecoin issuers during a period of stress.⁵

This is not to say stablecoins pose precisely the same risks as other products that feature similar characteristics, such as bank deposits. A stablecoin issuer that fully backs outstanding coins with high-quality liquid assets is subject to a meaningfully lower risk of debilitating runs than a deposit-taking bank that uses a fractional reserve model.⁶ And stablecoins that operate on decentralized, public networks may present different types of illicit finance risks compared to products that exist purely on traditional payment rails or on private permissioned networks; however, even on public networks, technological solutions to address illicit finance concerns may be available.⁷

I cannot say with certainty whether stablecoins represent part of the future of payments. Yet I feel quite confident that the current legal framework is ill-suited to comprehensively regulate payment stablecoins. Correspondingly, legislation that enables fit-for-purpose payment stablecoin regulation would help foster an environment where this technology can develop and scale. Some of the potential that payment stablecoins offer include: the programmability of money (e.g., increased automation of transactions); an additional means for mobile-based, real-time payments for consumers; and an additional payments infrastructure on which further innovation can occur. If realized, all of these developments may amplify the potential for building a more efficient, competitive and resilient payment system.⁸

Finds That Path of Least Regulation, BPI (Sept. 23, 2021), <https://bpi.com/liquidity-transformation-always-finds-that-path-of-least-regulation/>.

⁵ As a useful analogy, see Report of the President's Working Group on Financial Markets, MONEY MARKET FUND REFORM OPTIONS, (Oct. 2010), https://home.treasury.gov/system/files/136/archive-documents/10_21-PWVG-Report-Final.pdf, (introducing bank-like regulation of MMFs); Report of the President's Working Group on Financial Markets, OVERVIEW OF RECENT EVENTS AND POTENTIAL REFORM OPTIONS FOR MONEY MARKET FUNDS, (Dec. 2020), <https://home.treasury.gov/system/files/136/PWVG-MMF-report-final-Dec-2020.pdf> (examining COVID-19-related disruptions to short-term funding markets and suggesting prudential-based measures to improve market stability).

⁶ That said, even high-quality liquid assets, such as three-month Treasury bills, can experience stress during market crises. At the beginning of the COVID-19 pandemic, for example, the five-day moving average bid-ask spread for three-month Treasury bills widened from one basis point to nearly eight basis points. See Dep't. of the Treasury, Bd. of Governors of the Fed. Reserve System, Fed. Reserve Bank of New York, Sec. and Exch. Comm'n, COMMODITY FUTURES TRADING COMM'n, RECENT DISRUPTIONS AND POTENTIAL REFORMS IN THE U.S. TREASURY MARKET: A STAFF PROGRESS REPORT 15 (Nov. 8, 2021), <https://home.treasury.gov/system/files/136/AWVG-Treasury-Report.pdf>. This episode demonstrates that caution should be given to assuming some level of maturity mismatch is immune to run risk.

⁷ Technological innovations related to blockchain tracing and whitelisting capabilities may offer a viable approach to mitigate these risks. See, e.g., Forge Societe Generale Grp., *EUR CoinVertible (EURCV) Stablecoin White Paper* 18 (Apr. 2023), https://www.sgforge.com/wp-content/uploads/2023/04/SGF_Coinvertible_White-Paper-v1.0.pdf ("[O]nly addresses that are whitelisted by SG-FORGE will be eligible to receive our stablecoins. Such whitelisting process based on the CAST Framework means that SG-FORGE has performed compliance controls (KYC, AML-CFT, sanctions and embargoes) according to Societe Generale Group policies, and has duly onboarded the owner of such address.").

⁸ For a discussion of the potential benefits of payment stablecoins and the role regulation can play, see generally *Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?: Hearing Before the S. Comm. On Banking, Housing and Urban Affairs*, 117th Cong. (Dec. 14, 2021) (statement of Jai Massari, Partner, Davis Polk & Wardwell LLP), <https://www.banking.senate.gov/imo/media/doc/Massari%20Testimony%2012-14-211.pdf>.

Key issues for stablecoin legislation

The remainder of my remarks will focus on what I believe are the key issues that should be addressed in any payment stablecoin legislation.⁹ A common theme in my testimony today is that a one-size-fits-all approach is neither necessary nor prudent. I believe payment stablecoin legislation should establish privileges and responsibilities for stablecoin issuers along a spectrum. As a general principle, greater privileges from the government should be coupled with more stringent regulatory and supervisory oversight; a more tailored regulatory approach, on the other hand, should be coupled with appropriately calibrated privileges from the government.

1. *Who should be permitted to issue payment stablecoins?*

A threshold question relating to the regulation of stablecoins is, quite simply, *who* should be allowed to issue them? The PWG Report, for example, recommended that stablecoin issuers be limited to insured depository institutions.¹⁰ Since its release, many domestic and international regulatory bodies appear to have shifted away from this recommendation.¹¹ Indeed, Treasury Under Secretary for Domestic Finance Nellie Liang, a lead contributor to the PWG Report, subsequently acknowledged that an appropriate regulatory structure for nonbank stablecoin issuers could “plausibly address concerns about stablecoin runs and payment system risk.”¹² In addition, many of the legislative proposals released to date have contemplated a dual approach, whereby nonbanks would be permitted to issue stablecoins provided they comply with varying degrees of prudential regulation.¹³ These approaches make sense, given that the common conception of a payment stablecoin business (that is, issuance and redemption of an instrument backed by a discrete pool of high-quality liquid assets) is distinct from the business of fractional reserve banking.¹⁴

Because payment stablecoins typically hold a limited range of reserve assets, the regulatory framework should be designed to address the specific characteristics of this business model and the risk tradeoffs it presents. This principle is true whether the stablecoin issuer is a nonbank entity lacking any affiliation with a banking organization, or a subsidiary or affiliate

⁹ The issues I discuss in my testimony are not exhaustive, and many other important questions remain. For example, even if payment stablecoin legislation is enacted, there would still be questions around other types of stablecoins, such as the various categories of decentralized and algorithmic stablecoins. It is also not entirely clear how the regulation of payment stablecoins might interact with the potential for a future in which central bank digital currencies (CBDCs) or tokenized demand deposits issued by banks, also known as deposit coins, become mainstream.

¹⁰ PWG Report, *supra* note 1 at 2.

¹¹ See, e.g., FIN. STABILITY OVERSIGHT COUNCIL, REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION (Oct. 2022), <https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf>; FIN. STABILITY BD., REVIEW OF THE FSB HIGH-LEVEL RECOMMENDATIONS OF THE REGULATION, SUPERVISION AND OVERSIGHT OF “GLOBAL STABLECOIN” ARRANGEMENTS (Oct. 11, 2022), <https://www.fsb.org/wp-content/uploads/P111022-4.pdf>.

¹² Under Secretary for Domestic Finance Nellie Liang, Remarks at King’s College London’s Global Banking and Finance Conference (July 5, 2022), <https://home.treasury.gov/news/press-releases/jv0850>. Under Secretary Liang did, however, caution that bank stablecoin issuance and nonbank stablecoin issuance might have “different implications for financial stability.” *Id.*

¹³ See, e.g., Sam Sutton, Eleanor Mueller, *McHenry’s scaled-back stablecoin plan would give states flexibility*, POLITICO PRO (Apr. 2023), <https://subscriber.politicopro.com/article/2023/04/mchenry-scales-back-stablecoin-plan-gives-states-flexibility-00093539?source=email> (publishing revised discussion draft of stablecoin bill reportedly being developed by Rep. McHenry); Discussion Draft, S. __ 118th Cong. (2022), <https://docs.house.gov/meetings/BA/BA21/20230419/115753/BILLS-118pnh-Toprovidequirementsforpaymentstablecoinissuersresearchonadigitaldollarandforotherpurposes.pdf> (discussion draft of stablecoin bill posted for Apr. 19, 2023 House Financial Services Committee hearing); Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, 117th Cong. (2022); Stablecoin Transparency of Reserves and Uniform Safe Transactions Act of 2022, S. 3970 117th Cong. (2022); Gottheimer Stablecoin Innovation and Protection Act of 2022, S. __ 117th Cong. (2022).

¹⁴ In contrast, an insured depository institution could (and should be permitted to) issue tokenized deposits.

of a banking organization. For example, the existing minimum, non-risk sensitive leverage capital ratios that apply to banks would likely need to be modified to reduce the potential negative capital implications arising from a direct or indirect subsidiary of a bank or bank holding company issuing stablecoins.¹⁵

2. *Who should regulate payment stablecoins?*

The next question that naturally follows is one of jurisdiction: who should be the primary regulator of payment stablecoin issuers? Should stablecoin issuers be regulated at the federal or state level?

Federal regulation of stablecoin issuers would offer more uniform, consistent rules, whereas state regulation could promote more diversity and innovation in regulation and supervision. Today, for example, the most detailed publicly available prudential guidance and standards regarding stablecoins and related topics have been issued by a state regulator.¹⁶ But the answer to this question need not be binary. Many of the legislative proposals released by Congress to date have followed the model of our dual-banking system. That is, they would establish a framework in which stablecoin issuers could be regulated either (1) directly at the federal level, or (2) primarily at the state level, with an overlay of federal oversight. Options include providing federal regulation as a backup to state regulation or an approach that toggles based on the scale of an issuer. In all cases, the roles of federal and state regulators should be clear to avoid overlap, confusion and inefficiency.

3. *Should nonbank payment stablecoin issuers be provided access to the Federal Reserve's payment system or discount window?*

The question of who should be entitled to have a master account has emerged as a key policy question for the U.S. financial system. A master account at one of the twelve Federal Reserve Banks is necessary for an institution to have direct access to the Federal Reserve's payment systems, as well as to settle transactions in central bank money.¹⁷ Technological changes in the payments landscape have driven a number of fintech and crypto asset-based companies to seek access to these services.

Granting nonbank payment stablecoin issuers access to master accounts could help them provide more efficient services to their customers. It also carries monetary policy and political implications. Here, again, multiple options are possible. Perhaps legislation could grant nonbank stablecoin issuers with access to Federal Reserve Bank services, but limit those services in both scale and scope. For instance, the absolute or relative amount of reserves that a nonbank stablecoin issuer may invest in central bank deposits could be limited by the

¹⁵ See DAVIS POLK & WARDWELL LLP, *U.S. Regulators Speak on Stablecoin and Crypto Regulation* (Nov. 12, 2021), <https://www.davispolk.com/insights/client-update/us-regulators-speak-stablecoin-and-crypto-regulation#:~:text=The%20PVG%20Report%20on%20Stablecoins&text=The%20Report%20announces%20no%20immediate,issuers%20and%20custodial%20wallet%20providers> (explaining challenges for stablecoins associated with the minimum leverage capital ratios that apply to banks today). Cf. Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, 115th Cong. (2018) (tailoring the supplementary leverage ratio for custodial banks).

¹⁶ See N.Y. DEPT OF FIN. SERV., *GUIDANCE ON THE ISSUANCE OF U.S. DOLLAR-BACKED STABLECOINS* (June 8, 2022), https://www.dfs.ny.gov/industry_guidance/industry_letters/20220608_issuance_stablecoins; N.Y. DEPT OF FIN. SERV., *GUIDANCE ON CUSTODIAL STRUCTURES FOR CUSTOMER PROTECTION IN THE EVENT OF INSOLVENCY* (Jan. 23, 2023), https://www.dfs.ny.gov/industry_guidance/industry_letters/20230123_guidance_custodial_structures.

¹⁷ A master account is also a necessary, but not sufficient, condition for an institution to have access to the Federal Reserve's discount window.

Federal Reserve.¹⁸ Or perhaps issuers could be granted access to the discount window, but only at certain times and in limited amounts. Other options include making access to Federal Reserve Bank services available at the option, or based on the scale, of an issuer. In all events, it seems that if a firm is granted access to Federal Reserve Bank services, regulation and supervision should correspond to the level of such access (including with respect to issues such as limitations on affiliations with commercial companies).

4. *To what extent (if at all) should payment stablecoins be subject to “deposit” insurance?*

Banks offer economic and societal value, in the form of increased money supply and credit, by engaging in the business of maturity and liquidity transformation.¹⁹ But this business model is inherently susceptible to run risk.²⁰ Deposit insurance was introduced in the U.S. in the 1930s in an effort to mitigate this risk.

A similar form of insurance for payment stablecoins could also help mitigate run risks by making available aspects of the federal safety net to stablecoin issuers. The availability of deposit insurance would thus affect whether other bank-like requirements should be considered. For example, insured banks are subject to extensive capital, liquidity and risk management requirements, as well as activities restrictions, in part to prevent them from externalizing risks through the federal safety net.

Whether some form of insurance is ultimately needed for stablecoins may turn on the nature of the reserves that back them and, relatedly, the degree to which consumers expect their stablecoins to be redeemable on demand at par. As noted previously, a stablecoin issuer that fully backs its coins with high-quality liquid assets likely poses a meaningfully lower risk of becoming subject to a run than a bank.²¹

5. *What insolvency standards should be applicable to payment stablecoins?*

Recent high-profile bankruptcies of crypto asset-related companies have brought questions related to the treatment of customer assets in the event of an intermediary’s insolvency into stark focus. To the extent payment stablecoins are designed or perceived to be effectively free of credit risk, it would be prudent to provide stablecoin holders with structural priority over an issuer’s other creditors. Other important considerations include rehypothecation limits and recordkeeping requirements. In addition, a company that holds stablecoins for customers should be subject to standards to help ensure that a customer’s stablecoins are not commingled with the assets of the company and, therefore, to help ensure that the customer’s stablecoins would be available to the customer in the event of an insolvency of the company. Existing federal and state laws provide standards for custodians and should be useful in this context. In any case, clear rules and plain-language disclosure and terms are

¹⁸ Similarly, the amount of interest on reserve balances could be limited or capped at a certain amount.

¹⁹ E.g., Kenneth J. Arrow, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Non-market Allocation*, in JOINT ECONOMIC COMMITTEE OF THE CONGRESS OF THE UNITED STATES, *THE ANALYSIS AND EVALUATION OF PUBLIC EXPENDITURES: THE PPB SYSTEM* 48 (1969) (“The creation of money is in many respects an example of a public good.”).

²⁰ See, e.g., Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401 (1983) (“It is precisely the ‘transformation’ of illiquid assets into liquid assets that is responsible both for the liquidity service provided by banks and for their susceptibility to runs.”).

²¹ But see *supra* note 6.

important to provide customers and creditors confidence that their claims will be resolved in a predictable and timely manner.

6. *What other legal regimes should apply to payment stablecoins and related products and services?*

While I have focused primarily on prudential issues, payment stablecoins and related products, such as wallet and other custodial providers, also present other common regulatory concerns, such as those related to consumer protection and illicit finance. All of these considerations should be thoughtfully explored.

But this does not mean that payment stablecoins should be shoehorned into regulatory frameworks that were crafted for entirely different products. Nor does it mean that we should be vexed to paralysis in trying to answer questions that, frankly, permeate traditional finance – such as how to regulate any service provider that is adjacent to a regulated firm. Ultimately, consumers and our financial system more broadly will be best served by focusing on the above issues where I believe we can find common ground to establish a regulatory framework that treats payment stablecoins as such – payment instruments that are subject primarily to prudential regulation and supervision, rather than, for example, as an investment asset subject to market and investment management regulation.

* * *

Thank you again for the opportunity to participate today. I look forward to addressing your questions.

**Testimony of Fennie Wang
Founder and CEO of Humanity Cash**

**before the House Financial Services Committee,
Subcommittee on Digital Assets, Financial Technology and Inclusion**

**Hearing titled: *Putting the ‘Stable’ in ‘Stablecoins:’ How Legislation
Will Help Stablecoins Achieve Their Promise***

May 18, 2023



Humanity Cash Testimony to the House Financial Services Committee

Thank you Chairman McHenry, Chairman Hill, and Ranking Member Lynch and Ranking Member Waters for giving me this opportunity to testify. People like me rarely have this opportunity. I do not represent a large corporation or an industry organization. I am an independent lawyer and entrepreneur working on grassroots projects. My name is Fennie Wang and I run a small organization called Humanity Cash that works with community organizations to design local currencies that make money work harder for local communities. In my previous life, I worked as a research analyst on Wall Street, then a Wall Street lawyer before jumping into the deep end of digital currencies and start-ups. In that capacity, I have worked at a number of prominent projects, including stablecoins, where I developed my knowledge of the technology.

I. A brief introduction to existing stablecoins

Decentralized stablecoins are typically digital currency protocols that attempt to issue digital tokens with a price target of \$1 USD (or some other real world fiat currency), and achieves that target price through mechanisms that are primarily executed through smart contracts on a blockchain. Within the universe of decentralized stablecoins, there are different designs and mechanics for achieving the price target with different financial risk profiles. For example, some are called algorithmic stablecoins, whereby the stablecoin protocol uses predefined rules or algorithms to adjust its supply in response to demand in order to keep the stablecoin at its price target. For example, if the stablecoin rises above the price target, the algorithm may increase the stablecoin's supply by minting new stablecoins and removing related collateral tokens from the market. When the stablecoin falls below the price target, the algorithm may reduce supply by burning stablecoins in exchange for inflating the related collateral tokens. Oftentimes with algorithmic stablecoins, the stablecoin's supply is moderated by its relationship with a second token of fluctuating value that functions like collateral. Importantly, the second token is also issued by the same protocol; therefore its value and market behavior are endogenous to the stablecoin protocol and highly correlated with market behaviors of the stablecoin. This is inherently risky, given the highly correlated nature of the two tokens.

In contrast, other types of decentralized stablecoins are collateralized by digital assets and other digital currencies whose value are exogenous to the stablecoin protocol itself. Under these models, in order to generate one stablecoin (with a target value of \$1 USD), a user must deposit into a smart contract another digital currency of value as collateral e.g. \$1.50 worth of ETH. These protocols typically require overcollateralization due to the volatile prices of the underlying assets used as collateral. The stablecoin is collectively backed by all collateral locked into the protocol, which is a collection of different digital currencies that are approved as collateral types. A complex governance system of the stablecoin protocol is required to ensure that the price target of \$1 is met, given the varying market characteristics and price volatility of the underlying portfolio of collateral. Such a system may be considered, in some aspects, to be less risky than an

algorithmic model, where there is no collateral whose value and market dynamics are exogenous and orthogonal to the value or dynamics of the stablecoin itself. However, crypto-collateralized stablecoins still have inherent price risks, as the price target of \$1 USD is inherently asymmetrical with the value and price movement of the underlying collateral.

The only way to fundamentally reduce the price risk is to have the underlying collateral of a stablecoin match the price target e.g. one stablecoin with a price of \$1 USD is backed by one dollar (or dollar equivalent). These types of stablecoins are sometimes called centralized or custodial stablecoins because the peg mechanism is dependent on assets that are inherently off-chain and therefore not publicly verifiable in the same way that on-chain collateral may be verified. In short, the peg is dependent on the market's trust that the issuer of the stablecoin indeed has sufficient dollar assets to match the amount of stablecoins issued. Where that trust is established, primarily due to clear regulatory standards and market reputation for adhering to those standards, these types of dollar-backed stablecoins become go-to choices for transactions.

In all of the above examples, the predominant use case for the stablecoins is crypto-trading. For example, with crypto collateralized stablecoins, users are essentially borrowing against their collateral in order to generate additional liquidity in the form of stablecoins e.g. instead of having to sell ETH in order to buy another digital asset, a user can purchase the digital asset using a stablecoin that is issued against her ETH, and then when a profit is generated, she can return the stablecoin to retrieve her ETH collateral, capturing any upside value of her ETH. While a centralized dollar-backed stablecoin can be used for real world payments given its dollar reserves, these are still primarily traded on exchanges and most of its volume is still in the cryptomarkets where it is used as a dollar proxy for on-chain transactions.

However, with a clear regulatory framework, banks and other institutions will feel more confident in issuing stablecoins for payment use cases, which would have great public benefit by reducing the cost of transactions and increasing the speed of settlement. Currently, the U.S. lags behind many other countries in digital payments. For example, in the U.S. the predominant and cheapest form of payment transactions use a settlement network called the Automated Clearing House (ACH), which can take 5-6 business days for payments to fully clear. In contrast, in the European Union, the predominant payments network is the Single Euro Payments Area (SEPA), which can process payments in one business day. The difference of a few business days can make or break many small businesses that have tight working capital requirements. Therefore, laying the groundwork for regulated stablecoins for payment use cases would have enormous benefit to ordinary Americans and Main Street.

II. A short primer on community currencies

During the pandemic, I resolved to use my knowledge of blockchain and stablecoins to build non-speculative applications that could improve the lives of ordinary Americans. To understand

the role that alternative currencies can play in a non-speculative way, I studied the history of community currencies in the United States and around the world, which have existed long before the advent of Bitcoin and blockchain.

A fundamental tension of all ecosystems — whether monetary systems or blockchain ecosystems — is the balance between efficiency and resiliency. A broadly used currency is highly efficient given its breadth, yet it may be at the expense of local economies that provide resilience in the broader economic ecosystem. For example, a community that relies more on local production of food may be less susceptible to COVID supply chain issues or knock-on consequences from geopolitical events like war. The core thrust of community currencies is to restore resiliency to the monetary ecosystem by focusing on the balance of trade within localized economies, particularly those situated within a larger monetary regime. Community currencies are not legal tender, but they complement national currencies as a local medium of exchange to ensure more money recirculates and stays within local communities.

In times of crisis, community currencies, sometimes called complementary currencies, can function as an alternative source of funding to facilitate local trade and productive activity when national currency is scarce in the case of severe recessions, or as a means to organize productive activity at the local level in the absence of productive capacity at a national level. For example, when the only bank in the town of Tenino, Washington closed during the Great Depression, the local government issued a wooden currency to continue the facilitation of trade.¹ This wooden currency is still in circulation today and was utilized in the town's COVID19 relief program, which distributed \$300 a month to those with a demonstrated economic hardship to help them meet their basic needs. A similar approach was taken in post World War I Germany during the Weimar Republic with the creation of “notgeld,” an emergency scrip that was issued to combat hyperinflation and stabilize the economy.²

In the absence of a deep crisis, the role of community currencies is to create more balance in the flow of funds within regions. This is the primary space in which Humanity Cash operates. Our mission is to work with community banks, credit unions and community organizers to create locally responsive financial tools. With a broad currency, economic activity can easily flow out of a region to larger corporations headquartered elsewhere, sometimes even offshore. This dynamic is most visible on Main Street in the form of mom and pop shops that shut down because they cannot compete with big retailers.

Community currencies posit that when a currency (primarily functioning as a medium of exchange) is restricted to facilitating transactions in a particular community, this would stimulate local economic productivity. There is suggestive evidence that local currencies have a higher

¹ <https://www.strongtowns.org/journal/2020/6/29/wooden-money>

² <https://designobserver.com/feature/notgeld-emergency-money-in-inflationary-germany/39926>

velocity of money than national currencies.³ The velocity of money is a measure of how fast or how often the same dollar recirculates in the economy by facilitating multiple economic transactions. In other words, there is a multiplier effect. For every dollar injected into a community, it may create 3–4x the economic value.⁴ The initial recipient, for example, may spend that dollar at the local grocer, who then spends the same dollar at the local bakery, whose owner then spends the same dollar at the local diner before that dollar exits the community.

In addition, a key design of some community currencies is to keep underlying dollar reserves with community banks, which are critical to creating a money multiplier effect in local economies, whereby the same dollar deposited at a local bank creates more than one dollar of economic value to the local economy. When a community currency is working right, the currency is being used to facilitate multiple trades locally, creating multiples of income on the initial local dollar injected into the economy, while the underlying U.S. dollar is being reinvested into the local economy via local banks, creating additional multiplier effects.

Community currencies show how payment stablecoins can help support community banks and credit unions that are critical for financial inclusion. In the US, almost half of our deposits are kept with just 10 banks.⁵ *That is more than \$11 trillion with just 10 banks*,⁶ despite there being 4,750 community banks⁷ and 5,298 credit unions.⁸ This trend is now dangerously accelerating with the current regional banking crisis. The number of community banks has declined by 50% since 2000 due to market consolidation and competition.⁹ In total, we have lost more than two-thirds¹⁰ of our community banks since 1984 due to financial consolidation, with disproportionate impact on minority-owned banks.¹¹ The results are consequential.

Community banks are critical providers of financing for the local economy. While community banks hold only 15% of the banking industry's total loans, they hold 30% of the industry's commercial real estate loans that finance multifamily housing, retail, hospitality and industrial projects, 36% of the industry's small business loans, and 31% of farm loans.¹² More dollars held by community banks means greater liquidity for local productive activity.

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https://www.researchgate.net/figure/Figura-6-Fonte-De-la-Rosa-J-Stodder-J-On-velocity-in-several-complementary_fig4_306315018

⁴ Id.

⁵ <https://www.statista.com/statistics/727546/market-share-of-leading-banks-usa-domestic-deposits/#:~:text=Bank%20of%20America%20held%20the,bank's%20share%20exceeded%20five%20percent>.

⁶ <https://www.insiderintelligence.com/insights/largest-banks-us-list/>

⁷ <https://www.fdic.gov/resources/community-banking/cbi-study.html>

⁸ https://www.statista.com/topics/7633/credit-unions-in-the-us/#topicHeader__wrapper

⁹ <https://www.abrigo.com/blog/community-bank-outlook-challenges-and-opportunities-in-2021-and-beyond/>

¹⁰ <https://fred.stlouisfed.org/series/USNUM>

¹¹ <https://www.cnbc.com/2020/08/25/minority-entrepreneurs-at-tipping-point-as-black-owned-banks-dwindle.html>

¹² <https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf>

Every local dollar creates multiplier effects



III. Digital community currency experiment

In the summer of 2020, I discovered a community currency in Berkshire County, Massachusetts, which is collateralized by federal dollars held with local community banks and, at the height of its popularity, accepted at approximately 400 local stores. The goal is to promote patronage of small businesses and local banks, creating multiplier effects on both the demand side (stimulating transactions with local businesses) and the reserve side (keeping dollars with local banks to reinvest as local productive capital). The dollar backing and convertibility between the community currency and the underlying dollar reserves enabled small business owners to obtain liquidity to pay bills in USD if necessary, and provided a clear measure of the value of each local currency note. The local currency was originally in the form of paper notes that were exchanged for U.S. dollars on a 1:1 basis.

During the pandemic, small businesses were under, and continue to be under, pressure. Moreover, the pandemic accelerated the shift towards contactless payment. All else equal, this means more money is leaking out of local economies, just when they need it the most. I believed this was an opportunity to address a real world problem that blockchain was suited for – by digitizing a local currency, we can better compete with electronic payments and reduce transaction fees to the immediate benefit of small businesses, while ensuring that the underlying dollar reserves remained deposited, and therefore invested, in the local economy via local banks.

Humanity Cash transposed the Berkshires-based local currency model into digital form; instead of swapping federal dollars for paper notes at physical bank branches, we minted tokens in exchange for federal dollars electronically deposited with two local banks. On the asset side, the community banks can redeploy the deposits back to the local community; on the liability side,

the digital tokens are exchanged within a closed loop of local businesses, creating a virtuous cycle.

An important distinction between the digital community currency we created versus other stablecoins is that by design the community currency cannot be traded on an exchange, as its purpose is to facilitate economic transactions within a region. As such, by design a community currency is a closed loop system, which also substantially reduces the risk of money laundering and other types of financial crime risks. Users could load up their digital wallets by linking a bank account, with the funds transferred to two participating local banks in the Berkshires, upon which the user would be credited an equivalent amount of digital tokens to be spent at nearly 90 participating local businesses. Those local businesses may choose to cash out if they needed the liquidity, but many business owners chose to reuse their tokens to support other local businesses and show solidarity. Because the use case profile is focused on bona fide economic activity in a local community, as opposed to trading or purely financial activities, the risk profile of a community currency is also substantially lower, with underlying deposits of higher quality. Banks are allowed to loan out higher quality deposits, which creates the money multiplier effect in local economies.

IV. Lessons learned from the digital community currency experiment

1. *While ordinary people may or may not care about blockchain or cryptocurrency, there is an appetite and desire to use digital currency if people believe that it will benefit and strengthen their local communities.*

During the process of designing and launching the project in the Berkshires, I interviewed small business owners, community bankers and ordinary citizens. Whether in the Berkshires, or across the United States from Puerto Rico to Hawaii to Indiana, the people I've met are not interested in crypto as a speculative investment; they are deeply passionate about making money work for their communities. This includes a concrete mixer driver who spends 92 hours on the road each week, a retired accountant looking to give back, a small business owner who produces Massachusetts-made ukuleles, and community organizers who are experimenting with ways to use digital community currencies to support Black-owned businesses. There is a deep passion and appreciation for supporting local businesses, as well as trust in their community banks.

2. *Community banks see stablecoins as an innovative deposit-gathering tool, and see blockchain technology as replacing core banking infrastructure in the next 10-15 years, enabling smaller banks to be more innovative and competitive, while continuing to serve their local communities.*

The biggest shift in attitude came from the community bankers we worked with, who went from initially skeptical about participating in a digital currency-based project to very excited about how they might participate in the future of this new financial technology. The president of one of the banks noted that he understood that blockchain technology was the future, and they needed to get ahead of the curve in order to stay competitive. Participating in a community-based project was a low-risk way for them to learn about the technology, as they would not otherwise have the budget or bandwidth to engage in research and development work. Critically, they saw how participating in the program could enable smaller banks to be more innovative in the types of products they could offer.

We believe that with the right policies — starting with this stablecoin bill — alongside continued testing, education, and maturity of the technology, we have an existentially critical opportunity to staunch the flight of deposits from community banks and credit unions. Payment stablecoins enable higher quality deposits, as we can transact amongst each other without needing to withdraw the underlying dollars. The urgency of keeping deposits local is more important than ever. With the right policies that enable community organizations to safely experiment, the technology can mature to serve as a de-monopolizing force in our highly concentrated banking industry, by enabling community banks and credit unions to cost effectively deploy new products and services that better serve their communities.

3. Blockchain provided seamless and transparent ways to enable various aspects of legal compliance, including documentation of end users for pass-through insurance

In working with our external counsel and other stakeholders, consumer protection was of paramount importance. We were thoughtful in constructing the program such that the underlying deposits would qualify for FDIC pass-through insurance, which requires, in part, that there is a clear record of outstanding obligations and balances of end users. As a digital currency with transactions recorded in real-time on the blockchain, the blockchain functions as real-time record keeping of all wallets created and the real-time balances of each wallet. At the point of wallet creation, we collected information regarding user name and contact information associated with each wallet (not available to the public on a public ledger to preserve user confidentiality). Therefore, we can seamlessly and cost-effectively meet the requirements of FDIC pass-through insurance by showing verifiable recordkeeping of outstanding users and their balances, which would serve as evidence of claims in the event of a bank bankruptcy.

The use of a blockchain ledger can also cost effectively and transparently meet part of the public reporting requirements under the proposed stablecoin bill. For example, you can show in real time the number of tokens on-chain, compared against the U.S. dollar reserve balances. With the right policy, starting with this bill, we can enable our financial system to be more competitive

and less monopolistic, and more responsive to local economies, a benefit that ordinary Americans appreciate and deeply desire.

V. Importance of the stablecoin bill

As grassroots entrepreneurs and community innovators, we need risk-appropriate regulations that will not be cost prohibitive, while providing guardrails to protect us from bad actors. The proposed stablecoin bill strikes a good balance between those two needs. Importantly, it provides space for local initiatives and innovation through state regulators, and a clear roadmap for implementation. State regulators are closer to the ground and better able to tailor and respond to the regulatory needs of local innovation. It would not make sense for local or community initiatives to be governed by a federal organization. Small projects that are trialing or piloting different aspects of community development work are more likely to qualify for state regulator sponsored sandboxes, providing those necessary guardrails while allowing ordinary citizens to learn by doing. Without an opportunity for grassroots work and community experiments, the technology will indeed remain within big banks and other large financial institutions.

The concern that state regulators would somehow be lax regulators does not take into account grassroots innovation and the principle of risk appropriate regulation, which the proposed stablecoin bill mandates. For example, grassroots projects like the one we did are closed loop (does not trade widely or on exchanges) and focused on bona fide local payments and economic transactions, as opposed to financial transactions where there is greater risk for large swings in deposit and withdrawal activity. Both of these factors substantially reduce risks to the consumer. State regulators are better positioned to provide appropriate oversight for these kinds of projects. If those early grassroots projects provide lessons that are then scaled up in subsequent projects, the regulatory requirements would also scale up in proportion, and where appropriate those stablecoin projects may become federally regulated, which the proposed stablecoin bill also provides for. This pathway provides smaller organizations that are critical to local economies with the time to safely make mistakes, pivot, or build on initial successes into larger, more viable projects, with the confidence necessary to secure additional funding to meet greater regulatory requirements. The avenue for state regulation in the proposed stablecoin bill, alongside federal regulation, is in line with our Constitution's history that supports states as "laboratories" of democracy. As Justice Brandeis wrote in 1932, "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."¹³ Indeed, both state and federal oversight of stablecoins can co-exist and support the other in developing a healthy financial ecosystem.

¹³ *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

Enabling non-bank stablecoin issuers also falls within this tradition of local “laboratories.” In the case of our project in the Berkshires, the local banks did not have the capacity to take on such a project as an issuer given their capacity restraints. However, enabling another community organization to function as the issuer allowed them to learn in a low-risk, low-resource environment. They will now have more confidence and knowledge going forward should they decide to issue their own stablecoins, or to work with other community organizations to do so. For very small banks, they may never have the resources to take on stablecoin issuance. However, a local chamber of commerce or economic development agency could issue and market a stablecoin to support regional small businesses while keeping underlying reserves with community banks, therefore still locking in the money multiplier to the benefit of the local economy.

Finally, it is important to stress that the role of government is not to decide which projects are successful and useful. Indeed, many community-based and grassroots projects will fail or fail to achieve scale. What is important is that our government ensures that Americans have the ability to experiment and to fail safely. What has deeply moved me is speaking to ordinary Americans who feel both a deep passion for their communities *and* a sense of possibility that no matter how small they are, they have the ability to use new tools to help their communities become more self-sufficient and self-reliant. Though they deeply criticize the existing financial system, they are not cynical. They believe that even if they are not immediately successful, their work can help educate their communities and build upon lessons that can ultimately be successful in ensuring that our financial system works for everyone. This is the spirit that we must preserve and support. As one small business owner told me, she loves the concept of a community currency because it forces people to stop and acknowledge the human aspects of a financial transaction. Community currency this isn’t merely another faceless financial transaction; it is an exchange between one neighbor to another.



Statement for the Record
House Financial Services' Digital Asset Subcommittee Hearing
Putting the 'Stable' in 'Stablecoins:'
How Legislation Will Help Stablecoins Achieve Their Promise
May 17, 2023

Dear Chair Hill, Ranking Member Lynch, and other members of the House Financial Services Committee,

We write to express our concerns about the grave risks stablecoins pose to households and to our financial system and urge the Committee to take the utmost care to not advance legislation that will increase these risks by expanding the reach of stablecoins without at a minimum providing adequate protections from these risks for consumers, investors and financial markets..

We are also concerned that both legislative proposals being considered during this hearing may fall short of this standard, to varying degrees. The following comments are shared to provide context for discussion regarding stablecoins, some key principles that should be fully addressed by any regulatory approach to stablecoins, and some initial concerns we have with these proposals.

Stablecoins, despite their name, have proven anything but stable. There are ongoing questions regarding the degree to which their issuers hold enough stable reserves as collateral in order to redeem their customers should they choose to withdraw their funds. What's more, the fragility of stablecoins and how their vulnerabilities can amplify market instability was on full display during the market crash that began last year with the collapse of the Terra stablecoin and its ecosystem, along with other factors, helped to spur roughly \$2 trillion in investor losses in a mere few weeks.

In addition to these concerns, there are other risks and harms to consider. Stablecoins have yet to be proven as a truly effective means of payment. Instead, currently stablecoins are primarily used to facilitate speculative cryptocurrency trading, lending or various types of decentralized finance. The underlying blockchain technology used to generate these coins is also prone to hacks and theft. A large share of issued stablecoins rely on energy intensive verification methods that generate negative environmental impacts. And as of now, blockchain 'payment' systems are generally incapable of reversing erroneous or fraudulent transactions, given the inability to delete data from the chain. The Committee should thoroughly consider the possibility that stablecoin legislation intended to transform stablecoins into a mainstream, reliable mode of

payment might instead further fuel the mining and trading of cryptocurrencies in an environment rife with pump-and-dump scams, extreme volatility, and cybersecurity risks.

At the outset, we believe regulators already possess considerable authority to effectively police stablecoins. Section 21(a)(2) of the Glass-Steagall Act prohibits commercial entities and other nonbanks from offering financial products and services that are functionally equivalent to deposits. The banking agencies and the Department of Justice can and should interpret this section to include stablecoins. This would then require stablecoin issuers to apply for a banking charter without an act of Congress. The SEC under its authority from the Exchange Act of 1934 has the ability to police the exchanges on which stablecoins are traded or used. The CFPB has authority to enforce the Electronic Funds Transfer Act and other statutes with respect to stablecoins as they are used for consumer finance broadly and for electronic transfer of funds more specifically. Finally, FSOC has some authority to designate stablecoins and their issuers as systemically important financial institutions and/or market utilities. Using this authority might bring stablecoin issuers under regulatory oversight without having to establish a wholly new regulatory framework that could create unforeseen risks or weaknesses in coverage.

If the Committee decides to move forward with legislation, it must adequately and comprehensively address the risks associated with stablecoins, many of which are similar to the risks posed by banks; including, but not limited to: run risk, credit risk, operational risks, and liquidity risk, as discussed in the President's Working Group report on stablecoins. Furthermore, legislation must also fully address concentration and anti-competitive effects as stablecoins issuers continue to rapidly grow and eventually seek to benefit from economies of scale through mergers and acquisitions. Such legislation should also actively affirm the roles of various regulators in protecting investors and consumers, and lastly, should make it clear that rigorous standards should be applied to oversight of stablecoins, rather than relying primarily on the discretion of any one regulatory agency.

The bill H.R. _____, **To provide for the regulation of payment stablecoins, and for other purposes** (referred to by news reports as the "Republican" bill), fails to address many of these risks or principles. A few of our key concerns are as follows:

- **No Explicit Custody Rules.** The Republican bill lacks specific custody rules directing issuers how they will protect those assets they hold in custody for them. This could raise risks associated with the commingling of funds and complicate asset recovery for coin holders if and when an issuer became insolvent.
- **The Republican bill appears to strip or diminish SEC authority over stablecoins if/when traded on secondary markets.** The Republican bill does not acknowledge the current reality that most stablecoins are used to facilitate speculative investment or are traded on secondary markets – instances where the SEC has jurisdiction. Furthermore, the bill alters securities laws to specifically state that payment stablecoins are NOT securities – a change that would likely further erode securities regulator's authority over the investment and secondary trading activity.

- **The Republican bill is silent on how specific payments focused protections, such as EFTA would apply.** If payment stablecoins are supposed to be used as payments, rules such as Regulation E and EFTA should be applied to protect consumers using them – provisions that help reverse false or erroneous charges. Yet the bill does not affirm the application of these regulatory requirements, which either creates confusion or uncertainty or worse would allow stablecoin issuers to evade such requirements.
- **The Republican bill appears largely silent on how and whether issuers would be directly subject to Community Reinvestment Act (CRA) obligations or Community Benefit Agreements.** These are bedrock elements of the current banking regulatory regime, which ensure that banking entities don't abuse their privileges and extract wealth from or fail to meaningfully contribute to the economic health of the communities they operate in – in other words, help contribute to financial inclusion.

But, apart from a very brief mention of 'benefit to consumers' in the evaluation criteria that federal regulators would use to evaluate issuers and their applications, the Republican bill is silent on this topic, which raises concerns about whether approved issuers would be largely exempt from such requirements. This could negatively impact communities, and could also incentivize other financial institutions to migrate to the stablecoin model to avoid their obligations under the CRA and similar programs, depleting these funds, and communities, of important resources and support.

- **The Republican bill appears virtually silent on Glass Steagall/Bank Holding Company Act concerns.** This bill appears to have virtually no language that addresses concerns that large commercial non-financial entities might use this regulatory framework to become stablecoin issuers, despite longstanding concerns about such activity in terms of economic concentration, market risk and other issues. There is some language in the bill about "institution-affiliated parties" being subject similar oversight as the institutions (that is, issuers) are themselves, but that language appears weak and may primarily refer to individuals or persons associated with issuers, not with third parties, distribution partners or other types of entities that could exercise de facto control over issuers that are nominally regulated under this law.
- **The Republican bill appears silent on rules, requirements and procedures related to mergers and acquisitions.** This bill is virtually silent on this topic, raising concerns that the acquisition of an issuer by another company could increase risks and/or allow issuers and parents to bypass or elide meaningful oversight by federal or state regulators.

The one significant positive element of the Republican bill we are able to identify at this time is what it omits - namely, it does not have language giving non-bank stablecoin issuers access to Fed services such as master accounts or the discount window. Allowing such access would in our view create concerns about non-bank entities receiving access to banking services and privilege, without oversight and supervision equivalent to what banks are subject to - which could amplify the risk and impact should these non-bank issuers suffer failures. However, the other bill being considered by the committee today (discussed below) also omits this language.

H.R. ____, **To provide requirements for payment stablecoin issuers, research on a digital dollar, and for other purposes** (referred to by news reports as the "Democratic" bill), does have language that in some cases, relative to the Republican bill, better addresses the principles and concerns mentioned above. However, in a number of key ways, the Democratic bill still may fall short of what we believe would be necessary to adequately protect consumers and investors from the risks and harms posed by stablecoins. In some cases, the Democratic bill shares those shortcomings with the Republican bill; in others, language or elements are different but still raise concerns.

First, to note some relative improvements:

- **Custody and Asset Segregation Rules:** In contrast to the Republican bill, the Democratic bill has specific rules requiring issuers to protect those assets they hold in custody from customers, with some restrictions on commingling of customer and company assets.
- **Fed veto of state issuers:** Compared to the Republican bill, The Democratic bill gives the Fed, as one primary federal regulator of issuers, power to decline applications of state stablecoin issuers (filed at the state level) prior to the issuer going on the market. This provision does appear to give a bit more weight to federal oversight of state issuers, in ways that could somewhat offset concerns about regulatory arbitrage between state and federal regimes.

It's unclear, however, how effective this would be in practice. The Fed has veto power but doesn't appear to have the ability to proactively and/or directly influence the evaluation of state issuers prior to actually reviewing completed applications (beyond some consultative powers). Thus, if that is the case, this power would not establish a 'floor' for federal oversight of state issuers, but more of a ceiling, which could limit its usefulness in ensuring issuers use the state application process to avoid more rigorous regulatory scrutiny.

- **A moratorium on endogenously collateralized stablecoins:** The bill would establish a moratorium on these types of stablecoins, more commonly known as 'algorithmic' stablecoins - and authorize a study of such coins for future consideration. These coins have consistently demonstrated fragility and instability that has resulted in harms to consumers - most famously with the collapse of Terra.

Second, we note concerns specific to the Democratic bill:

- **Over reliance on the Fed as the regulator as the default regulator for federally approved issuers.** The bill says the OCC, Fed and FDIC are the appropriate federal regulators. But it seems likely most non-bank issuers would seek or be qualified to apply with the Federal Reserve. The Democratic bill gives the Fed more ways to exert oversight over issuers than the Republican bill, including state issuers, and provides more details on how the Fed might evaluate federally licensed issuers.

But we remain concerned that, while the Fed has an important role to play in overseeing the systemic risks posed by stablecoins, in several respects it is sometimes ill-suited to conduct more direct supervision and oversight (as we've learned from the SVB collapse). In particular, the lack of statutory specifics in the bill around how supervision and examination by the Fed would occur raises questions - how feasible is it for the Fed to suddenly develop new, robust rules in a timely fashion for yet another novel class of assets with unique risks, yet pose a very small part of the financial ecosystem?

- **The State pathway for issuer registrations is too permissive, and lacks adequate federal oversight.** The bill as drafted provides an optional pathway for stablecoin issuers to become regulated under federal law, but continues to give states the authority to regulate stablecoin issuers on their own - albeit with some federal power to decline state issuers.

While it is possible the Fed might establish a regulatory framework that guards against regulatory arbitrage between federal and state pathways, we remain concerned that state issuers might use this framework more easily avoid meaningful federal oversight and seek out permissive, crypto-friendly regimes (such as Wyoming) that would provide issuers with a light-touch approval process.

- **The bill's language regarding the Bank Holding Company (BHC) Act's application to non-bank issuers is vague and may not provide a sufficient firewall.** While it is good to see language in the Democratic bill that speaks to and attempts to address BHC related issues, we remain concerned that language lacks sufficient clarity about how it would enable effective enforcement of the Bank Holding Company Act to prevent the co-mingling of commercial and banking activities.

For example, the bill designates IDI-affiliated issuers as subject to Bank Holding Company Act, prohibits non-financial commercial companies from controlling non-bank entities, and requires that affiliates of that entity be financial in nature. But there's no clear definition in this bill or elsewhere that articulates what 'financial in nature' might mean. And there's less in the bill about how non-financial companies might act (and be regulated as) so-called 'distributors' of stablecoins issued by non-bank entities - a marketing arrangement that has been a key feature of some prominent proposed stablecoin products, including Meta's (Facebook) proposal to distribute its Diem (previously Libra) coin in partnership with nominal issuers.

This lack of clarity is a significant concern given the very real interest of tech and commercial companies in securing market share in the private payment space, despite obvious concerns that such encroachment would pose in terms of economic concentration and collusion.

- **The bill's language regarding SEC or CFPB authority over stablecoins when traded or used as payments may be insufficient.** Unlike the Republican bill, the Democratic bill does have a section stating that nothing in the bill shall infringe on the

jurisdiction or authority of other regulators, including the SEC and CFPB, as appropriate. However, we are concerned that without additional explicit affirmation of how and when these regulators would have authority, this infringement language could be read too narrowly.

For example, at a minimum, the SEC should have jurisdiction over stablecoins when traded on secondary markets. Yet, without mentioning such in this bill, stablecoin issuers could challenge the SEC's attempts to exert jurisdiction once the law is enacted, citing lack of statutory clarity beyond this statement.

With respect to the CFPB, payment stablecoins are meant to be used as payments. As such, the consumer protection laws that the CFPB administers with respect to payment systems, such as the Electronic Funds Transfer Act, should apply. But there are no specific and/or explicit references to these and other key consumer protections relevant to payment systems in the bill. Without such explicit language, we're concerned the bill would enable issuers to evade or avoid such obligations, or might otherwise undermine the CFPB's role in protecting consumers from potential risks associated with these products.

- **The bill lacks sufficient statutory language regarding how and whether issuers would meet standards comparable to Community Reinvestment Act obligations and Community Benefit Agreements.** In contrast to the Republican bill which appears largely silent on these programs and requirements, the Democratic bill does appear to speak more directly to them. Specifically, the evaluation criteria the bill instructs federal regulators to use to evaluate applicants does provide some detail on how an issuer and its coin might contribute to a range of community benefits.

However, the language used isn't standardized or fully consistent with what's already in use with respect to these programs. As such, the new language could create confusion or uncertainty and ultimately might allow issuers to avoid some or much of what normal depository institutions are required to do under these programs. This in turn could affect overall funds available for these programs, if and when financial institutions took advantage and moved their business to the less rigorous stablecoin regime.

Lastly, we have a range of initial concerns with characteristics shared by both bills, including:

- **Insufficient Audit Requirements for Issuer Reserves.** Attestations are not the same as audits and are not adequate to provide real insight into the stability of a stablecoin issuer's reserve assets. There is ample literature that spells this out and demonstrates why relying on attestations is insufficient. Issuers should be subject to real, independent audits.
- **Lack of Deposit Insurance Requirements for Issuers:** The bill specifically states that stablecoins and their issuers are not insured deposits or deposit institutions. This is done in the name of differentiating stablecoin issuers as 'higher' risk, so that customers won't treat the coins they buy or use as such. But, given past misleading practices by crypto

asset firms, and given that there are already risks with customers using non-bank payment platforms effectively as they would depository instruments, our concern is that by allowing deposit-like instruments to not only be uninsured, but issued by banks who insure other deposits, will create confusion for customers, especially during periods of financial distress, and inevitably provide less protection for consumers that choose to purchase stablecoins that do not offer such insurance.

Unfortunately, the list of concerns above is not exhaustive. We are continuing to evaluate these bills and consult experts and allies regarding both bills' treatment of a number of issues, including: consolidated supervision; operational risks associated with cybersecurity and blockchain technology; interoperability standards; the adequacy of the bankruptcy protection provisions described in the bills; the lack of coverage of state issuers under Graham-Leach-Bliley; the requirement that federal regulators 'tailor' their regulations, rules, and examination procedures to 'unique aspects of crypto assets; the significant restrictions placed on federal regulators to not duplicate information requests when conducting supervision or regulatory oversight; the wisdom of authorizing credit unions to become issuers and the NCUA as a federal regulator, despite significant concerns about whether either is suited to the task; and other issues.

Given the wide range of concerns listed above, and because the use or theorized uses of stablecoins spans the gamut of financial sector activities (e.g. banking, consumer finance, investments, etc.), crafting legislation that would adequately address the risks associated with all of these activities is a complex and difficult endeavor that requires time and careful consideration.

We strongly urge the Committee to first seek to empower the regulators to use the tools currently at their disposal to address present risks associated with stablecoins, and only proceed with legislation that rigorously protects consumers and investors and prevents stablecoins from posing systemic threats to our financial system and economy.

Rather than seek to get 'something on the books' with respect to regulatory oversight, Congress should seek to get it right, and seek first to do no harm to existing regulatory frameworks.

We would be happy to speak further and at length with Members of your Committee and staff on these guiding principles in more detail.

Thank you.

Mark Hays
Senior Policy Analyst
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Fact Sheet: “Un” Stablecoins and Risks to Investors, Consumers, and Economic Productivity

“History doesn’t repeat itself, but it often rhymes”

The short history of stablecoins has been characterized by instability, bank-like runs, and the evaporation of tens of billions of dollars in investor losses. The use of the moniker “stablecoin” has become a misnomer in that these financial products are anything but stable. A more appropriate name would be “unstablecoins” considering how susceptible they are to bank-like runs and how often they depeg from their “stable” value. In fact, stablecoins are remarkably similar to money market funds – an industry that had to be bailed out by the federal government in 2008 and 2020 after experiencing bank-like runs. And despite industry fantasies and talking points touting stablecoins as an innovative and inclusive form of payment, stablecoins have not lived up to the hype as a payment mechanism outside the unregulated crypto ecosystem. In fact, more than 80 percent of the trade volume on major centralized exchanges involves stablecoins – demonstrating that their primary use case is simply trading activity for no purpose other than the pursuit of speculative profit.¹ However, despite their instability and lack of prowess as a form of payment, policymakers have debated codifying these money market fund-like products as a payment mechanism. For the reasons stated below, regulators and policymakers should stop and consider the risks to investors, consumers, and the economy before legislating stablecoins into a form of payments.

The Myth of “Stable” coins and Inherent Run Risk

Stablecoins are defined in President Biden’s Executive Order as “a category of cryptocurrencies with mechanisms that are aimed at maintaining a stable value, such as by pegging the value of the coin to a specific currency, asset, or pool of assets or by algorithmically controlling supply in response to changes in demand in order to stabilize value.”² The term “stablecoin” can refer to a number of different types of digital asset products, which all claim to maintain a stable value relative to a reference asset, often the U.S. dollar, but not exclusively. There are principally three different types of stablecoins:

- off-chain collateralized (fiat-based or commodity-based)
- on-chain collateralized (crypto-based); and
- non-collateralized (algorithmic).

¹ *Share of Trade Volume by Paid Denomination*, THE BLOCK (last visited May 16, 2023), <https://www.theblock.co/data/crypto-markets/spot/share-of-trade-volume-by-pair-denomination>.

² Exec. Order No. 14,067, Ensuring Responsible Development of Digital Assets, 87 Fed. Reg. 14,143, 14,152 (Mar. 14, 2022).

Despite stablecoins only having existed for a few years, all three types of stablecoins have exhibited bank-like run risk that is inherent in any financial product that is not guaranteed by a sovereign government. While each type of stablecoin presents differing degrees of run risk, they all present run risk, nonetheless. The President's Working Group on Financial Markets *Report on Stablecoins* identifies four specific ways confidence in stablecoins could be undermined and trigger bank-like runs:

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.³

We have already witnessed that many of these risk factors have already triggered runs on stablecoins within the past year alone. If stablecoins have proved anything over their short history, it is that they will experience bank-like runs and depeg. The questions regarding stablecoins have quickly become *when* will they depeg from their exchange rate, not *if* they will depeg, and what happens to token-holders in the aftermath.

Off-chain collateralized stablecoins.

Off-chain collateralized stablecoins are the most popular stablecoins. These stablecoins are designed to maintain a stable value in reference to a specific asset, often the U.S. dollar, with a fixed one-to-one exchange rate by holding in reserves various forms of traditional financial products (e.g., cash, U.S. treasury securities, commercial bonds, etc.). But there is often little transparency into the reserves held by stablecoin issuers. And stablecoin issuers are vulnerable to runs if customers lose faith in their reserves. What is more, most stablecoin issuers are not subject to federal regulations and protections designed to instill faith in an issuer's reserves, such as deposit insurance and portfolio restrictions.⁴ Issuers are also free to change the composition of their reserves or modify their disclosures without prior notice.⁵

Specifically, the two most prominent off-chain collateralized stablecoins, Tether (\$82.8 billion) and USDC (\$29.9 billion), make up about 80% of the market cap of all stablecoins.⁶ Tether reportedly⁷ holds a combination of cash and cash equivalents, corporate bonds, commodities,

³ President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins* 12 (November 2021).

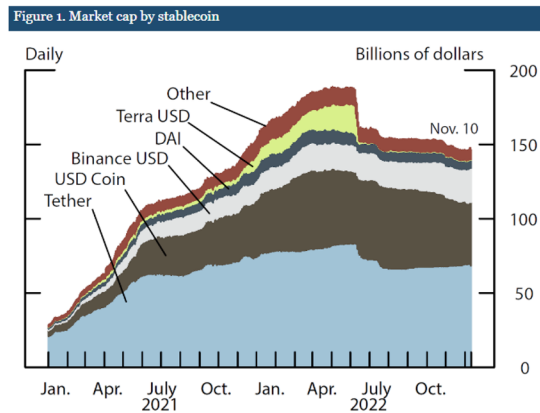
⁴ *Stablecoins: Legal Issues and Regulatory Options* (Part I), Congressional Research Service, June 9, 2022, <https://crsreports.congress.gov/product/pdf/L/SB/LSB10753>.

⁵ Wilmarth, Arthur E. Jr., Comment Letter to the U.S. Treasury Department regarding the Risks of Stablecoins (2022), https://scholarship.law.gwu.edu/faculty_publications/1623.

⁶ David Canellis, *Tether Nears 50% of Stablecoin Markets, Highest in 14 Months*, BLOCKWORKS (Feb. 13, 2023), <https://blockworks.co/news/tether-stablecoin-market-half>.

⁷ Tether has been fined by the NYAG and CFTC for lying about its reserves in the past. See Press Release, Attorney General James Ends Virtual Currency Trading Platform Bitfinex's Illegal Activities in New York,

and other cryptocurrencies in reserves to maintain its peg to the U.S. Dollar. For its part, USDC reportedly holds a more conservative mix of assets in reserves that includes cash and cash equivalents. However, it is important to remember that cash equivalents can include short-term investment securities with maturity periods up to 90 days, which are much more illiquid than the instant liquidity stablecoins offer to investors.



Source: Federal Reserve [The Fed - The stable in stablecoins \(federalreserve.gov\)](https://www.federalreserve.gov/monetarypolicy/stablecoins.htm)

Despite their market dominance, both stablecoins have experienced bank-like runs and depegged from their fixed exchange rate within the past 6 months. Tether, a stablecoin notorious for secrecy and misstatements about the status of their reserves, depegged in November 2022 after the failure of FTX. In the days after the collapse of FTX, Tether traded as low as 96 cents on the dollar.⁸ As a point of reference, in 2008, the Federal Reserve felt compelled to intervene and rescue the money market fund industry as it confronted funds facing less dramatic deviations from the dollar. Similarly, USDC depegged in March 2023 after the failure of Silicon Valley Bank, who held \$3 billion of USDC's reserves, dropping to as low as 85 cents on the dollar and experiencing \$6 billion in redemptions.⁹

NYAG (Feb. 23, 2021) ("Tether's claims that its virtual currency was fully backed by U.S. dollars at all times was a lie"), <https://ag.ny.gov/press-release/2021/attorney-general-james-ends-virtual-currency-trading-platform-bitfinex-illegal>; See also Press Release, CFTC Orders Tether and Bitfinex to Pay Fines Totaling \$42.5 Million, CFTC (Oct. 15, 2021) ("Tether has represented that the tether token is a stablecoin with its value pegged to fiat currency and 100% backed by corresponding fiat assets...However... Tether misrepresented to customers and the market that Tether maintained sufficient U.S. dollar reserves to back every USDT in circulation with the "equivalent amount of corresponding fiat currency" held by Tether and "safely deposited" in Tether's bank accounts. In fact Tether reserves were not "fully-backed" the majority of the time").

⁸ Crystal Kim, *Tether's USDT stablecoin depegs from dollar for a brief window*, AXIOS (Nov. 10, 2022), <https://www.axios.com/2022/11/10/tethers-usdt-stablecoin-depegs-from-dollar-for-a-brief-window>.

⁹ Olga Kharif, *Circle USDC Stablecoin Redemptions Rise to About \$6 billion*, BLOOMBERG (Mar. 21, 2023), <https://www.bloomberg.com/news/articles/2023-03-21/redemptions-rise-to-about-6-billion-from-circle-usdc-stablecoin?sref=mOvUqJZj>.

On-chain collateralized stablecoins.

On-chain collateralized stablecoins represent a much smaller subset of stablecoins in the market. Similar to off-chain collateralized stablecoins, on-chain collateralized stablecoins are designed to maintain a stable value in reference to a specific asset, often the U.S. dollar, with a fixed one-to-one exchange rate. However, instead of holding traditional financial products such as cash and bonds in reserves, they instead hold other cryptocurrencies in their reserves. So on-chain collateralized stablecoins introduce an additional weakness, as the collateral is another cryptocurrency whose value can fluctuate significantly relative to the U.S. Dollar.¹⁰ The largest on-chain collateralized stablecoin is MakerDAO's DAI (\$4.8 billion), which uses a system of smart contracts and user deposits of Ethereum in exchange for DAI stablecoin tokens. Despite the decentralized nature of DAI and the use of Ethereum as collateral for its stablecoins, the DAI stablecoin depegged in March 2023 after the collapse of Silicon Valley Bank to 88 cents on the dollar.¹¹

Non-collateralized stablecoins.

The most volatile and most dangerous of the three types of stablecoins are the non-collateralized stablecoins. Similar to off-chain and on-chain collateralized stablecoins, these stablecoins are designed to maintain a stable value in reference to a specific asset, often the U.S. dollar, with a fixed one-to-one exchange rate. However, instead of holding assets in reserves, non-collateralized stablecoins utilize complicated algorithms and smart contracts to maintain their peg to their reference assets.

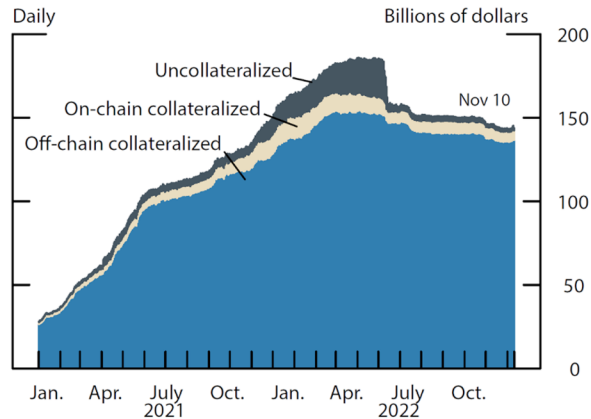
While these stablecoin witnessed the most growth in the first half of 2022, they also witnessed the most dramatic collapses of all stablecoins. The most prominent collapse, which triggered the crypto carnage of 2022, was that of TerraUSD. At its height, TerraUSD was a \$18 billion non-collateralized stablecoin that used a companion token, LUNA, to help it maintain a one-to-one peg with the U.S. dollar. However, this financial alchemy project blew up in a matter of days in May 2022. The crash in crypto markets that followed Terra's collapse inflicted painful losses on millions of retail investors.¹² The \$40 billion overnight collapse of both TerraUSD and LUNA caused widespread financial panic in the crypto ecosystem, spurring more than \$300 billion in losses in the aftermath, including notably FTX.¹³

¹⁰ Garth Baughman, Francesca Carapella, Jacob Gerszten, and David Mills, "The stable in stablecoins," FEDS Notes, Board of Governors of the Federal Reserve System (Dec. 16, 2022), <https://www.federalreserve.gov/econres/notes/feds-notes/the-stable-in-stablecoins-20221216.html>.

¹¹ Sam Reynolds, "DAI Depegs to Lifetime Lows as Stablecoin Rout Plagues Crypto," COINDESK (Mar. 11, 2023), <https://www.coindesk.com/markets/2023/03/11/dai-depegs-as-stablecoin-rout-plagues-crypto/>.

¹² Wilmarth, Arthur E. Jr., "Comment Letter to the U.S. Treasury Department regarding the Risks of Stablecoins" (2022), https://scholarship.law.gwu.edu/faculty_publications/1623.

¹³ Elizabeth Napolitano, "The Fall of Celsius Network: A Timeline of the Crypto Lender's Descent Into Insolvency," COINDESK (Jul 15, 2022), <https://www.coindesk.com/markets/2022/07/15/the-fall-of-celsius-network-a-timeline-of-the-crypto-lenders-descent-into-insolvency/>.



Source: Federal Reserve [The Fed - The stable in stablecoins \(federalreserve.gov\)](https://www.federalreserve.gov)

Redeemability Risks

In addition to the risk of stablecoins due to their stabilization mechanism, stablecoins contain other features that add to their riskiness. For instance, investors should be able to redeem their stablecoins at any moment and at par value to the referenced, fixed exchange rate. However, stablecoin issuers often constrain investors' right of redemption and offer insufficient public disclosure about their redemption terms. Currently, the two most prominent stablecoin issuers do not provide a direct right of redemption to investors because many of those investors purchase the stablecoin through unregulated cryptocurrency exchanges.¹⁴ In other cases, holders of stablecoins also face limits or high minimum thresholds for redemptions.¹⁵ This makes them unredeemable for the majority of ordinary retail users.¹⁶ Investors must pay particular close attention to the terms of service to ensure they understand their right of redemption, which is often mischaracterized by stablecoin issuers.

¹⁴ See Gary Gensler, Chairman, Sec. and Exch. Comm'n, Prepared Remarks of Gary Gensler on Crypto Markets at Penn Law Capital Markets Association Annual Conference (Apr. 4, 2022); *See, e.g.*, Circle Legal & Privacy (Last updated December 20, 2022), <https://www.circle.com/en/legal/usdc-terms> ("You may not redeem USDC with Circle unless and until you open a Circle Account. Eligibility for and requirements related to opening a Circle Account are set forth in the Circle Account User Agreement."); *See, e.g.*, Tether Legal (Last updated September 2, 2022) ("In order to cause Tether Tokens to be issued or redeemed directly by Tether, you must be a verified customer of Tether. No exceptions will be made to this provision"), <https://tether.to/en/legal/>.

¹⁵ *See* Tether Legal (Last updated September 2, 2022) ("Tether reserves the right to delay the redemption or withdrawal of Tether Tokens if such delay is necessitated by the illiquidity or unavailability or loss of any Reserves held by Tether to back the Tether Tokens"), <https://tether.to/en/legal/>.

¹⁶ Mitsu Adachi et. al, Stablecoins role in crypto and beyond: functions, risks, and policy, European Central Bank, https://www.ecb.europa.eu/pub/financial-stability/macroeconomic-bulletin/html/ecb.mpbu202207_2-836f682ed7.en.html#4%20Potential%20Risks%20to%20Financial%20Stability%20stemming%20from%20StableCoins.

Money Market Funds by Another Name

Much like an off-chain collateralized stablecoin, a money market fund is a financial services product that invests in short-term corporate and government debt securities while offering investors a stable value of exchange. Created in the 1970s, money market funds purported to offer investors higher returns than bank deposit accounts, while at the same time offering the same security as a bank account. Because of their stable value and higher rate of return, investors came to expect they could benefit from the same on-demand liquidity and protection from losses that they already received through bank deposit accounts. However, money market funds are unlike bank deposit accounts, which are facilitated and supported by extensive regulations that ensure the safety and soundness of banks and explicitly protect depositors from losses—from capital requirements that ensure the financial health of banks to federally-backed, bank-funded deposit insurance that protects depositors from losses should their banks fail. Money market funds do not have mandatory capital cushions, deposit insurance, or the other protections surrounding bank accounts. Thus, despite the purported stable value offered to investors by money market funds, in times of stress they have experienced bank-like runs requiring government bailouts.

During the Financial Crisis of 2008 and the COVID-19 panic in the markets in March 2020, money market funds “broke the buck” from their fixed exchange rates. During the week of September 15, 2008, investors withdrew approximately \$310 billion (or 15 percent) of prime money market fund assets. This caused havoc in the short-term funding markets, triggering a vicious cycle of asset fire sales, depressed prices, redemption requests, more asset fire sales, and rapidly evaporating liquidity. Controlling the run required drastic government (and taxpayer) intervention: the Treasury, on September 19, 2008, established the Temporary Guarantee Program for Money Market Funds, and the Federal Reserve established a variety of facilities to support the credit markets frozen by the money market fund crisis.

Once again, in March 2020, the money market fund industry experienced financial stress and the corresponding contagion imperiled the markets broadly and forced government intervention. For the second time in just a dozen years, taxpayer money had to be put at risk to support a backstop of money market funds. The assets of prime money market funds dropped dramatically. For example, ICI data showed that prime money market fund assets overall dropped by \$85.38 billion, or over 10%, just between March 4 and March 18, 2020. Some funds were faring much worse, with their assets falling by half as investors withdrew.¹⁷ And many money market fund sponsors were being forced to backstop their money market funds with cash infusions to prevent them from “breaking the buck” as they sold assets to meet redemptions when all asset classes were falling in value. The situation became so grim that on Wednesday, March 18, 2020, the Federal Reserve established an emergency lending facility so that banks could buy more assets from prime funds, thus injecting desperately needed cash, preserving the ability of money market

¹⁷ Paul Kiernan, Andrew Ackerman & Dave Michaels, *Why the Fed Had to Backstop Money Market Funds, Again*, WALL ST. J. (Mar. 21, 2020), https://www.wsj.com/articles/why-the-fedhad-to-backstop-money-market-funds-again-11584788401?mod=article_inline.

funds to honor redemptions, and supporting the commercial paper market upon which so many companies rely.¹⁸ And, the \$2 trillion rescue legislation passed in early 2020 renewed the Treasury Department's authority to guarantee the money market fund industry again. This put the full faith and credit of the United States behind a single financial product, just as the government—and the taxpayers—did in 2008.

One of the purported benefits of money market funds to investors is the higher rate of return than bank deposit accounts. A big distinction between money market funds and some of the most prominent stablecoins is that money market funds actually return interest to its investors. Investors in Tether and USDC receive none of the interest that the pooled assets collect. Instead, those assets go right to Tether and USDC's bottom line. Even a conservative investment portfolio of short-term U.S. Treasury bills can yield between 2-4%, which for an \$80 billion investment portfolio can mean billions of dollars in profits that investors of stablecoins are forgoing. For example, Tether claimed to make \$1.4 billion in net profit last quarter alone, all forgone interest income from its investors.¹⁹ Compared to the \$2.36 billion in net income Mastercard made last quarter, stablecoins are quickly catching up to major credit card companies in gouging their consumers.

The short history of stablecoins and the much longer history of money market funds have confirmed that these similarly designed products—offering instant liquidity to investors despite holding much longer duration assets—are susceptible to bank-like runs, especially during periods of financial stress. However, unlike bank deposits accounts, investor assets are not insured by the FDIC. Further, the recent volatility in the regional banking sector, specifically the runs on banks with high percentages of uninsured deposits, is further proof that any financial product will be subject to bank-like runs absent a federal guarantee. Stablecoins have already faced significant bank-like runs in their short history and have proven that during times of financial stress they are anything but “stable.”

The Misguided Lure of Private Money

Since the announcement of Facebook's Project Libra in June 2019, which sought to create a blockchain-based stablecoin payment system, regulators and policymakers have grappled with the idea of a blockchain-based stablecoin. In the midst of the announcement, governments around the world and policymakers in the U.S. expressed concern with the project on a bipartisan basis. For example, Chairwoman of the House Financial Services Committee, Maxine Waters, said in a statement that “[r]egulators should see this as a wake-up call to get serious about privacy and national security concerns, cybersecurity risks, and trading risks that are posed by cryptocurrencies.” Additionally, even then-President Donald J. Trump tweeted that “[i]f

¹⁸ James Politi, Federal Reserve sets up facility to make loans to banks, FIN. TIMES (Mar. 19, 2020), <https://www.ft.com/content/0e6029be-6995-11ea-800d-da70cffe4d3>.

¹⁹ Tether, Tether's Latest Q1 2023 Assurance Report Shows Reserves Surplus At All-Time high of \$2.44B, up \$1.48B in Net Profit; New Categories for Additional Transparency Reveals Bitcoin and Gold Allocations, (May 10, 2023), <https://tether.to/en/tethers-latest-q1-2023-assurance-report-shows-reserves-surplus-at-all-time-high-of-244b-up-148b-in-net-profit-new-categories-for-additional-transparency-reveals-bitcoin-and-gold-allocations/>.



Facebook and other companies want to become a bank they must seek a new [b]anking [c]harter and become subject to all [b]anking [r]egulations.” Facing extensive backlash, Facebook later abandoned its initiative to issue a private, global currency.

However, despite that announcement by Facebook and the severe backlash by governments around the world, the use of stablecoins have risen in prominence, although only as a means of facilitating trading in cryptocurrencies. Nevertheless, stablecoin advocates have advanced the theory that stablecoins could be an effective form of payment for a broader spectrum of assets. Now, regulators and policymakers are debating how to regulate stablecoins as “payment stablecoins” even though they are not currently used as a form of payment outside the incestuous world of crypto. Moreover, both regulators and policymakers have skipped the more important threshold question of whether or not it is desirable to have a form of currency controlled by a private company coexisting with the U.S. dollar, a sovereign currency controlled and issued by the U.S. government. For instance, banks use customer deposit funds to make loans to individuals in their community, spurring economic activity. Additionally, tying up safe and liquid assets in a stablecoin arrangement means they are not available for other uses, such as helping banks satisfy their regulatory requirements to maintain sufficient capital and liquidity. This could lead to disruptive shortages of safe and liquid assets.²⁰ Have regulators or policymakers explored the primary and secondary economic effects of a migration of customer funds out of banks and into digital wallets? What are the effects on bank lending to prospective homeowners to purchase their first house or the effects on small business lending for innovative entrepreneurs seeking to start their own business? These are important economic considerations being glossed over in this debate over how to regulate payment stablecoins.

There is a reason why privately issued currencies are not prominent in the U.S. economy and it isn’t because they have never been attempted. Prior to enactment of the National Banking Act of 1863, private banks issued their own bank notes on a one-for-one basis with state bonds in a period known as the Free Banking Era.²¹ However, these hyper-localized currencies required merchants to be wary when accepting bank notes for fear of counterfeiting.²² The inefficient Free Banking Era was replaced when the National Bank Act required all notes to be backed by U.S. Treasury bonds and the taxation of all forms of private bank notes. Another example of private currencies in the U.S. was the use of company scrip in remote towns across the country. Scrip was a credit for wages and it was often used in remote towns where money supply was scarce and a single private enterprise such as a mining company was the central employer. Private companies used scrip as a credit to employees on their earned wages to spend at the local company-owned shops. It quickly became a trap employers used to exploit their workforces that was largely outlawed by the Supreme Court in 1918.

²⁰ Rod Garratt, Michael Lee, Antoine Martin, and Joseph Torregrossa, *The Future of Payments is Not Stablecoins*, Liberty Street Economics, Federal Reserve Bank of New York (Feb. 7, 2022), <https://libertystreeteconomics.newyorkfed.org/2022/02/the-future-of-payments-is-not-stablecoins/>.

²¹ Gary B. Gorton and Jeffrey Y. Zhang, *Taming Wildcat Stablecoins*, 90 UNIV. OF CHICAGO L. REV. at 25 (Forthcoming 2023).

²² Gorton and Zhang at 29.



Regulators and policymakers should first debate whether or not private currencies as a form of payments, such as stablecoins, are in the best interest of the American people prior to codifying stablecoins as a form of payments. Private currencies have been tried in the U.S. before and abandoned because they were either too inefficient or because they were used by private enterprise to exploit their workers. Payment stablecoins appear to be repeating the mistakes of the past.



Better Banks | Better Businesses

Better Jobs | Better Economic Growth

Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

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

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buy-side and protect investors and consumers.

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National Association of Federally-Insured Credit Unions

May 17, 2023

The Honorable French Hill
Chairman
Committee on Financial Services
Subcommittee on Digital Assets,
Financial Technology, and Inclusion
United States House of Representatives
Washington, DC 20515

The Honorable Stephen Lynch
Ranking Member
Committee on Financial Services
Subcommittee on Digital Assets,
Financial Technology, and Inclusion
United States House of Representatives
Washington, DC 20515

Re: Tomorrow's Hearing: "Putting the 'Stable' in 'Stablecoins:' How Legislation Will Help Stablecoins Achieve Their Promise"

Dear Chairman Hill and Ranking Member Lynch:

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 stablecoins. NAFCU advocates for all federally-insured not-for profit credit unions that, in turn, serve over 135 million consumers with personal and small business financial service products.

NAFCU appreciates the continued work of the Subcommittee in examining the integration of digital assets into traditional financial products, including the creation of stablecoins. As we have previously shared, we appreciate that both drafts of legislation noticed for this hearing use definitions of an insured depository institution (IDI) that include credit unions and definitions of federal banking regulators that include the National Credit Union Administration (NCUA). However, the Subcommittee must be careful not to unintentionally create an uneven playing field among credit unions, banks, and non-depository institutions by establishing chartering and enforcement provisions based solely on the Federal Deposit Insurance Act, with which the NCUA cannot strictly comply. The Subcommittee should also be cautious of granting bank-like chartering privileges to entities not offering insured deposits or engaged solely in stablecoin activities if doing so compromises safety and soundness. Along those lines, we have concern with the language found on the May 11th discussion draft noticed for this hearing that would seem to open the door for a special purpose "fintech" charter on page 24. We have concerns about this section and would urge better clarity before this draft moves forward.

To operate most efficiently, regulatory frameworks for stablecoins should acknowledge the NCUA's role as the primary financial regulator for credit unions. Establishing barriers to credit union engagement with digital assets would undercut many of the financial inclusion benefits that may be realized through related technologies. The credit union industry has a long history of prioritizing the needs of underserved and low-income communities and desires to continue this important work. While the bills generally recognize this, we have particular concern with language found in the May 11th discussion draft under subclause VIII on page 34 that clarifies supervisory and consumer protection requirements for functionally regulated custodians. This language appears to exclude credit unions because it cross-

The Honorable French Hill
 The Honorable Stephen Lynch
 May 17, 2023
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references a “primary financial regulatory agency” as described “under subparagraph (A), (B), or (C) of section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12))” and this section of the Dodd-Frank Act does not explicitly reference the NCUA. We would urge you to amend this language before advancing this draft.

NAFCU also supports enforcement and examination being left up to existing regulators—in the case of credit unions, the NCUA—as well as establishing a basic framework for oversight of non-depository stablecoin issuers.

Finally, we would like to take this opportunity to reiterate our strong opposition to creating a Central Bank Digital Currency (CBDC). NAFCU believes that any advantages of a CBDC are outweighed by a multitude of risks, including those related to consumer privacy, financial stability, misallocation of Federal Reserve resources, and government intrusion into banking services traditionally provided by the private sector. Whatever benefits CBDC might hypothetically provide can be achieved more reliably and with less risk using existing financial sector infrastructure, including the Federal Reserve’s soon-to-launch FedNow service. Furthermore, studies that consider the role of a CBDC in relation to other countries’ use of digital currency—particularly China—tend to overlook critical issues around privacy and have not fully considered whether adoption of digital currency in foreign jurisdictions serves primarily a surveillance purpose. Given the strong position of the U.S. dollar today and public wariness of CBDC as a surveillance tool, near-term attention should be devoted instead to policy actions that can strengthen institutions like credit unions that stand ready to offer affordable and safe financial products and services to millions of Americans without fear of financial institutions acting as a government monitor.

Notwithstanding our concerns over a CBDC and our additional comments above, we are generally supportive of both legislative approaches for stablecoins that were noticed for this hearing. We believe that any study of CBDCs will confirm our concerns and further prove the need for stablecoins as a trusted means of real time settlements.

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 Senior Associate Director of Legislative Affairs, at (703) 258-4981 or lplush@nafcuh.org.

Sincerely,



Brad Thaler
 Vice President of Legislative Affairs

cc: Members of the Subcommittee on Digital Assets, Financial Technology, and Inclusion

**Questions for the Record from Ranking Member Maxine Waters
Subcommittee Hearing, entitled “Putting the ‘Stable’ in ‘Stablecoins:’ How Legislation
Will Help Stablecoins Achieve Their Promise”
Thursday, May 18, 2023 9am**

Ms. Fennie Wang

1. Which of the following options best describes your self-identified race? (you may choose more than one)
 - a. White or Caucasian
 - b. Black or African American
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
2. Which of the following options best describes your gender identity?
 - a. Woman
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Mr. Matt Homer

1. Which of the following options best describes your self-identified race? (you may choose more than one)
 - a. White or Caucasian
 - b. Black or African American
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
 - a. Woman
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Mr. David Portilla

3. Which of the following options best describes your self-identified race? (you may choose more than one)
- a. White or Caucasian
 - b. Black or African American
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
4. Which of the following options best describes your gender identity?
- a. Woman
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Mr. Robert Morgan

3. Which of the following options best describes your self-identified race? (you may choose more than one)
 - a. White or Caucasian
 - b. Black or African American
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)
4. Which of the following options best describes your gender identity?
 - a. Woman
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Ms. Delicia Reynolds Hand

1. Which of the following options best describes your self-identified race? (you may choose more than one)
 - a. White or Caucasian
 - b. Black or African American**
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
 - a. Woman**
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Statement for the Record of Steven L. Schwarcz, the Stanley A. Star Distinguished Professor of Law & Business, Duke University School of Law, for the May 18, 2023 Stablecoin Hearing, U.S. House of Representatives, Financial Services Committee, Digital Assets Subcommittee

INTRODUCTION

The principal challenge for digital, or electronic, currencies is facilitating day-to-day retail payments, in order to improve speed, reduce costs, and increase consumer financial access. Businesses already quickly and efficiently send large “wholesale” payments electronically through Fedwire, SWIFT, and other electronic wire-transfer systems.

The Federal Reserve could simply and cost-effectively utilize these existing wire-transfer systems to implement a retail central bank digital currency, or CBDC.¹ Although such a CBDC would require consumers to have bank accounts, consumers could use their ordinary commercial bank accounts.² Still, that could potentially limit financial access to the unbanked.

Stablecoins represent nongovernment-issued “currencies”³ that are backed by—that is, exchangeable for—highly liquid assets (sometimes called “reference assets”) that have intrinsic value.⁴ Being cryptographically recorded, their transfer does not require the use of bank

¹ See Steven L. Schwarcz, *Regulating Digital Currencies: Towards an Analytical Framework*, 102 BOSTON UNIVERSITY LAW REVIEW 1037, 1051-55 (2022) (hereinafter, “*Regulating Digital Currencies*”).

² *Id.*

³ Stablecoins represent currencies insofar as they operate as a medium of exchange to facilitate the sale of goods and services and to otherwise make payments and satisfy debts. *Id.* at 1046. That function does not depend on a stablecoin being seen as “legal tender.” See Steven L. Schwarcz, *Regulating Global Stablecoins: A Model-Law Strategy*, 75 VANDERBILT LAW REVIEW 1729, 1747-48 (2022) (hereinafter, “*Regulating Global Stablecoins*”) (observing, among other things (*id.* at 1747 n.113), that the United States does not limit the medium of legal payment; rather, it allows any commercially reasonable and widely accepted medium to be used for payment).

⁴ Stablecoins contrast sharply with bitcoin and other nongovernment-issued digital “currencies” that are *not* backed by reference assets. Those generic cryptocurrencies have unpredictably fluctuating values, which makes it difficult for consumers to use them on a daily basis as an alternative to cash; a successful retail currency should have a stable value. *Regulating Global Stablecoins*, *supra* note 3, at 1736-37.

Statement of Schwarcz re H.R. Stablecoin Bill - May 2023

accounts. (A CBDC could also be designed to be cryptographically recorded and thus not require the use of bank accounts.⁵)

Not being government issued, stablecoins present complex and novel domestic and, when used for making international payments, cross-border regulatory challenges. This Statement for the Record focuses on the domestic regulation of stablecoins that are intended to be used as mediums of exchange. This Statement also concerns a Discussion Draft of a Bill to “provide for the [effectively, domestic] regulation of payment stablecoins, and for other purposes” (hereinafter, the “Bill”).⁶

If interested, please note that I have separately analyzed in detail the possible cross-border regulation of stablecoins.⁷

OVERVIEW OF REGULATORY CHALLENGES

The principal challenges for the domestic regulation of stablecoins include protecting consumers and their privacy, protecting monetary integrity (including prohibiting money laundering and restricting the financing of terrorism and weapons proliferation that could threaten national security), protecting against breaches of cybersecurity and failures of operational resilience, and protecting against factors that could undermine financial stability or otherwise threaten the broader financial system.⁸

Of these challenges, the most fundamental to the nature of stablecoins is their underlying financial stability. Consumers could lose confidence in a stablecoin due to the issuer’s inability

⁵ See *Regulating Digital Currencies*, *supra* note 1, at 1051-55.

⁶ Bill § 2(13)(A), at p. 4, lines 10-11. *Cf. supra* note 3 (observing that stablecoins would represent currencies if they operate as a medium of exchange).

⁷ See *Regulating Global Stablecoins*, *supra* note 3.

⁸ See, e.g., PRESIDENT’S WORKING GRP. ON FIN. MKTS., FED. DEPOSIT INS. CORP. & OFF. OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS 1, 3 (2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf [<https://perma.cc/2A79-AL95>]; *Regulating Global Stablecoins*, *supra* note 3, at 1743-44.

to timely redeem the stablecoin for its underlying reference asset.⁹ Consumer could even lose confidence due to doubt about that ability.¹⁰ That loss of confidence could trigger a run on the issuer that resembles a classic bank run: the issuer may well be unable to obtain sufficient reference assets in time to satisfy correlated demands by stablecoin holders.¹¹

I have separately proposed possible text for a model law to regulate stablecoins.¹² That text includes various ways to protect against the aforesaid run risk, including by collateralizing the redemption obligation by segregated investment-grade short-term money market instruments or by making stablecoins the equivalent of insured deposits.¹³ That text also includes protections against the other above-referenced regulatory challenges.

The text of my model law is “generally consistent with the principles and recommendations advanced by the world’s leading central banks [including the U.S. Federal Reserve] and multinational financial organizations [including the Bank for International Settlements (BIS) and the G20’s Financial Stability Board]” for regulating stablecoins.¹⁴ For that reason, I will reference the model law’s text as applicable when analyzing the Bill, below.

ANALYSIS OF THE BILL

The Bill protects against certain of the above identified regulatory challenges. I next address each such regulatory challenge. Thereafter, I provide some additional observations.

REGULATORY CHALLENGES

⁹ *Regulating Global Stablecoins*, *supra* note 3, at 1758.

¹⁰ *Id.*

¹¹ *Id.*

¹² See Appendix – Proposed Text for a Model Law, *Regulating Global Stablecoins*, *supra* note 3, at 1778-85.

¹³ *Id.* at 1758-59 & 1782.

¹⁴ *Id.* at 1778.

Protecting against factors that could undermine financial stability or otherwise threaten the broader financial system. Section 4(a)(1) of the Bill (at pp. 8-9) reasonably requires permitted stablecoin issuers to “maintain reserves backing the issuer’s payment stablecoins outstanding on an at least one to one basis” with reasonably liquid assets. You may wish to analyze, however, whether 90-day maturity Treasury bills would enable an issuer to timely meet a run.

Section § 4(a)(3) of the Bill (at pp. 10-11) appropriately contemplates the possible issuance of capital, liquidity, and risk-management regulatory requirements. The “may not exceed what is sufficient” language is odd, though. Although that language may well be politically motivated, I’d have preferred “is sufficient.” Also (and though I recognize the political backlash against creating moral hazard), I wonder whether some government entity should serve as a discretionary emergency liquidity provider, as I have separately proposed for consideration.¹⁵

The Bill also lacks a clear mechanism for the government to restrict stablecoin issuance and use in order to protect monetary policy.¹⁶

Protecting consumers. I did not see any consumer protection provisions in the Bill. That may well be because the U.S. Electronic Fund Transfer Act¹⁷ already provides at least some protection.¹⁸ Section 3.02 of my proposed model law provides possible comparative consumer-protection text.¹⁹

A question might arise whether the Bill should require segregation (and prohibition against commingling) of customer assets. I do not believe that would be relevant because stablecoin issuers would not, in their capacity as issuers, operate as exchanges or hold (in a

¹⁵ *Cf. Regulating Global Stablecoins*, *supra* note 3, at 1761-62 & 1781.

¹⁶ *Cf. id.* at 1767-68 & 1781 (discussing how to protect monetary policy).

¹⁷ 15 U.S.C. § 1693.

¹⁸ *Cf. Regulating Global Stablecoins*, *supra* note 3, at 1751 (discussing consumer protections for stablecoins).

¹⁹ *Id.* at 1782.

custodial capacity or otherwise) or trade customer assets. The relevant segregation requirement regards collateral being used to satisfy the redemption obligation.²⁰

Protecting privacy. I did not see any privacy protections in the Bill.²¹ Section 3.03 of my proposed model law provides possible comparative privacy-protection text.²²

Protecting monetary integrity. I did not see any provisions in the Bill prohibiting money laundering or restricting the financing of terrorism and weapons proliferation that could threaten national security. That may well be because the U.S. government already is committed to observe (and separately will be observing) the Financial Action Task Force's recommendations to implement these types of protections.²³ Section 3.05 of my proposed model law provides possible comparative text regarding anti-money-laundering and related protections.²⁴

Protecting against breaches of cybersecurity and failures of operational resilience. I did not see these types of protections in the Bill.²⁵ Section 3.04 of my proposed model law provides possible comparative text regarding these types of protections.²⁶

ADDITIONAL OBSERVATIONS

I support § 2(7) of the Bill (at p. 3), which allows nonbank entities to be approved by the primary Federal payment stablecoin regulator. Allowing “nonbanks to become stablecoin issuers” would “provide[] additional commercial flexibility for experimentation and innovation.”²⁷

²⁰ See *supra* note 13 and accompanying text.

²¹ Cf. *Regulating Global Stablecoins*, *supra* note 3, at 1752 (discussing privacy protections for stablecoins).

²² *Id.* at 1782-83.

²³ Cf. *id.* at 1753-54 (discussing monetary integrity protections for stablecoins).

²⁴ *Id.* at 1783-84.

²⁵ Cf. *id.* at 1755-58 & 1783 (discussing cybersecurity and operational resilience protections for stablecoins).

²⁶ *Id.* at 1783.

²⁷ *Id.* at 1749.

I am concerned that the “unsafe or unsound” standard of § 5(a)(4)(C) of the Bill (at p. 15, lines 12-15) is too weak to enable denial of an application to entities that lack integrity, reliability, or stability.²⁸ At the very least, that language of the Bill appears to invite litigation; an approved stablecoin issuer should have standards that exceed not merely being unsafe or unsound.

It is unclear why the Bill fails to cover the right to trade stablecoins or otherwise to engage in stablecoin-related services or other activities.²⁹

Questions may arise regarding state approval of stablecoin issuers. I have not yet reviewed the interaction between the Bill’s federal and state approval process sufficiently to express a view.³⁰

There might be concern that the Bill does not explicitly address the ability of large commercial retailers to issue their own stablecoins. The Bill implicitly addresses that concern, however, by making it unlawful for any person other than a “permitted payment stablecoin issuer” to issue a payment stablecoin.³¹

There also might be concern that the Bill does not explicitly address algorithmic stablecoins. Algorithmic stablecoins are stablecoins that are backed by reference assets that are crypto-assets.³² The Bill implicitly addresses that concern, however, by limiting the reference assets to specific high quality short-term assets that do not include crypto-assets.³³

²⁸ *Cf. id.* (discussing the importance of a stablecoin issuer having integrity, reliability, and stability).

²⁹ *Cf. id.* at 1750 & 1779-80 (discussing regulating the right to trade stablecoins).

³⁰ I note, however, that giving the Federal Reserve Board the option to decline any state-approved issuer would (at least to that extent) reduce state regulatory autonomy.

³¹ Bill § 3, at p. 8, lines 7-9.

³² The required collateral reserves would then vary on a dynamic basis based on the changing market value of those crypto-assets.

³³ Bill § 4(a)(1)(A), at pp. 8-9, lines 16-24 & 1-3, respectively.

The following additional observations are more technical.

Sec. 3, p. 8, line 9 of the Bill: Should the phrase “use by any person in the United States” be expanded? For example, should non-permitted persons have the right to issue a stablecoin that is used by persons outside the United States to make payments within the United States?

Sec. 6(b)(5)(A), p. 27, line 18 of the Bill: Change “issued” to “issued or outstanding.”

Sec. 10, p. 35, lines 16-25 of the Bill: Is “insolvency” too limited? Also, in line 23, consider changing “from” to “by.” In lines 24-25, should stablecoin holders have priority over, for example, depositors? Also, should stablecoin holders have priority over state-law perfected secured creditors?

Respectfully submitted,

A handwritten signature in black ink, appearing to read "H. J. Schwartz", is written over a horizontal line. The signature is fluid and cursive, with a long, sweeping underline that extends to the right.

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