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.

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