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The Honorable Patrick McHenry
Chair
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Re: Opposition to H.R. 4766, the "Clarity for Payment Stablecoins Act of 2023"

July 25, 2023

Dear Chair McHenry and Ranking Member Waters,

We write to you today regarding H.R. 4766, the Clarity for Payment Stablecoins Act of 2023. Earlier this year, we submitted a statement for the record to the Subcommittee in response to its May 18th hearing on stablecoins, where we shared our analysis and concerns regarding two different versions of these bills being discussed by the Committee.

Since that time, H.R. 4766 has been formally introduced and slated for mark-up this week. As you know, this version of the bill contains features that are more like those found in the version introduced earlier by Chair McHenry, though it does reflect changes made presumably in response to language or concepts first presented this year int the version offered by Ranking Member Waters. We also understand that negotiations between members of the Committee and relevant state and federal agencies are ongoing and may result in further changes to the draft in the lead up to the mark-up.

We recognize the efforts by members of the Committee to seek a proposal that would address the need for regulatory oversight of this less than stable asset class. We also recognize negotiations about this bill are ongoing. Nevertheless, we write today to oppose H.R. 4766 as introduced, and urge members of the Committee to vote against the bill, or any version of the bill that fails to adequately address the concerns raised here, during this week’s scheduled mark-up.

We outline our reasons for opposing the bill below; this list touches on fundamental issues, but it is not exhaustive.

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Flaws in H.R. 4766, the Clarity for Payment Stablecoins Act of 2023

The state pathway for issuer registration and approval is too permissive and lacks adequate federal oversight. For stablecoins approved by state regulators, the bill largely leaves supervision and examination authority to the states and creates a path for the Federal Reserve to step in only in exigent circumstances. Not only does this mean the Fed would have even less power to intervene should market-wide instability occur; it also appears to mean that a variety of actors, including money services businesses, could qualify as state-approved stablecoin issuers. If the goal of this bill is to ensure stablecoin issuers are regulated in a manner similar to banking institutions, including prudential oversight, we believe the state issuer path offers too much leeway and insufficient standards for the entities that would become issuers. This would subject users to more risks, fewer protections and overall result in less oversight and accountability for issuers.

Critically, we believe this would also make it easier for large tech firms to secure approval to become stablecoin issuers, setting the stage for large commercial firms to become de facto issuers of private money on a global scale without the accompanying adequate oversight. Not only does this increase the ballooning economic concentration among large firms, but also increases market risk, and privacy concerns associated with data tracking of consumer transactions via stablecoins issued on public blockchains.

Fed regulation of non-bank stablecoin issuers appears vague and may be ill-fitted to provide effective oversight. The bill names FDIC, OCC, and the Federal Reserve as primary regulators for federally approved stablecoins – with FDIC and OCC largely responsible for issuers that are IDI subsidiaries and the Fed responsible for non-bank issuers. In a previous version of the bill, each agency was directed to evaluate issuers based on a set of criteria specific to that agency. In this version, it appears the criteria has been set the same for each agency. These criteria appear both broad yet vague, and the passage does not contain language in previous drafts that at least attempted to incorporate more specific evaluation criteria with respect to community benefits and range of other criteria that at least mirrored how banking institutions are evaluated in a similar fashion.

This vague set of criteria feels particularly concerning with respect to the Fed and its oversight of non-bank issuers. While the Fed has an important role to play in overseeing the systemic risks posed by stablecoins (as above), in several respects it is sometimes ill-suited to conduct more direct supervision and oversight (as we've learned from the SVB collapse) - especially when Congress passes legislation to restrict the Fed's ability to intervene, as in 2018.[1]

In particular, the lack of statutory specifics in the bill around how supervision and examination by the Fed would occur (largely left to rulemaking) 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 that pose unique risks, but are still a very small part of the financial ecosystem? In other areas of policy, there are similar rules still yet to be written by the Fed, years after passage of legislation that directed them to do so.

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[1] https://rooseveltinstitute.org/2023/03/15/how-2018-regulatory-rollbacks-set-the-stage-for-the-silicon-valley-bank-collapse-and-how-to-change-course/

There is serious reason to worry that under this model the Fed would play a largely reactive role, cleaning up the failures of stablecoins after they have collapsed, rather than the proactive one of preventing faulty issuers from spreading contagion. And, given that less proactive regulatory oversight is likely to be more preferred by issuers, we remain concerned that given a choice between applying to issue stablecoins at the federal either as a subsidiary of an IDI or as a non-bank entity, more applicants will be likely to choose the non-bank route, which likely means oversight of more federally issued coins would fall to the Federal Reserve.

This version of the bill appears to allow federal and state regulators to, beyond a set class of defined assets, approve at their discretion a wider range of potential assets or investments for use as stablecoin reserves. The history of stablecoins is replete with use of unreliable assets - from other crypto assets to riskier traditional assets such as commercial paper - most famously by Tether. Earlier drafts of this bill limited reserve assets to a narrower set of more stable, government backed assets, minimizing risks associated with fluctuations in interest rates. Even with the safest assets, the collapse of SVB demonstrates that market conditions can force depositors to receive significant haircuts unless there is government intervention, which is why deposit insurance and bankruptcy remote provisions are important consumer protection features found within the banking system (neither of which is adequately addressed with this legislation). This bill, however, appears to be moving in the opposite direction. This increases the chance that would-be stablecoin issuers will forum shop to find the jurisdiction willing to approve coins backed by less stable assets.

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, third-party independent audits and examinations. Yet, the bill relies on an attestation model to evaluate and oversee the quality and quantity of stablecoin issuer's assets - even though the industry has often demonstrated its failure to ensure its coins are fully collateralized.

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 will not treat the coins they buy or use as deposits. 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.

The bill appears silent on Glass Steagall/Bank Holding Company Act concerns. HR 4766 as introduced contains no language that addresses concerns that large commercial non-financial entities (such as a Wal-Mart) 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 bill appears silent on rules, requirements and procedures related to mergers and acquisitions. This bill is 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 bill appears to strip or diminish SEC authority over stablecoins if/when traded on secondary markets. H.R. 4766 as introduced 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 further erode securities regulators' authority over the investment and secondary trading activity.

The 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 bill appears 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 do not 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, H.R. 4766 as introduced is silent on this topic, which raises concerns about whether approved issuers would be 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.

Conclusion

As we write this letter, tech industry news coverage is dominated by the newly rebranded Twitter platform's (now known as "X") ambitions to become an "everything" app. X CEO Linda Yaccarino posted on X (Twitter) that "X is the future state of unlimited interactivity – centered in audio, video, messaging, **payments/banking** – creating a global marketplace for ideas, goods, services, and opportunities.(*emphasis added)*"[2]

While this vision was delivered with the typical grandiose rhetoric often heard from tech moguls, it appears that with respect to payments, this may be no idle proposition: last month, then Twitter

[2] https://twitter.com/lindayacc/status/1683213895463215104?s=20

successfully received money-service business licenses from three states, with more potentially in the offing.[3]

Were the bill proposed here to pass Congress today, our concern is that the bill's provisions would make it significantly easier for a tech company like Twitter/X to establish itself as a global payments provider via the issuance (directly or indirectly) of a stablecoin; a dicey proposition in general, and a frightening proposition given the way in which this bill would likely fail to give regulators the necessary tools and authority to reign in the risks such a scenario might pose.

We urge the committee to reconsider this proposal, and instead to pursue policy measures - either alternative legislative proposals or enhanced engagement and coordination with federal regulators - that will adequately address the risks we know stablecoins pose to customers, investors, markets, and communities.

Thank you.

Mark Hays

Senior Policy Analyst, Fintech

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[3] https://cointelegraph.com/news/twitter-receives-money-transmitter-licenses-three-us-states