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

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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

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<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.