



## **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 Consortium<sup>1</sup> 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.

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<sup>1</sup> 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.<sup>2</sup>

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.<sup>3</sup> 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.

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

<sup>3</sup> 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.”<sup>4</sup> 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.

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<sup>4</sup> 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%.<sup>5</sup> 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."<sup>6</sup>

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.

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

<sup>6</sup> 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.<sup>7</sup> To date, no clear set of expectations has been determined for regulatory approval and few approvals have been given.

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<sup>7</sup> 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.<sup>8</sup>
- Federal Reserve Policy Statement and Final Rule (1/27/23, 2/7/23): The Federal Reserve issued a policy statement,<sup>9</sup> which was later published as a final rule,<sup>10</sup> 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.<sup>11</sup>
- 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.<sup>12</sup>

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.

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<sup>8</sup> 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>.

<sup>9</sup> 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>.

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

<sup>11</sup> 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/>.

<sup>12</sup> 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.