Testimony of Delicia Reynolds Hand, Director, Financial Fairness, Consumer Reports
Before the United States House Committee on Financial Services Committee

"Understanding Stablecoins' Role in Payments and the Need for Legislation"

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

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

My name is Delicia Reynolds Hand, and I currently serve as the Director of Financial Fairness at Consumer Reports where I lead the organization's work in digital finance. There, I am evolving Consumer Reports' evaluation and ratings model to 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.

Purveyors of digitized financial products and services promise all kinds of things - financial security, well-being, improved credit scores, the ability to manage daily expenses, the ability to leverage new forms of asset classes as investments without having to work through the complex landscape of financial intermediaries, all with a "simple" swipe or click. Whether digital financial products and services are living up to these promises is still an open question.

The marketplace of new digital products and financial asset types is vast and continually expanding. In 2019, there were approximately 5,800 new fintech startups in the United States. In 2021, this grew to approximately 11,000. As of February 2023, there were nearing 30K fintech start-ups, of which payments, cryptocurrency and blockchain technology startups represent a significant portion of this growth. From a consumer's perspective, this is a myriad of choices and promises for managing all things - basic financial transactions, payments, achieving financial security, and the American dream. It is confusing and there really is no meaningful choice in payments, for example, for consumers. Consumers pay by the means of payments requested;

and one day potentially, in the mode of currency requested. Despite innovations meant to stabilize consumer digital asset transactions, there are no comprehensive frameworks or safeguards to ensure consumers are protected from potential risks and harm.

At Consumer Reports, we have begun evaluating these new digital financial products and services in order to demonstrate what these products and services actually do for consumers and how they rate alongside each other. Additionally, we hope 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.

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. Aligned with other statistics showing a similar trend, a 2022 Consumer Reports survey showed that African Americans owned cryptocurrencies at a higher rate than other ethnic groups.

Why? Because, these consumers have never been a priority of the traditional finance and banking system. These are consumers who continue to live in credit and intergenerational wealth deserts, exacerbated by bad business practices and government redlining. They have never had the benefit of financial advisors or adequate access to financial services, much less investment products. Thus, there is great allure of an asset class driven through payments and investment innovation, where power and governance is distributed outside of the very financial system which has largely ignored them. And these are the consumers who are targets of Super Bowl and other celebrity influencer ads, Cryptocurrency kiosks or ATMs at convenience stores and gas stations where consumers can easily and quickly convert fiat currency into cryptocurrency, and back.

Stablecoins and consumers

The last couple of years have shown that 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. 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

Stablecoins – a type of crypto-asset designed to maintain a stable value – have grown in popularity over recent years, alongside a wave of stablecoin companies which have entered the marketplace and facilitated consumer access to cryptocurrencies. Stablecoins are touted as an example of how cryptocurrencies can be used for payments and facilitate trade between fiat currency and other crypto-assets or between different crypto assets. In 2022 more than 75% of trading on large crypto exchanges involved a stablecoin on one or both sides of the trade. Pegged to $1 USD, stablecoins are also purported to be a safer store of value in the crypto ecosystem. However, as we saw with the introduction of algorithmic stablecoins and the collapse of Terra and Celsius, stablecoins have also been volatile. Investors and consumers have lost their investments at the same time that globally financial institutions interests continue to grow and converge around the use of stablecoins to enhance or facilitate payments and other financial transactions.

Stablecoins and the Consumer Experience

Although stablecoins by design are meant to stabilize digital assets, we have seen in recent periods that reserves held by asset-backed stablecoins are subject to market, credit and liquidity risks. There are additional heightened risks due to unregistered, under regulated or unregulated issuers and service providers, opacity and complexity of the crypto ecosystem, potential conflicts of interest between issuers and consumers, and a lack of recourse for lost or stolen crypto-assets. If there is continued growth in the use of stablecoins, these could also become systemic risks as more consumers and the institutions they bank at continue to lose income and future financial security. And, with the billions of dollars in losses still being tabulated coming out of 2022's collapses of Terra Luna, Celsius and FTX, it is a public policy disaster to permit crypto currencies without comprehensive regulatory oversight and leave consumers at risk in this wild, wild west environment of caveat emptor or buyer beware. A comprehensive stablecoin framework that engages prudential, market and consumer protection regulators along with state banking and state securities regulators, is a critical first step to eliminate regulatory gaps and prevent regulatory arbitrage. As long as there are consumers in the cryptocurrency marketplace, there should be the strongest comprehensive oversight.

Common sense, consumer first, comprehensive regulation

Consumer Reports urges this committee to build on the work from last Congress 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.

It is clear, however, that the draft bill published in advance of this hearing is very close to the bill which was published in September of last year, under the last Congress. It appears that this

committee has failed to take the critically important step to integrate into the bill key learnings from the continued volatility we saw at the end of last year with the collapse of FTX and recently with the collapse of Silicon Valley Bank and Signature Bank. As the country continues to tabulate the growing costs of these losses, lawmakers should aim to create a regulatory framework for stablecoin payments that reflects what we've learned from these events.

As drafted the bill introduces some important prudential standards into the regulation of the issuance and trading of payment stablecoins. But given the continued instability and the broader ecosystem, anything but the most comprehensive regulatory oversight that, at the very least, parallels existing guardrails in consumer protections in the prudential system, will be insufficient.

Inadequate regulatory process and potential for regulatory arbitrage

In banking, before granting a charter, the chartering regulator must determine that the applicant bank has a reasonable chance for success and will operate in a safe and sound manner. This is an important check in our banking system which requires that even state chartered institutions obtain federal approval. There are no equivalent requirements for federal regulator review to allow meaningful assessment of surety in this bill. By not allowing the Federal Reserve Board authority to reject state licenses, this 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 this bill outlines an application process for becoming a stablecoin payment issuer for depository institutions and non-depository institutions, the bill could 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 there are some equivalent requirements to provide information about the organizers, the business plan, senior management team, capital adequacy, and their plan to promote diversity and inclusion, there is no requirement for entities to outline their risk management infrastructure, and other relevant factors.

Second, while the bill does outline a role for federal oversight, the bill 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 bill attempts to make it clear that issuers shall not represent stablecoins as insured deposits. 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.

Meaningful payment requirements and consumer protections

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.

Additionally, stablecoin payment regulation should 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. This bill lacks any language which would require this and 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 would like to see the language associated with custodial wallets improved to provide strong oversight of custodial wallets. Language in the current bill 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 Graham-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, additional language in the bill allows stablecoin issuers to co-mingle 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.

Some additional key improvements we would like to see

1. Redemptions. While a process to allow redemptions is required, there is no specific timeframe established or comparable right to redeem at par or at some minimum threshold. At minimum, there should be a 24 hour redemption requirement. We want consumers 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.
2. Increased activity limitations. While the bill does restrict risky activities such as pledging, rehypothecating, 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.
3. There should be no exception to the prohibition of certain convicted individuals to participate in stablecoin payments.
4. This bill, while outlining a clear role for the Federal Reserve Board over stablecoin payment issues, the FRB's authority would come second to that of the prudential regulators and consumer protection regulators.

Lack of Affirmative, Explicit Recognition of SEC authority

Perhaps one of the most notable things missing from this bill is the absence of any explicit recognition, consultation, or authority for the SEC, given the agency's active role in this space and the number of interventions it has brought on behalf of consumers. This is most unfortunate as the bill goes further than the last Congress to outline consultation with the states, a role for FinCEN and recognizes even the CFPB's authority, the lack of any role for the SEC is conspicuously absent from the bill.

Many stablecoins function and have been marketed as investment products like swaps or function like money market funds (MMFs). The 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.

As it goes so far as to outline other engagement with other agencies, this bill would be enhanced by inserting a new consultation provision. Section “102 (d) (2) (E)” - Consultation with SEC, regarding “registration, disclosure and investor protection.”

I urge the Committee to resume bipartisan efforts to ensure that the legacy of the country’s first attempt to outline comprehensive oversight of stablecoin payments, is as robust and consumer first as possible. If not, this effort will not be a punctuated shift into more clarity, certainty and stability during this period of volatility; it will instead be a predictable pause before the next even bigger boom and bust.

Thank you again for the opportunity to testify today.