Testimony of Delicia Reynolds Hand, Director, Financial Fairness, Consumer Reports
Before the United States House Committee on Financial Services
Subcommittee on Digital Assets, Financial Technology and Inclusion

““Putting the ‘Stable’ in ‘Stablecoins:’ How Legislation Will Help Stablecoins Achieve Their Promise.””

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Rayburn House Office Building
Washington, DC

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

Thank you for this invitation to testify. I’m pleased to be back to participate in this important conversation about the overarching regulatory framework for stablecoins.

My name is Delicia Reynolds Hand, and I am the Director of Financial Fairness at Consumer Reports where I lead the organization’s work in digital finance. Among other things, we 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.

At Consumer Reports, we are beginning to demonstrate what fintech products and services actually do for consumers and how they rate alongside each other. Additionally, we are beginning 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.

As I previously testified, 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. However, a 2022 Consumer Reports nationally representative survey of 3,208 U.S. adults reported that African Americans were significantly more likely than other racial/ethnic groups to say they had owned crypto in the past but don't anymore. In a volatile and stressed economic environment, consumers are at an even greater risk in the absence of rules to protect consumers and investors and to prevent the misuse of these assets.

Stablecoins and consumers

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. Since this subcommittee's last conversation on stablecoins, Europe has succeeded in bringing crypto-assets, crypto-assets issuers and crypto-asset service providers under a regulatory framework. And, today we have two bills under consideration; one of which has stripped out important safeguarding principles and consumer protections. We must avoid repeating history in an area so volatile and potentially disruptive, at a moment where we verge on recession, interest rates are high, workers are being displaced and losing jobs to emerging technology, collapsing markets; and U.S. companies begin to chase lowest common denominator states and overseas as the places from which to drive innovation. We need the strongest federal floors to ensure a solid foundation upon which companies and consumers can safely and reliably participate in digital assets.

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

Common sense, consumer first, comprehensive regulation

Consumer Reports urges this committee to bridge the gap 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.

The presence of two draft bills published in advance of this hearing signals that instead of one conversation, we are potentially going down divergent paths. To be clear, this space will be regulated and frameworks will be developed. The question is what will drive the development of oversight. The question remains whether the driver will be crisis or collaboration.
There are alas two bills; one of which seems to be a compromise on many issues. The other of which seems to have pared back prior areas of agreement. Both, as drafted, will introduce some important prudential standards into the regulation of the issuance and trading of payment

stablecoins. As previously emphasized, anything but the most comprehensive will be insufficient.

Strong regulatory process and federal oversight are needed

Consumer Reports supports the updates to the committee draft which include federal regulator review to ensure the safety and soundness of stablecoin issuers. While the committee draft would allow federal regulators to bring an enforcement action following the failure of a state regulator to do so, we encourage the adoption of provisions in the compromise bill granting the Federal Reserve Board authority to reject state licenses. Not including these provisions 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 the committee bill outlines an application process for becoming a stablecoin payment issuer for depository institutions and non-depository institutions, the bill should 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 both drafts retained some equivalent requirements to provide information about the organizers, senior management team, and capital adequacy, we urge the committee to retain requirements to promote diversity and inclusion found in the compromise bill. We support the addition of requirements for federal regulators to issue rules related to risk management infrastructure.

Second, while the committee bill does outline a role for federal oversight, it 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 compromise bill draft attempts to make it clear that issuers shall not represent stablecoins as insured deposits while the committee draft does not even require this disclosure. 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.

Strong consumer protections needed

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.

We urge the committee to move forward with the provisions in the compromise bill that require stablecoin payment regulation to 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. The lack of interoperability 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 request the committee to adopt language associated with strong oversight of custodial wallets. The committee draft 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 Gramm-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, the committee should include clarifying language that prohibits stablecoin issuers from co-mingling 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.

We encourage the committee to move forward with language in the compromise bill that imposes a timeline to allow consumers to redeem their stablecoins within 24 hours. We suggest adding clarifying language to specify that consumers should be able to redeem 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.

Some additional key improvements we would like to see

1. Increased activity limitations. While the bill does restrict risky activities such as pledging, rehypothecation, 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.
2. There should be no exception to the prohibition of certain convicted individuals to participate in stablecoin payments. The committee draft being considered removed the prohibitions altogether.
3. This bill, while outlining a clear role for the Federal Reserve Board over stablecoin payment issuers, the FRB's authority would come second to that of the prudential regulators and consumer protection regulators.

Explicit Recognition of SEC authority is needed

Given the agency's active role and number of interventions brought on behalf of consumers, we are pleased to see that the compromise bill retains provisions that the SEC is not limited in its authority by the bill to regulate stablecoins but there is no further clarity. The compromise bill also requires the SEC to be consulted in a study of endogenously collateralized stablecoins, which are stablecoins backed by other crypto such as bitcoin or ether.

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

I urge the Committee to resume bipartisan efforts to achieve comprehensive oversight of stablecoin, that is as robust and consumer first as possible.

Thank you again for the opportunity to testify today.