DIGITAL ASSETS AND THE FUTURE OF FINANCE: THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS' REPORT ON STABLECOINS

HYBRID HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTEENTH CONGRESS

SECOND SESSION

FEBRUARY 8, 2022

Printed for the use of the Committee on Financial Services

Serial No. 117–68

U.S. GOVERNMENT PUBLISHING OFFICE
47–106 PDF WASHINGTON : 2022

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DIGITAL ASSETS AND THE FUTURE OF FINANCE: THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS' REPORT ON STABLECOINS

Tuesday, February 8, 2022

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Velazquez, Sherman, Meeks, Scott, Green, Cleaver, Perlmutter, Himes, Foster, Beatty, Vargas, Gottheimer, Lawson, Axne, Casten, Torres, Lynch, Adams, Tlaib, Dean, Garcia of Illinois, Garcia of Texas, Williams of Georgia, Auchincloss; McHenry, Lucas, Posey, Luetkemeyer, Huizenga, Wagner, Barr, Williams of Texas, Hill, Emmer, Zeldin, Loudermilk, Mooney, Davidson, Budd, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, Timmons, and Sessions.

Chairwoman WATERS. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Before I begin, I will call up the two resolutions noticed for today's hearing, reauthorizing the Committee's Task Forces on Artificial Intelligence and Financial Technology, and ask unanimous consent that the resolutions be adopted.

Without objection, it is so ordered.

Today's hearing is entitled, "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins." I now recognize myself for 5 minutes to give an opening statement.

Today's hearing is part of this committee's ongoing review of digital assets. This committee has been at the forefront of congressional oversight of cutting-edge technology in financial services. Through our Task Forces on Artificial Intelligence and Financial Technology, and our Digital Assets Working Group of Democratic Members, we have continued to explore how emerging technologies impact our financial system, including the emergence of cryptocurrencies.

Soon after learning of Facebook's plans to launch a global stablecoin in 2019, I asked Facebook to immediately pause its work until regulators and Congress had an opportunity to review the project. I invited Mark Zuckerberg to testify at a hearing where we scrutinized their plans, and I led a bipartisan delegation to Switzerland to meet with officials to discuss their plans to oversee the Libra Association, which was later rebranded as Diem.

After deep scrutiny from me, the members of this committee, and our nation's regulators, Diem relented and recently sold its assets, effectively, and, I hope, permanently ending Facebook's misadventures in cryptocurrency. I am pleased that our committee's leadership on this issue has made an impact, including helping to focus the attention of regulators on these issues.

Last December, the committee convened a first-of-its-kind hearing with a panel of cryptocurrency CEOs, building on earlier subcommittee hearings to understand where crypto products, services, and technologies were heading and how they should comply with applicable financial regulations. From the start, our committee has recognized that the explosive growth of digital assets presents a variety of risks and opportunities for our economy and communities, especially communities of color that have been left behind by our financial system. Their voices must be heard in the decision-making and regulatory process.

Today's hearing focuses on stablecoins, which are a subset of cryptocurrencies pegged to a reserve asset such as the U.S. dollar. Stablecoins are primarily used in the United States to facilitate trading, lending, or borrowing of other cryptocurrencies. Troubling investigations have shown that many of these so-called stablecoins are not, in fact, fully backed by reserved assets. Moreover, due to speculative trading and a lack of investor protections, stablecoins could even threaten U.S. financial stability.

The President's Working Group on Financial Markets (PWG) published its report on stablecoins, reviewing the regulatory landscape of this fast-growing type of cryptocurrency. The report outlined various risks that stablecoins may present to market integrity, investor protection, and illicit finance.

The report also highlighted systemic risk concerns due to the threat of stablecoin runs when they are not fully backed, including concentration of economic power concerns, and regulatory gaps in effectively overseeing the stablecoin market. These risks could harm both ordinary users of these products, as well as our financial system overall, and the PWG recommended that Congress take action.

As more people invest in and use cryptocurrencies, including stablecoins, the committee will continue its efforts to look at how they are affecting many aspects of our lives and our financial system. In particular, regulators and policymakers must work to ensure that any innovation in this space is responsible, that it provides robust consumer and investor protection, that it mitigates environmental impact, and that financial inclusion is front and center.

We will also continue to investigate the development of a U.S. central bank digital currency (CBDC) that may provide a safe, stable, and secure method of instantaneous digital payment.

I thank the ranking member for his recent letter on this committee's approach on digital assets, and I hope to continue working with him in a bipartisan way as we move forward.

I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Thank you, Madam Chairwoman.

I do welcome that bipartisan approach, and I am grateful that we are undertaking these hearings to learn more before we seek to take action.

Under Secretary Liang, thank you, and I appreciate your participation in today's hearing on behalf of the Presidential Working Group on Financial Markets.

What is clear is that we need legislation. We agree on that. Regardless of what some may believe, it is our job on Capitol Hill to develop legislation to direct regulatory action, if there is to be regulatory action. And let me be clear, it is specifically the House Financial Services Committee that will lead this legislative effort and bring clarity to this ecosystem.

Currently, there is no Federal law to address digital assets. With nearly a quarter of American adults now investing in crypto, we must move quickly to put in place a framework that clearly defines the rules of the road. The good news is that Financial Services Committee Republicans have already laid the foundation for the work that must be done to maintain the U.S. as a leader in digital assets and the digital asset revolution.

In fact, committee Republicans released a set of principles on the central bank digital currency question, one of which emphasized the potential that stablecoins hold if issued under a thoughtful regulatory framework. The Working Group's report outlines a model that could be pursued. However, it does not take into account the full picture and the array of options available to us. So, let's break that down.

We know that the Democrat debate here in Washington has been focused in the last decade on de-risking the financial services arena. Beginning with the Dodd-Frank Act, they have talked about de-risking banks in particular.

And as you state in the President's Working Group report here, and as I expect many Democrats will say today, stablecoins are viewed as extremely risky. So, what is the solution of this Working Group? How do they mitigate this alleged risk? Well, they make them all banks. They regulate them all as banks, and they give them a Federal taxpayer backstop, which is completely the opposite direction we have been moving in for the last decade in Washington. We are trying to de-risk, not add risk to the Federal taxpayer. So, that doesn't make any sense to me.

Now, let me be clear, I am not saying that there is zero risk, but Washington's knee-jerk reaction to regulate out of fear will not allow stablecoins to achieve their full potential and the myriad of solutions that they may be able to present. This new technology, like all financial technology, deserves appropriate and thoughtful regulatory approaches.

The report also includes an analysis of the stablecoin market. Yet in this analysis, in this paper, there was absolutely no discussion of existing regulatory frameworks for stablecoin issuers at the State level. These issuers are subjected to a comprehensive set of supervisory regimes, including reserve requirements, examinations, compliance with anti-money laundering (AML) rules. And that is being done in a couple of States. We should be examining all existing regulatory frameworks and structures for best practices and taking advantage of the lessons learned from those operating on the forefront at the State level.

Another critical component missing from this report was the potential benefits of stablecoins, not just the risks, but the potential benefits. In this committee, we have witnessed the payments industry address shifts in customer and consumer demand and the never-ending race to move money faster, cheaper, and better. Digital currencies like stablecoins are a natural continuation of the same issues we have addressed in this committee over the years and, I might add, in a bipartisan way.

We cannot regulate out of fear of the future. It is Congress' role to seek solutions that directly address the risks at hand and ensure that the benefits are also part of those discussions. Requiring stablecoins to only be issued by banks would be a major obstacle for us to continue to foster innovation within this nascent industry.

My friends across the aisle would like to force new products into unfitting and often inappropriate existing regulatory structures. I think we need to move forward and think of this in a new approach.

And while I recognize the Working Group's inclination to do what has been Democrat orthodoxy, I hope that today we can think bigger and more comprehensively and discuss the potential benefits of increased use of stablecoins. The policies we develop must promote private sector innovation and foster competition to build a resilient product without creating risk in other areas.

We should not, as this report does, limit our focus to only the risks, and we should not focus only at a Federal structure. We should understand what is being done at the State level as well. But to only focus on the risks would be shortsighted and would not allow us to realize the potential to the digital ecosystem of stablecoins and what the consumers want.

Madam Chairwoman, thank you. Thank you for this undertaking, and I hope we can have a thoughtful discussion about what is a really important subject matter for so many Americans and for us here on Capitol Hill. I look forward to working with you in the months to come.

Chairwoman WATERS. Thank you, Ranking Member McHenry.

At this time, I want to welcome our distinguished witness, the Honorable Nellie Liang, who is the Under Secretary for Domestic Finance at the United States Department of the Treasury.

You will have 5 minutes to summarize your testimony. You should be able to see a timer that will indicate how much time you have left in your testimony. And without objection, your written statement will be made a part of the record

Under Secretary Liang, you are now recognized for 5 minutes to present your testimony.

STATEMENT OF THE HONORABLE NELLIE LIANG, UNDER SECRETARY FOR DOMESTIC FINANCE, U.S. DEPARTMENT OF THE TREASURY

Ms. LIANG. Thank you very much for having me today.

Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for the opportunity to testify this morning on the stablecoin report by the President's Working Group on Financial Markets (PWG).

The PWG is chaired by the Secretary of the Treasury, and is composed of the Federal Reserve Board, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. It was formed by a Presidential Executive Order in response to the 1987 stock market crash, and regularly produces reports on financial market issues for the President, which may include recommended legislative changes.

For the stablecoin report, the PWG was joined by the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

stablecoins are part of an emerging set of digital assets, activities, and services that could have profound implications for the U.S. financial system and economy. The distinguishing feature of stablecoins, as compared to other digital assets, is that they are designed to maintain a stable value relative to a reference asset, often the U.S. dollar. Stablecoins have grown rapidly from a market capitalization of roughly $5 billion at the start of 2020, to approximately $175 billion today.

The PWG report focused on stablecoins because the offer of a stable value means they have the potential to be widely used as a means of payment by households, businesses, and financial firms. This potential use could create significant benefits for stablecoin users and payments transactions, but it could also pose risks.

The PWG report focused on three prudential risks associated with the use of stablecoins for payment. First, run risk, a scenario in which loss of confidence in the stablecoin triggers a wave of redemptions, which could have broader spillover effects for the financial system.

Second, payment risk, including operational issues that could interfere with the ability of users to store stablecoins or use them to make payments.

And third, concerns related to concentration of economic power, for example, if a stablecoin provider scaled quickly and gained market power as a provider of payments.

The PWG report found significant gaps in authority that would address these prudential risks. Some of the largest stablecoin issuers operate with limited regulatory oversight, raising significant questions about whether their stablecoins are adequately backed. Even where a stablecoin issuer is subject to oversight, supervisors may not have sufficient visibility into the broader operations that support the use of stablecoins, which may be distributed among multiple entities.

Neither State money transmitters nor securities law requirements were designed to address the financial stability, payment system, or concentration of economic powers for a payment instrument that is based on new distributive ledger technology. To fill this regulatory gap, the PWG report recommended legislation to ensure that stablecoins are subject to a consistent and comprehensive framework that is proportionate to the risks posed. Such legislation would complement existing authorities with respect to market integrity, investor and consumer protection, and illicit finance.

Specifically, the report recommended limiting issuance of stablecoins to insured depository institutions, giving supervisors of stablecoin issuers visibility into the broader stablecoin arrangement and the authority to set risk management standards for critical activities related to the use of stablecoins for payment, and certain measures to reduce concerns about concentration of market power.

In developing this recommendation for stablecoin issuers to be insured depository institutions, the PWG report relied on the flexibility that the banking agencies would have to adjust for differences between stablecoin issuers and traditional commercial banks and to adjust to new products and structures that may emerge over time.

As noted at the beginning of my testimony, stablecoins are a subset of a larger and quickly evolving digital assets market. The Treasury Department supports responsible innovations from digital assets but is also committed to protecting against risk to users, the financial system, and the broader economy.

The Biden Administration continues to work across the agencies to develop a comprehensive strategy for all digital assets, with the goals of ensuring that cryptocurrency is not used for illicit finance, addressing risks related to financial stability and consumer investor protection, and furthering financial inclusion and our continued leadership in the global financial system.

We look forward to partnering with Congress on these critical issues as we make progress, and I appreciate the committee's leadership in this area.

Thank you again for the opportunity to testify this morning. I would be happy to answer any questions from the committee.

[The prepared statement of Under Secretary Liang can be found on page 66 of the appendix.]

Chairwoman WATERS. Thank you, Under Secretary Liang.

I now recognize myself for 5 minutes for questions.

Ms. Liang, after much scrutiny from this committee, as well as from regulators, the Diem Association, which was founded by Facebook, announced last month that it had sold its stablecoin project to a bank, effectively exiting the cryptocurrency market. Facebook attempted many times to enter the cryptocurrency market, including in 2019 when Facebook formed the Libra Association in Switzerland to create a stablecoin.

However, Facebook slowed down its activities after this committee held hearings and raised significant concerns leading to a number of Libra Association members pulling out. To address systemic risk and concentration of economic power concerns, the President's Working Group report, among other things, recommends that stablecoin issuers should be required to restrict their activities to limit affiliation with commercial entities, similar to the separation we impose between banking and commerce.

In your view, does that mean technology companies such as Facebook that have access to huge amounts of sensitive personal data should not be allowed to create their own stablecoin or other cryptocurrencies? And if they do, should they be subject to heightened scrutiny?

Ms. LIANG. Thank you, Chairwoman Waters, for that question.

I would answer that in two parts. I think the first question is, should technology companies be allowed to issue stablecoins? The report recommends that stablecoins be issued by insured depository institutions. And in that sense, we would not recommend that stablecoins be issued by technology companies.

This is the issue of the separation of banking and commerce, and it has been an issue that Congress has grappled with for many years. In this case, we believe stablecoins, as a payment instrument, should not be issued by a technology firm.

Second, there is a question of whether technology providers could be providers of other parts of the stablecoin arrangement, including custodial wallet providers and providing some of the other services involved with the use, the storage, and the transfer of stablecoins for payments.

The recommendation in the report is for Congress to consider this particular issue as to whether commercial entities could be providers. A more targeted solution that was included in the report is to consider restrictions on what wallet providers can do with the customer transactions data that they would have access to, and whether there are limitations on privacy and security that could address the concerns about concentrations of economic power if commercial companies were involved in the stablecoin arrangement.

Chairwoman WATERS. Thank you.

Stablecoins have grown at an incredible rate in the past year, going from $30 billion late last year, to over $170 billion today. However, simply labeling something as stable or overly relying on one-to-one ratio does not, in itself, mean it maintains a stable value. We learned that lesson painfully when money market funds crashed in 2008 and needed a Federal bailout to protect investors and markets.

Recently, some stablecoin issuers transitioned from having their stablecoins being backed by various forms of debt securities to now supposedly being backed only by the U.S. dollar and short-term U.S. Treasuries. Do you think this is enough to address the systemic risks and the run risk concerns of stablecoins that the President's Working Group report highlighted?

Ms. LIANG. Thank you for the question.

The stablecoins that the PWG report focused on, focused on the function that they could provide because of their stable value to be widely used as a means of payment by households, businesses, financial firms, and governments. We identified three risks, and one is the run risk that you referred to, and that is the ability, if investors were to lose confidence in the quality of the assets backing the stablecoin, there could be a run, which has potential systemic risk consequences.

But in addition, stablecoin is not just the creation and redemption of the stablecoin. It is also, as a payment mechanism, involved in the operations that involve the storage, and the transfer of stablecoins for payments. And that is what the President's Working Group added to the conversation, that that part of the arrangement is also important for supervisors to have some visibility to and to establish some risk management standards to ensure that the payment system retains its integrity.

So, while an insured depository institution allows for sufficient confidence in the value of the assets backing the stablecoin, the supervision also allows some oversight of the overall payment arrangement.

Chairwoman WATERS. Thank you very much.

The gentleman from North Carolina, Mr. McHenry, the ranking member of the committee, is now recognized for 5 minutes.

Mr. MCHENRY. Thank you, Chairwoman Waters.

And Under Secretary Liang, thank you. Thanks for your engagement and for running points on this report, and I do appreciate the conversation that we have had and that you have had actively on Capitol Hill, on both sides of the aisle. I think that is very good.

But just so we are on the same page, I want to make sure that we are looking at this in a similar fashion. Is there current Federal law that governs stablecoins or, frankly, digital assets, for that matter?

Ms. LIANG. There are Federal laws that apply to various aspects of stablecoins that address illicit finance, address stablecoins as an investment asset, and consumer protection laws would apply to stablecoins.

Mr. MCHENRY. But nothing that is explicitly about stablecoins?

Ms. LIANG. Nothing explicitly, but the function, yes.

Mr. MCHENRY. And that's what we try to address, right? So, yes, of course. And by that same measure, something 100 years in the future, we currently have laws for, so that is a pretty expansive response you have given me.

But there is no notion of a stablecoin in current law or digital assets in current law that is explicit about those things. This question wasn't meant to be a, "gotcha." The answer is no.

Ms. LIANG. I do not believe so. I don't believe so, yes.

Mr. MCHENRY. Right. That is it. I'm sorry. This was supposed to be the easy question.

Ms. LIANG. Absolutely.

Mr. MCHENRY. And I think we can have some consensus here on how we get ahead, but one area that I think this committee should examine is the current State regulatory frameworks. Did the Working Group consult with State regulators on their existing frameworks?

Ms. LIANG. Yes, the Working Group did consult and talk to State regulators, and a number of State regulators have increased their expertise in this area. The PWG report believes that a more consistent, less fragmented framework is preferred.

Mr. MCHENRY. And does that also mean that the President's Working Group would think that we shouldn't have State-chartered credit unions or banks? By that same notion, that would be like saying we should only have Federal banks.

To that point, you consulted with these regulators, but there was no mention of the existing State regulatory framework. Why was that? Why did the President's Working Group make that decision to not mention existing frameworks and lessons learned from those existing State frameworks?

Ms. LIANG. The Working Group proposed a consistent framework—

Mr. MCHENRY. I understand what you proposed.

Ms. LIANG. —built on the State regulators. So, a proposal for an insured depository institution (IDI) could be a State-chartered or a Federal-chartered bank.

Mr. MCHENRY. But what I am asking is a separate question.

Look, this is not an adversarial conversation. I think the fact that the Administration has put out this report is a welcome thing, and you have given one solution to a really complex set of industries. But there was no mention of any State regulatory framework.

We know that New York is the most active, and they have a very safe, but very robust set of regulations and disclosures. But there is no mention of New York. There are no lessons learned from the States included in this report, and I was interested in why that was, not the question of what you reported. I have read the report.

So why not understand the lessons learned from the States, and why was that not included in the report?

Ms. LIANG. Right. There is no explicit reason for why it was not included. It was certainly considered as an alternative.

The principal reason is that the State regulatory system is fragmented. There is an issuer, and then there are the custodial wallet providers, the other parts of the arrangement that are subject to different kinds of regulations. There was no plenary oversight of the entire arrangement.

Mr. MCHENRY. Thank you. I appreciate your response.

By that same notion, you would like to have a single regulator at the Federal level for all financial institutions. That didn't succeed in the Dodd-Frank Act.

I do want to ask about de-risking, though. In the report, you outlined that this is an extremely risky proposition of stablecoins. But the conclusion here is that you should put them in a federally-insured depository institution. With Dodd-Frank, we attempted to de-risk those institutions. And what you are adding to explicitly with this report is a riskier aspect that would have a Federal backstop and a Federal taxpayer backstop in the unwinding authority granted under Dodd-Frank for these institutions and specifically this product.

Shouldn't we be in the game of de-risking rather than adding to the risk of a Federal bailout or, yes, for these products?

Ms. LIANG. I think in the current environment, regulators are in a bit of an uncomfortable position. Stablecoins are increasing. They have grown rapidly, as you have said. There are risks. Its regulation is about where those risks should reside and how to protect users and investors.

If stablecoins are backed by high-quality assets, their risk is quite low, and they can form a building block, a cornerstone of a payment system. But if they are not supported, and there are questions about the quality of the assets in the reserve pool backing them, then they create risk.

Mr. MCHENRY. Madam Chairwoman, I appreciate the extended time we both got to share on this.

Chairwoman WATERS. Yes.

Mr. MCHENRY. I do think we can learn a lot from the State regulatory framework, what they have done well, and the things that we can do better.

Chairwoman WATERS. Thank you, Mr. McHenry.

Mr. MCHENRY. I appreciate the engagement, and I yield back the balance of my time.

Chairwoman WATERS. Thank you.

The gentlewoman from New York, Ms. Velazquez, who is also the Chair of the House Committee on Small Business, is now recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Chairwoman Waters, and welcome, Under Secretary Liang.

I would like to ask you about the investigation that was conducted by New York Attorney General Letitia James last year, which revealed that starting in 2017, the stablecoin, Tether, deceived clients and markets by failing to hold reserves to back their Tethers in circulation, which was contrary to their representations.

The President's Working Group report highlights the lack of standards of reserve assets as a concern and recommends legislation which requires stablecoin issuers become insured depository institutions. Can you elaborate on this recommendation and why it could create standards regarding the composition of the reserve assets and information issuers make to the public?

Ms. LIANG. Yes. Thank you for your question.

The issues that you raise are extremely pertinent to the first risk that the PWG report identified, which is the risk of runs on a stablecoin arrangement because the quality of the assets, the composition of the assets backing the coin are not, in fact, able to offer stable value perhaps in periods of stress. That is, the current market regulators have authorities to promote market integrity and to protect investors.

The proposal for an IDI is to bring the quality and composition of assets under a supervisory framework where there is a regulator who can attest to the quality of those assets backing a stablecoin, and there is a regulator and a supervisor who can also oversee the entire arrangement for a stablecoin to be used for payment.

So, that is the core of the approach. We believe it provides clarity to stablecoin issuers in terms of a consistent framework versus State-level regulations and money transmitter licenses in 49 States and allows for beneficial innovation. In our outreach, the industry really asked for clarity so they could move forward and believed it would facilitate innovation.

Ms. VELAZQUEZ. Thank you, Under Secretary, for that answer.

Secretary Liang, Puerto Rico has become a favorite location for cryptocurrency speculators and investors from the Mainland. And the Mainland media—Bloomberg, Rolling Stone, CNN, Data Report, Wall Street Journal, and other reports—so at the heart of this situation is Puerto Rico's Individual Investors Act, which enables wealthy Mainlanders who establish themselves as Puerto Rican residents to pay zero tax on capital gains, dividends, and interest, making the island particularly attractive for cryptocurrency investors.

Would additional legislative authority from Congress be helpful to go after these crypto investors who are attempting to use Puerto Rico as a tax shelter and evade IRS reporting?

Ms. LIANG. Congresswoman, I am not familiar with that particular Act, the Individual Investors Act. But the Treasury Department does believe and works by the principle that taxpayers should pay the taxes they owe. I believe maybe Treasury officials and the IRS are looking at that issue quite closely with respect to crypto transactions, and we would be happy to follow up further on this particular situation.

Ms. VELAZQUEZ. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Missouri, Mrs. Wagner, is now recognized for 5 minutes.

Mrs. WAGNER. Thank you, Madam Chairwoman.

Under Secretary Liang, the Financial Stability Board (FSB) included high-level recommendations to provide for supervision and oversight of global stablecoin arrangements, and I am going to highlight all four of them: one, a comprehensive governance framework with a clear allocation of accountability for the functions and activities; two, effective risk management frameworks with regard to reserve management, operational resilience, and cybersecurity safeguards; three, transparent information necessary to understand the functioning of these arrangements; and four, the legal clarity for users on the nature and enforceability of any redemption rights and the process for redemption, among others.

These recommendations seek to address one of the critical issues, which is the potential for fraud and the mismanagement of reserves.

In December, a number of CEOs discussed their operations before this committee, and it seems that based on certain issuers' existing regulatory structures at the State level, the requirements would meet these high-level recommendations and address a number of the risks highlighted in the report.

Under Secretary Liang, do you share that same view?

Ms. LIANG. Thank you, Congresswoman.

I think the principles that you laid out under the FSB are exactly the principles that the PWG report believes its recommendations are trying to meet. I think under the current regulatory framework, it does not meet all of those criteria at this point in the United States.

Mrs. WAGNER. The CEOs who came before us really, as to regulatory structures that they set up and were working with, especially at the State level, met these high-level recommendations and addressed a number of these risks that were highlighted in the report.

Do you want to—

Ms. LIANG. We have talked to some of the States and have talked to supervisors, and I believe that while they believe they—under some of the licenses, they have oversight of the issuers. And a different look through a different lens at the wallet providers and the other kinds of entities that are involved in storing, transferring, and allowing stablecoins to be used as payment—that is a different set of regulations under the money transmitters licenses.

And there is not plenary oversight of the overall arrangement.

And if stablecoins are going to be used widely as a payments mechanism, there is a concern of trying to make sure that they can actually perform their function, that there is oversight of operations for cyber—

Mrs. WAGNER. Let me just say this. It seems to me that we should be examining the best practices under State frameworks instead of pretending that they do not exist. Applying a uniform regulatory framework to stablecoin issuers will discourage innovation and push stablecoin activity and jobs out of the United States. We must, I think, ensure that any Federal regulatory framework provides clarity and also ensures that the regulation fits the activity rather than simply overlaying traditional banking regulation over stablecoins.

Under Secretary Liang, in your opinion, how can stablecoins reduce barriers to financial inclusion and lower transaction costs?

Ms. LIANG. I think the potential for digital assets and stablecoins to improve financial inclusion are high. It can reduce the costs of payment, and it can help individuals who are unbanked or underbanked if they are more comfortable conducting payments on their iPhone than going into a banking office.

So I think there is quite a bit of potential, and there are pilot programs to test the use of stablecoins for cross-border remittances. And I think that is a very positive, favorable development.

Mrs. WAGNER. I would agree with you, and I thank you for your testimony.

I have run out of time, and I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you.

The gentleman from California, Mr. Sherman, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is now recognized for 5 minutes.

Mr. SHERMAN. Thank you, Madam Chairwoman, and thank you for having that hearing where we had Mr. Zuckerberg come before us, and we pretty much stopped the Libra, which would have been a cryptocurrency that had so much money and power behind it with Facebook and others that it could have emerged as an everyday currency.

The ranking member talks about State regulation. I will just point out that, imagine if we didn't have any Federal regulation of State-chartered banks. The FDIC didn't propose any capital rules. The FDIC didn't do any audits. It would only be a matter of time before there was a race to the bottom, and we would have banks operating in my State chartered by some other small State, and those banks would be going bankrupt because they would have found the jurisdiction that had the lowest capital requirements.

We are told to look at the benefits of these digital systems, but it is really just a potential or hoped-for benefit. I want a more efficient way to buy a burger. Right now, I use a credit card, and the burger company, the seller, has to pay a 2- or 3-percent fee, or a debit card might cost 50 cents.

But it is unfair to compare the alleged potential of crypto to the actuality or current system that we have now. If you are going to compare things, you have to compare current with current.

Currently, if I want to buy a burger with a stablecoin or a crypto coin, I have to find an Uber, and get them to drive me to the one burger stand that is rumored to exist in Cleveland, Ohio, where you can use a stablecoin or a crypto coin to buy a burger. But I can't find a burger here in Washington, D.C.

We are told about the risks to investors, and they are substantial, and where the stablecoin invests in cryptocurrency, you have a joining of two risks. You have all of the stablecoin risk with an unstable coin, and then all of the risks of the underlying crypto investment.

But we can't just look at investors. We have to look at the risk posed to our payment system, and that is why I am glad, Madam Under Secretary, that your report focused on how stablecoins and cryptocurrencies are undermining the U.S. Anti-Money Laundering (AML) and Know Your Customer (KYC) rules. I sense sometimes what I call patriotic anarchists, who wave the American flag and cheer whenever law enforcement or tax enforcement is thwarted.

Madam Under Secretary, you have a tough job to get a bill through Congress, because all of the money and power is on the other side. You don't have a political action committee (PAC). You don't have gangs of lobbyists. You don't have the arena in my city named, "enforce anti-money laundering dot-com." No, it's called Crypto.com.

What you do have is the credibility of knowing that the Treasury Department and your affiliated agencies are putting the national interests over the pecuniary interests of certain investors. But for that credibility to translate into legislation, you represent the Working Group, and so I am going to ask you to do more work.

Can you come before us and offer specific statutes that you think that we should adopt, rather than just a few sentences of explanation? Because if you don't do that, then anything that does pass will be considerably weaker than what you are recommending.

Ms. LIANG. Thank you.

We would, of course, be happy to work with the Congress on any proposals, and I believe that proposals that include an IDI as an option are in the appropriate direction.

Mr. SHERMAN. I hope that—and I will make the request formal—you will take your recommendations and turn them into something very close to or actually statutory language so that we know specifically what you are proposing.

I am told that cryptocurrencies enjoy significant investment by those in disenfranchised and minority communities. Of course, that was also true of subprime lending. Are you concerned that low- and moderate-income people in our country, particularly those of color, will be left holding the bag if we see a collapse in cryptocurrency or stablecoin?

Ms. LIANG. Of course. Crypto assets broadly, digital assets broadly, have the potential for benefits, as you mentioned, but there are currently too many incidents of fraud, misleading advertising, and the member agencies, as part of the PWG—the SEC, the CFTC—are taking actions to try to protect investors and consumers.

Mr. SHERMAN. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

The gentleman from Missouri, Mr. Luetkemeyer, is now recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman, and thank you for being here, Ms. Liang.

In 2019, the average daily turnover value of the U.S. dollar constituted 88 percent of the foreign exchange market transactions globally. This dominance by the dollar in the global marketplace is a key reason why the dollar remains the reserve currency of the world.

Existence of hundreds of different types of privately-established cryptocurrency, in my view, presents a threat to the dollar's status in global transactions. However, I believe that stablecoins backed by the U.S. dollar present a unique opportunity to ensure that the U.S. remains the reserve currency of the world as the financial services industry adapts to new technologies of blockchain cryptocurrencies.

Despite this critical aspect of stablecoins, the President's Working Group on Financial Markets' Report on Stablecoins does not mention global competitiveness as a key aspect of stablecoin development. I think that is a striking oversight.

I have a couple of questions here. Do you have any concern about the number of these cryptocurrencies and how they are being established and how they are working? And with respect to stablecoins, do you see an opportunity to be able to actually help protect the reserve currency status and enhance the U.S. dollar? Where would you stand on some of those issues, and can you elaborate, please?

Ms. LIANG. Yes. I believe the importance of the U.S. dollar and its position in the global financial system is incredibly important for the economic well-being of the United States. I believe the recommendations to require stablecoin issuers, backed by the U.S. dollar, to be put within a regulatory framework which ensures that they are, in fact, stable, is the best way to promote the U.S. dollar.

Currently, stablecoins are being issued with limited regulatory oversight or outside the regulations backed by the U.S. dollar, so they are claiming stable value without any assurance that they can provide stable value. I do strongly believe the PWG recommendations are highly supportive of ensuring the position of the U.S. dollar in the global system.

Mr. LUETKEMEYER. Well, short of regulating and forcing them to do this, is there a way to incentivize these stablecoins to use dollars as the medium to be matched against, in your view? I am not a big fan of regulation. But by the same token, I think we have to understand—I think there is a threat here with these cryptocurrencies being utilized in a way, fortunately, right now everybody will either turn around and go back to dollars or the natural currency of their country to eventually be able to get their investments back monetized.

But is there a way we can incentivize the stablecoin folks to use dollars, or have you looked into that at all?

Ms. LIANG. I think, currently, they have a natural incentive to use the U.S. dollar because it is the global currency. I believe the incentives we need to put in place are to ensure that it remains the global currency. And I think the role of the U.S. dollar is based on the country's respect for the rule of law, the strength of its institutions, its economic potential, and the depth and breadth of the financial markets, not the technology, per se. But it is important, so the critical element is the fundamental strength of the dollar, and the technology can reinforce it.

Mr. LUETKEMEYER. It is interesting that you make that comment, and I appreciate the fact that you believe that in order for stablecoins to be successful, we have to have a stable economy, and we have to have a stable currency in this country. And that is the incentive. So, it makes sense for us to continue to work hard to maintain our reserve currency and the stability of our money and our country's economy. Thank you for that.

You talked a little bit about, theoretically, a run on stablecoins and cryptocurrencies. Has there ever been a run on one at this point?

Ms. LIANG. I believe there have been on some smaller stablecoins. As you know, this market is evolving very rapidly. At times, there could be 50 or 60 different stablecoins pegged to the dollar or to another reference asset that might mimic the dollar.

I believe there has been maybe one or two, but these have not been large stablecoins at this point.

Mr. LUETKEMEYER. Very good. My time has expired, Madam Chairwoman.

Thank you very much. I yield back.

Chairwoman WATERS. Thank you very much.

The gentleman from Georgia, Mr. Scott, who is also the Chair of the House Agriculture Committee, is now recognized for 5 minutes.

Mr. SCOTT. Thank you.

First of all, both Chairlady Waters and Ranking Member Patrick McHenry raised some of my concerns as well.

Under Secretary Liang, there is a significant portion of our nation's population—Blacks, Hispanics, Asians, and White people as well—who are lacking basic access to banking services, payment technologies, and financial literacy. So, Madam Under Secretary, can you explain how stablecoins connect nontraditional banking populations to the broader financial system? And what are the guardrails, if there are any that exist, to protect these consumers?

Ms. LIANG. Thank you, Representative Scott.

I believe that stablecoins can promote financial inclusion by reducing the cost of payments, by making them faster and cheaper. If users are interested, more interested and more willing to use technology on, say, their iPhone for payments than they would be going to a bank and using a bank. So, I believe the costs can be cheaper, and the execution can be faster.

And I think the pilot programs for using stablecoins for cross-border remittances is a good example of how stablecoins could potentially be used for payments in a significant way and in a way that reduces costs and—

Mr. SCOTT. But my specific point is, where are the guardrails? Do you have any guardrails currently in existence to protect these consumers? Because, Under Secretary, wouldn't you agree with me that absent a robust legal and regulatory framework, one with clear and effective consumer protections, there is a very real possibility that without that, the entire market could collapse before our very eyes?

Ms. LIANG. The recommendations of the PWG report try to get to exactly that risk, that stablecoins as a payment mechanism, in fact, offer stable value and can provide a strong operational payment structure. And that is the best approach to protecting consumers.

Mr. SCOTT. Okay. And you sort of opened the door here to this President's Working Group report. Tell me, what are their recommendations? Where in this report are their recommendations to specifically ensure that as stablecoins are adopted into our more mainstream market, that there are corresponding increases in protections so that ordinary users don't fall through the cracks?

Ms. LIANG. In fact, the recommendations are built on the idea, on the premise that stablecoins will be growing, continue to grow rapidly, and that the guardrails need to be put in place to protect users and, in fact—

Mr. SCOTT. Okay. In my short time left, what are these recommendations?

Ms. LIANG. One is to build on existing securities and consumer protection laws. There are complements to those laws that exist. But to require stablecoin issuers to be insured depository institutions, to require that the custodians—the wallet providers, those who manage the reserve assets—to also be subject to supervisory oversight to ensure the integrity of the payment operations.

Those are, in my view, and in the President's Working Group's view, the best way to protect both consumers and users and the payment system.

Mr. SCOTT. And do you have that enforcer and target in process to enforce these recommendations?

Ms. LIANG. That would be the role of the regulatory and supervisory framework.

Chairwoman WATERS. Thank you very much. The gentleman from Michigan, Mr. Huizenga, is now recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman, and I appreciate you being here, Under Secretary Liang.

Under Secretary, I am assuming you may be familiar with this, but I just want to make sure. At the end of last year, the House Financial Services Republicans released a principles position to guide Congress' evaluation of potential proposals for a U.S. central bank digital currency, and in that document, Committee Republicans noted, "If Congress contemplates authorizing the use of a Fed-issued digital currency, it should not impede the development and utilization of stablecoins, both those currently in circulation and those yet to be developed."

In short, we need to make sure that the private sector is leading the way. That is one of the concerns that many of us have had. And I will continue to advocate for that because I think it is important to remember that issue as we continue this discussion on digital currencies.

I want to move on to my questions here. The SEC is a member of the Presidential Working Group on Financial Markets, correct?

Ms. LIANG. Correct.

Mr. HUIZENGA. Okay. Just about a month or so before the release of the report, SEC Chair Gensler stated in an interview that stablecoins, "may have attributes of investment contracts, have some attributes like banking products, but the banking authorities right now don't have the full gamut of what they need and how we work with Congress to sort through that."

While that may not be the most clear statement of intent, it does suggest that the Chair believes that Congress needs to act in order for most or all stablecoins to fall under the SEC's regulatory authority. Yet during his testimony to the Senate, Chair Gensler stated, in a somewhat contradictory way, that, "some of these tokens have been deemed to be commodities and many of them are securities."

So, I am curious, will you be able to explain why the report did not include any analysis of policy issues under the securities laws as they pertain to stablecoins, and was it discussed? And again, given that the SEC is a member of the Working Group, if it wasn't discussed, why not?

Ms. LIANG. Yes, of course. The President's Working Group was convened to review stablecoins as a possible way to improve the payment system, and the mandate was to identify whether this new possible payment instrument, based on a new technology, would have the appropriate regulatory framework, and the goal was to identify gaps in regulation.

As I mentioned in my testimony, this proposal builds on existing laws and regulations that apply, including SEC regulations that apply to stablecoins as an investment asset or a security.

Mr. HUIZENGA. Did I miss something? It doesn't look like there was any analysis that was actually done on that.

Ms. LIANG. We did not include what the existing securities were, but—

Mr. HUIZENGA. Hold on. I'm sorry. It is unclear already, so why would you not do that analysis? If we don't have a clear picture, why would you not have done that analysis?

Ms. LIANG. I think I would need to defer to the SEC for its strategies about how to address stablecoins. But its authorities are for market integrity and investor protection related to the redemption and creation of stablecoins, not for their use as a payment instrument.

Mr. HUIZENGA. I have 1 minute left, and while I want to revisit that, I need to move on to this quickly, because I need to have your opinion. In your written testimony this morning, you indicated that, "Some have suggested that stablecoins could be regulated either as securities or as money market mutual funds." Assuming that stablecoins satisfy the definition of securities or MMFs, there is a further question as to whether these regimes would effectively address the prudential risks of stablecoins. And in your view, what are the parallels between MMFs and stablecoins and what considerations would be helpful for us to consider?

Ms. LIANG. Yes. Thank you for this question. Let me start with money market funds that invest in government securities, high-quality securities, as if that was the pool of assets backing a stablecoin. Investors purchase those with the expectation of earning the yield on the underlying assets. It is an investment asset.

A stablecoin can be purchased and used for payments, not necessarily investment, and that is what makes stablecoins unique. They are that bank-like product that the SEC Chair referred to as well as an investment-like product. And that is why we believe there was a regulatory gap for which a new framework should be considered.

Chairwoman WATERS. The gentleman's time has expired.

The gentleman from Texas, Mr. Green, who is also the Chair of our Subcommittee on Oversight and Investigations, is now recognized for 5 minutes.

Mr. GREEN. Thank you. Madam Chairwoman, I greatly appreciate you having this hearing, as well as the ranking member, and to the witness, I have always appreciated you, and I thank you so much for what you have shared with us over the years.

Let's talk for just a moment about a particular coin. As you have explained, I understand that this is not one of the stablecoins, but let's talk about Doge, D-o-g-e, if I am pronouncing it correctly. Would you agree that is not a stablecoin?

Ms. LIANG. That is not a stablecoin.

Mr. GREEN. And one of the things that I have noticed is how it has fluctuated. At one time, it had a high, in terms of its capitalization, of over $80 billion, and now it is down to around $20 billion. And it seems that this was initiated as a point of amusement for some persons and it became an investment tool for some other persons.

What do you see as the foundation for this cryptocurrency? What is the foundation for it? What is it resting on?

Ms. LIANG. I believe first, I would say that the digital asset marketplace is evolving very rapidly. It is changing. It is ongoing change for a while. But it is built around a new technology that has the potential to radically change how different financial services will be provided.

There are a lot of products being offered, and services being provided that investors can evaluate. They should, in my view, have the information needed and evaluate the risks they take if they choose to invest in them. And they also should have the protections that current laws would apply to investors. But I think it is difficult for us—for regulators and policymakers—to anticipate what this digital asset landscape will look like many years from now.

Mr. GREEN. Let me ask this question: What are you investing in when you invest in this particular piece of cryptocurrency? What are you investing in?

Ms. LIANG. Not speaking about any particular product, but I believe that people may be investing in the adaptation of this new digital technology, this distributed ledger technology, to all kinds of services, and its application. And I think there is a view in the industry that the more people invest in these kinds of assets and get comfortable with them, the potential for them to develop new applications continues to grow.

So I think it is a very open question, which of the products currently being provided will be lasting and durable, but it is in the position right now that regulators and policymakers think it is very difficult to prejudge who the winners and losers will be.

Mr. GREEN. I concur with your notion that it is difficult to prejudge, but I would add this commentary: If you invest in nothing, there is a good likelihood that at some point you will get what you pay for. And that causes me a good deal of concern, because a good many people have assumptions that are not necessarily going to be comparable to the facts. And people who are investing in coins that have no fiat currency associated with them—I know of very little associated with some of them—those investments are at a higher risk than some others, and that causes me a lot of concern.

I do believe that at some point we are going to have to look at certain coins literally as being without the law. They will be without the law, because we cannot allow certain things to happen. We just can't allow people to invest in nothing. Investing in nothing does not end well, it seems to me. There may be some rare occasion where you will get some great benefit, but usually you will get what you pay for. And I am so grateful to you. Thank you so much.

Chairwoman WATERS. Thank you so very much.

The gentleman from Oklahoma, Mr. Lucas, is now recognized for 5 minutes.

Mr. LUCAS. Thank you, Madam Chairwoman. Under Secretary Liang, could you discuss the differences between the types of reserve assets that stablecoins hold?

Ms. LIANG. As I mentioned, there are many stablecoins that are being offered that are tied to the value of, say, the U.S. dollar predominantly. Some of them are backed by Treasury securities, and bank deposits. Some of them are backed by short-term liabilities such as commercial paper, corporate debt, or others. These are self-reported assets, which I believe are subject to audit by a private firm. They are not confirmed by any regulators. But there is a mix of the reserve assets backing stablecoins, and not all of them, we believe, would be able to deliver a dollar in stress conditions.

Mr. LUCAS. Which takes me to my next question, if there is such a thing, what would a typical assortment of reserve assets be? You mentioned every one of these is unique in itself, but is there such a thing as a typical assortment of assets in these pools?

Ms. LIANG. I think the desired asset pool would be high-quality assets that could deliver a dollar even under stress conditions. But I think the current mix varies across the different stablecoin issuers. As I mentioned, there may well be 50 or 60 different stablecoin issuers out there right now. The largest, however, has some corporate, short-term liabilities that has not proven to be able to deliver a dollar in the past, under stress conditions.

Mr. LUCAS. Exactly, and that takes me to my last question in this line of logic, thinking about my predecessor from Texas's comments. That mixture of reserve assets, of course, would impact a user's ability to redeem stablecoins at some future point, correct?

Ms. LIANG. Absolutely.

Mr. LUCAS. So, one would need to be thoughtful.

Ms. LIANG. Absolutely.

Mr. LUCAS. Second question, Under Secretary. The CFTC has shown through enforcement action that it has some authority over stablecoins. Is it the Working Group's view that the Commodity Exchange Act gives the CFTC the full authority to audit stablecoins to ensure that the assets backing stablecoins are fully accounted for?

Ms. LIANG. I would definitely need to refer you to the CFTC on that. The PWG did not try to come to a conclusion about the applicability of the securities and the commodities laws. That is something their agencies are working on. And as I understand it, there are enforcement cases in the courts that are addressing this issue. The PWG was looking for gaps in existing regulations related to stablecoins as a payment instrument.

Mr. LUCAS. The report touches on how many stablecoins aspire one day to be widely used by retail users to pay for goods and services and other uses. Can you discuss the current barriers stablecoins might face in becoming widely adopted, and in your view, would the wide adoption of stablecoins be a positive development for the consumer?

Ms. LIANG. I think the potential for stablecoins to be widely used is that there are potential benefits, again, in faster and cheaper payments.

The current barriers would—in our outreach, when we were doing this study, we spoke to 40 to 50 market participants. And one thing that was a common theme was that greater clarity about the regulatory structure would be helpful to developers and innovators on stablecoins. I also think it is at the beginning of adoption. I think adoption of technology can scale up very quickly. There are quite a few companies now considering whether to issue stablecoins and how to do so. I think the potential is there to really improve the payment system.

Mr. LUCAS. With that, Madam Chairwoman, I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on Housing, Community Development, and Insurance, is now recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman, and Under Secretary Liang, thank you for being here today and for being so candid with us.

I am following along the same lines that many of my colleagues have raised during this discussion. Madam Under Secretary, I am suffering from, "Ponzi paranoia." I know you probably haven't heard of that disease, but when I start thinking about and discussing this whole issue, I think of Bernie Madoff and how easy it would be for us to have some kind of devastating economic problem as it relates to this whole new digital currency, digital dollars.

And let me just find out if there is any kind of antipsychotic regime that is put in place by you or other doctors. You are a Ph.D., right, so you are a doctor. I need a doctor on this anyway.

What protects the American public right now, at this very moment, from being taken in?

Ms. LIANG. I think that the issues that you raise are of serious concern, that consumers and investors need to be protected. The digital asset space, while built on a new technology and while offering the potential for innovation that is beneficial to the economy and consumers also carries some risks to consumers and users and investors.

The market regulators, the CFPB and the bank agencies, to the extent that their entities are involved, are taking actions to try to protect consumers and investors, and I expect these actions will continue. And they address fraud, misleading advertising, and manipulation.

So, I think those are the protections in place. From a broader financial stability perspective, there is ongoing monitoring, following developments and whether leverage might be used in some trading of digital assets that could increase the potential for a much more serious fall in asset prices. So, I think the regulators are very much focused on protecting investors and consumers.

The PWG report focused on stablecoin, which has a much more stable value because that is its offer, so it doesn't have quite that level of concern about the volatile asset prices that come along with the other assets. But I believe the regulatory community is very much focused on these issues you are raising.

Mr. CLEAVER. Yes, I am sure they are, but the private sector is setting up whole divisions right now, crypto divisions and corporations. They are ahead of us. And the reason I mentioned Bernie Madoff and Ponzi scams, which is investment fraud, is that all you need is a constant flow of new money to thrive. And when you face the reality that there are probably unlicensed sellers out there, and they are not registered with the Securities and Exchange Commission, it frightens me. Do you have any such concerns?

Ms. LIANG. Absolutely. I think new developing technologies, rapidly growing markets with an unclear, inconsistent regulatory framework is not appropriate. And the PWG report tried to start the conversation of what the regulatory framework should be for stablecoins, which is a subset of the digital asset space. And as I mentioned in my testimony, the Administration has an ongoing effort to take a more comprehensive strategy across all kinds of digital assets, including concerns about user protection and financial stability.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Chairwoman WATERS. You are welcome.

The gentleman from Florida, Mr. Posey, is now recognized for 5 minutes.

Mr. POSEY. Thank you, Madam Chairwoman.

Under Secretary Liang, one of the reasons for prudential supervision of banks and deposit insurance is to ensure that our payment system can redeem its deposit liabilities at par, or dollar for dollar. This is essential for bank deposits functioning as money that can be redeemed even in periods of stress.

In this regard, a number of questions have arisen in the stablecoin realm about asset quality. Let me use Tether as an example. Can you tell us if Tether is backed by a dollar or cash equivalent?

Ms. LIANG. My understanding from their public documents that they post is that their reserve assets include assets that are not credit risk free.

Mr. POSEY. Okay. Does Tether have investments in Chinese commercial paper or any other illiquid assets that might threaten the redeemability of stablecoins?

Ms. LIANG. I understand they hold commercial paper of private firms, which is not a credit-free asset.

Mr. POSEY. Okay. Has a Tether been issued that is not fully collateralized?

Ms. LIANG. I'm sorry. Could you repeat that question?

Mr. POSEY. Has a Tether been issued that is not totally or fully collateralized?

Ms. LIANG. I expect that is the case. They are not regulated. They publish data, but based on what I understand, they may not be able to deliver a dollar. They are not fully collateralized under all conditions.

Mr. POSEY. Okay. Thank you. Do you have concerns about Tether's opaqueness and its impact on consumers?

Ms. LIANG. I do have concerns about the opacity of the reserve assets of stablecoin issues. That is, in fact, one of the reasons for our first risk that we identified, the run risk, and the potential that could have for other short-term funding markets if investors were to become concerned about the quality of the assets underlying a stablecoin.

Mr. POSEY. As we move forward, I hope we can find a path that provides for protection of consumers and investors in the stablecoin realm, but which also permits our economy to realize the benefits of the newer innovations. The President's Working Group explored regulatory alternatives to doing this. The conclusion that the group reached seemed to be that stablecoins ought to look more like banks and deposits, including deposit insurance.

Can you share with us the alternative regulatory regimes for providing adequate disclosure that would make sure the consumers of stablecoins are not perfect substitutes for cash or bank deposits, as they are currently structured, to anybody?

Ms. LIANG. As I mentioned in my testimony, the IDI proposal, that issuers be IDIs, really did rely on the flexibility of supervision and regulation under that proposal, that a stablecoin issuer that only issued stablecoins for payments and did not make commercial loans like a commercial bank, a traditional commercial bank, would be subject to a very different supervisory regime. So, I think there is a degree of flexibility within the proposal that we put forward.

The PWG report also did not make a statement about deposit insurance. Depending on the quality of the assets and the capital and liquidity standards that could be applied to a stablecoin issuer, they may not need deposit insurance. So I think there is also a possibility that within that one framework of IDI, there is a range of ways that could be applied.

Mr. POSEY. Okay. And you have covered part already, but I am wondering what the current Administration policy proposal for addressing stablecoins is in our financial system?

Ms. LIANG. Currently, the PWG report recognize that there are gaps in the current system, that there are securities laws, and there are consumer protection laws, and there are illicit finance laws to address stablecoins and other virtual assets. But there is not a regulatory framework at the Federal level that builds on State-level regulations that would apply to stablecoins as a use of payment by households and businesses and financial firms and governments, if it became widely used.

Mr. POSEY. I thank you for your forthright answers, and I see my time has expired. I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you.

The gentleman from Colorado, Mr. Perlmutter, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, is now recognized for 5 minutes.

Mr. PERLMUTTER. Thanks, Madam Chairwoman, and thank you, Under Secretary Liang, for joining us today. This is a very interesting conversation because it is almost like we are trying to talk about the nature of money or the nature of an investment or the nature of commodities. So even though there is a glossary of new terms dealing with digital assets, we are dealing with some things that are very basic to an economic system.

For me, I just see there is a spectrum here, and you are trying to figure out where on the spectrum these stablecoins fall. The first part of the spectrum would be, you go buy something, it is a stupid purchase, you should never have bought it, but we have caveat emptor, buyer beware. Why did you buy that dumb thing?

But then, say, 10,000 people buy it, and you say, okay, and it falls apart, well, you guys got defrauded. Maybe, let's take a look at it. You move further ahead and a million people invest in something. Now, all of a sudden, you have other questions you have to ask. Is it a currency? Is it a medium of exchange that so many people are using? And I want to thank Mr. Davidson, who convened a group a couple of days ago on cryptocurrency. It was a very interesting conversation.

Here, it reminds me of money markets. It also reminds me of silver certificates. It is not like we have not had in history something backed by what was thought to be a stable reserve, silver, but then there was a crash of the silver market and those silver certificates were absolutely worthless.

In this instance, in this spectrum, these stablecoins, what do you consider, based on the review of the group—what would you consider the most secure of the stablecoins that have been developed? And not to the point where they are a currency, a medium of exchange that a million people are using back and forth, but more like an investment. Can you see this sort of spectrum that I am talking about?

Ms. LIANG. Yes, of course, and I think you highlighted the particular uniqueness of stablecoins, that it can be both the investment and it can serve as a payment mechanism. And the PWG report was focused on the future of stablecoins, the near future of stablecoins as a payment mechanism.

But as an investment contract there are, I believe, stablecoins that are backed by high-quality assets, and if they were not used as payments and there were not issues of concerns about operational risks of storage, transfer, and the actual use as payments, then the PWG recommendations are not applicable. The PWG recommendations are focused on those that could be used for payments and how to convert convertibility and operational risks as well.

Mr. PERLMUTTER. Let's talk about that. This is where it gets to money markets.

Ms. LIANG. Yes.

Mr. PERLMUTTER. And we broke the buck, the reserve, whenever it was, we broke the buck. And Mrs. Wagner and Mr. McHenry were sort of saying, well, why are we trying to make this a Federal issue? Let's just go State by State. We saw with money markets that even though we didn't back them because so many people used them as currency or as a payment medium, we ended up backing them.

Ms. LIANG. Right.

Mr. PERLMUTTER. The question is, do we want to do this before something goes to heck or after it goes to heck? That seems to me to be the question.

Ms. LIANG. Right. The PWG report would suggest before.

Mr. PERLMUTTER. Okay. I think this is a great education on sort of an economic system and the payment system, and I wish you very good luck in trying to come up with a good answer. Thank you.

Ms. LIANG. Thank you very much.

Chairwoman WATERS. Thank you very much.

The gentleman from Kentucky, Mr. Barr, is now recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman, and thank you, Under Secretary Liang, for your testimony.

I want to follow up on the questions from Mr. Luetkemeyer a little bit about protecting the dollar as the world's reserve currency. As innovations in digital assets advance, it is vitally important that we maintain the dollar's position as the world's reserve currency. Given that major stablecoins are denominated in dollars, the adoption would likely not compromise the dollar as the world's reserve currency.

Under Secretary, first, do you agree with that, and second, do you agree that as dollar-backed stablecoins such as USDC are adopted, the threat to the dollar from cryptocurrencies and other central bank digital currencies is diminished?

Ms. LIANG. I agree with your statement that it is important to preserve the value of the dollar. I believe stablecoins that are stable and can deliver a stable value tied to the dollar would benefit the U.S. dollar.

Mr. BARR. Great. The Fed is exploring a digital dollar and recently released its long-awaited CBDC report. We don't want the development of a Fed CBDC to quash private sector innovation, including in the stablecoin space. Do you believe that stablecoins issued within a clear regulatory framework may be able to coexist with a Fed-issued CBDC?

Ms. LIANG. Yes. In my view, regulating stablecoins tied to the dollar does not in any way preclude anything with respect to the introduction of a CBDC. It is hard to know what the future will look like, but one could imagine they could coexist. One could imagine a CBDC that supplants private stablecoins. But I don't see any reason that creating a regulatory framework for U.S. stablecoins would foreclose any avenues on the digital dollar.

Mr. BARR. One editorial comment—and I am still developing my opinions on this—but it does seem to me that the dollar-backed stablecoin concept solves the problem of protecting the dollar as the world reserve currency and perhaps diminishes the case for a Fed central bank digital currency.

Let me ask another question. I want the United States to be competitive and the leader in stablecoins, and one of the key recommendations of the PWG is that Congress pass a law requiring stablecoins to be issued only by insured depository institutions, bringing stablecoins within the banking regulatory regime. I do worry that this could push crypto talent innovation and stablecoin issuers overseas to other jurisdictions, and I also worry that it is inconsistent to take the position that only banks should be allowed to issue stablecoins, but then fail to grant bank charters to the largest issuers of stablecoins.

As you think about American competitiveness and making sure that we are on the cutting edge and the leaders in this space, can you address these concerns in the context of the PWG's recommendation that we bring stablecoin issuance into the bank regulatory regime?

Ms. LIANG. The proposal for issuers to be insured depository institutions is designed to make them stable, and I think stability is probably the key attribute of a good stablecoin. So, I think stability and leadership in this space are not in conflict.

Mr. BARR. Under Secretary, that is a fair point, and if I may interject with limited time, if you have an audit, if you have oversights of the integrity of audits to ensure that stablecoins truly are stable, that diminishes the likelihood of runs, run risk for example, that, to me, solves the problem without requiring stablecoin issuance to be done through insured depository institutions. Why is that wrong?

Ms. LIANG. The first risk that we identified in the report was run risk. The second risk was risk to the payment system, and that I do not think the disclosure or the money market fund type regulations are designed to address.

Mr. BARR. Thank you for your work on this. I look forward to continuing to be an advocate for innovation and American leadership in this space, and I yield back.

Ms. LIANG. Absolutely.

Chairwoman WATERS. Thank you.

The gentleman from Connecticut, Mr. Himes, who is also the Chair of our Subcommittee on National Security, International Development and Monetary Policy, is now recognized for 5 minutes.

Mr. HIMES. Thank you, Madam Chairwoman, and thank you, Madam Under Secretary, for being with us.

Like Mr. Perlmutter, I think this is an interesting conversation. I want to just start by level-setting, because I think it is important that we move on beyond what we have been doing, in a constructive way, and understanding these implements, to realizing that like every other innovation that the Congress has faced, probably for centuries, there is a potential upside, and a potential downside. My guess is that 110 years ago, when we were presented with the concept of the automobile, we never imagined that 35,000 Americans would die every single year on the roads because of the automobile. But nobody is proposing that we do away with the automobile. I suspect that is true for air travel, for the internet, and for all of the innovations that we see every single year.

So the question really is not, should we allow it or not, because it is already here. And the question is, just as it was with the automobile and with the internet and with everything else, how do we regulate it in a way that allows for innovation and the benefit but protects the consumers, et cetera?

And, by the way, I will just remind my colleagues that we famously did a number of hearings on GameStop back in February. Had Grandma bought GameStop in February, at $350 a share, Grandma would be out two-thirds of her money today. And we don't say we should stop trading in GameStop. We say it should be transparent, it should be disclosed, all of the risks, and when that happens, we trust American consumers to take informed risks.

That leads me, Madam Under Secretary, to my question, which is, I think you would agree with me that there is a radical difference between a stablecoin which is fully-backed, dollar for dollar, with reserves that are not leverageable, where there is redemption at par, where there is no maturity transformation—there is a radical difference between that and what Mr. Green so memorably called investing in nothing. Correct?

Ms. LIANG. Agreed.

Mr. HIMES. Dogecoin. And I think we have an opportunity here to recognize that by saying that if a stablecoin is dollar-for-dollar backed with currency, it is redeemable at par, there is good transparency, we can regulate it in a way that is different than a much more risky instrument. And we have talked about this, but I wonder whether you would agree that full IDI regulation, bank charter may not be necessary in that former case?

Ms. LIANG. I agree there are important distinctions between stablecoin and the unbacked digital assets. I also agree the full set of bank regulations do not need to be applied to a stablecoin issuer that does only stablecoin issuance. There is flexibility within the IDI framework to not focus on credit risk in making loans, because the stablecoin issuers do not make loans. They do not engage in fractional reserve banking. But they do have payments, and there are operational and convertibility risks that are associated with that, over which you would like some oversight to ensure that the payment system continues to operate well, which is a public service to the financial system. And that is the core of the PWG recommendation.

Mr. HIMES. I appreciate that, and I appreciate the way—and we have had a couple of conversations about this—you are thinking flexibly, because I really do think our sole job right now is to figure out how to adequately regulate instruments which can be very, very safe or potentially very, very risky, and that is actually an exciting endeavor, I think.

Let me use my last minute, Under Secretary Liang, on something I have not thought too much about, but I would love to hear you on for a minute, which is systemic risk. It doesn't feel to me like you have quite the market cap yet, or leverage—and I really highlight the word, "leverage"—to create the kind of systemic risk. And I am a refugee of 2009, 2010. But give us a minute on what we need to watch for, vis-a-vis the development of systemic risk in this space?

Ms. LIANG. I think you have identified one of the key things you would watch for systemic risk. It is an asset which the value becomes increasingly based on more leveraged positions. The regulators, including the Financial Stability Oversight Council (FSOC), have been monitoring developments in digital assets, looking for leverage. Leverage is a fundamental vulnerability that increases risk to financial stability. Others are, whether they become much more interconnected with the traditional financial system.

Currently, crypto assets, digital assets have pretty tenuous links to the traditional financial system. The banking regulators have raised capital requirements on any crypto asset holdings. They are cautiously issuing guidance for how banks can get involved in this category. That is another thing that, if you were monitoring for emerging systemic risks you would look for greater connections with the traditional system and you would look for leverage, increasing leverage.

Chairwoman WATERS. Thank you very much. The gentleman's time has expired.

The gentleman from Texas, Mr. Williams, is now recognized for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Madam Chairwoman. Cryptocurrencies have shown great promise to fill many shortcomings with the traditional financial services marketplace. They are offering new ways to reach unbanked communities and are making it easier to send payments anywhere in the world, and are making oracles that transfer real-time data to blockchain networks.

Stablecoins play an integral part in making this entire ecosystem function by allowing people to remove the volatility that is often associated with crypto, so you can preserve value without the need to transfer digital coins back into fiat currencies.

Your report suggests that we should treat all stablecoin users as banks. This would give a massive advantage to all of the institutions who are most skeptical about cryptocurrencies in the first place, and leave behind the entrepreneurs who have worked to make cryptocurrencies more mainstream. It would guarantee that the largest banks in the country have a built-in advantage over another market participant who may not have the resources to comply with the minimum regulations that are coming.

So, this would give the largest banks an even greater advantage in this developing space over every other entrepreneur who may have been doing this for much longer.

So, Ms. Liang, how did the Working Group balance the effect on innovation as they came up with these recommendations?

Ms. LIANG. Thank you for the question. Of course, the group was very focused on balancing the benefits for financial innovation with reducing the risks to users and the broader financial stability of stablecoins.

I believe that stablecoins, because they offer stability, should be held accountable to actually be able to provide that stability when demanded, and that requires more regulation than they currently are under.

While the proposal was for stablecoins to be issued by insured depository institutions, the proposal also relied on the fact that regulation and supervision of IDIs can be quite flexible, and that stablecoin issuers that have those simple business models of holding high-quality reserve assets and issuing liability such as stablecoins, would be subject to a very much less stringent type of supervision and regulation than would a traditional commercial bank.

So I think that we, the PWG, came out balancing the risks that could be reduced by that framework while providing clarity and consistency and safety that would be beneficial for innovation.

Mr. WILLIAMS OF TEXAS. As you developed this report, you have sought the input of regulators, academics, and private sector participants, and as a business owner myself, I value the input of the private sector. I think it is the most important. And since most people who took risks to build these new products and provide service are in the private sector, they are the ones who took risks and have the most to lose if the government gets this regulation wrong.

So in closing, can you describe your work in consulting the private sector as you developed this report, and do you think their voices were adequately accounted for?

Ms. LIANG. We did reach out to many stakeholders, including academics, regulators, and the private sector. We talked to many in the industry to hear their concerns, to learn more about the actual business and the problems that they face. I think many of them are comfortable with the idea of an IDI bank charter. Some are pursuing it. Some are already within the regulatory parameter, even on their own.

So I think, again, we are balancing innovation with safety, trying to find the right balance. I think this recommendation is one path forward. Of course, Congress will determine how it wants to write legislation. We believe this element could be very beneficial to the system.

Mr. WILLIAMS OF TEXAS. I yield back. Thank you.

Chairwoman WATERS. Thank you very much.

The gentleman from New York, Mr. Meeks, who is also the Chair of the House Committee on Foreign Affairs, is now recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman. Madam Under Secretary, as mentioned, a core recommendation of the President's Working Group is to require stablecoin issuers to be insured depository institutions. So my question is, to what extent was this recommendation analyzed through the context of the President's Executive Order on promoting competition, as well as his Executive Order on racial equity? It occurs to me that limiting stablecoin issuers to insured depository institutions, which have a high barrier to entry, could limit competition. Furthermore, given the disproportionate number of people of color who gravitate to nonbank financial institutions, such recommendations could have a racial equity impact.

So what I want to know is, did the Working Group consider this recommendation's impact on both competition and racial equity, and if so, please explain?

Ms. LIANG. Thank you. The group did consider the impact on competition. I think the view is that the current regulatory framework is inconsistent and fragmented, and that a more consistent, comprehensive framework would benefit competition. It also believes that financial innovation is important and tried to provide clarity, which is something that the industry has asked for, and also that competitive advantages should not arise from differences in how standards are implemented across different regulators. So, my view is that it balanced competition by providing more clarity, and more consistency.

In terms of meeting equity goals and meeting the needs of the unbanked or underbanked, I think stablecoins have the potential to help by lowering costs, and if those who choose not to go to banks are more comfortable using the technology of the stablecoin. And so, I think that is the potential to improve financial inclusion and address some of the equity goals of this Administration.

Mr. MEEKS. Thank you for your answer, and there are certainly areas of regulatory gap when it comes to this new type of payment system and technology. And there are also tremendous ways we can use stablecoins to help underbanked communities. And as Chairwoman Waters said, I am the Chair of the House Committee on Foreign Affairs, so it also could help communities abroad who may be facing turmoil in their home countries.

Ms. LIANG. Yes.

Mr. MEEKS. And we are hearing about NGOs who can assist refugees with assessing their cash in their new country through the use of stablecoin, where the population of a country in distress can access a mobile crypto wallet and the government cannot get to it, making it a great use case for humanitarian aid and relief.

So, how can the Treasury assist some of those NGOs in partnership with stablecoin issuers to help get humanitarian aid out to these populations safely and efficiently? And is there anything that Congress can do to assist in this area?

Ms. LIANG. The examples you cite of being able to provide aid to other countries is exactly some of the benefits that could come from this new technology. The President's Working Group recommendations are to make that service more stable, so that it functions as needed without raising other risks to financial stability. And that is exactly an example of the beneficial effects of a new technology in allowing innovation.

Mr. MEEKS. Thank you for that. And I am pretty pleased to see that the industry is interested in using stablecoins to help citizens of some foreign countries, and a lot of them are going through the necessary steps to ensure that there is proper Anti-Money Laundering (AML) and Know Your Customer (KYC) procedures in place. But in peer-to-peer transactions, that doesn't have a formal broker.

The Financial Crimes Enforcement Network's (FinCEN's) jurisdictional reach is limited, and many crypto users value the autonomy aspect, and therefore a great number of transactions don't require the same level of KYC procedures that others may do.

And I know I am out of time, but my question would be, what role can the Financial Action Task Force (FATF) and FinCEN play when it comes to combatting these bad actors while also ensuring that good use cases like humanitarian aid and simple cross-border payments are not stifled or made more complicated?

Ms. LIANG. Treasury is leading the Financial Action Task Force (FATF), and trying to improve the implementation of standards in countries that may be lagging in their implementation. This is a high priority for them.

Chairwoman WATERS. Thank you very much.

The gentleman from Arkansas, Mr. Hill, is now recognized for 5 minutes.

Mr. HILL. Thank you, Madam Chairwoman. Thanks for convening this hearing. I appreciate the comments of the ranking member as well. And Madam Under Secretary, thanks for sitting there patiently with all of these Members asking questions.

My sense, listening today to Chairwoman Waters, is that there is a fair amount of agreement between Democrats and Republicans on stablecoins, starting with the belief in their potential to improve the efficiency, speed, and cost of payments, especially cross-border payments, as just noted by Chairman Meeks, expand financial access, and facilitate the use and adoption of digital assets due to the role of the stablecoin as being sort of an onramp to the greater crypto developing ecosystem. I would say a very fledgling, but developing ecosystem.

And, as noted by Mr. Himes and Mr. Barr, maintaining the U.S. as a preferred currency, is obviously important to all of us—Mr. Himes and I have our U.S. dollar legislation pending about working on that—but also, the U.S. is a preferred place for innovation and a host country for financial technology.

So as Congress considers legislating, I think we ought to focus on permissible reserve assets, their credit quality, and the collateral requirements, liquidity and redemption requirements, risk management and other governance issues, including audit and transparency controls and privacy, irrespective of what the use case is. And this is something, Madam Under Secretary, this issue of whether it acts as a money market mutual fund or a payment system, I think we ought to be neutral on that. I don't think we should preempt that. I think we ought to have narrowly crafted legislation that simply determines, as I have just outlined, what is a good stablecoin, from a consumer or business point of view.

Do you agree that we should focus on that definition above all, after working on the output of the Working Group?

Ms. LIANG. Representative Hill, thank you for that question. It is a thoughtful question. I think regulations should follow the function of the product or the service.

Mr. HILL. Yes, I agree with that. It is just that my time is short.

I am an activities-based person as opposed to jamming everything through entity regulation, particularly in an innovation, and the jury is out for me on whether these have to be issued by a depository institution, for example. I don't think you are wrong to suggest that, but would you support a Federal money transmission license, or a national payment provider license that would be a national license similar to what we see in the EU? Is that an alternative that you would accept?

Ms. LIANG. I think that is a possibility definitely worth exploring. The U.S. does not have a Federal money transmitter license, so we did not build on that framework.

Mr. HILL. Yes. And that gets into this issue, as Ranking Member McHenry asked, about State regulation. Are you supportive of

States going ahead and defining some of these quality standards around stablecoins, as we have seen in the case of New York?

Ms. LIANG. I think in the current environment with stablecoins already in play and growing rapidly, the current regulators need to take actions to meet their mandates. As I understand it, some State money transmitter licenses don't even apply to digital assets, so it feels like there is probably room for different States to be revisiting their rules.

Mr. HILL. Yes. Thanks. And on the subject of deposit insurance, I agreed with a lot of the comments, and I don't really think that's the right road to go down for these assets. I think defining them is a much better approach, whether they are used as a payment activity or as an investment holding activity, and that we just use activity-based regulation, based on the definition.

As to whether or not they are systemically important, that seems a stretch for me at $150 billion or $170 billion, when you think about how we have $5 trillion in credit card transactions a year, and we have almost $5 trillion in money market funds. So to me, I thought that was a stretch. I encourage my colleagues to work together on a narrowly-crafted definitions bill for what is a good stablecoin.

Thank you for your time, and I yield back.

Chairwoman WATERS. Thank you very much, Mr. Hill, and I just want to remind you that while you talk about how it appears that there is growing consensus between both sides of the aisle, do not minimize permissible reserves. That is very important. Thank you.

The gentleman from Illinois, Mr. Foster, who is also the Chair of our Task Force on Artificial Intelligence, is now recognized for 5 minutes.

Mr. FOSTER. Thank you. Under Secretary Liang, I would like to follow up regarding any specific recommendations that you might have for providing a secure and legally-traceable digital identity for participants. It seems to me that it is clear that if stablecoins, or even central bank digital currencies or other crypto assets, become generally available for consumer transactions, and we want to prevent them from being used for ransomware, money laundering, human trafficking, you name it, we must have a legally-traceable identity to the beneficial owners behind the transaction, that can be executed in a court, in a trusted jurisdiction, in a country with which we have extradition treaties.

And I thought it was quite remarkable that when we had crypto billionaires in front of our committee a while ago, they pretty much agreed that was a necessary condition for preventing this kind of crime. And we can't simply just use KYC requirements as they exist today, because the fact that someone or some shell company has a bank account in Cyprus just will not cut it.

What are your thoughts on how to proceed with traceable digital identity for crypto assets generally, both nationally and internationally, and do you need more specific guidance from Congress on how to proceed?

Ms. LIANG. Thank you for that question. I think in the context of digital assets, the principles of security and privacy can, at times, be in conflict. But privacy is very important, as is security.

I think this is an area for legislation. The PWG report did not make any recommendations around this issue. But I would say that they were very aware of this potential, and I think with the role of a CBDC, these are issues as well.

One area that the PWG report did touch on this topic is the potential for a stablecoin to scale rapidly, perhaps because of network effects, and there are benefits to that. But that also gives them quite a bit of information and control over a lot of customer financial transaction data. So an issue that we raised was that Congress should consider whether they would want to put some authorities around how to manage the security of that data. And I think that is an important issue to address if digital assets, as a currency, become widely used by the population, and you have a big system where everything is digital. As you know, consumer privacy is important, as well as security, and those are a balance, and I think that is an area for Congress to be doing more in, as they are, I should say.

Mr. FOSTER. Yes. I just would, as I have done before in this committee, draw people's attention to the National Institute of Standards and Technology (NIST) standards for using a modern cellphone and a REAL ID-compliant mobile ID or driver's license as a way for consumers to prove who they are, who they say they are.

Ms. LIANG. Yes. I understand there are proposals to build on the real ID system that is being implemented and tying it to the iPhone or their phones as a way to ensure the identity of an individual. That would help to prevent fraud, and it would also increase security for an individual.

Mr. FOSTER. And is this something that FinCEN would have specific recommendations on, on how to proceed?

Ms. LIANG. I would be happy to ask. I am sure my colleagues at FinCEN would be happy to follow up on this.

Mr. FOSTER. Thank you. I think this is one of the really positive ways that this committee can get involved in crypto asset regulation generally.

Thank you, and I yield back.

Chairwoman WATERS. Thank you very much.

The gentleman from Minnesota, Mr. Emmer, is now recognized for 5 minutes.

Mr. EMMER. Thank you, Chairwoman Waters, and thank you, Ms. Liang, for your testimony and your time today. I am going to try to be efficient with my time, so I would appreciate as concise responses as you can provide to my questions.

Currently, stablecoins represent just 5 percent of the digital asset industry's total value. It is a relatively small fraction. But they, stablecoins, are facilitating more than 75 percent of trading in the entire digital asset ecosystem. That's quite significant.

Clearly, stablecoins offer economic benefits that cannot be ignored. Stablecoin transfers have nearly instant settlement, and settlement can be confirmed by both parties on a public blockchain. These characteristics lead many to view stablecoins as less risky than the heavily-regulated payment rails of our current banking system.

Yet, the President's Working Group report on Stablecoins focused almost solely on their perceived risks. The report doesn't even provide a definition for stablecoin. But it doesn't hesitate to assert that the risks of stablecoins are so broad and across cross-jurisdictional lines that only insured depository institutions or banks should be allowed to issue them.

As you mentioned to my colleague, Mr. Huizenga, you believe stablecoins could be both a bank-like product as well as an investment-like product, which is why you believe they should only be issued by banks. I firmly contend that the stablecoin is a payment instrument and is a fundamentally different asset than an investment product. If we base the evaluation of the report in this hearing today on a narrowly-tailored definition of stablecoin, I think we might come to see that a bank-like regulatory framework would improperly regulate the asset class and inadvertently capture potential future financial products that are vastly different than what you and I think of as stablecoin.

For instance, under this report a tokenized money market fund, which clearly would be a security, could fall under the same stablecoin umbrella as a fiat-backed payment token that is fully redeemable for cash. How is it that such vastly different financial products could be both defined as stablecoins, and the only institutional players that would be able to offer these vastly different products are banks?

The reason I elevate this concern is because legislating and regulating in this space should not be done under such broad definitional scope, and doing so would severely limit future market growth. It is not unlikely that tokenized money market funds backed by government debt or commercial paper might seek to come to market in the future. These potential future financial products could ostensibly lower the costs of participation in the asset class while offering conservative returns to investors.

Ms. Liang, do you think the same run risks and prudential risks when attached to stablecoins backed purely by U.S. Government debt or highly rated commercial paper?

Ms. LIANG. I believe you're raising some important issues about how quickly the technology is evolving and what the future of digital assets will be, that—

Mr. EMMER. No. That was a very specific question. How about this. Do you think U.S. Government debt that underpins U.S. Government money market funds is risky?

Ms. LIANG. There is no credit risk. There can be convertibility risks if—

Mr. EMMER. They are risky or they aren't?

Ms. LIANG. There is no credit risk.

Mr. EMMER. Okay, so—

Ms. LIANG. There can be liquidity risk, just in being able to execute the transactions.

Mr. EMMER. In the time I have left, Under Secretary Liang, I want to thank you. Tokenized money market funds backed by government debt or highly rated commercial paper clearly would not impose prudential risks significant enough to reserve the issuance of all tokenized money market funds to banks. This is important to highlight because there is a void in the market between stablecoins and security tokens, and a tokenized money market fund could provide an attractive, low-cost financial product with conservative returns. For this reason, I am working on a nonpartisan legislation that would allow tokenized money market funds to come to market.

Here is the bottom line. Banks should not be the only institutions in the ecosystem with dibs to issue the potential array of financial products that the President's Working Group report simply lumps together and ties as a stablecoin.

Thank you. I yield back the remainder of my time.

Chairwoman WATERS. Thank you very much.

The gentlewoman from Ohio, Mrs. Beatty, who is also the Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Mrs. BEATTY. Thank you, Madam Chairwoman, and thank you for holding this hearing. And Under Secretary Liang, thank you for being our witness today.

As I have listened to both sides of the aisle today, this has been very eye-opening and interesting to me. In full disclosure, at one time I probably thought this was more like the Wild Wild West of what we are doing, and now I realize that it is the future frontier. And while I don't want to overregulate to the point that it chokes off innovation, I do believe that some well-thought-out regulation would provide some legitimacy to this space and allow it to further flourish.

Earlier in your testimony, Madam Under Secretary, you talked about the largest stablecoin. Were you making reference to Tether?

Ms. LIANG. That is the largest stablecoin.

Mrs. BEATTY. Okay. Recently, they settled lawsuits with, I believe it was the State of New York and the CFTC for lying about the state of reserves that back this currency. And further, they claimed that about $30 billion of its holdings are invested in commercial paper, making them the seventh-largest holder of such debt. And this is coming from an article in Bloomberg.

So I guess what I want to ask you, Ms. Liang, is how important is it that stablecoin issuers are transparent—everybody knows, whether we are talking about this or diversity and inclusion, that I am a big believer that transparency is important—so that issuers are transparent with their reserves and these reserves are audited by United States accredited firms, not Cayman Islands firms?

Ms. LIANG. Right. I believe transparency is important, but it alone is not sufficient to prevent runs. For example, on money market funds, the holdings are transparent, but we had runs on two money market funds when the assets backing those funds are other than government securities. So when the holdings are Treasury securities and corporate high quality, in stress investors may still run. And we saw that in 2008, and we saw that in 2020.

So, transparency itself is extremely helpful, but it is not sufficient to address the issue of investor runs.

Mrs. BEATTY. Okay. Because of time, we will come back to that later, and maybe I can talk to some of your team.

Let me ask you this: What do you believe are the consequences for financial stability when so few hold such a large percentage of these different types of tokens?

Ms. LIANG. I think currently the risks to financial stability, the systemic risks, are not high. They are growing. They are emerging. One issue in the broader digital asset space is the high price volatility, and as mentioned earlier if that were fueled, in part, by leverage or when prices fell it would have impacts on the traditional—

Mrs. BEATTY. I am only rushing because of the time.

Ms. LIANG. —systemic risk.

Mrs. BEATTY. Congressman Meeks talked about minority communities and different communities. In full disclosure, I thought this only applied to the top 1 or 2 percent. But now, I am hearing that Black and Brown communities who are underbanked and unbanked are also playing in this space. What are the risks for them, or how, if I am underbanked or unbanked, can I put myself in something that we don't really have regulations for now? Quickly, because the clock is ticking.

Ms. LIANG. Yes. Here, I would like to distinguish again between digital assets and stablecoins. Stablecoins have the potential to improve payments—make them cheaper, make them faster—and we are seeing potential benefits for cross-border.

Digital assets, those that are not backed by, say, a pool of reserve assets, and whose volatility, the prices are highly volatile, investors really need to understand the risks when they make those investments. There are potential losses. High-volatility stocks are not for all investors.

Mrs. BEATTY. So, should we be advising people to wait? That is a yes-or-no question.

Ms. LIANG. I think we should advise investors and consumers that they should be aware of the risks of any assets that they are purchasing for investment purposes.

Mrs. BEATTY. Okay. Thank you. My time is up. Thank you so much.

Chairwoman WATERS. Thank you very much.

The gentleman from Georgia, Mr. Loudermilk, is now recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Madam Chairwoman. Thank you for having this hearing today.

One thing I have seen over my years on this earth and the time I have spent in government is the hesitancy of some people to adopt new technologies, especially when it comes to government. And I am not one to run out and just haphazardly accept anything that is new technology just because it is new, but I think it is very important for us to weigh the benefits and the other issues with any type of technology.

My mind goes back to the early 1900s, when the Washington Post ran an article when the word came out that these two bicycle mechanics, the Wright brothers, were testing a controlled flight device called an airplane. And the article said men will not be able to fly and should never be able to fly, just because of the hesitancy to adopt new technology.

However, when it comes to people in our positions, it is important that we have an honest weighing of the costs and the risks and the benefits of new technologies. And like Mr. Emmer had expressed, I am a little concerned and disappointed about how onesided this report really seems to be, for us to make a good decision. Most of it focuses on the risk of stablecoins, which obviously there are some, but there is little discussion of the benefits. In fact, the report mentions risk 131 times, but only mentions benefits 2 times.

So, I wish the report was more balanced, and I hope this Administration will be more ready to embrace some innovation, not just accept everything, but actually give an honest look at innovation and technology and not try to stifle it.

The report also doesn't address the regulatory frameworks that many States have already established for digital assets. Banking regulators in a number of States supervise stablecoin issuers under money transmittal laws.

Ms. Liang, the report calls for Congress to establish a Federal regulatory structure for stablecoins. As part of that, does the Administration intend to account for the regulatory frameworks that many States have already established for digital assets to avoid creating redundant requirements?

Ms. LIANG. The PWG report recommends a framework that reduces inconsistency and reduces the fragmentation of current regulations, and builds on the current State framework. It can build on the State money transmitter laws. Insured depository institutions can be Federally-chartered or State-chartered.

The goal of the framework was to provide some consistency, which we believe actually is beneficial to innovation, that having State laws apply, which vary, and increase the complexity of addressing lots of different regulations is a hindrance to innovation.

Mr. LOUDERMILK. So what you are looking at doing, to make sure I understand this, is considering State laws, but you want to avoid having contradictory State laws? Is that where one State may have one regulation, and another State, another regulation? What I am understanding you are saying is you are considering existing State regulations.

Ms. LIANG. Yes. It would build on existing State frameworks, as I mentioned. Insured depository institutions can be State-chartered or Federally-chartered. State money transmitter laws, as was mentioned, are at the State level. There is no Federal money transmitter license.

This was an approach to try to reduce some of the fragmentation in the system, with an approach that we believe can be flexible and does not use the entire set of rules that apply to traditional banks, and they could be adapted to stablecoin issuers.

Mr. LOUDERMILK. I think that it is important not to have fragmentation or conflicting regulations, but I also think it is important to avoid one-size-fits-all regulations specifically. We should not be broadly applying banking regulations to stablecoins.

Does the Administration intend to account for the significant differences between depository institutions and stablecoin issuers in its regulatory approach? Am I understanding that?

Ms. LIANG. Yes, that is our understanding, that the banking regulators have flexibility to address the supervision and regulation that would account for differences between stablecoin issuers and banks that also make loans. So, it would be a different approach.

Mr. LOUDERMILK. Thank you, and Madam Chairwoman, I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

The gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Madam Chairwoman. I want to thank you for holding this hearing, and also the ranking member. It has been very fascinating. And Madam Under Secretary, I appreciate the time you have spent with us.

I do think that stablecoin and cryptocurrency has some potential advantages. Certainly, when we take a look at remittances, remittances are very important in my district, and frankly, I think a benefit to Latin America and our hemisphere, and I think that this is a real possibility.

But I also think that there is real potential risk here. Just listening to the previous speaker here, he said that this Administration should be more balanced when it comes to cryptocurrency and digital assets.

Are you familiar with what President Trump said about Bitcoin?

Ms. LIANG. I am not.

Mr. VARGAS. Let me tell you what he said, since you are not familiar with it. "Bitcoin, it just seems like a scam. I don't like it because it's another currency competing with the dollar." Hardly seems balanced there.

But anyway, I just throw that out there because certainly the last Administration had a particular point of view, and certainly the President. So when you get accused of not being balanced, I don't think that is correct. But anyway, I appreciate all of the work that you have done on this.

But I do have concerns. I also heard that this is a new technology and it is new stuff that we have never seen before. The reality is that before the Civil War, banks used to issue their own paper, and they were redeemable for either silver or gold. And what you would see is that many of these banks, unfortunately, would issue more paper that was not redeemable, and then you would have a run, and you would have all sorts of chaos. That is why we had the National Bank Act of 1863, to make sure that we had the dollar, and that the dollar was backed by the full credit, and also rolls at the time of the United States of America.

So it is not the notion that we have never had this before, that you haven't had people issuing coins. The reality is we have had that, and it didn't work out very well. Now, we have new technology, and that is why we have to be open-minded; I certainly am.

But I do have concerns about the—and I will read here from page 2 of the report, which says, "While stablecoins have the potential to address shortcomings, the existing payment systems such as the potential for lower-cost or real-time payments, they pose legal regulatory and oversight challenges and may present risk to monetary policy." I do think risk is associated there.

We have been saying how small stablecoin is. I remember when we were saying how small cryptocurrency was. We used to talk about it in the billions. Now, we talk about it in the trillions. Could you talk a little bit about that risk?

Ms. LIANG. Yes. Sure. One of the risks that we focused on was something we would call concentration of economic power, and that is because stablecoins, as a payment mechanism, could scale up very quickly. One could imagine that you would create a closed loop, almost a private system of money, similar to what you were referring to in the late 1800s. That kind of risk is something that we think Congress should consider. The proposal in the PWG report, one possible path on that is to have supervisors require interoperability so that there would be greater competition among stablecoins and less potential for one system. That also would reduce interference with implementation of monetary policy, as you mentioned, that you have an alternative form of money system. So, that is the third prudential risk that we identified in the report.

Mr. VARGAS. Would some of these things be corrected if you did have the central bank digital coin? It seems to me that you would then have a possible solution there with the CBDC.

Ms. LIANG. Yes. CBDC, that possibility I think, as I mentioned, will depend quite a bit on the kind of features the CBDC would offer. It could be very different. The current situation, however, is that a CBDC is still being investigated by many central banks, including the United States. It could be years before it were introduced, if they made the decision to introduce it. And stablecoins are here today, and they are growing quickly. And it leaves regulators in an uncomfortable position to say, we should wait until there are decisions about a CBDC.

Mr. VARGAS. Thank you.

Chairwoman WATERS. Thank you.

The gentleman from West Virginia, Mr. Mooney, is now recognized for 5 minutes.

Mr. MOONEY. Thank you, Madam Chairwoman.

The growing popularity of stablecoins introduces some regulatory challenges but it also presents some opportunities. At a time when some regimes, for example, Communist China, are using top-down restrictions on their digital yuan to maintain totalitarian control of their populace, stablecoins have emerged as an innovative, entrepreneurial way to provide wider access to the U.S. dollar around the world. Stablecoins pegged to the U.S. dollar can help ease cross-border transactions and help maintain the dollar's status as the world's reserve currency.

Ms. Liang, in your testimony you mentioned furthering the United States' continued leadership of the global financial system as a goal of the President's Working Group framework. Can you explain how the President's Working Group's recommendations aim to further America's global leadership on the world stage?

Ms. LIANG. I think first, the role of the dollar and the role of the U.S. in the global financial system depends primarily on the country's governing structure, its respect for the rule of law, the strength of its institutions, the strength of its economy, and the liquidity of its financial markets.

Technology can play a role, but it is not the primary role. And I believe that stablecoins that are tied to the value of the U.S. dollar can help to promote the role of the U.S. dollar, but it needs to be on a stable footing. It needs to actually be stable. Stablecoins that are not stable could undermine some of the confidence in the dollar.

Mr. MOONEY. Thank you. I want to ensure that any regulation we provide of stablecoins does not get in the way of one of our country's greatest strengths here in America, which is innovation. With global adversaries like China, which have banned cryptocurrencies and the freedom they represent, our country can embrace them.

Next, I would like to pivot to the role of Congress in this progress. The report calls for congressional action on stablecoins, but also says that FSOC should act on its own to regulate stablecoins in the absence of legislation. So Ms. Liang, do you have any specific timeline in mind for congressional action before the FSOC would step in on its own?

Ms. LIANG. As you mentioned, the recommendation is for legislation. The Financial Stability Oversight Council has a responsibility to be monitoring for risk to financial stability and to consider actions to reduce those risks. So, it is an ongoing monitoring of the issues. They have some tools, but they are not a substitute for legislation. They cannot make structural changes to what stablecoin issuers would be.

Any action they would take is a little premature, given how quickly the system changes. I am sure that their processes are defined by what is laid out in the Dodd-Frank Act, and it would be very data-driven and very deliberate and would invite public input and be transparent.

Mr. MOONEY. Okay. To follow up and make a final point on it, let's say, for example, that stablecoin legislation makes it through Congress by the end of this year. How do you think Treasury would respond to that?

Ms. LIANG. I think, again, FSOC would be monitoring risks to financial stability. To the extent that any risks to financial stability were increasing, it would be their responsibility to consider what tools it has to address those risks. But it is not a substitute for legislation.

Mr. MOONEY. In my last 30 seconds, let me just say thank you, and I do fear that hasty action on the part of regulators could do more harm than good. Sometimes, people have the best of intentions but it has an opposite effect. The last thing we need is a rushed regulatory process. Congress, where we are elected to serve, is a deliberative body, and the legislative process does take time. I say, let Congress do its work. Let this committee do its work. This is a complex issue. It is more important to get it right than to rush and get something done quickly.

Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. You are welcome.

The gentleman from New Jersey, Mr. Gottheimer, who is also the Vice Chair of our Subcommittee on National Security, International Development and Monetary Policy, is now recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you, Madam Chairwoman, for holding this important hearing and discussion on new innovations in the stablecoin space.

Given the explosive growth in the stablecoin and cryptocurrency space, including, as I said, stablecoins, which continue to be front and center as an issue, it is critical, I believe, that Congress examine how best to establish appropriate guardrails around stablecoins to ensure these assets continue to mature here within the United States instead of fleeing overseas.

I am continuing to work on draft legislation examining how best to establish guidelines on stablecoins, including coins issued by insured depository institutions, but also through properly-constituted nonbank stablecoin issuers. Establishing appropriate guardrails to mitigate the risk of a run and potential collapse of a stablecoin issuer should be a primary goal of any stablecoin legislation, and I look forward to working with my colleagues on both sides of the aisle on this issue.

Ms. Liang, it is great to see you again, and thank you for coming today to testify. If Congress looks at stablecoins through a partisan lens and, in turn, fails to pass meaningful reform in short order, do you believe we could see the collapse of improperly-backed issuers, and would the effect be on the broader cryptocurrency market as well, as ordinary people invest in this market?

Ms. LIANG. I do believe that if stablecoins continue to increase rapidly and there are large stablecoins without appropriate reserve assets backing the ability for investors to redeem, that is a potential run risk and could have implications for other short-term funding markets and systemic risks for the financial system.

Mr. GOTTHEIMER. I agree. I am very concerned that if we sit here and let partisan games get in the way of getting a bill done it would be a huge mistake, and obviously, we will continue to lose companies overseas and they will flee our markets and consumers will be hurt.

As part of the PWG report, you outline how stablecoins can pose substantial illicit finance risks without appropriate oversight. The report specifically cites the need to counter terrorist financing as a major objective of stablecoin oversight. Additionally, crypto scams resulted in $14 billion in losses in 2021, and I have heard from some of my own constituents who have seen funds stolen. The hard-earned dollars of ordinary citizens could have literally been stolen to help finance terrorist attacks.

Do you think the only appropriate oversight method for stablecoins would be to ensure all issuers are subject to bank-like AML/KYC requirements to counter terrorist financing and scams?

Ms. LIANG. Currently, stablecoin issuers are subject to the AML/CFT regulations, the anti-money laundering, under the State money transmitter licenses. So, they have an anti-money laundering framework. It triggers various reporting requirements of large transactions or suspicious activities.

The banking charter could increase some of those compliance regulations, but I do think that FinCEN has a framework in place that, as I understand it, some of the bigger issues with illicit finance now is inadequate enforcement of existing regulations in other countries. And Treasury is leading an effort at FATF to try to improve compliance and enforcement of these actions in other countries and the exchanges in those countries.

Mr. GOTTHEIMER. There are some potential holes right now. We need to make sure we close them, right?

Ms. LIANG. Yes. That is correct.

Mr. GOTTHEIMER. When examining privately-issued stablecoins, I think a major concern is ensuring we do not allow these coins to undermine the supremacy of the U.S. dollar. The PWG report advocates for an approach where stablecoins could be issued by insured depository institutions. Actually, the report says, "If well-designed and appropriately regulated, stablecoins could support faster, more efficient and more inclusive payment options." Would you mind elaborating a little bit on that, please?

Ms. LIANG. As I mentioned, the potential for stablecoins to improve the speed and efficiency of payments is large. We are seeing payments being offered 24/7, instantaneous, on public blockchain ledgers, on public blockchains. So, that has a benefit to help all consumers by reducing the cost of payments and increasing their speed. We are seeing that being tested in cross-border remittances. We are seeing consumers respond to surveys to say they would benefit, and they would like to use stablecoins. So, I think when that becomes used to conduct transactions in the system that we all share, a payment system, it is important that that payment system be operationally resilient to all kinds of stresses, and that is the basis for the recommendations of the PWG.

Mr. GOTTHEIMER. Thank you so much. I yield back.

Chairwoman WATERS. Thank you.

The committee will take a break for 5 minutes.

[brief recess]

Chairwoman WATERS. The committee will come to order.

The gentleman from Ohio, Mr. Davidson, is now recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Madam Chairwoman.

And thank you, Ms. Liang, for the testimony today and the work that you have been doing on this topic.

I would like to step back and discuss the concept of a stablecoin more broadly. I think it is easy to get caught up in discussing this topic solely in the context of digital assets that are pegged to currency or to a commodity. The President's Working Group Report acknowledges that some stablecoin arrangements could fall under U.S. securities laws, which is the SEC's jurisdiction. This risked a siloed approach to addressing specific types of stablecoins; in fact, footnote 2 of the report explicitly states that the report, "does not provide recommendations regarding issues or risks under Federal securities laws under the Commodity Exchange Act."

This gap, to me, is concerning. So, my question is this, if you think about stablecoins, you have referred to them as risky, as potentially systemically risky, but you haven't really talked about specific things. I guess we did briefly allude to Tether, which I have called a time bomb. It is not regulated. It is not getting a lot of scrutiny, and I think the Securities and Exchange Commission should focus some attention on Tether.

But if you look at the next-largest stablecoin, the U.S. Dollar Coin, it is a highly-regulated asset. Do you believe that the New York financial services regulatory framework is a deficient means of providing regulatory clarity for things regulated as New York Trusts?

In fact, we are talking about stablecoins as this new or emerging idea, but there have been stablecoins approved under New York Trust laws since 2015. We are 7 years late.

Could you address the regulatory framework of New York, specifically, and those coins that are audited, have audited financials, and transparency requirements under New York law, as just one example, to be specific?

Ms. LIANG. Yes. Thank you for that question, Congressman Davidson.

I think the issue of stablecoin that the PWG report focused on is that it can serve as an investment, and SEC and CFTC laws and regulations would apply. But it also serves as a payment instrument, which distinguishes it from, say, a money market fund.

The New York State laws apply to stablecoins as an investment, and look to audit the assets or provide some transparency around the assets, but do not have the authority to look into the other functions of a stablecoin that are necessary for it to function as a payment.

Mr. DAVIDSON. Okay. Thank you for that.

If you look at it, it is okay as a payment system, Visa and MasterCard aren't legal tender, but, frankly, they are about the only thing that is accepted in America. It is almost impossible to pay in cash, and that is actually the legal tendered currency in the United States. We have made it almost impossible to transact that way, which has made it so that there is an emerging technology for better payment systems.

And, frankly, digital assets aren't subject to the Durbin Amendment, so the market is working; there are more affordable, lower-cost transaction processes. And as an investment, stablecoins aren't really, generally, good investments. They are worth a dollar, so why would you own them?

And so, the question is, if we think about dollars, like the U.S. Dollar Coin is U.S. dollars and Treasuries. Another one would be gold. We have talked about the silver notes. One of the first ones approved was a New York Trust-regulated stablecoin for gold.

But there are also stablecoins that are pegged to other very liquid assets like, say, shares of Apple. So, if somebody has custody of shares of Apple, some would say, and make this choice clearly every day in our financial markets, the best in the world, and say, I would rather hold shares of Apple than cash, because I don't think my cash is going to keep up with inflation and I do believe that Apple is going to become more valuable over time; that is an investment. They could tokenize that and the share, and the token would be represented by someone who truly had custody of shares of Apple, as an example.

Right now, that is not possible for American citizens, but it is for others around the world. Wouldn't that also be a stablecoin?

Ms. LIANG. I think the value of the stablecoin is distinct, because the value is designed to be stable and close to a dollar. The value of Apple stock, you could use it to transact, but it is volatile, and so both the purchaser and the consumer—

Mr. DAVIDSON. It is volatile in terms of U.S. dollars, but less volatile than—it has done better to keep up with inflation than U.S. dollars. It has outperformed inflation, as an example. So, the U.S. dollar isn't a good metric; frankly, the stablecoin should be relative to what it holds.

And I don't think that this Working Group does anything except protect the big banks. It may as well be called a big-bank protection concept.

Chairwoman WATERS. The gentleman's time has expired.

Mr. DAVIDSON. My time has expired, and I wish we could go a lot longer on the topic. Thank you.

Chairwoman WATERS. The gentleman from Florida, Mr. Lawson, is now recognized for 5 minutes.

Mr. LAWSON. Thank you, Madam Chairwoman, for having this hearing, and I thank Ranking Member McHenry as well. It is a great opportunity for us to learn more about what is going on in the economy.

Under Secretary Liang, according to the recent NASDAQ article, data shows that Black and Latino communities are driving national, mainstream adoption. The article highlights that in a Harvard and Harris Poll, only 11 percent of White Americans, 23 percent of Black Americans, and 17 percent of Hispanic Americans own such assets. This is a positive trend, but it also signals a greater need for financial literacy and skill training. The rising interest in new technology is instrumental, and an opportunity to prepare key demographics for a next-gen workforce.

How do you suggest the Federal Government be more proactive when it comes to future work strategies to position the historically-disadvantaged groups to compete in a global innovation of the economy and force digital equity?

Ms. LIANG. Thank you for that question. That actually gives me an opportunity to highlight a new initiative at Treasury.

Through the Financial Literacy and Education Council, we announced a new initiative on digital assets just within the last month or two. We think there is a need and an opportunity to introduce digital assets, highlight the risks and the opportunities, and highlight the distinctions between types of digital assets. This is a cross-government council, and has been around for many years, and digital assets is a new initiative.

In addition to that, which is just, which is just the education component, the Consumer Financial Protection Bureau (CFPB) is clearly following and tracking and taking actions against misleading advertising, and the market regulators will, of course, be looking to take actions to reduce fraud, and to take other actions to protect investors.

Mr. LAWSON. Okay. Thank you.

A financial regulator stated that an effective payment settlement system requires four things: lower fees; predictability; exchangeability for goods and services; and consistent high speed. Present day, there is a consensus among most experts that stablecoins do not meet all of these objectives.

Compared to our traditional financial system, would you still consider stablecoins to be an effective way to settle payments?

Ms. LIANG. The stablecoins have developed very quickly. They are continuing to develop. There is an incentive for developers to make them very efficient, to manage all of these, to meet all of these requirements to be an efficient payment method.

Are they there yet? That is hard to tell. They haven't been tested in periods of stress. I think there still needs to be more oversight of their operational risks, and their convertibility risks to function as payments. But I think the potential for them to be beneficial to the payment system, to cut costs, to make it faster, to offer 24/7, is absolutely there.

Mr. LAWSON. Okay. Madam Chairwoman, I am going to try to get this in.

Do you think it is necessary for stablecoin issuers to meet the same capital requirements as traditional IDIs if the majority of the reserved assets are backed by cash?

Ms. LIANG. I believe in terms of capital requirements, risk-based capital requirements would clearly be lower, if stablecoin issuers held only high-quality, liquid assets.

Mr. LAWSON. With that, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you.

The gentleman from North Carolina, Mr. Budd, is now recognized for 5 minutes.

Mr. BUDD. Thank you, Madam Chairwoman.

And thank you, Ms. Liang, for being here.

The President's Working Group Report states that absent urgently-needed legislation, the respective agencies in the FSOC can apply their existing authorities.

So, do you see a scenario where they get tired of waiting for Congress to act and, in turn, they would place centralized finance (CeFi) designations on particular stablecoins?

Ms. LIANG. I think the scenario for the FSOC to take such actions is premature to understand how it could apply its tools. FSOC has a responsibility to monitor risks to financial stability. It has been following and monitoring digital assets.

But FSOC's tools are limited. Designation is limited. It is not a substitution for a requirement that stablecoin issuers be insured depository institutions.

Mr. BUDD. But if I am hearing you correctly, that is—

Ms. LIANG. Proper authorities in the future would have to be very factored in and deliberate.

Mr. BUDD. So, if I hear you correctly, you don't see a scenario where FSOC would front-run Congress and then place heavy limitations on stablecoins?

Ms. LIANG. In the current environment, I don't see that FSOC would take such actions.

Mr. BUDD. Okay. So, second question: In his confirmation hearing last month before the Senate Banking Committee, Fed Chairman Powell agreed that well-regulated, privately-issued stablecoins can coexist along a Fed-issued CBDC.

Do you and the Treasury Department share the same opinion with Chairman Powell or do you differ from that?

Ms. LIANG. No, I absolutely agree with that assessment. I think regulation of stablecoins will make them more stable, but does not preclude, at all, the introduction of a CBDC, nor does it determine, the future of the CBDC will probably be the ones that determine how stablecoins exist or coexist.

Mr. BUDD. Okay. Thank you.

So, there seems to be some disagreement among regulators about whether or not stablecoins are securities, which would determine if they fall under the SEC's regulatory regime. My view is that stablecoins that are backed by quality assets do not meet the Howey Test.

Do you believe that stablecoins should be treated as securities?

Ms. LIANG. I would really need to defer to the SEC or the CFTC for their views on the applicability of their laws and regulations. I think that this is a product that has futures of a number of different financial products and services, and as such, that is why the regulatory approach to it should meet those differences.

Mr. BUDD. Very good. I thank you for your time.

And, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much.

The gentleman from New York, Mr. Torres, is now recognized for 5 minutes.

Mr. TORRES. Thank you, Madam Chairwoman.

Under Secretary, do you believe, as I do, that 100 percent of stablecoin reserves should consist of cash and cash equivalents?

In the interests of time, a simple yes or no will suffice.

Ms. LIANG. Yes.

Mr. TORRES. And I share the PWG's concern that stablecoin, if left unregulated or poorly reserved, could impose a systemic risk as it becomes more widely adopted as a means of payment.

But here is where we disagree. The risk of stablecoin, to me, is best managed not by the blunt instrument of banking regulation, but by common-sense rules, requiring transparency and accountability, reporting, auditing, liquidity standards, and redemption rights; rules that can be passed on a bipartisan basis.

The benefits of stablecoins, simply, safely, and soundly-regulated, will ultimately outweigh the risks. And for me, the tokenization of the dollar or the ability of the dollar to move at the speed of a blockchain, has the potential to lead to a better, cheaper, and faster payment system.

Now, the leading stablecoin issuers in the world have chosen to peg their stablecoins to the U.S. dollar, which, to me, represents a re-invigoration of the dollar as the world's reserve currency.

Under Secretary, do you believe, as I do, that dollar stablecoins have a role to play in preserving the primacy of the U.S. dollar?

Ms. LIANG. I do believe that, yes.

Mr. TORRES. During a House Financial Services hearing in December of 2021, Brian Brooks testified that Circle, the stablecoin issuers of USD Coin, had applied for a bank charter with the Office of the Comptroller of the Currency (OCC), but was unlikely to receive one.

Under Secretary, should the OCC grant a banking charter to Circle?

Ms. LIANG. I am not in a position to understand a particular application. The PWG recommendation is for an issuer to become an insured depository institution with the appropriate regulation that matches the activities. So, that would be the recommendation, but I cannot comment on a particular application.

Mr. TORRES. I will just note that the PWG, as you noted, has taken the position that stablecoin issuers should operate within the regulated banking system. If that is, indeed, the policy preference of the PWG, it seems contradictory to deny a stablecoin issuer the ability to operate within the regulated banking system.

I have a question about the notion of regulating stablecoin issuers as banks. Suppose for a moment there is a stablecoin issuer whose reserves are verifiably backed by the dollar on a 1:1 basis, and whose reserves can be immediately redeemed for a dollar on a 1:1 basis.

If the stablecoin issuer has no fractionalization of reserves and has no lending, it would seem to me that the stablecoin issuer is operating differently from a bank and, therefore, should be regulated differently from a bank.

Under Secretary, even though the PWG proposes regulating stablecoin issuers as banks, do you acknowledge that at some level, the absence of fractionalization and the absence of lending are relevant factors that differentiate stablecoin issuers from banking and, therefore, should differentiate stablecoin regulations from banking regulations?

Ms. LIANG. I absolutely acknowledge that there are differences, and the lack of lending makes a stablecoin issuer different from a traditional, commercial bank.

The proposal recognizes or relies on the flexibility of current banking regulation to distinguish between those kinds of activities that a stablecoin issuer that does not make loans would not be subject to regulations that would apply to institutions that make loans.

The distinction about the stablecoin issuer is that it is more than just a redemption and creation of stablecoins, which the transparency and disclosure rules could apply to, but it is also about storing, transferring, using the stablecoin for payments and that is why—

Mr. TORRES. In the interests of time, I just want to interject.

The reserves of Tether, the largest stablecoin issuer, consist heavily of commercial paper, and is shrouded in secrecy. The public has a right to know the names of the companies buying the commercial paper and the countries in which those companies are located in order to fully assess the true safety of Tether's reserve assets.

Suppose for a moment we were to adopt the rule of requiring reserves that were 100 percent cash or cash equivalent. Since Tether has become one of the largest holders of commercial paper in the world, what unintended effects could a 100 percent cash or cash-equivalent rule have on the commercial paperwork?

Ms. LIANG. I believe this is similar to the issues that arise in the money market fund regulation. There are government money market funds and there are prime money market funds. The prime money market funds, under new regulations, have reduced their holdings of commercial paper and commercial paper issuers have sought other investors.

I think over time, the choice, the markets and the issuers find the right investors and reduce risk to the system overall.

Mr. TORRES. My time has expired. Thank you.

Chairwoman WATERS. Thank you very much.

The gentleman from Tennessee, Mr. Kustoff, is now recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Madam Chairwoman. I thank you and the ranking member for calling today's hearing.

And Under Secretary Liang, thank you very much for sitting here for almost 3 hours. Frankly, I appreciate your straightforwardness in talking about issues that are complex to a lot of people.

And to that point, if we could, the President's Working Group report that talked about the uses and the benefits of stablecoins, I think you have touched on this and we have gotten in the weeds during today's hearing, if you were talking to any one of our Rotary Clubs or Kiwanis Clubs anywhere in the country, could you talk to that degree or if you were talking to one of those groups, about the uses and the benefits of stablecoins?

Ms. LIANG. I think stablecoins reflect a new technology and the technology, itself, can be complicated. But what it does offer is the ability to transact payments instantaneously, 24/7, on a public chain so that the transactions are viewable. So, I think it offers efficiency, makes the payments cheaper, and faster to meet consumers' needs. And the technology is sort of behind that, but I think that is what the benefits are.

How that technology can evolve and introduce other innovations is sort of open at this point. This is just every adoption and further adaptation, I am sure, will come. So, I think that is what the explanation of stablecoin is; it is an alternative form of cash, an alternative way to make a payment.

Mr. KUSTOFF. You mentioned the technology, which I appreciate. I know we are talking in theory, but it would be a true statement that if we were too heavy-handed from a regulatory standpoint, as it relates to the technology, and it doesn't catch up. Is that fair?

Ms. LIANG. I agree. I think it is a balance that needs to be—there are benefits and there are costs, yes.

Mr. KUSTOFF. Right. It is not easy to find that balance and, obviously, you have been questioned today by Members who have different thoughts about the degree of regulation, which is fair, and that is why we are here and that is why we appreciate you participating in today's hearing.

If I could, and I know there have been some questions to you related to the Chinese Communist Party (CCP), we have recently seen the CCP go after some digital assets, an outright ban on some of those assets in China. Can you talk about the consequences, if you will, of China's crackdown on digital assets and maybe what lesson we can learn in the United States from those crackdowns?

Ms. LIANG. I believe, as I understand it, China is trying—introducing the eCNY, the digital law, is in some parts, a way to take back some control that they have lost to private firms that offer digital assets. And they are offering their own digital currency as a CBDC, which will offer a lot of lessons for other countries.

In terms of adoption, they are offering incentives. As we understand it, people are still evaluating whether to use the eCNY or the other two products that they have become accustomed to. I think it is reflecting that there is a change in technology for how payments will work and consumers will make the choices, and they are moving into this market.

China doesn't value privacy as much as, say, the U.S. does, so I think the lessons from how they introduce theirs versus how the U.S. could introduce one here, in that space are a little less direct, but I think the use, the provision of a CBDC, the introduction of custodial wallets by the Central Bank of China will have a lot of lessons for other countries as they consider how to introduce a CBDC, if they choose to do so.

Mr. KUSTOFF. Thank you, Under Secretary Liang.

And thank you, Madam Chairwoman.

Chairwoman WATERS. The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch, who is also the Chair of our Task Force on Financial Technology, for 5 minutes.

Mr. LYNCH. Thank you, Madam Chairwoman.

And Under Secretary Liang, thank you for your willingness to come before the committee to help us with our work. This has been a very good hearing.

We are currently in a period of elevated inflation and the Fed has made announcements that over the coming months and perhaps into next year, they will introduce a series of interest rate increases in order to try to get control of that inflation by increasing the cost of money. And my concern is that that monetary policy, that ability to control the cost of money, would be undermined by, let's say, if Meta, formerly known as Facebook, had an idea about a digital currency, and they have that network effect where they have 2 billion daily users or something like that.

Wouldn't the introduction of stablecoins on a wider basis undermine the Federal Reserve's ability to control inflation, for example?

Ms. LIANG. I think you are raising an important issue about private money increasing quickly in scale that could produce its own internal system, which is then outside what the central bank would set interest rates and control. I think that is exactly one of the concerns about large technology firms or large firms with networks that could create a closed loop. I think the implementation of monetary policy does come into play. The questions around how will you do that, I think is an important issue. That was a potential risk we raised.

Mr. LYNCH. Okay. Have you thought through how, in periods of high inflation, for example, the Fed could retain the ability to restrict, say, an issuance of a stablecoin during that high-inflation period? Is that something that might be a tool that would mitigate that danger, or am I getting into someone else's jurisdiction, as opposed to Treasury?

Ms. LIANG. Yes, I think that probably starts to cross the line of independence of monetary policy from the regulatory structure of the financial institutions. But it is something that I am sure the central bank, the Fed, would be thinking about in terms of introducing a central bank digital currency and how it would coexist with private stablecoin issuers and that they would be considering that seriously when they are in those, in that, in their efforts.

Mr. LYNCH. Okay. Let me ask you this. I know a couple of Members have raised this in the past, but it would seem to me that the issuance of a central bank digital currency by the Fed—and I know that the Boston Fed is working with MIT in Boston to come up with the technology around that—would diminish the value of many of these stablecoins, especially with respect to the payment system; in other words, instantaneous transactions with near-instantaneous reconciliation and settlement.

Ms. LIANG. Yes. I think there are a lot of really important questions in terms of designing a CBDC, all of which would have implications for how they either coexist or compete with private stablecoins. There would be issues of who they held the accounts with, whether there would be caps on the accounts, and whether they would be interoperable with private stablecoins.

As you know, the Fed is looking at this, and in their paper they raised 20-something questions about it, which just suggests the complexity of the issues. And I think that it is a critically-important issue for the Fed and for Congress to consider what the future of the money and payment system should look like in this country.

Mr. LYNCH. Thank you, Madam Chairwoman.

And I yield back.

Chairwoman WATERS. Thank you very much.

The gentleman from Indiana, Mr. Hollingsworth, is now recognized for 5 minutes.

Mr. HOLLINGSWORTH. Good afternoon, everybody. I am really excited about this hearing. I have been looking forward to it for quite a while.

Under Secretary Liang, I have been on an emotional roller coaster over the last couple of weeks and through this hearing. I started off dismayed because I saw in the report put out that only banks should issue stablecoins and that they should be subject to prudential regulation. But then, surprisingly, and happily, by the way, I have heard you a couple of times in response to some of my colleagues' questions, maybe draw a little nuance to that particular issue, and I want to go back to a few things that you said earlier.

First, "The full set of bank regulations do not need to be applied to a stablecoin issuer that does only stablecoin issuance. There is flexibility in the insurer depository institution framework."

Next quote: "stablecoin issuers that have a simple business model, holding high-quality assets, would be subject to less-stringent supervision and regulation."

I think these are really important points to make, that there is the opportunity for good stablecoin issuers, and I have met many stablecoin issuers that are very interested in being good operators, good stewards, and good issuers, for them to have a lower-regulatory model, provided that they are wholly reserving for the issued assets.

Can you talk a little bit about the type of assets that should qualify as high-quality assets, according to you?

Ms. LIANG. Thank you for that. And I stand behind those statements I made.

The high-quality assets that can meet the abilities for investors and consumers to redeem their stablecoins should be cash, or reasury securities. It could be, if it were in the banking system, reserves at the central bank, which are the highest quality, and then would also not have any convertibility issues upon redemption. I am not trying to specify or limit what could be in that category, but just high-quality, credit risk-free assets.

Mr. HOLLINGSWORTH. And I think we would also want to make sure, not just high-quality—30-year Treasuries are high-quality—but we also want to make sure they are of a limited maturity, right? You talked about run-risks several times.

Ms. LIANG. Yes.

Mr. HOLLINGSWORTH. Making sure near-term maturity at par is important, as well; is that right?

Ms. LIANG. I think that is an important consideration that short-term Treasury bills convert much more quickly to cash than longer-term Treasury securities, we found, at least in March 2020.

Mr. HOLLINGSWORTH. And several times previous to that, and, obviously, you are taking less interest rate risks, with a shorter duration.

Ms. LIANG. Yes.

Mr. HOLLINGSWORTH. So, I guess my point here today, and I think you have elucidated it very well, is that we do have the ability to say if you are going to be, I will use your word, a simple stablecoin issuer that, and you are going to fully reserve and your assets are going to meet a certain quality and are going to be no longer than a certain duration, we should accept that even without prudential regulation layered over and above that, right?

Ms. LIANG. I think there are regulations related to the operational risks of stablecoin for storing and transferring the stablecoins as payments and that are more than just the consumer-protection kinds of the rules that the State money transmitter laws usually focus on.

Mr. HOLLINGSWORTH. There are a lot of businesses that aren't subject to full prudential regulation that do those very things. We have figured out custody of assets, outside of banking the loan and other issues related to, I will call it the back-end operations that we could sufficiently ensure they operate without the full weight of prudential banking regulations. There are businesses that we allow to do business today.

Ms. LIANG. Yes. The other service providers in the recommendation were not required to be—the recommendation was not to require them to be an insured depository institution.

Mr. HOLLINGSWORTH. Right.

Ms. LIANG. It only applied to the issuer of the stablecoin.

Mr. HOLLINGSWORTH. Right.

Ms. LIANG. As you know, it is part of a broader arrangement for—

Mr. HOLLINGSWORTH. In my 20 last seconds, I just want to make sure I hit this nail on the head. I think there is room for non-bank stablecoin issuers, provided that their assets are backed wholly and that they are of sufficient quality and they don't exceed a certain maturity. I think that we should find another avenue for this technology to develop outside of giving the exclusive power to banks themselves.

Chairwoman WATERS. Thank you very much. The gentleman's time has expired.

The gentleman from Illinois, Mr. Casten, who is also the Vice Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is now recognized for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman.

And thank you, Under Secretary Liang.

I want to follow up on the conversation you had with Mr. Huizenga. I think there are all these really, really cool things around digital money and all of these things we are developing. I also think sometimes we wrap things in acronyms and technospeak. We make the old sound new and some of these things are simple, and I want to just focus on sort of the simplicity of currency.

Because if I understood your answer to Mr. Huizenga, and I hope you will correct me if I get this wrong, when he asked you why shouldn't we regulate this like money market mutual funds, you said, because that can't be used as a currency and this can. I see you are nodding, so hopefully, I got that right.

It seems to me that it can be used as a currency is one question, is a separate one—cowrie shells can be used as a currency, and as Mr. Sherman noted, there are an awful lot of people who are not taking them, stablecoins or any digital currency, as money right now.

And to my simple way of thinking, that is not really that surprising. If you want a dollar-denominated currency, we have one: It is the dollar. And we have created a world where the dollar is valuable as a currency: one, because we pay our taxes with it, which is 20 percent of the economy, roughly; and two, because it is backed by the full faith and credit of the government.

Since, presumably, I didn't see anything in the PWG report that said when we will allow people to pay taxes in stablecoin or Dogecoin or Ethereum or whatever else, then the full faith and credit piece of any dollar-backed stablecoin really comes down to making sure that we have the management and reserve rules, such as we already have for money market and mutual funds.

Regardless of whether or not this actually becomes a currency that converts from, "can be used" to, "is being used," is there any reason why we should not be saying, let's put all of those same fiscal protections that we have in money market mutual funds, in these stablecoin markets?

Ms. LIANG. I believe that the protections of the money market fund industry that apply to money market funds would apply to stablecoins, to the extent that they offer a stable, a redemption into a dollar. I guess I would think that stablecoins, because they can be used as payments by households and businesses and are currently being adapted to do so, raises a separate set of issues, and that is what the PWG report—

Mr. CASTEN. And if I may, and I understand that you have to be a little bit careful about not recommending policy, but I understand that people are trying to do that. I think that is the separate question of, until they do, how does this behave in the market, because we do still need to have all of those consumer protections that I think Mr. Himes so eloquently outlined.

So, to the extent that this is being used as a currency today, where there is a push, if I understand your testimony, and I understand the markets right, these three big values: number one, in remittances; number two, in clearing time; and number three, in lower fees, and all of the benefits that creates.

Did I understand your answer to Mr. Gottheimer correctly, that you think that those issues are not creating, essentially, an arbitrage issue with anti-money laundering and know-your-customer rules, that the rules around this are robust enough that we are just arbitraging away existing market and efficiency, not dodging regulations. Is that the gist of your answer to Mr. Gottheimer?

Ms. LIANG. Yes, in terms of the illicit finance risks of stablecoins, yes, absolutely.

Mr. CASTEN. Okay. So, then I get back to saying, okay, if we think that eventually this thing is going to have appropriate regulation as it sits right now to make sure that there is the fiscal protections and the don't break the bucket of a money market fund, and if we agree that the existing rules, and I don't know that I am convinced on this, but if I am just, do I take your testimony, do we agree that if the existing rules provide all of the AML/KYC protections, why go through all the complexity of creating a stablecoin that exposes us to those risks that we have to regulate around to protect? Aren't we just really creating a central bank digital currency that would solve those issues just as well and not have all of these other exposures?

What is a well-regulated stablecoin providing that a CBDC doesn't?

Ms. LIANG. I think, one, a central bank digital currency would be the backed by the central bank. This is by high-quality assets, which are not central bank reserves. So, there is that distinction.

The other distinction that I think we were trying to grapple with is that there are private stablecoins now and they are growing and growing quickly and may grow faster if network effects allow them to scale up. And there is not a central bank digital currency being issued right now, so this could be the substitute. It could be a complement.

They could go away once a central bank digital currency were to be introduced, if it were.

But the current situation is they are currently being used and—

Mr. CASTEN. The Chair is telling me we are out of time. I know. So, thank you.

I am all for private sector innovation. I just want to make sure that if that requires us to build a big regulatory framework, let's have eyes wide open about what that means.

Ms. LIANG. Yes.

Chairwoman WATERS. Thank you very much, Mr. Casten.

Mr. CASTEN. Thank you, Madam Chairwoman.

Chairwoman WATERS. The gentleman from Ohio, Mr. Gonzalez, is now recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman. Thank you for holding this hearing.

And thank you, Under Secretary Liang, for your participation.

I will start with the question that I think Mr. Casten just left off with, which is, what do we get with a well-regulated stablecoin that we do not get with a central bank digital currency?

I think privacy, for one, right? There is a design question with the CBDC. But me, personally, I have massive privacy concerns that I don't see a CBDC being able to address.

And, two, the innovation that we get on the private sector, the history on this is pretty clean. I think that private sector innovation tends to be more efficient, more economical, and better. And so, I think those two things are worth considering.

Ms. Liang, I want to start with a question with respect to where the primary, prudential oversight of stablecoin should exist. There are some proposals that have been put out that would put that under the Treasury. My view is, that is an option. I would like you to opine on that, and maybe if you are willing, where do you think primary prudential regulation should be housed other than the Federal Government?

Ms. LIANG. Thank you. I agree with you on the central bank digital currency, that privacy and innovation are advantages of the private versus the central bank digital currency. I appreciate that.

The U.S. Treasury is not set up to regulate financial institutions, and has not been, historically.

The OCC, of course, is a regulator. The Federal Reserve is a regulator. The FDIC is a regulator.

I think a proposal for a stablecoin issuer to be an IDI would, depending on the charter as an IDI, go into the regulator as under current practices. That could be a choice—

Mr. GONZALEZ OF OHIO. I would like to interject here if I could, and pick up where Mr. Hollingsworth and Mr. Torres left off. I would like to associate myself with much of what they said.

I want to ask a pretty direct question. The IDI recommendation, as you have said, is more or less to ensure safety and soundness and to guarantee a consumer protection mechanism so that if you have a stablecoin, it can be redeemed for a dollar. I think you have said in various instances that if the reserve quality is high enough and there are redemption rights in place, maybe that is not necessarily required.

Did I hear that correctly, that there could be a world that you would agree with, which is to say, hey, there are some who probably need to be IDIs, but if we define what a stablecoin is in a particular way, that is not necessary.

Is that fair?

Ms. LIANG. I think a stablecoin issuer, and these are all issues for further discussion, but a stablecoin issuer within an IDI framework that held capital and was subject to liquidity standards, could have reserve assets that were not 100 percent cash because of the capital and liquidity standards and the other standards.

If it didn't have the capital or liquidity, one would want, basically, cash—

Mr. GONZALEZ OF OHIO. So, there is a world where we could have stablecoins regulated as such that they do not need to be IDIs. I think that is really important for a whole host of reasons, one of which is the diversity and inclusion aspect of crypto. As has been pointed out, crypto has been disproportionately adopted by diverse communities, which is in contrast to other financial innovations, which typically benefit non-diverse communities disproportionately.

I would argue that part of this is because the barriers to entry for diverse communities are much lower in crypto and also, it gets around to two things that when the FDIC surveys the underbanked and unbanked, why do they remain unbanked? One, minimum-balance requirements, and two, they don't trust banks; they are unbanked.

And so, I think a fear I have with the IDI requirement is that we push our diverse communities and those who are unbanked into a banking relationship that they either, don't trust or have natural reasons why it doesn't make sense. So, I think to preserve the innovation for all Americans, doing so outside of the IDI framework is something of which we absolutely should be cognizant.

And with that, I yield back.

Chairwoman WATERS. Thank you very much.

The gentlewoman from North Carolina, Ms. Adams, is now recognized for 5 minutes.

Ms. ADAMS. Thank you, Chairwoman Waters, and Ranking Member McHenry, for hosting the hearing today.

And Madam Under Secretary, thank you for your expert testimony and for answering our questions here today.

You know as well as I do that industry, academia, and everyone in between has their own opinion on who should regulate cryptocurrencies and stablecoins. The report that we are discussing today suggests that our prudential regulators should be the primary Federal overseer of stablecoins,

So, Madam Under Secretary, are you concerned that there could be confusion if stablecoins are brought into the prudential regulatory framework, but other cryptocurrencies are not?

Ms. LIANG. I believe that there is a distinction in consumers' minds and investors' minds between what are unbacked crypto assets and stablecoins. And I think we, as regulators and policymakers, can actually try to reinforce that distinction with regulation, that stablecoins offer stable value, actually can provide stable value.

I think that is an important distinction to make and I think regulation can help that. I am not concerned that it introduces confusion.

Ms. ADAMS. Okay. Thank you.

You have heard today that there is bipartisan desire to provide this industry the tools that it needs to grow in a strong and safe manner. In your view, how can both Democrats and Republicans in Congress work together with the Administration, industry, and other stakeholders to best provide those tools?

Ms. LIANG. I think that Members of Congress have been proposing pieces of, parts of legislation to consider how to make stablecoins more stable. I think there is a general acceptance of what are the sensible risks of stablecoins for payments. And there is a discussion about what is the best regulatory approach for it, but there does seem to be some common acceptance of a need for regulation, and I think that there is agreement that more consistent is value to promote innovation and competition.

So, I think these are issues for Congress to consider and balance the benefits of innovation with the costs, and the risks to users and the payment system on the financial system broadly. We are very happy to continue to engage in that process.

Ms. ADAMS. Thank you very much.

Madam Chairwoman, I am going to yield the rest of my time back. Thank you.

Chairwoman WATERS. Thank you very much.

The gentleman from Tennessee, Mr. Rose, is now recognized for 5 minutes.

Mr. ROSE. Thank you very much, Chairwoman Waters, and Ranking Member McHenry, for holding the hearing.

And I also want to thank our witness for being here today.

As my time is limited, I am going to go ahead and dive right in. Under Secretary Liang, I wanted to follow up on a line of questioning on the importance of the dollar on the global stage. If Congress banned stablecoins, do you think that stablecoins would be developed in other countries?

Ms. LIANG. Yes, I think stablecoins would continue to develop.

Mr. ROSE. And do you think that stablecoins would be pegged to other currencies, rather than the dollar?

Ms. LIANG. I think the use cases would determine what it would want to peg to. But if the U.S. dollar is supported by not stablecoins or technology, but by the country's respect for the rule of law, it is the infrastructure or the economic potential of the country, but no doubt if you created currency or payment systems that are separate and independent, it would take away from what could have been additional contributions to the role of the dollar.

Mr. ROSE. Sure. The U.S. dollar, of course, is the world's dominant reserve currency, and as I think has already been mentioned, approximately 59 percent of all foreign exchange reserves are held in U.S. dollars. Currently, the five-dollar pegged stablecoins represent 94 percent of the market.

Under Secretary Liang, what are the benefits of having stablecoins pegged to the U.S. dollar, as opposed to other currencies?

Ms. LIANG. I think the reflection that many of the major stablecoins being pegged to the dollar reflects that the dollar is the primary reserve currency. And I think for policy purposes, policies to promote the strength of the dollar are critical, and stablecoins will continue to peg to the dollar as long as the dollar remains strong and reflects—

Mr. ROSE. Okay. So, is the inverse true, that having a majority of stablecoins pegged to the dollar might help to preserve the dollar's status as the world's reserve currency?

Ms. LIANG. Yes. I think it is a positive contribution.

Mr. ROSE. And are there stablecoins that reference other currencies, such as the Yuan or the Euro today?

Ms. LIANG. The Central Bank of China has issued additional currency, yes, but—

Mr. ROSE. According to a recent staff working paper released by the Federal Reserve, entitled, "Stablecoins Growth Potential and Impact on Banking", quote, "stablecoins served as a digital safe asset, while more speculative crypto assets were temporarily in free fall during the crypto market crashes in March of 2020 and May of 2021." The paper adds that these episodes demonstrate the potential for stablecoins to serve as a digital safe haven during market distress.

You testified that stablecoins may pose systemic risk. Do you know what the size of the market for stablecoins is today?

Ms. LIANG. Currently, stablecoins are roughly $170 billion, but they are used in many transactions. Their value does not represent their importance in the crypto asset market, because they are used in many transactions and that doesn't [Audio malfunction.] in share of transactions, it is much higher.

Mr. ROSE. To give some contrast, what is the size of the money market funds today?

Ms. LIANG. The money market fund industry, I would guess, is in the $4 trillion range at this point.

Mr. ROSE. And then, similarly, what is the market for U.S. Treasuries today?

Ms. LIANG. The market for U.S. Treasuries is much larger than stablecoins.

Mr. ROSE. Right. So, is the stablecoin market really big enough to pose systemic risk, and do these incidents in March of 2020 and May of 2021, those market events, do they tend to show that adequately-capitalized stablecoins with appropriate safeguards in place, can, as the Fed's working paper states, "serve as a digital safe haven during market distress and provide a level of stability that is on par with traditional forms of safe value"?

Ms. LIANG. Yes. The PWG report does not suggest that stablecoins currently are a threat to financial stability and pose systemic risk. It is the ability for stablecoins to scale up rapidly because of network effects, once they become adopted, then it could pose a systemic risk.

Mr. ROSE. Thank you, Under Secretary Liang.

I see my time has expired. I appreciate your responses.

And Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Texas, Ms. Garcia, who is also the Vice Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Madam Chairwoman, and thank you for this very important hearing.

And Under Secretary Liang, thank you so much for your patience and your endurance. The end is in sight. We are coming down to the last few Nembers, and votes are taking place, so I will have to rush through my questions.

But I just want to quickly follow up on Mr. Rose's question. The $170 billion market share that stablecoins represent, how many consumers would that be? How many people are actually using this?

Ms. LIANG. That is a great question. I would have to get back to you on that.

Ms. GARCIA OF TEXAS. How many investors does it represent?

Ms. LIANG. I do not know.

Ms. GARCIA OF TEXAS. So, we just know the growth in value, but we really don't know if we are talking about 1,000 consumers or 2,000 investors. And I just wanted to say, to keep things in perspective, that we are saying it is growing, and we need to do something. But is it really? Who is really using it?

And I ask that because the report states that legislation should require stablecoin issuers to be registered as insured depository institutions in order to participate in issuing currency. Well, I understand the reason behind this, and I think I do support it. I want to explore the possibility of this requirement preventing smaller issuers from participating in market activity.

We always have challenges, and I think other Members have asked you about barriers for unbanked and smaller providers, smaller issuers. I don't want us to create a system that is just going to repeat what the banks have been doing, which is leaving us out.

And if we don't know who is using it now or who is investing now, I am afraid that we are just going to repeat ourselves. So my question is, what can we do to make sure that the little guys or the little gals are not left out while allowing only the big banks coin issuers to participate?

Ms. LIANG. Right. The proposal for an IDI does, of course, raise some costs of entry for this business. But I believe that there is a lot of flexibility in a new charter. So, it is not trying to reduce—

Ms. GARCIA OF TEXAS. I understand that. I don't mean to interrupt, but I just want to be clear. My question is, how are we going to make sure that there is true equity—I think Mr. Meeks also asked this question—and that it will be accessible and that we are not just putting together another system that is going to leave the same people out who have always been left out?

Because you have mentioned remittances, and while that is a laudable goal, I think there's a lot of work to do before we could get there. Because you have mentioned in terms of things that are good about stablecoins and creating a new payment system would be lower costs, but I am worried about conversion fees. I am worried about accessibility to be able to get those funds.

If I am in Mexico, and I am a poor person waiting for my relative here in Texas to send money, how do I convert this stablecoin into money that I can then take to the market to buy a jug of milk? Shouldn't we think this through?

Ms. LIANG. That is exactly the pilot programs that stablecoin issuers and wallets are testing. Can you improve the speed and reduce the cost of these remittances between, say, Texas and Mexico?

Ms. GARCIA OF TEXAS. But you understand that a lot of people don't use wallets. A lot of folks don't have cell phones. That has been my pet peeve of the entire vaccine rollout. It is so tech-dependent.

Ms. LIANG. Yes.

Ms. GARCIA OF TEXAS. Because there are people in my district—I have a 77-percent Latino district—who don't have Wi-Fi and don't have the tech capacity to do that. So, once again, we are creating this system that is just going to help those who already have and leave the have-nots out of the picture.

I just want us to be mindful that $170 billion does not mean it is 170 billion people who are using it.

Ms. LIANG. No, absolutely. And I share your concern that not all households can access this. But I believe greater competition is probably the best way to improve the payment system, and that stablecoins are a competitor to the existing payment system.

I would say we won't know what our payment system will look like many years from now. But competition is probably the strongest force for improving a payment system over time and meeting the needs of all consumers.

Ms. GARCIA OF TEXAS. Thank you. I see my time has run out.

Madam Chairwoman, I yield back, and I am running to the Floor to vote. Thank you.

Chairwoman WATERS. Thank you very much.

The gentlewoman from Michigan, Ms. Tlaib, is now recognized for 5 minutes. Is Ms. Tlaib on the platform?

[No response.]

Chairwoman WATERS. The gentleman from Wisconsin, Mr. Steil, is recognized for 5 minutes.

Mr. STEIL. Thank you very much, Madam Chairwoman. I appreciate you holding today's hearing on a really important topic.

As we have seen, digital assets are already transforming our financial system, and I think we really have an amazing opportunity right now to put in place the legal foundations that are going to support continued innovation and long-term growth, in particular, in the United States. And I am concerned that if we continue down a path of ill-fitted regulatory constructs, we may be moving this innovation offshore, rather than coming up with the approach of, how can we help bring innovation into the United States?

And so, with that background, Under Secretary Liang, we have had a great conversation today about digital asset coins, how they are currently and particularly State-regulated. And besides the money transmitter regimes, as we have noted today, several States have developed pretty sophisticated approaches to digital assets regulation.

As we noted, in New York, the BitLicense allows firms to apply for limited purpose trust charters under State laws. But I notice in many ways, your report didn't really address the regulatory framework in States. Earlier, I think you mentioned that you talked to State regulators and analyzed State frameworks. Is that correct?

Ms. LIANG. We did consider State frameworks. Yes, we considered State frameworks.

Mr. STEIL. But there is not really an actual analysis of State frameworks included in your report. Is that correct?

Ms. LIANG. No, we did not include a discussion of State framework analysis.

Mr. STEIL. So, do State-chartered depository institutions have a primary Federal regulator, and are they subject to Federal banking regulations?

Ms. LIANG. I think Federal banking regulations can apply to banks that are State-chartered.

Mr. STEIL. Okay.

Ms. LIANG. Some of the BitLicenses are, as you said, limited purpose banks or charter banks, as I understand them, or trust banks. Yes.

Mr. STEIL. I appreciate that. I would like to go back a little bit in time here to earlier in the hearing, back to a response you gave to my colleague, Mr. Loudermilk's, question on the PWG approach. I think you referenced, if I recall correctly—you said it builds upon existing State laws.

But as we just noted, the report doesn't really analyze State laws. There is definitely a Federal primary approach. What do you mean by, "builds upon State laws?"

Ms. LIANG. Yes. One is partly all stablecoin issuers and custodial wallet providers are money services businesses, and money transmitter laws apply to them. That is at least 49 State regimes.

The proposal does not replace the State money transmitter with the Federal money transmitter proposal, which I understand maybe some legislators are considering. But it could build on that and require a set of risk management standards that could apply to custodial wallet providers. In that sense, it builds on the State frameworks.

Also, insured depository institutions can be State-chartered or Federal-chartered. That is in the current system. But even a State-chartered bank has always had some Federal layer on it for deposit insurance or some of the other features of a traditional bank.

Mr. STEIL. I just think it is a really interesting topic here. So, I am just trying to flesh it out a little bit.

Ms. LIANG. Yes.

Mr. STEIL. We are looking at kind of a construct that would privilege federally-insured depository institutions. How would you account for the existing State-based regimes that already apply to incumbent firms? It is a little bit what you are talking to. Could you hit that point for us?

Ms. LIANG. Yes. I think that would be something that needs further discussion. The current existing State charters, at least some of them, do not provide the supervisors of those institutions sufficient visibility into the broader payment arrangement. Therefore, we are looking to fill that gap.

Mr. STEIL. Yes, understood. Under Secretary Liang, I appreciate your time. I think it is really important that we get this right. I think we are digging into the right topics.

I think the key here is to make sure that we don't overregulate, that we encourage innovation in the United States of America. I think we are at a moment in time where there is great opportunity. We don't want to overregulate this and throw the baby out with the bath water on what is clearly a really interesting space of development.

And so, conscious of the time, Madam Chairwoman, I will yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Pennsylvania, Ms. Dean, is now recognized for 5 minutes.

Ms. DEAN. Thank you, Madam Chairwoman.

And thank you, Under Secretary Liang, for testifying today and for all of this valuable information.

When we had a hearing on digital assets in December with witnesses from the crypto industry, I talked about my concerns over the extreme volatility that we see in the market, and I asked the panel if we are at risk of a bubble akin to that which was triggered in the 2008 financial crisis. I will note that the volatility that we have seen in the 2 months since the hearing has certainly not reassured me.

But at the hearing, in response to my question, Mr. Brian Brooks likened this volatility to what we saw in the first 100 years of the stock market. While it may be turbulent in the early days, the long chart is up and to the right, he said, just like the U.S. equity markets. Well, that may be true, but I am worried, and that doesn't quite tell the whole story.

Under Secretary Liang, what are your thoughts? Are we at risk of another bubble?

Ms. LIANG. I think with many of the digital assets, especially those that are unbacked, the price volatility is very high, and investors absolutely need to understand whether those investments are appropriate for them.

The costs of a bubble are high when the prices are supported by financial leverage in the system, or they are connected to traditional highly-levered banking institutions that could magnify the impact of any price decline in crypto assets.

Currently, investors in crypto assets and digital assets—this is separate from stable value, but in terms of the digital assets with highly-volatile assets—are bearing the losses and the gains largely on their own. But we definitely are concerned that those do not cause problems for the broader financial system or the economy where consumers who are least financially and economically resilient would bear the cost of a decline in prices of a bubble bursting.

But to the extent that these prices are within the sort of digital asset space, the implications of the price decline are less severe for the broader economy and less severe for the consumers who really are most vulnerable to these kinds of outcomes.

Ms. DEAN. Thank you. That is really helpful.

And I wanted to build on that issue of leverage. You have talked today about your concerns with the systemic risk posed by the buildup of leverage against digital assets.

In your written testimony, you stated, "As we saw in 2007–2008, financial risk—and most that preceded it—leverage can play a key role in catalyzing and accelerating financial instability." And you note that the Administration is still working to understand the role that leverage plays in digital asset markets.

Can you give us any further clarity along those lines of leverage and what the Administration is recognizing?

Ms. LIANG. I think it is early to say very much, except to highlight that it is a topic of high importance because high leverage in a volatile asset can cause problems for the financial system and the economy. The Financial Stability Oversight Council is following this, and looking at it. But I think it is too early to say that we have conclusions.

Ms. DEAN. And in terms of the investor base, I think some of the reports that I have read, it is quite diverse, which makes me worry about those that would be potentially at risk. Can you talk about the investor base? What do we know about the demographics?

Ms. LIANG. I think there are concerns about the demographics if they—some surveys suggest more minorities, more lower-income investing in these assets. To the extent those surveys are accurate, that is of great concern, because as we mentioned, these prices are highly volatile.

But this is a space that is not regulated, and I think the information about who the investors are and the transactions is actually quite limited, and we are relying on various surveys.

Ms. DEAN. That's very helpful.

My time has expired. I yield back. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you.

The gentleman from South Carolina, Mr. Timmons, is now recognized for 5 minutes.

Mr. TIMMONS. Thank you, Madam Chairwoman.

And first, I want to thank the Under Secretary for her work on the President's Working Group and for being here with us today.

I want to first touch on a subject many of my colleagues have brought up with you today, whether stablecoins should be regulated and housed solely within the banking system or not. I know that your report speaks to this, and you have discussed it at length in today's hearing. But I wanted to ask you myself, do you and the PWG see stablecoins existing exclusively within the traditional banking system?

Ms. LIANG. I think the recommendation is to require the issuer to be an insured depository institution with a flexible regulatory framework that is lower cost for simpler business models.

Mr. TIMMONS. Were there other options discussed in the PWG?

Ms. LIANG. Yes, of course, other options were considered in developing a recommendation. I think the principles of providing clarity, consistency, and a comprehensive framework is what led to this particular recommendation, recognizing that there is some flexibility in the IDI framework.

And no one was recommending that a stablecoin issuer be regulated like a traditional commercial bank. But the IDI charter has the flexibility to provide some supervision and regulation that is adjusted for the risks of the activities of the stablecoin issuer.

Mr. TIMMONS. I think it seems obvious to me that regulating a product under a regime designed for something completely different, while it may solve some problems, it is likely to create many more problems and stifle innovation and investment in an emerging industry that shows great promise.

I guess my question is, what do you think the obstacles are that stablecoin issuers are likely to face if PWG's recommendation to regulate them like banks comes to fruition?

Ms. LIANG. I think it would be on the regulators to try to reduce the costs for an issuer that is not a traditional bank. And they can have some flexibility to keep those costs down, and I think that is the function, the stablecoin function of providing payments is a bank-like function. And that is why the recommendation was to use the bank framework.

But recognizing that a stablecoin issuer is not likely to make loans and extend credit and engage in fractional reserve banking, the regulatory system can be adjusted to not apply all the kinds of rules and regulations that would apply if you were to make laws.

Mr. TIMMONS. You are making a lot of assumptions on their ability to thread the needle. I personally think it would be better for Congress to do their job and to craft policy specifically for this new emerging industry. What are your thoughts on that?

Ms. LIANG. Yes, I think that is clearly an issue for Congress to certainly discuss. Again, we were trying to promote a more consistent framework, less fragmented, not—we were just less compelled to introduce yet another regulatory scheme. And to the extent an existing tested framework is available and could be applied, that seemed to be the preference of the group.

Mr. TIMMONS. Sure. Well, I would like to think that Congress might be able to do better. Disruption is a natural part of a free market economy. New products and technology emerge and shake things up.

It can sometimes lead to short-term pain for entrenched industries, but it forces adaption and almost always leads to better products for consumers and more prosperity for our communities. I urge my colleagues to really find a better path forward.

And with that, Madam Chairwoman, I will yield back. Thank you.

Chairwoman WATERS. Thank you very much.

The gentlewoman from Michigan, Ms. Tlaib, is now recognized for 5 minutes.

Ms. TLAIB. Thank you so much, Chairwoman Waters, for holding this important hearing, and I thank the Under Secretary for being so patient with all of us, and for presenting the Working Group's report. I thank you so much for the important work.

As fintech becomes an entry point for the underbanked and unbanked to access financial services, we must ensure that we are putting in place adequate protections on behalf of our constituents.

[Audio malfunction.]

Ms. LIANG. I believe we lost her connection.

Chairwoman WATERS. Okay. We are going to hope that she gets back in, and we are going to go on to our next Member at this point.

The gentleman from Illinois, Mr. Garcia, is now recognized for 5 minutes. I don't see Mr. Garcia on the platform anymore.

The gentleman from Massachusetts, Mr. Auchincloss, who is also the Vice Chair of the committee, is now recognized for 5 minutes.

Mr. AUCHINCLOSS. Thank you, Madam Chairwoman.

And Under Secretary Liang, I appreciate your stamina in a long hearing and your thoughtful answers, and I have learned a great deal from your memo and the PWG and my colleagues' good questions from both sides of the aisle. I want to talk about three different domains of risk that I think we can bucket this conversation into.

The first near-term bucket is prudential risk, is run risk and payment risk of stablecoins, which you have articulated and have answered a lot of questions about. It seems like from your previous answers—I believe specifically to Mr. Himes—you feel like run risk could be mitigated with a simple registration process by stablecoin issuers which where they were audited and disclosed not as IDIs, but just in a transparent auditing process. But that you feel like payment risk really is what requires the IDI.

And I want to press on that a little bit because it is not really clicking to me. I understand that stablecoin is used as a medium of exchange, but only really within the crypto economy. So, why do we feel like there needs to be a federally-insured regulation around a medium of exchange that is really quite constrained to the crypto economy, when other fintech innovations, like the PayPals or Venmos of the world, weren't subject to the same type of regulation?

Ms. LIANG. Thank you for that clarifying question.

The premise of the PWG report is that stablecoins will continue to work, try to be converted just via currency, be work outside the crypto economy, that it will not only be used to facilitate crypto trading.

An example is cross-border remittances, which are translated into currency in some successful sense, right? And it then becomes part of the payment system the way that money is transacted—

Mr. AUCHINCLOSS. I would encourage us then to investigate that premise further and try to find a way to mitigate payment risk that is in keeping with that premise and more narrowly tailor it. I am not convinced that we need to have it fully an IDI, partly because we risk regulatory capture by the banks.

Part of the promise of Web3 is that it is disruptive in a good way to the financial services system, and I worry that layering on these requirements that may be unnecessary, given the actual payment risk, could actually just be a boon to established incumbents.

But this leads us, your answer, to our second kind of big bucket of risk here, which is systemic risk, and my colleague, Mr. Hill, asked about this. And you answered that you really did not see this stablecoin economy as being a systemic risk at this point.

It seems that FSOC should really be doing persistent monitoring of that, and reporting back to Congress about whether it is becoming so. You also suggested that interoperability between stablecoins could help mitigate some of that systemic risk.

Are there measures that you would recommend beyond FSOC monitoring and interoperability standards that could mitigate systemic risk, or is there a firewall that could be set up, or at least monitored to forewarn of it?

Ms. LIANG. Ideally, I think this is always about trying to identify the next potential source of systemic risk, and the way that regulators approach that is to look at the common sort of vulnerabilities like leverage. So, if there were a way to measure and quantify leverage in this system, that would be an early warning indicator.

Mr. AUCHINCLOSS. So, again, for—

Ms. LIANG. I think in the current environment, that is not easily done.

Mr. AUCHINCLOSS. Another reason why registration, auditing, and disclosure would be helpful, but not necessarily—you wouldn't need to have IDI status to be able to track leverage. You could do just basic registration to accomplish that?

Ms. LIANG. Yes. The stablecoin itself, as registered, that itself is not leverage. It is the use of the stablecoin as collateral to lender stablecoins so that someone can use it to purchase on margin. Because it is a stable value, it provides a stable collateral.

Mr. AUCHINCLOSS. So, that might be more the custody wallets then that have to be—

Ms. LIANG. Exactly.

Mr. AUCHINCLOSS. So, custody wallets and stablecoin issuers are registering and disclosing and auditing. All of that seems to sort of make sense to me. Again, it is just the IDI.

Finally, Under Secretary, in my last couple of seconds, do we need a CBDC in order to address this third bucket of risk, which is the United States losing its preeminence on the global stage as the world's reserve currency? I loved your answer about how it is more about the liquidity of our markets, it is more about the rule of law; this is not a tech fix.

The CBDC paper—and I appreciate the work that the Fed did—struck me as a solution in search of a problem. Can't we just accomplish a lot of these aims with better stablecoin regulation and with compounding the existing strengths of our nation?

Ms. LIANG. Yes. I guess I would—as you say, I would repeat my previous answer that the strength of the U.S. dollar is based on its country's laws and governance and its markets and its economic potential. Technology can play a constructive role, but it is not the primary indicator.

Mr. AUCHINCLOSS. Under Secretary Liang, thank you again for your testimony today.

Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much.

I just want to make sure that Mr. Garcia and Ms. Tlaib left the platform and that somehow they were not frozen out of here.

It is about time for us to close down, and I would like to thank our witness for her testimony today.

Thank you so much for the time that you have spent with us. Thank you so much for your patience. And thank you so much for the way that you were able to address all of the questions that were asked of you.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place her responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

Ms. LIANG. Thank you.

[Whereupon, at 2:12 p.m., the hearing was adjourned.]

A P P E N D I X

February 8, 2022

Statement by

Jean Nellie Liang

Under Secretary for Domestic Finance

United States Department of the Treasury

before the

Committee on Financial Services

U.S. House of Representatives

February 8, 2022

Chairwoman Waters, Ranking Member McHenry, and other members of the Committee, thank you for the opportunity to testify this morning on stablecoins.

Stablecoins are part of an emerging set of digital assets, activities, and services that could have profound implications for the U.S. financial system and economy. Treasury supports responsible innovation that helps meet the evolving needs of users and the financial system. But stablecoins also raise policy concerns, including those related to illicit finance, user protection, and systemic risk. To mitigate these risks while supporting the potential benefits from innovation, Treasury believes that regulation of stablecoins should be clear and consistent.

In November, the President's Working Group on Financial Markets, along with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, took an important step in this direction with the publication of a stablecoin report (PWG Report). The PWG was formed by Executive Order in response to the 1987 stock market crash. The group is chaired by the Secretary of the Treasury and composed of federal financial regulators. The PWG regularly produces reports on financial markets issues for the President, which may include recommended legislative changes.

As described in the PWG Report, stablecoins are a type of digital asset designed to maintain a stable value relative to the U.S. dollar or other reference asset. Today, stablecoins are used primarily to facilitate trading in digital assets. But, because stablecoins are designed to maintain a stable value, they could potentially be used more widely as a means of payment by households, businesses, and financial firms. There are no standards regarding the composition of assets used to support the value of stablecoins (reserve assets), and information made publicly available regarding stablecoin reserve assets is not consistent across stablecoin arrangements in either its content or the frequency of its release.

Stablecoins are growing and developing rapidly and are not subject to a statutory or regulatory framework that mitigates the risks they present in a consistent and comprehensive manner. Currently, regulators have authorities that can be used to address illicit finance and investor protection concerns in the context of stablecoins. However, as described in the PWG Report, regulatory gaps exist regarding certain prudential risks. The PWG Report recommends legislation to ensure that stablecoins are subject to appropriate federal prudential oversight. Such legislation would complement existing authorities with respect to market integrity, investor and consumer protection, and illicit finance. The PWG's specific recommendations included: limiting issuance of stablecoins to insured depository institutions (IDI); giving supervisors of stablecoin issuers authority to set risk management standards for critical activities related to use of stablecoin as a means of payment; and certain measures to reduce concerns related to concentration of economic power.

As mentioned, stablecoins are part of the much larger and quickly evolving market for digital assets. The Biden Administration continues to work across the agencies to develop a comprehensive strategy for all digital assets, with the goals of ensuring that cryptocurrency is not used for illicit finance; addressing risks related to financial stability and consumer and investor protection; and furthering financial inclusion and our continued leadership of the global financial system.

1. Prudential Risks of Stablecoins

Given their potential to be used as a means of payment, as well as the design mechanisms that they rely on to maintain a stable value, stablecoins present risks that are similar to some of the prudential risks traditionally associated with bank deposits and other forms of private money. History has shown that, without adequate safeguards, bank deposits and other forms of private money have the potential to pose risks to consumers and the financial system. These prudential risks include the risk of stablecoin runs; payment system risks related to the mechanisms that are used to store or transfer stablecoins; and broader concerns related to concentration of economic power.

"Run risk" refers to the potential for a scenario in which a loss of confidence in a stablecoin sets off a wave of stablecoin redemptions, which could then be followed by distressed sales of the stablecoin's reserve assets. Such distressed sales of assets could negatively affect critical funding markets and broader financial conditions. Runs could also spread contagiously from one stablecoin to another, or to other types of financial institutions that are viewed as having a similar risk profile. The dynamics of a run, as well as the harm that runs can inflict on the broader system, are amply demonstrated by the history of runs on banks and shadow banks – including those that occurred in 2007-2008 and, more recently, at the start of the Covid-19 pandemic in March 2020. The first stablecoin run is believed to have occurred in June 2021, when a sharp drop in the price of the assets used to back the stablecoin set off a negative feedback loop of stablecoin redemptions and further price declines.

"Payment system risks" refer to a disruption in the mechanisms used to store or transfer value, which could interfere with the ability of users to make or settle payments. Payment system risks distinguish stablecoins from certain investment products that are not designed to serve as a means of payment. Custodial wallet providers – meaning wallet providers that hold stablecoins on behalf of users – are one locus of payment system risk, as the failure or disruption of such a wallet provider could deprive users of access to their stablecoins. More generally, use of stablecoins depends on a range of activities that are often distributed across multiple entities within a stablecoin arrangement.[1] Depending on the particular design of a stablecoin, these activities include: governance of the stablecoin arrangement; stablecoin issuance and redemption; management and custody of stablecoin reserve assets; distributed ledger operation, validation, and settlement; and interfacing with stablecoin holders. Even if a stablecoin itself is adequately protected against run risk, problems related to the activities or entities that support the stablecoin could still interfere with its use as a means of payment, harming stablecoin users and resulting in a loss of payments efficiency.

Finally, I would highlight two concerns related to concentration of economic power. First, connections between a stablecoin (or stablecoin wallet provider), on one hand, and a commercial company, on the other, could be used to give the commercial company an unfair competitive advantage. These policy concerns are analogous to those traditionally associated with the mixing of banking and commerce, such as advantages in accessing credit or using data to market or

[1] The term "stablecoin arrangement" refers to a stablecoin together with the functions and activities that allow the stablecoin to be used as a means of payment.

restrict access to products. Second, the issuer of a stablecoin that becomes sufficiently widely adopted as a means of payment could become a dominant provider of payment services. Market power with respect to payments could reduce incentives for further investment in payments innovations or lead to higher prices for payment services.

2. Regulatory Gaps

Current statutory and regulatory frameworks do not provide consistent and comprehensive standards for the risks of stablecoins as a new type of payment product. Certain regulatory schemes may have the flexibility to address some issues presented by stablecoins, such as illicit finance. However, stablecoins are not subject to standards to address concerns about run risk, payment system risk, or concentration of economic power. Some of the largest stablecoin issuers operate with limited regulatory oversight, raising significant questions about whether these stablecoins are adequately backed and other aspects of their operations. The regulatory frameworks that apply to stablecoin issuers and service providers are inconsistent, creating opportunities for regulatory arbitrage and uncertainty among stablecoin users. Even where the issuer of a given stablecoin is subject to oversight, the number of different key parties that may be involved in an arrangement, and the operational complexity of these arrangements, may pose substantial challenges for supervisors. The exponential growth of stablecoins – from a market capitalization of roughly $5 billion at the start of 2020 to approximately $175 billion today – increases the urgency of ensuring that an appropriate regulatory framework is in place.

Having described the regulatory gaps at a high level, I would like to discuss in more detail several frameworks that have featured prominently in discussions of stablecoins: state money transmitter laws, securities laws, and commodities laws. While Treasury and the PWG fully support efforts by state and federal agencies to use existing authorities in support of their statutory mandates, we do not believe existing authorities provide a sufficient basis for comprehensive and consistent oversight of stablecoins.

A. Money Transmitter Requirements

In many states, stablecoin operators are licensed or registered as money transmitters and money services businesses, and are subject to standards that include minimum net worth requirements, surety bond and other security requirements, and restrictions on permissible investments. These standards are generally designed to address consumer protection concerns. They are not meant to address the financial stability and payment system concerns that would arise if stablecoins become widely adopted by households, corporations, and financial institutions as a means of payment.

B. Securities Regulation

Some have suggested that stablecoins could be regulated either as securities or as money market mutual funds (MMFs). Certain legal academics have raised a threshold question as to whether stablecoins qualify as securities or MMFs under existing laws. Assuming that stablecoins satisfy the definition of securities or MMFs, there is a further question as to whether these regimes would effectively address the prudential risks of stablecoins. Requirements that apply generally to issuers of public securities are not designed to address concerns about run risk, payment system risk, or concentration of economic power. MMF regulations do not focus on payment system risks or concerns about concentration of economic power.

C. Commodities Regulation

Under the Commodities Exchange Act, the CFTC has the authority to police fraud and manipulation in commodities spot markets, which the CFTC has indicated include digital assets.[2] In addition, derivatives products on commodities and leveraged retail transactions are subject to jurisdiction of the CFTC. These are important tools for ensuring the integrity of these markets and protecting investors, but they are not intended to address prudential risks.

3. Recommendation regarding stablecoin issuers

The PWG Report recommends requiring stablecoin issuers to be IDIs because IDIs are subject to a regulatory and supervisory framework that would help to mitigate the prudential risks the report identifies. Run risk would be reduced by features including capital, liquidity, and other prudential standards, as well as access to the Federal Reserve as lender-of-last resort. Payment system risk would be mitigated through the establishment of risk-management standards for entities that conduct critical activities within stablecoin arrangements. Concerns about concentration of economic power would be addressed by prohibiting stablecoin issuers from conducting commercial activities, or affiliating with commercial companies, and by allowing supervisors to establish interoperability standards. In short, IDI regulation provides a tested regulatory model that would protect against the prudential risks of stablecoins and help to support confidence of stablecoin users.

In developing this recommendation, the PWG relied upon the flexibility that the banking agencies would have to calibrate supervision and regulation of stablecoins based on risk. Banking agencies currently use existing authorities to adjust supervision and regulation in the context of overseeing IDIs with a diverse range of business models (e.g., commercial banks, trading banks, custody banks) and systemic risk footprints (e.g., community banks, mid-size banks, regional banks, large banks). The fact that some prominent stablecoin issuers are already seeking IDI charters provides additional reason to think that IDI regulation is a feasible regulatory model for stablecoin issuance.

Since the publication of the PWG Report, some have asked whether stablecoins issued by an IDI would be covered by FDIC insurance, or its equivalent. The PWG Report does not take a position on this issue. While insuring stablecoins would protect users against the risk of loss, it would also introduce certain policy and technical challenges. For this reason, Congress (or the banking agencies) might want to consider alternative measures to protect stablecoin users.[3]

Finally, the Financial Stability Oversight Council (FSOC) continues to evaluate potential systemic risks related to stablecoins and other digital assets, and the steps that may be available

[2] https://www.cftc.gov/media/4636/VirtualCurrencyMonitoringReportFY2020/download
[3] For example, there could be a requirement for stablecoins issued by an IDI to be fully backed by safe assets – consistent with how many stablecoins currently purport to be backed.

to the FSOC to mitigate such risks. These may include designation of certain activities conducted within a stablecoin arrangement as, or as likely to become, systemically important payment activities.

4. Digital Assets and Distributed Ledger Technology

As I stated at the beginning of my testimony, Treasury supports responsible innovations that meet the needs of users, the financial system, and the economy. The Administration continues to evaluate the broader set of issues and opportunities posed by digital assets and distributed ledger technology, and welcomes the opportunity to continue to work with Congress.

To date, much of the public policy discussion of digital assets has focused on regulatory questions about digital assets themselves. I would identify two additional sets of issues that merit focus as policy is developed in this area:

The first relates to the regulation of intermediaries that participate in digital asset markets. Some of these intermediaries are banks, investment companies, and other traditional financial actors that are increasingly expanding into digital assets. Other intermediaries -- such as stablecoin issuers, custodial wallet providers, and digital asset exchanges – are native to the digital asset ecosystem, but provide financial services similar (and sometimes identical) to those provided by traditional financial services providers. For both traditional and digital native intermediaries, it is critical to ensure that regulatory frameworks are in place that appropriately address risks to businesses, consumers, and investors, as well as the broader financial system. The banking agencies' recent "crypto sprint," the Securities and Exchange Commission and Commodities Futures Trading Commission's assessment of authorities over digital exchanges, and the PWG's work on stablecoins are important steps in this direction. But clearly, much work remains to be done.

The second set of issues relates to potential for systemic risk that could result from the build-up of leverage against digital assets. As we saw in the 2007-2008 financial crisis (and most that preceded it), leverage can play a key role in catalyzing and accelerating financial instability. To address these risks, the Administration is building its knowledge and understanding of the role that leverage plays in digital asset markets and of the implications of that leverage for the rest of the financial system. We would be pleased to discuss this set of issues further with the Committee as our understanding deepens.

Conclusion

I want to thank the Committee for its leadership on these important issues and for inviting me here to testify today. I am happy to answer any questions from the Committee. I also look forward to additional conversations regarding broader issues raised by digital assets and distributed ledger technology.

Statement for the Record

On Behalf of the

American Bankers Association

Before the

Financial Services Committee

of the

U.S. House of Representatives

February 8, 2022

American Bankers Association®

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Chairman Waters, Ranking Member McHenry, and distinguished Members of the Committee, the American Bankers Association (**ABA**)[1] appreciates the opportunity to submit a statement for the record for the hearing titled "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins" The topic of today's hearing is an important one.

The origins of cryptocurrency were driven by the desire to build a "trustless" financial system, where parties can transact directly with each other without the need for intermediaries. But the trust inherent in our regulated banking system is important to consumers and as interest in cryptocurrencies and other digital assets such as stablecoins continues to grow, consumers engaging with digital assets most often seek out trusted financial institutions to act as financial intermediaries.[2] ***ABA believes that customers who choose to access digital asset markets, including stablecoins, will be best served when they can do so through fully regulated banks where they are afforded robust consumer protection.*** To accommodate this customer demand, banks are actively developing ways to safely and responsibly allow their customers to buy, hold, and sell digital assets through their existing banking relationships, as well as become involved in stablecoin arrangements. We have encourage regulators to acknowledge that such digital asset activities are generally permissible for banks, as

[1] *The ABA is the voice of the nation's $23.3 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.2 trillion in deposits and extend $11 trillion in loans.*

[2] *See, e.g.*, NYDIG, *Survey: Bitcoin + Banking* (Jan. 2021), https://assets-global.website-files.com/614e11536f66309636c98688/616db2743df0d03cf3824093_NYDIG-Survey-Bitcoin-Banking.pdf.

functions incidental to the permissible banking activities, when conducted in a safe and sound manner, notwithstanding the novel technology involved.[3]

Recently, the President's Working Group on Financial Markets, together with the FDIC and OCC, released a report on stablecoins that are pegged or linked to the value of fiat currencies (**Report**).[4] Given the risks these products pose to consumers, the payments system, and the broader financial system, the Report recommends that Congress act promptly to enact legislation to ensure that stablecoin arrangements are subject to a consistent and comprehensive federal prudential regulatory framework. The Report also identifies certain interim measures detailing how financial and banking regulators can address stablecoin risks falling within their respective jurisdictions. In addition, in the absence of Congressional action, the Report recommends that the Financial Stability Oversite Council (**FSOC**) consider steps to address the risks outlined in the Report. ***ABA agrees that action is urgently needed to address the gaps in the federal regulation of the stablecoin market and urges Congress to enact the Report's recommendations.***

Stablecoins are unique among digital assets in that their stable value positions them as a functional alternative to a traditional deposit account. This introduces a new set of risks that banking regulations are well positioned to address. Stablecoins often seek to maintain their stable value by holding reserve assets and offering to redeem a stablecoin one-to-one for its fiat counterpart. When offered through a bank, these assets are subject to oversight that ensures the reserves are sound and there is appropriate liquidity to pay outstanding claims. That oversight is also critical to assure that the responsible party can and will deliver the reserve asset according to the terms of the stablecoin arrangement upon redemption. Even if stablecoins remain outstanding and unredeemed, their usefulness in payments transactions depends upon this degree of stability. However, many stablecoins today are issued by non-banks which are not subject to the same oversight designed to mitigate the risks they pose to consumers and the financial system.

The lack of regulation for nonbanks is particularly concerning as the rapidly evolving uses of stablecoins is fueling significant market growth. To date, stablecoins have primarily been used to facilitate digital asset trading and lending activities, but

[3] *See* ABA Comment Letter on FDIC RFI on Digital Assets (July 15, 2021), https://www.aba.com/advocacy/policy-analysis/aba-comment-letter-on-fdic-rfi-on-digital-assets; *see also* OCC Interpretive Letter No. 1179, Chief Counsel's Interpretation Clarifying: (1) Authority of a Bank to Engage in Certain Cryptocurrency Activities; and (2) Authority of the OCC to Charter a National Trust Bank (Nov. 18, 2021), https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdfhttps://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1172.pdf.

[4] President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins* (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

increasingly they are being used as a store of value and means of payment for real-world goods and services (*e.g.*, Facebook/Meta's new digital wallet using stablecoins, called "Novi Wallet").

While enthusiasts claim that stablecoins have the potential to support faster and more efficient payments options, real-time payments facilitated through the regulated banking system are fast becoming a reality. Many non-bank stablecoins are designed to circumvent this established regulatory architecture and pose a number of unmitigated risks including harm to consumers, the potential for stablecoin runs, and payment system risks, the latter of which could spill over into the broader financial system. The possibility that some stablecoins may rapidly scale, particularly as affiliates of commercial entities, also raises additional issues related to the concentration of economic power and concerns that transactions through unregulated entities may compromise protections against money laundering and terrorist financing.

Existing regulation of stablecoin arrangements is neither comprehensive nor sufficient to address these nonbank risks. The Securities and Exchange Commission (**SEC**) and the Commodity Futures Trading Commission (**CFTC**) exercise jurisdiction over certain aspects of stablecoin activity. At the state level some states subject virtual currencies, including stablecoins, to money transmission laws, but other states are undecided in their approaches. While these state laws are often aimed at a range of policy goals, including consumer protection and prevention of payment instrument default, they are not consistently applied and lack rigorous supervision and enforcement. This has resulted in a patchwork of guidance at a state and federal level that fails to ensure that all stablecoin arrangements are subject to appropriate prudential oversight on a consistent and comprehensive basis and that consumer financial protection laws are rigorously enforced.[5] This is particularly troubling in the case of stablecoins that may pose systemic significance once scaled.

Accordingly, ABA supports appropriate regulatory and legislative actions to provide a comprehensive federal regulatory framework for stablecoins. While Congressional action is pending, we encourage regulatory agencies to use their existing authorities to identify and address the risks of nonbank stablecoin arrangements, as well as FSOC to engage in a determination of whether certain activities conducted within a stablecoin arrangement are, or are likely to become, systemically important payment, clearing, and/or settlement activities.

[5] Accepting and transmitting activity denominated in stablecoins does make a person a money transmitter under the Bank Secrecy Act (**BSA**). As a result, administrators of stablecoins, and potentially other participants in stablecoin arrangements, are required to register as money transmitter businesses (**MSBs**) with the Financial Crimes Enforcement Network (**FinCEN**) and become subject to AML and sanctions requirements. However, FinCEN has delegated its supervisory authority to a variety of different entities.

In connection with this, ABA wishes to emphasize that any regulatory or Congressional action should:

- Provide a clear and comprehensive definition of “stablecoin” that avoids creating loopholes or permitting regulatory arbitrage and that clearly differentiates stablecoins from other types of digital assets. This would also ensure the regulatory treatment of stablecoins is appropriately calibrated to their risks;
- Recognize that nonbank stablecoin arrangements can pose *both* systemic risks *and* consumer and investor protection concerns, making it critical to regulate not just stablecoin issuers, but also other participants in the stablecoin ecosystem, including custodial wallet providers and parties engaged in the business of stablecoin trading and/or brokerage;
- Encourage banking and financial regulators to collaborate on and coordinate a comprehensive approach to prevent the rise of unregulated (or under-regulated) stablecoin issuers and platforms that could pose risks to consumers, investors, the financial system, and the general economy; and
- Provide consistent treatment of banks and non-banks that engage in similar stablecoin activity to prevent regulatory arbitrage and ensure all customers are protected equally.

* * *

ABA Assessment of Legislative Recommendations in the PWG Report	
Legislative Recommendations	**ABA Assessment**
Stablecoin Runs: Require stablecoin issuers to be insured depository institutions, subject to appropriate supervision and regulation at the depository institution and the holding company level, and require them to be subject to standards and regulations aimed at managing liquidity risk.	ABA supports this recommendation. A key risk related to the use of stablecoins is the possibility for loss of value. The design of Stablecoins sets them up as a store of value that can be used as an alternative to bank deposits. To protect stablecoin users and prevent stablecoin runs it is critical to maintain trust in the value of a stablecoin. The PWG report identifies the following factors that could undermine this confidence: (1) use of reserve assets that could fall in price or become illiquid; (2) a failure to appropriately safeguard reserve assets; (3) a lack of clarity regarding the redemption rights of stablecoin holders; and (4) operational risks related to cybersecurity and the collecting, storing, and safeguarding of data. Banking regulation is designed to address exactly these risks and requiring stablecoin issuers to be insured depository institutions is the most effective way to address them while guarding against stablecoin runs. This would provide for supervision on a consolidated basis; prudential standards; and, potentially, access to appropriate components of the federal safety net. Furthermore, insured depository institutions, which include both state and federally chartered banks and savings associations, have deposits that are covered, subject to legal limits, by deposit insurance, and have access to emergency liquidity and Federal Reserve services, unlike stablecoin issuers that are not insured depository institutions.
Payment System Risk: Require custodial wallet providers to be subject to appropriate federal oversight.	ABA supports these recommendations. Custodial wallet providers play a key role in the stablecoin ecosystem and should be

Provide the federal supervisor of a stablecoin issuer with the authority to require any entity that performs activities that are critical to the functioning of the stablecoin arrangement to meet appropriate risk-management standards.	subject to appropriate federal oversight to address payment system risk. This should include, among other things, requirements for clear and complete disclosures and protections against fraud, manipulation, and related risks, as well as appropriate risk management standards. Oversight at the federal level is critical because there is a patchwork of guidance at the state and federal level that fails to ensure that all stablecoin arrangements are subject to appropriate prudential oversight on a consistent and comprehensive basis and that consumer financial protection laws are rigorously enforced, and that the entities issuing stablecoins are subject to rigorous supervision and enforcement.
Systemic Risk and Concentration: Require stablecoin issuers to comply with activities restrictions that limit affiliation with commercial entities. Supervisors should have authority to implement standards to promote interoperability among stablecoins. In addition, Congress may wish to consider other standards for custodial wallet providers, such as limits on affiliation with commercial entities or on use of users' transaction data.	ABA supports imposing activities restrictions that limit the affiliation of stablecoin issuers with commercial entities to prevent inappropriate concentrations of economic power and to address additional concerns about systemic risk. Interoperability among stablecoins and between stablecoins and other payment instruments is critical in order not to disrupt existing payments systems. Appropriate restrictions that limit affiliation of custodial wallet providers with commercial entities and the use of users' transaction data will help to prevent concentration of economic power.

BANK POLICY INSTITUTE

Statement by the Bank Policy Institute

Before the U.S. House Committee on Financial Services
'Digital Assets and the Future of Finance'

Feb. 8, 2022

Chair Waters, Ranking Member McHenry and members of the U.S. House Committee on Financial Services:

The Bank Policy Institute appreciates the opportunity to submit comments to the Committee on today's hearing titled "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins."

Innovation is occurring at a rapid pace within the financial services sector. BPI members support innovation and welcome competition when it is conducted responsibly and in a way that ensures that customers are protected through consistent regulation and oversight.

To date, much of the innovation in cryptocurrencies — including stablecoins — has occurred outside the regulated banking sector, largely in nonbank fintech firms subject to little to no government oversight. Now that these innovations are well past proof-of-concept stages, gaining steam and becoming more widely understood and accepted by consumers, many banks are becoming more and more interested in finding ways to give their customers the ability to access, invest and transact in them. As banks enter this space, ordinary consumers will benefit by being able to access these innovations through trusted intermediaries. Banks are subject to an extensive federal regulatory and supervisory framework that allows policymakers to ensure consumers are protected and that the banking and financial system remains resilient. That framework does not apply equally to the nonbank fintech providers, leaving consumers more exposed to potential harm.

U.S. banking regulators should move swiftly to finalize long-promised guidance about supervisory expectations for banks that choose to engage in broader digital assets, including crypto and stablecoin, activities. Absent such guidance, the highly regulated banking sector will be left on the sidelines as digital asset innovations continue to advance unchecked in the unregulated sectors, with little to no government oversight to ensure the safety and soundness of our financial system and the protection of ordinary American consumers.

BPI has long argued that both consumers and the U.S. financial system are put at risk when entities operating outside the federal bank regulatory perimeter offer banking products and services without adhering to appropriate consumer and prudential regulatory protections and with far more limited – if any – onsite supervision to determine compliance with those protections. By way of example, BPI has repeatedly identified significant risks posed by stablecoins and stablecoin issuers, both of which exist almost entirely outside the regulated financial system. Many of these risks have been identified by members of this Committee, domestic and international regulatory bodies and members of the President's Working Group — whose recent report is the focus of today's hearing. Most notably, BPI has expressed serious concern about issuers of stablecoins that market their products as being "backed 100% by reserves" when that is in fact false.

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In banking, "reserves" refers to vault cash and deposits at the Fed, both of which are short-term loans, highly-liquid and whose values experience inconsequential fluctuation. Many of the leading stablecoins — including the two largest stablecoin issuers that together represent 77% of all stablecoins in circulation[1] — claimed up until recently to hold 100% reserves while also applying a broad definition to "reserves" to count commercial paper (i.e., short-term corporate debt that can be volatile in periods of stress), including in the case of Tether investing in Chinese commercial paper of dubious value. Thus, it's a risk to consumers and potentially also financial stability when these products are called "stablecoins" and the assets that back them are anything but stable. In substance, they are actually more like 2008-style prime money funds that contributed to the destabilization of the financial sector during the Global Financial Crisis. Some stablecoin issuers have committed to greater transparency. However, this transparency has not fully materialized, and oversight of these activities has largely been confined to state-level money transmitter rules that may not be sufficiently robust to address the run risk of these products.

BPI is encouraged by the Committee's attention to this important topic. It is critical that Congress and other policymakers pursue measures that would address the risks posed by stablecoin issuers and further ensure that they adhere to existing consumer protections.

The attached note delves deeper into the aforementioned concerns. Thank you for considering our perspective.

[1] Nelson, B., & Paridon, P. P. (2021, December 10). Stablecoins are backed by 'reserves'? give us a break. American Banker. https://www.americanbanker.com/opinion/ststablecoins-are-backed-by-reserves-give-us-a-break

Liquidity Transformation Always Finds the Path of Least Regulation

Bill Nelson | September 23, 2021

Banking is inherently unstable. The business of banking in a nutshell is borrowing deposits and using the funds to make loans. If too many depositors ask for their money back at the same time, the bank will default because it doesn't have the money on hand, it has lent it out. So if you are a depositor and you think other depositors are going to demand their money back, it makes sense to withdraw your money first before the bank fails. Since each depositor knows this, a deposit run can develop simply because there is fear of a deposit run. That's unstable.

The instability has been well understood for as long as there have been banks. In modern times, bank regulation and deposit insurance have reduced the instability. Capital regulations require a bank to have a lot more assets than liabilities so that even if the bank suffers losses, it still has assets to cover its borrowings (including the deposits owed to customers). Liquidity regulations require banks to hold safe and highly liquid assets—basically short-term loans to the federal government—so that each bank has funds on hand to cover deposit withdrawals (or other demands on its funds) for long enough for the bank to sell or borrow against its other assets, if necessary, to generate cash to meet ongoing deposit withdrawals. Lastly, banks are required to purchase federal insurance for their deposits, so that most depositors are assured their money is safe no matter what happens to the bank.

Banking is also profitable. People like to deposit their cash at a bank because they know it is safe and its value is stable: every dollar deposited will still be worth a dollar when it is withdrawn. Plus, they can withdraw their cash at any time (as long as they don't all try to withdraw their cash at once). People also value the transaction services that a bank provides (i.e., the ability to pay and receive payments from others). Deposit rates are lower than interest rates on other short-term investments to reflect the value of these money-like features. On the other side of the balance sheet, loan-making requires expertise and extensive due diligence to make sure the borrower is credit-worthy—loans are "informationally intensive"—and loan rates cover those added cost. Loan rates also include risk premiums and liquidity premiums and often term premiums because loans are risky, illiquid and often longer-term. Due to these characteristics of deposits and loans, banks are engaging in what is called "liquidity" or "maturity transformation" when they fund loans with deposits – funding long-term or illiquid assets with short-term liabilities. For all these reasons, loan rates are generally above deposit rates. Banks earn the spread.

Regulations and deposit insurance reduce bank profitability. Capital is more expensive than deposits as a source of funding. Liquid assets yield less profit than bank loans. And deposit insurance is costly.

It is profitable for *any* institution, not just banks, to fund itself with deposit-like liabilities (liabilities where the creditor is seemingly guaranteed to get at least a dollar back for every dollar invested) and invest in risky and illiquid assets. And it is even more profitable if the intermediation avoids costly regulations and deposit insurance. As a result, there is always an incentive for maturity and liquidity transformation to take place outside of regulated, federally insured banks. But when that happens, the result is always increased instability in the financial system.

It isn't unstable right away. Usually, the institutions claim to have found a new, innovative, and safe way to take in deposit-like investments and turn a profit. People that raise concerns are accused of not understanding how things are different this time and being "anti-innovation."

We saw this dynamic in the years before the Global Financial Crisis. Prime money funds promised investors that every dollar they invested would be worth a dollar, plus they'd earn interest. The money funds invested in, among other things, asset-backed commercial paper that was supposedly perfectly safe because it was backed by large amounts of asset-backed securities. The asset-backed securities were safe because they were backed by large amounts of subprime mortgages. The mortgages, which were made by mortgage brokers, not banks, were safe, or at least safe enough, because they'd only go bad if housing prices fell and a lot of people became unemployed. Between 2002 and 2007, credit intermediation through the shadow banking system grew by about 75 percent.

In the end, it was all just a complicated way to fund loans with deposits without regulation or insurance. And, of course, it proved unstable. Once "investors" in prime money funds realized that they might not all get their money back, they all headed for the exit at once, and the darkest days of the Global Financial Crisis began. Since then, prime money funds have no longer been allowed to treat investments like deposits; instead of the value of a share being pegged to a dollar, the value moves up and down as the funds' investments fluctuate in value.

Liquidity transformation outside the banking system is starting up again. This time, it is FinTech that makes everything different. This time, digital dollars and uninsured deposits at FinTech banks really will be perfectly safe. The new digital crowd has it all figured out. Anyone doubting it either doesn't understand or is afraid of competition or innovation or both.

This time, we are told, stablecoins and uninsured deposits at FinTech banks are safe because they aren't used to fund loans, they are invested 100 percent in "reserves." And that does sound safe. In banking, "reserves" means vault cash and deposits at the Fed, both of which are very short-term loans to the government that don't fluctuate in value and are perfectly liquid. Moreover, many remember from their college money and banking courses that we have a "fractional reserve banking system" where banks "magically" – and some would say recklessly or perhaps even unconstitutionally – create money by loaning out deposits while only holding a fraction as reserves. Being backed 100 percent by "reserves" then, as stablecoin issuers and FinTech banks assert they are, must be the opposite. It's not only safe, it's an act of defiance against the whole evil banking system.

Those of us that have seen this show before, who spent years cleaning up the pieces from the Global Financial Crisis, who have worked to make the financial system safer, are not surprised at all to learn those "reserves" aren't at all perfectly safe and liquid assets. No, they are once again risky and illiquid assets.

Consider the two largest stablecoin issuers in the United States, Tether and USDC. Together they have issued about $100 billion in coins. In both cases, people who buy a stablecoin using real money are told that they can get all their money back whenever they want it. In that sense, these stablecoins are just like a demand deposit at a bank. Recently, however, they've been forced to provide information on the "reserves" that they have invested in using the dollars people have given them in exchange for their stablecoins, and the reserves don't look anything like the "reserves" that banks hold.

Table 1		
Tether's Reserve Disclosure as of June 2021		
Cash & Cash Equivalents & Other Short-Term Deposits & Commercial Paper:		
	$billions	percent
Commercial Paper & Certificates of Deposit[2]	30.8	49
Cash & Bank Deposits[3]	6.3	10
Reverse Repo Notes[4]	1.0	2
Treasury Bills[5]	15.3	24
Subtotal		
Secured Loans (none to affiliated entities)	2.5	4
Corporate Bonds, Funds & Precious Metals	4.8	8
Other Investments (including digital tokens)	2.1	3

[2] Commercial paper & certificates of deposit comprises commercial paper (short-term debt issued by corporations) and certificates of deposit (negotiable short-term deposits issued by financial institutions). The average duration of items in this category is 150 days and the average rating is A-2.

[3] Cash & bank deposits comprises: cash deposits at financial institutions and call deposits, i.e., deposits that may be withdrawn with two days' notice or less; fiduciary deposits, i.e., deposits made by banks on behalf of and for the benefit of members of the consolidated group; and, term deposits, i.e., deposits placed by members of the consolidated group at its banks for a fixed term.

[4] Reverse repo notes comprises reverse-repurchase agreements that have been entered into by means of the purchase of structured notes or fund vehicles whose ultimate issuer or guarantor has a rating of A-2 or better.

[5] Treasury bills comprises U.S. Treasury bills with a maturity of less than 90 days.

As shown in Table 1, More than half of Tether's "reserves" are invested in commercial paper and certificates of deposit.[1] When Tether invests in commercial paper, it gives a company money and at some later time, from the next day to a year later, the company gives Tether back the money plus interest. Sounds like a loan, doesn't it? That's because there is no meaningful difference. Plus, more than half of Tether's commercial paper is so risky that even prime money funds can't hold it. Another 10 percent of Tether's "reserves" is bank deposits, and yet another 10 percent is corporate bonds, precious metals, digital tokens, and "other" assets. Less than a quarter of Tether's reserves consists of Treasury bills, the short-term loans to the federal government of the sort that most people mean when they use the term "reserves."

Until earlier this summer, USDC stablecoin, which is issued through a partnership between Coinbase and Circle, was marketed as being backed by U.S. dollars. Circle, too, recently provided additional information on its reserves (Table 2). As of last month, Circle states that nearly all (92 percent) of its reserves are cash and "cash equivalents" and only 2 percent commercial paper.[2] That sounds pretty good until you read the fine print. "Cash Equivalents" includes *any* security with a maturity less than or equal to 90 days, which includes most commercial paper. The

[1] See Independent Accountant's Report by Moore Cayman, dated 6 August 2021, available at https://tether.to/wp-content/uploads/2021/08/tether_assuranceconsolidated_reserves_report_2021-06-30.pdf

[2] *See* Independent Accountant's Report by Grant Northam, dated September 20, 2021, available at https://www.centre.io/hubfs/pdfs/attestation/2021%20Circle%20Examination%20Report%20August%202021%20Final.pdf?hsLang=en

"commercial paper" line listed separately only includes CP with maturity between 91 days and 13 months. So some unknown fraction of that 92 percent in "cash & cash equivalents" is actually invested in commercial paper.

Table 2

Circle's Reserve Disclosure as of August 2021

USDC Reserve Breakdown	$billions	percent
Cash & Cash Equivalents[1]	25.3	92
Corporate Bonds[2]	0.4	1
Yankee CDs[3]	1.3	5
Commercial Paper[4]	0.5	2
Total [6]	**27.5**	**100**

[1] Cash and cash equivalents include U.S. dollar deposits at banks and short-term, highly liquid investments that are readily convertible to known amounts of cash and have a maturity less than or equal to 90 days from purchase, as consistent with generally accepted accounting principles (US GAAP).

[2] Unsecured debt obligations of corporations and financial institutions with a maturity of less than or equal to 3 years. Minimum S&P rating of BBB+; maximum maturity of 3 years.

[3] USD denominated Certificates of Deposit issued in the US by branch(es) of Foreign Banking Organizations. Minimum S&P rating of S/T A1; maximum maturity of 13 months.

[4] Unsecured debt obligations of corporations and financial institutions with maturities between 91 days and 13 months. Minimum S&P rating of S/T A1; maximum maturity of 13 months.

At present, Tether, Coinbase, and Circle are earning the interest being paid on their "reserves" while paying no interest on the funds that they received for their stablecoins. But as soon as any of the risky assets that they have invested in go bad, they will not have the wherewithal to repay all those stablecoin holders because they don't have sufficient capital cushions to absorb investment losses nor enough liquidity to meet massive outflows immediately. Those holding stablecoins – all stablecoins – will all demand their real dollars back at the same time, and the house of cards will collapse again.

Indeed, as discussed in a recent interview of Tether's CTO and General Counsel on CNBC, there are rumors that Tether has invested in the commercial paper of Chinese companies.[3] While Tether has issued a statement that it is not holding any of Evergrande's (a large, financially troubled Chinese financial institution) commercial paper, if it is holding the commercial paper of other Chinese financial institutions, it would be exposed to losses should any of those firms default.[4]

Liquidity transformation outside the traditional banking system may also soon begin at Wyoming's Special Purpose Depository Institutions (SPDIs). SPDIs can accept deposits, offer payment services and provide debit cards, but their deposits are not insured. They are not insured because the state of Wyoming requires that the SPDIs invest

[3] See https://www.youtube.com/watch?v=ZBEqyiO35cQ.
[4] See "Stablecoin Tether says holds no Evergrande commercial paper," Reuters, September 16, 2021. https://www.reuters.com/business/finance/stablecoin-tether-says-holds-no-evergrande-commercial-paper-2021-09-16/.

only in "reserves," thus rendering deposit insurance unnecessary.[5] The deposits are no different than ordinary bank deposits: they are marketed as safe and stable, and they are available on demand. Except "ordinary" bank deposits are insured.

It is not clear what "reserves" means, though. The regulation provides a list of allowable assets that includes reserves balances and Treasury securities (which qualify as level 1 High Quality Liquid Assets (HQLA), a category of assets that can be used to satisfy federal liquidity regulations), as well as other things that do not count as level 1 HQLA (like munis and most agency MBS).[6] However, the regulation then states that only level 1 HQLA is allowed except for any other asset consistent with "safe and sound banking practices" approved by the Wyoming Banking Commissioner. Any asset a bank is legally allowed to hold that hasn't gone bad – boat loans, construction loans, etc. – is consistent with "safe and sound" banking practice. The Wyoming Banking Commissioner has not indicated what assets he would allow.

Nor have any of the SPDIs, which have not yet opened for business, stated unambiguously what they will invest in. Kraken, for example, the first institution to get an SPDI charter, acknowledges in a website FAQ on deposit insurance that a customer's investments will not be FDIC-insured and then goes on to say:

> However, Kraken Bank will be fully reserved (i.e., no fractional reserve banking or associated re-hypothecation and lending activities). All assets will be kept on hand and available as cash or the least risky, most liquid cash equivalents. We will also maintain significant capital reserves and surpluses of our own capital to cover the full balance of all clients, even in the event of a "bank run."[7]

Because Kraken does not publicly disclose the assets into which customer deposits will be invested, or otherwise substantiate its claim that they are "the least risky, most liquid cash equivalents," we contacted Kraken customer service and asked what "Cash Equivalents" means. We were told "stocks, bonds, and mutual funds."[8]

Is this beginning to sound familiar? Offer a deposit-like product that is going to be so ultra-safe that it doesn't need insurance, using a new technology that makes everything so different the institution doesn't need to be subject to insured-commercial-bank-level regulations. Use the funds received to invest in assets that turn out not to be safe and liquid. Earn the spread.

WHY NOT BE TRANSPARENT?

All the parties involved – the stablecoin issuers, the SPDIs, the Wyoming Banking Commissioner – have every incentive to be completely transparent. The stablecoin issuers want customers to be confident that their coins are safe. The SPDIs want customers to know that their deposits are safe. The Wyoming Division of Banking wants SPDIs to be seen as so safe that they don't need FDIC insurance.

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[5] For example, Kraken states that it "is required by Wyoming law to maintain 100% reserves of its deposits of fiat currency at all times." https://blog.kraken.com/post/6241/kraken-wyoming-first-digital-asset-bank/. Avanti states that it offers "full-reserve requirement for dollar deposits". https://avantibank.com/.

Also see Wyo. Stat. 13-12-105: "At all times, a special purpose depository institution shall maintain unencumbered liquid assets valued at not less than one hundred percent (100%) of its depository liabilities."

[6] Wyoming SPDI Rules (05-21), section 9, available at https://drive.google.com/file/d/1EVLJjkvgV3--gWnie72fJwn_9VwVaJLC/view.
[7] https://www.kraken.com/en-us/bank.
[8] Our exchange with Kraken customer service is available on request. It is, of course, possible that the customer service representative was incorrect.

The only reason to be anything but fully transparent is to be able to invest in higher-yielding assets that are inconsistent with the message that the stablecoins or uninsured deposits are backed by vanilla, ultra-safe, highly liquid assets. There are no trade secrets involved in investing in Treasury bills.

Nevertheless, not only does the lack of transparency persist, Tether is taking legal action to avoid being transparent. Tether recently petitioned the New York Supreme Court to block a Freedom of Information Law request from the publication CoinDesk for documents detailing the composition of Tether's reserves over the past few years.[9] Tether states that releasing the documents would put it at a disadvantage relative to its competitors.

Similarly, there is no reason for the Wyoming regulations to define liquid assets as anything the Banking Commissioner says they are. Such ambiguity and unfettered secret discretion is generally not present in federal banking regulations. When the Fed requires a bank to hold a certain quantity of reserves against deposits, it is completely clear that reserves are defined as vault cash and deposits at a Federal Reserve Bank. There is no "other things the Fed defines" category, secret or not. The banking agencies have been unambiguous about what assets count as level 1 HQLA for the purposes of satisfying liquidity requirements or equity for the purposes of satisfying capital requirements. Will the Commissioner decide that Wyoming state or local municipal debt is liquid, or investments in equity mutual funds, or deposits at a Wyoming bank? Has the Commissioner already approved some assets – will those decisions be made public? Why not provide a definitive list now?

OUTLOOK

There is reason to be optimistic that a financial crisis will be avoided this time. All the U.S. financial regulators appear deeply concerned about the financial stability and other risks that are building. In July, the President's Working Group on Financial Markets met to discuss the rapid growth of stablecoins and the possible risks they present to end users, the financial system and national security. The Secretary of the Treasury underscored the need for government to act quickly to ensure that there is an appropriate U.S. regulatory framework in place, and the PWG indicated that it expects to issue recommendations for such a framework in the coming months. In addition, Fed Chair Powell has stated that the Fed will be issuing a research paper this month discussing crypto currency, including stablecoins. Finally, stablecoins and their issuers have been the recent target of the attention of the SEC. Chairman Gensler has said that he believes many are operating illegally as unregistered investment securities, and just recently, Coinbase revealed that the SEC is investigating the crypto exchange's planned offering for crypto holders to lend out stablecoins and earn interest as constituting an unregistered investment.

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[9] In the Matter of the application of iFinex Inc. et al against State of New York, Office of the Attorney General, regarding Freedom of Information Law Requests G000260 and G000261, filed August 30, 2021. See also "Tether Asks Court to Block NYAG From Releasing Documents to CoinDesk," CoinDesk, August 31, 2021. https://www.coindesk.com/policy/2021/08/31/tether-asks-court-to-block-nyag-from-releasing-documents-to-coindesk/

CHAMBER OF DIGITAL COMMERCE

October 18, 2021

The Honorable Janet Yellen
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Rostin Behnam
Acting Chairman
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Regulatory Framework to Address the Growth and Promise of Stablecoin Payments Systems

Dear President's Working Group Members:

The Chamber of Digital Commerce (the "Chamber") and its members appreciate the efforts of the President's Working Group on Financial Markets ("the Working Group") to determine the appropriate U.S. regulatory framework for stablecoins.[1] As the world's first and largest blockchain trade association, we are writing to you to help inform those efforts by recommending a regulatory approach that addresses potential risks while allowing for continued innovation.

Established in 2014, the Chamber's mission is to promote the acceptance and use of digital assets and blockchain technology, and we are supported by a diverse membership that represents the blockchain industry globally. We represent the world's leading innovators, operators, and investors in

[1] "Readout of the Meeting of the President's Working Group on Financial Markets to Discuss Stablecoins," U.S. Department of Treasury, July 19, 2021.

the blockchain ecosystem, including leading edge startups, software companies, financial institutions, and investment firms. More than a dozen of our members are involved in stablecoin projects.

In our 2020 report, *Understanding Digital Tokens: Market Overviews and Guidelines for Policymakers and Practitioners,* we defined stablecoins as: "A [digital] token for which the value is pegged to an external value, such as fiat currency, cryptocurrency, or other financial asset, or an algorithm, designed to limit price volatility."[2] We further defined a digital token as "computer code maintained on a blockchain-based ledger that [is] secured using cryptography, with each token typically representing a specific value or amount on the ledger."[3] The scope of this letter is limited to stablecoins that are pegged to the U.S. dollar, focused on the U.S. retail market, and subject to U.S. financial regulations.[4]

Digital tokens promise to bring tremendous improvements to our financial system by enabling frictionless, instantaneous transferability of value. Stablecoins, a type of digital payments instrument, bridge the gap between the innovations of digital tokens and the functionality of legacy payment systems. Stablecoins promise faster, lower-cost payments, as well as the opportunity for greater financial inclusion. In particular, the proliferation of stablecoins built upon open blockchains could bring about immeasurable uses and applications across the economy due to the programmable nature of these payments' instruments.[5] Thus, as policymakers contemplate the proper regulatory treatment of stablecoins, they should seek a balanced approach that appropriately mitigates risk without stifling innovation.

With this directive in mind, we would like to emphasize the following points:

- Fiat currency-pegged stablecoins, like other forms of retail-focused digital payments instruments, can underpin efficient payments systems that facilitate wider financial inclusion by reducing the costs of basic financial services, adding transparency to the financial system, and overcoming the lack of trust felt by communities underserved by the existing financial system.

[2] "Understanding Digital Tokens: Market Overviews and Guidelines for Policy Makers and Practitioners" (second edition), Chamber of Digital Commerce, January 2020, 22.
[3] Ibid., 12.
[4] This focus is similar to the scope that the Working Group articulated in its December 2020 report, although unlike that statement, this letter also focuses on stablecoin payments systems that are not "significant." "Statement on Key Regulatory and Supervisory Issues Relevant to Certain Stablecoins," President's Working Group on Financial Markets, December 2020, 1.
[5] For example, smart contracts could ensure that payments will be received upon the delivery of goods or services. *See* Eswar Prasad, "Five myths about cryptocurrency," *Brookings Institution*, May 4, 2021 (explaining that "digital tokens representing money . . . could ease electronic transactions that involve transfers of assets and payments, often without trusted third parties such as real estate settlement attorneys"). *See also* Jeremy Allaire (@jerallaire) referring to stablecoins as "dollar[s] on the internet" with use cases ranging from start-up financing, international logistics, and worldwide payroll, Twitter, September 27, 2021.

- U.S.-headquartered stablecoin payments systems, or payments systems built upon stablecoins, are already well-regulated at the state and federal level.[6] Stablecoins themselves should be regulated similarly to other retail-focused digital payments instruments, as opposed to being regulated as securities under federal securities regulation. It is important that regulators avoid imposing an overly rigid regulatory regime that stifles innovation.

- No stablecoin payments system currently poses a systemic risk to the U.S. financial system. If regulators determine that certain large stablecoin payments systems pose unique risks or require additional oversight, it is important for U.S. regulatory responses to be tailored and tiered so that the potential benefits from emerging stablecoin innovations can flourish.

- To protect consumers and reduce costs, we encourage the streamlining of state-level regulatory frameworks for stablecoins and the issuance of special-purpose charters by federal banking regulators for stablecoin companies[7] seeking to operate nationally.

We elaborate on these points below.

1. Innovative uses of stablecoins promise to transform today's payments systems

Stablecoins provide a less costly and faster means of payment, addressing some of the most pressing problems inherent in current payments systems. While the benefits of faster, cheaper, and more reliable payments will result in innovations in many sectors of the economy, these benefits could be most impactful to those on the lowest rungs of the economic ladder. Stablecoin payments systems are creating innovation around how we send and receive payments similar to how the Internet disrupted how information is shared.

a) Stablecoins as a payment method provide instant, real-time transferability

The U.S. still relies on the Automated Clearing House (ACH) for 66.1% of the value of non-cash payments.[8] And despite recent initiatives to improve retail payments speed, these efforts are not projected to meaningfully impact reliance upon ACH for years to come, meaning that ACH payments will still take anywhere from a few hours to several days to clear.[9] International money transfers can take anywhere from one to five days depending on the banks involved, the destination country, bank hours of operation, and currency conversions required.[10] Certain large incumbent payments systems have, in many ways, become outdated in light of the

[6] Notably, in situations where a U.S. dollar-pegged, cryptocurrency-backed stablecoin is generated through users interacting with open-source software, there is not an intermediary in the creation of the underlying stablecoin. However, regulated intermediaries may be involved in the distribution (e.g., through centralized exchanges) and use (e.g., through regulated businesses, such as lending) of these types of stablecoins.
[7] Such a company could include, for example, a company that facilitates the generation of stablecoins backed by reserves for which it serves as the custodian.
[8] "The 2019 Federal Reserve Payments Study," The Federal Reserve, last modified January 2020.
[9] Aaron Klein and George Selgin, "We shouldn't have to wait for FedNow to have faster payments," *Brookings,* March 3, 2020.
[10] Cecilia Hendrix, "How long do international money transfers take?," *Western Union*, April 2021.

technologically-advanced society we live in today.[11] Stablecoin payments systems, on the other hand, can settle transactions nearly instantaneously due to the use of blockchain technology, which does not rely solely on intermediaries.

Not only are payment processing times faster with stablecoins, but the time available for processing is not restricted by the operating hours of banks and other intermediaries – as is the case for certain legacy payment systems. As Securities and Exchange Commission (SEC) Chair Gary Gensler has stated, "[u]nlike other trading markets, where investors go through an intermediary, people can trade on crypto trading platforms without a broker — 24 hours a day, 7 days a week, from around the globe."[12] Just as cryptocurrencies can be traded globally 24 hours a day, 7 days a week, stablecoin-based transactions can be paid and settled regardless of the time of day or the location of transacting parties – so peer-to-peer payments and remittances can be made in near real time.[13] On the other hand, the latest time in the day that a payment can be submitted for processing through the ACH is 4:45 pm ET.[14]

b) Stablecoins as a payment method result in lower fees

Traditional payments infrastructure is rife with fees given its over reliance on intermediaries. These fees are disproportionately borne by low-income Americans.[15] A Brookings Institution study estimates that eliminating just 10% of bank overdraft, payday loans, and check cashing services would save American working families $3.4 billion annually.[16] The proliferation of U.S. dollar-pegged stablecoins can help bring about these savings.

The time delay inherent in the current system is ultimately borne by consumers in the form of fees for services that seek to circumvent the timing problem such as check cashers and payday lenders, services that cost American consumers approximately $1.6 billion and $4.5 billion in annual fees, respectively.[17] The lack of real-time payments is also a driver of overdraft fees, which cost American consumers approximately $12.4 billion annually.[18]

Stablecoin payments systems also have the promise to provide a far more cost-effective means for processing cross-border payments. The average remittance fee for cross-border transactions is

[11] "Payment System Improvement – Public Consultation Paper," Federal Reserve Financial Services, September 2013, 4. "Legacy payment systems provide a solid foundation for payment services; however, some of these systems (check and ACH) rely on paper-based and/or batched processes, which are not universally fast or efficient from an end-user perspective by today's standards."
[12] Letter from Chair Gary Gensler to Sen. Elizabeth Warren, August 5, 2021.
[13] *See, e.g.*, Charles Cascarilla, "Presentation at CFTC TAC Panel II: Stablecoins," Paxos, February 26, 2020 (explaining that two key characteristics of Paxos Standard, a stablecoin built on Ethereum, are that it is "available 24/7" and "accessible globally").
[14] "Expanding Same Day ACH," *NACHA*, accessed October 6, 2021.
[15] Aaron Klein, "Real-time payments can help combat income inequality," *Brookings Institution*, March 2019. *See also* Aaron Klein, "The fastest way to address income inequality? Implement a real time payment system," *Brookings Institution*, January 2019.
[16] Letter from Aaron Klein, Brookings Institution, to Secretary Misback, Board of Governors of the Federal Reserve System, "Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments Docket No. OP-1625," December 2018.
[17] "The FinHealth Spend Report 2021," Financial Health Network, 2021, 23.
[18] Ibid.

6.5% of the amount sent, over double the World Bank's Sustainable Development Goal of 3%.[19] Stablecoin-backed cross-border payments, on the other hand, typically cost between 0.5% to 1% of the transmission amount.[20]

Stablecoin payments systems may also serve as a lower-cost alternative to prepaid cards and credit cards. Prepaid cards are commonly used by those without access to a traditional bank account.[21] Prepaid card issuers charge as many as 14 different types of fees, including balance inquiry fees, paper statement fees, and reloading fees.[22] Interchange fees charged to merchants for prepaid cards averaged 1.39% of transaction value in 2019, compared to 0.75% for other debit cards,[23] while credit card merchant fees can range from 1.5% to 3.5%.[24] These fees are ultimately borne by consumers in the form of higher costs. Stablecoin payments systems, on the other hand, provide enormous savings to end users by allowing them to store funds in digital token wallets without any fees other than comparatively tiny transaction fees.

c) Stablecoins as a payment method improve financial equity and inclusion

Stablecoin payment systems provide an opportunity to service the unbanked (those without an account at a financial institution) and underbanked (those who have an account but appear to access services insufficient to meet their financial needs).[25] Globally, about 1.7 billion people are unbanked.[26] In the U.S. approximately 46 million people, representing 18% of the adult population, are either unbanked or underbanked.[27] The underbanked tend to be less educated, less wealthy, and more diverse than the fully banked.[28]

Data illustrates that minorities are adopting digital tokens at a higher rate than other demographics.[29] Stablecoin payments systems could provide a way for underbanked and unbanked minorities to access basic financial services without a traditional banking relationship. Indeed, decentralized finance platforms are already utilizing stablecoins to offer basic financial services to anyone with a smartphone.[30] These solutions allow for stablecoins to be used to fund

[19] Kristo Kaarmann, "Ending remittance hidden fees: the international community calls for action," World Bank, May 2021.
[20] "Crypto-backed Cross-border Payment – A non-exhaustive study of BitPay, Uphold, Wirex, Coinify, Wyre, Coinpayments, Terra, Celo, and Paxful," *Blockchain4all*, January 2020.
[21] Peter Bennett, "Among the Unbanked, Prepaid Cards are More Popular than Cat Videos," Bank Tracker, August 20, 2021 (citing statistic that the unbanked make up only seven percent of the adult population but 23 percent of prepaid card users).
[22] "What types of fees do prepaid cards typically charge?," CFPB, last modified April 1, 2019.
[23] "Reports and Data Collections, Interchange Fee Revenue," Board of Governors of the Federal Reserve System, accessed October 9, 2021.
[24] Holly Johnson, "Average credit card processing fees in 2020," *Bankrate*, September 22, 2020.
[25] "Economic Well-Being of U.S. Households in 2020," Board of Governors of the Federal Reserve System, May 2021, 45.
[26] "The Unbanked," The World Bank, 2017.
[27] "Economic Well-Being of U.S. Households in 2020," Board of Governors of the Federal Reserve System, May 2021, 45.
[28] Ibid.
[29] Akayla Gardner, "Black Americans Are Embracing Stocks and Bitcoin to Make Up for Stolen Time," *Bloomberg*, April 13, 2021 (according to a recent Harris Poll survey, 13% of whites, 18% of African Americans, and 20% of Hispanics own cryptocurrencies).
[30] "Celo launches $100m fund to support DeFi adoption," *Finextra*, August 30, 2021.

and make payments from open-source digital token wallets that do not require a banking relationship to download. These wallets can in turn be used for peer-to-peer transactions (like Venmo) and for direct remittances, with very low fees, as mentioned above.

Stablecoins may also provide the unbanked and underbanked an affordable way to make purchases on e-commerce platforms. These platforms often provide access to more cost-effective goods and services, but typically cannot be used without a debit or credit card. The proliferation of stablecoins could provide the underbanked the option of not relying upon costly alternatives to conduct online shopping.[31] Already, an underbanked or unbanked person can fund and make payments with low-fee payments card products using stablecoins.[32] Thanks to stablecoins and other digital token innovations, the future of finance is more inclusive than ever before.

d) Stablecoin networks are built to be reliable

Critics claim that, despite the benefits of stablecoins, widespread adoption of these payments instruments is impractical because the systems upon which they are built are not reliable. As with any technology, the open blockchains upon which most retail-focused stablecoins are currently built can be susceptible to bugs and issues.[33] But these issues should be evaluated and measured against the major glitches and security failures that incumbent payments systems have experienced in recent years.[34] In 2018, one of the major credit card networks suffered an outage, which left users in the United Kingdom and Europe without services for more than 10 hours, causing more than 5.2 million transactions to fail during this time.[35] In February, a large payments service provider suffered an outage which left businesses across the U.S. unable to accept payments.[36] Although not a panacea to preventing outages, the decentralized nature of open blockchains – where peer-to-peer networks validate and record transactions – have proven extraordinarily secure and resilient because there is no single point of failure.[37] Accordingly, it is important for policymakers to create a regulatory environment that allows for continued experimentation with payments arrangements built upon these peer-to-peer networks.

2. Stablecoin payments systems headquartered in the U.S. are subject to extensive regulation at the state and federal levels

U.S. dollar-pegged stablecoin payments systems headquartered in the U.S. are subject to extensive regulation. As explained below, applicable regulatory frameworks can involve money transmission laws and state-level trust company charters on the federal level, and FinCEN, CFPB, and CFTC regulations on the federal level. Before attempting to develop a new regulatory

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[31] Marco Di Maggio and Nicholas Platias, "Is Stablecoin the Next Big Thing in E-Commerce?," *Harvard Business Review*, last modified May 21, 2020.
[32] *See e.g.*, "BitPay Launches Worldwide Stablecoin Payments," *BusinessWire*, December 10, 2019.
[33] Neha Narula, "The Technology Underlying Stablecoins," *Neha's Writings*, September 23, 2021.
[34] Ann Saphir, "Fedwire resumes operations after hourslong disruption," *Reuters*, February 24, 2021. *See also* Alan Katz and Wenxin Fan, "A Baccarat Binge Helped Launder the World's Biggest Cyberheist," *Bloomberg*, August 3, 2017.
[35] "Visa says 5.2m payments failed during 10 hour outage," *Finextra*, June 19, 2018.
[36] Natasha Dailey and Kate Taylor, "Customers are reporting credit-card payment crashes at restaurants and stores across the US, including Chick-fil-A and Ikea," *Business Insider*, February 26, 2021.
[37] Curtis Miles, "Blockchain security: What keeps your transaction data safe?" *IBM*, December 12, 2017.

regime, policymakers should first establish through a transparent and open process what gaps, if any, exist under the current approach. We believe that for U.S. dollar-pegged stablecoin payments systems headquartered in the U.S., there are no major gaps in the existing regulatory regime, but there are opportunities to streamline and improve regulatory approaches.

U.S. dollar-pegged stablecoin payments systems focused on the U.S. market but with no U.S. headquarters are also generally subject to U.S. regulations.[38] In our view, one important way for the U.S. to respond to the growth of stablecoin payments systems primarily based outside the U.S. is to ensure that the U.S. regulatory environment allows for U.S. headquartered, transparently structured U.S. dollar-pegged stablecoin payments systems to safely and efficiently flourish and grow.

Additionally, international cooperation is crucial to mitigating financial risks and preventing regulatory arbitrage. The U.S. should continue to work through the Financial Stability Board and other international standard-setting bodies, as well as align and coordinate, when possible, with other major market jurisdictions, to ensure regulatory coordination that mitigates risk while allowing innovation to occur. For example, in 2019, the Financial Conduct Authority (FCA) in the United Kingdom published its *Guidance on Cryptoassets*[39] which clarified with respect to stablecoins that where cryptoassets may meet the definition of electronic money – that is (1) electronically stored monetary value that represents a claim on the issuer, (2) issued on receipt of funds for the purpose of making payment transactions, and fall within the scope of Electronic Money Regulations (EMRs), (3) not excluded by regulation 3 of the EMRs accepted by a person other than the issuer, and (4) not excluded by regulation 3 of the EMRs – the cryptoasset would be considered an e-Money token and regulated under the existing EMRs.[40]

a) State regulatory regimes

Stablecoin payments systems focused on the U.S. retail market are often regulated under state-level money-transmitter licensing regimes – the same regime applicable to other retail-focused digital payment platforms.[41] State money transmitter laws vary from state to state[42] and are aimed at a range of policy goals including protecting consumers, maintaining public confidence in payment businesses, protecting against default of payment instruments, preventing money laundering, and eliminating financial fraud.[43] In many states, these laws allow consumer funds to

[38] A recent example of U.S. regulation extending to foreign-based stablecoin entities is the New York Attorney General's enforcement action against Tether, which resulted in a $18.5 million penalty. "Attorney General James Ends Virtual Currency Trading Platform Bitfinex's Illegal Activities in New York," New York State Office of the Attorney General, February 2021.
[39] "Guidance on Cryptoassets," Financial Conduct Authority, July 2019.
[40] "The Electronic Money Regulations," United Kingdom Legislation, 2011.
[41] Notably, in situations where users interacting with open-source software can generate a U.S. dollar-pegged, cryptocurrency-backed stablecoin, it may be the case that no entity related to the creation of the software that permits the generation of that stablecoin needs to register as a state money transmitter or money services business. However, companies offering financial services using that type of stablecoin would need to adhere to relevant regulatory requirements.
[42] Importantly, states have undertaken significant efforts to coordinate their regulatory regimes. "Model Money Transmission Modernization Act," Conference of State Bank Supervisors, September 2021.
[43] Carol R. Goforth, "The Case for Preempting State Money Transmission Laws for Crypto-Based Businesses," Arkansas Law Review 73, no. 2 (2020): 316.

be invested in commercial debt and municipal securities.[44] Some state regulations require that the market value of these permissible investments not fall below the aggregate amount of outstanding payment instruments or significantly below the net carrying value of these instruments.[45]

While most states simply apply the same regime created for other payment services to virtual currencies, other states such as Louisiana and New York have crafted special licensing regimes for virtual currency-focused money transmission businesses.[46] New York's Virtual Currency regulation, "BitLicense," contains a host of compliance policies, including capital requirements, consumer protection and asset custody standards, bookkeeping policies, anti-money laundering requirements, and cybersecurity programs.[47]

Alternatively, virtual currency companies can register as trust companies or special purpose depository institutions in certain states, which may provide an exemption from or reciprocity with other states' money transmission laws. Virtual currency companies may become limited purpose trust companies under the New York Banking Law, which includes rules regarding minimum capital and capital composition.[48] Similarly, Nevada's Department of Business and Industry allows virtual currency businesses to register as a trust.[49]

Similar to a trust, Wyoming offers a "special purpose depository institution" charter to institutions that conduct activity incidental to the business of banking.[50] Such entities are not allowed to make loans with customer deposits and must maintain "unencumbered level 1 high-quality liquid assets" equal to or greater than depository liabilities.[51]

Finally, state Attorney Generals may apply state unfair or deceptive acts or practices laws or other state laws to bring actions against activities they deem to be deceptive or unfair.[52]

b) Federal regulatory regimes

A host of federal agencies may also possess and exercise regulatory authority over stablecoin payments systems focused on the U.S. retail market. As a general matter, entities performing functions integral to stablecoin payments systems are required to register with FinCEN and follow FinCEN regulations as a money servicing business.[53] FinCEN guidance requires entities

[44] *E.g.*, Code of Virginia § 6.2-1919.
[45] AZ Rev Stat § 6-1212.
[46] 23 NYCRR Part 200; 6 La. Rev. Stat. 21, §1381 – 1394.
[47] 23 NYCRR Part 200.
[48] "Banks and Trusts," New York State, accessed October 6, 2021.
[49] "Nevada Financial Institutions Division statement on regulation of cryptocurrency in Nevada," State of Nevada, Department of Business & Industry, August 19, 2019.
[50] "Special Purpose Depository Institutions," Wyoming Division of Banking, accessed October 6, 2021.
[51] Ibid.
[52] "Attorney General James Ends Virtual Currency Trading Platform Bitfinex's Illegal Activities in New York," New York State Office of the Attorney General, accessed October 6, 2021.
[53] 18 USC § 20, including in the definition of financial institution "any person who engages as a business in the transmission of funds." *See also* Bank Secrecy Act Regulations, Definitions and Other Regulations Relating to Money Services Businesses, 76 FR 43585, 43596 (July 2011). This expanded the definition of "money transmission services" to include "the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by

performing functions integral to these stablecoin payments systems to comply with anti-money laundering (AML) and sanctions requirements.[54] This is consistent with the Financial Action Task Force's standards.[55]

Additionally, stablecoins that are considered commodities or derivatives are subject to the Commodity Futures Trading Commission's (CFTC) anti-fraud and anti-manipulation authority.[56] The Consumer Financial Protection Bureau (CFPB) also has jurisdiction over stablecoin payments systems under its payment instruments authority, which includes, for example, the authority to enforce against "unfair, deceptive, or abusive acts or practices."[57] Also, while not mandatory, the OCC has permitted entities performing functions integral to stablecoin payments systems to apply to be chartered as national trust banks if they meet certain requirements.[58]

The breadth of the existing regulatory framework described above demonstrates that, far from being akin to the "Wild West,"[59] entities operating in the stablecoin space today are subject to regulatory requirements and oversight from multiple angles.

3. Principles of any future regulatory action

The Chamber believes that the following principles should guide regulators' decision-making on stablecoin policy: a) be technology neutral, b) regulate proportionate to the risk, c) ensure U.S. global leadership in the blockchain space, d) recognize stablecoins as a type of digital payments instrument, not an investment product, e) ensure compliance with AML and countering the financing of terrorism requirements, and f) craft flexible, principles-based rules.

a) Be technology neutral

Consistent with the "same business, same risk, same rules" principle,[60] stablecoins should be regulated like other retail-focused digital payments systems in the U.S. and should not be subject to a new regulatory regime simply because new technology is being deployed. New regulatory treatment for stablecoins should only be invoked to the extent necessary to mitigate unique risks

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any means." Notably, in situations where a U.S. dollar-pegged, cryptocurrency-backed stablecoin is generated through users interacting with open software, there appears to be no need for any entity related to the generation of that stablecoin register with FinCEN. "Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies," FinCEN, May 9, 2019, 23-24, 27.

[54] "Application Of FinCEN's Regulations To Persons Administering, Exchanging, Or Using Virtual Currencies," FinCEN, March 18, 2013.

[55] "FATF Report to the G20 Finance Ministers and Central Bank Governors on So-called Stablecoins," Financial Action Task Force, June 2020, 11.

[56] "Understand the Risks of Virtual Currency Trading," CFTC, accessed October 6, 2021. This advisory states that "the CFTC maintains general anti-fraud and manipulation enforcement authority over virtual currency cash markets as a commodity in interstate commerce."

[57] "Unfair, Deceptive, or Abusive Acts or Practices (UDAAPs) examination procedures," CFPB, October 1, 2012.

[58] "OCC Conditionally Approves Chartering of Paxos National Trust," OCC, April 23, 2021.

[59] Tom Newmyer, "SEC's Gensler likens stablecoins to 'poker chips' amid call for tougher crypto regulation," *The Washington Post*, September 21, 2021. Quoting Chair Gensler as stating, "we've got a lot of casinos here in the Wild West, and the poker chip is these stablecoins."

[60] "Statement on Key Regulatory and Supervisory Issues Relevant to Certain Stablecoins," President's Working Group on Financial Markets, December 2020, 1. *See also* "Regulation, Supervision, and Oversight of 'Global Stablecoin' Arrangements," Financial Stability Board, October 2020, 31.

that are not currently addressed by the regulatory regime or to account for stablecoins' ability to reduce risk or provide new benefits. If the technology reduces risk, then the regulatory approach should adjust in recognition of this risk reduction. If the technology provides new benefits, the approach should likewise adjust to avoid eliminating the new benefits.

b) Regulate proportionate to the risk

We believe that stablecoin regulation should be tailored to reflect the different risk profiles of varying types of stablecoin payments systems. Accordingly, it would be appropriate for federal regulators to consider additional safeguards only when stablecoin payments systems are adopted at significant scale nationwide. In our view, no stablecoin payments system has reached this threshold, and stablecoin activities broadly are likewise not at significant scale to merit a separate, compulsory regulatory regime.

To begin with, leading U.S.-headquartered stablecoin payments systems – unlike banks – are not leveraged. Instead, the reserves of these stablecoin payments systems are held almost entirely in cash or cash equivalents. And, notably, the only sizable U.S. dollar-pegged, cryptocurrency-backed stablecoin is over collateralized.[61] The reserves of these stablecoin payments systems arguably have a much lower risk profile than permissible investments of other state-regulated money services businesses.[62]

Moreover, the overall value of stablecoin payments systems is quite small relative to areas of the financial sector that pose higher risk. For example, the market capitalization of all stablecoins globally is approximately $132 billion,[63] while the total asset value of U.S. money market funds – which are distinctly different than stablecoins for reasons explored below and have been flagged for financial stability concerns[64] – is over $5 trillion.[65]

The financial size of most stablecoin payments systems is in fact most similar in size to corporate rewards programs, such as airline miles or Starbucks gift cards. As of Q3 2021, Starbucks had over $1.6 billion in customer prepaid balances, which is the equivalent of the sixth largest stablecoin in circulation.[66] And while the outstanding dollar value of the largest stablecoin in circulation eclipses those of all others, even its outstanding value of approximately $69 billion[67] equals only 3% of deposits at J.P Morgan.[68] While the daily volume of transactions involving that stablecoin is approximately $65 billion, accounting for over 87% of total daily stablecoin transaction volume, [69]even this figure represents a tiny fraction of the payments processed by payments settlement and clearing entities designated as "systemically important" by the

[61] "The Crypto Ecosystem and Financial Stability Challenges," International Monetary Fund, 2021, 41, 43, 48.
[62] *Supra* note 46 and accompanying text.
[63] "Stablecoins by Market Capitalization," *CoinGecko*, accessed October 16, 2021.
[64] "Policy Proposals to Enhance Money Market Fund Resilience, Consultation Report," Financial Stability Board, June 2021.
[65] "Division of Investment Management, Money Market Fund Statistics," Securities and Exchange Commission, September 20, 2021.
[66] "Starbucks Reports Record Q3 Fiscal 2021 Results," *Starbucks*, July 27, 2021.
[67] "Stablecoins by Market Capitalization," *CoinGecko*, accessed October 16, 2021.
[68] "2020 Annual Report," JP Morgan Chase & Co., 2020.
[69] "Stablecoins by Market Capitalization," *CoinGecko*, accessed October 16, 2021.

Financial Stability Oversight Council (FSOC)[70], such as the Clearing House Interbank Payments System which clears $2 trillion in payments daily.[71] Notably, the FSOC does not consider any retail-focused digital payments business systemically important.[72]

Ultimately, if regulators determine that certain stablecoin payments systems require federal regulation due to concerns over systemic risk, such regulation should only apply to individual stablecoin payments systems that are significant enough to generate systemic risk. The Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions recently identified several systemic risk factors for stablecoin payments systems that we believe are helpful, including number of users, value and volume of transactions, type of user, type of transaction, and interconnectedness with the financial system.[73] Currently, however, we do not believe any stablecoin payments system or activity meets the threshold of systemic importance using these criteria.

Critics will claim that the rapid growth stablecoins have experienced over the past year justifies their designation as systemically important by the FSOC. Indeed, the market value of stablecoins has grown from approximately $37 billion at the beginning of 2021 to $132 billion by October 2021- a $95 billion increase in value.[74] However, comparatively, junk bond issuance in the U.S. grew $142 billion in value from 2019 to 2020,[75] a nearly 50 percent higher level of growth. Clearly, the growth of stablecoins is significantly less than the level of growth of leveraged, historically crisis-prone sectors of the U.S. economy like the high-yield bond market.

c) Ensure U.S. global leadership in the blockchain space

As new blockchain technology is developed around the world, the regulatory environment for digital tokens in any given country will dramatically impact that country's competitiveness in the global environment. For the U.S. to retain its position as the leader for innovation in both finance and technology, policymakers must ensure government policies foster rather than limit innovation. A regulatory scheme for stablecoins that is hastily enacted with insufficient consideration of potential unintended consequences poses a risk of driving digital token-related investment out of the U.S. and into competing economies. It is critical that any regulatory changes be made with caution and full knowledge of the potential economic consequences.

China's recent crackdown on digital token activities highlights the fundamental differences between the U.S. market-based economy and China's controlled economy and provides an opportunity for the U.S. to fill the gap.[76] Specifically, it is important for the U.S. to allow for U.S. dollar denominated stablecoins built on open blockchains to thrive both at home and

[70] "Nonbank Financial Company Designations," U.S. Department of the Treasury, accessed October 6, 2021.
[71] "Our History," *The Clearing House*, accessed October 6, 2021.
[72] "Nonbank Financial Company Designations," U.S. Department of the Treasury, accessed October 6, 2021. *See also* "Application of the Principles for Financial Market Infrastructures to stablecoin arrangements," BIS, October 2021, 11.
[73] Ibid.
[74] "Stablecoins by Market Capitalization," *CoinGecko*, accessed October 16, 2021.
[75] Jeff Cox, "The junk bond market is on fire this year as yields hit a record low," *CNBC*, July 14, 2021.
[76] Alun John, Samuel Shen, and Tom Wilson, "China's top regulators ban crypto trading and mining, sending bitcoin tumbling," *Reuters*, September 2021.

abroad. Doing so will allow the U.S. to counterbalance China's central bank digital currency ambitions, which among other things, risk undermining financial privacy globally. While we acknowledge the concern that building a dominant U.S. retail payments rail or U.S. wholesale payments infrastructure on currently existing open blockchains may create risk,[77] we do not believe such risks outweigh the benefit of action given the small size of existing stablecoin payments systems.

d) Recognize stablecoins as a type of retail-focused digital payments instrument, not as an investment product

As evidenced in Section 1, stablecoins are a type of retail-focused digital payments instrument and should be regulated as such. Accordingly, the appropriate regulator for most stablecoin payments systems subject to U.S. jurisdiction is not the Securities and Exchange Commission (SEC), but a regulator that is accustomed to dealing with payment instruments.

Indeed, most stablecoins do not fall into categories traditionally regulated by the SEC. The Supreme Court has stated that for an investment contract to meet the definition of a security, there must be an expectation of profit.[78] Stablecoins are inherently designed not to increase in value. Stablecoins functioning as a payment method by design do not carry an expectation of profit, and therefore should not be regulated as a security.[79] As the Conference of State Bank Supervisors has stated, "There are too many use cases for stablecoins to be universally considered securities."[80] Furthermore, current SEC guidance has listed features of stablecoins among the list of factors that make a digital asset less likely to be a security.[81]

Similarly, as mentioned above, no significant U.S.-headquartered stablecoin payments system resembles a money market fund. These arrangements are built upon digital payments instruments that offer users no interest, while money market fund shares are interest-bearing. Money market funds are used as a passive investment, whereas most stablecoins are not designed to increase in value and are used for digital payments. Further, investors in money market funds purchase shares while stablecoin purchasers buy the asset directly.

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[77] Neha Narula, "The Technology Underlying Stablecoins," Neha's Writings, September 23, 2021.

[78] *SEC v. Howey Co.,* 328 U.S. 293, 299 (1946). *See also* "Framework for 'Investment Contract,' Analysis of Digital Assets," Securities and Exchange Commission, accessed October 6, 2021.

[79] Additionally, when determining whether a "note" is a security for the purposes of U.S. federal securities laws, the Supreme Court has set forth a test which considers "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." *Reves v. Ernst & Young*, 494 U.S. 56, 67 (1990).

[80] Letter from Conference of Bank Supervisors to Sen. Pat Toomey, September 7, 2021. "Many stablecoins likely fit within the definition of stored value… [w]hen stablecoins performs this activity, they likely should be considered money transmission."

[81] "Framework for 'Investment Contract,' Analysis of Digital Assets," Securities and Exchange Commission, accessed October 6, 2021 (citing features less likely to be a security as "… the design of the digital asset provides that its value will remain constant or even degrade over time, and therefore, a reasonable purchaser would not be expected to hold the digital asset for extended periods as an investment" and "any economic benefit that may be derive from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality").

In the interest of creating more regulatory certainty, the SEC should clarify that most stablecoin payments systems subject to U.S. financial regulations are neither securities nor money-market funds.[82] As it stands, instead of providing clear rules and binding interpretations, the SEC appears to be implementing regulation through enforcement.[83] This leaves market participants confused as to which digital assets might be deemed to be securities. This approach could drive innovation offshore to countries such as Canada, Singapore, and the United Kingdom, where regulators have more clearly stated that many digital tokens are *not* securities.[84]

e) Ensure compliance with AML, sanctions, and countering the financing of terrorism requirements

We believe that concerns over the role stablecoins could play in facilitating illicit activity are vastly overblown. Compliance with AML, sanctions, and countering the financing of terrorism obligations is of utmost importance to our members. As discussed in Section 2b, stablecoin transactions and entities involved in the distribution of stablecoins are subject to AML regulatory requirements.[85] The Chamber and its members will continue to work with regulators on implementing AML and sanctions best practices, including leveraging blockchain technology and innovative tools such as modern location intelligence and effective geo-blocking to advance AML and sanctions compliance. Importantly, stablecoins built on open blockchains are particularly advantageous from the perspective of identifying and mitigating financial crime. The public, traceable nature of these blockchains provides law enforcement with a significant tool for investigating and stopping illicit transactions.[86]

f) Craft flexible, principles-based rules

The structure of stablecoin payments systems will continue to adapt and grow, and regulatory frameworks must be able to adapt and grow with it. Therefore, we recommend that the states and the federal government implement regulations that adopt principles-based rather than rules-based guidelines. Regulations should also allow the U.S. private sector to retain its place as the leader in cryptocurrency innovation and development, with the room to develop without being hindered

[82] Letter from Conference of Bank Supervisors to Sen. Pat Toomey, September 7, 2021."Clear guidelines should be in place differentiating between a security and a medium of exchange, removing the ambiguity currently facing consumers and the industry."
[83] Senate Committee on Banking, Housing, and Urban Affairs, *Oversight of the U.S. Securities and Exchange Commission: Hearing before the Senate Banking Committee,* 117th Cong., 2021. Chair Gensler responding to Sen. Toomey's question on whether the SEC will provide regulatory clarity on what digital assets, specifically stablecoins, meet the definition of a security: "The Supreme Court has weighed in a number of times… I think there's been a fair amount of clarity over the years."
[84] Chanyaporn Chanjaroen and Haslinda Amin, "Singapore Will Help Crypto Firms Set Up Local Bank Accounts," *Bloomberg*, October 9, 2018. In 2018, the head of the Monetary Authority of Singapore stated that "We've seen quite a lot of [initial coin offering] activity that is not security related." *See also* "Guidance on Cryptoassets," Financial Conduct Authority, July 2019. *See also* "Understanding Digital Tokens: Market Overviews and Guidelines for Policymakers and Practitioners" (second edition), Chamber of Digital Commerce, January 2020, 183-196.
[85] "FATF Report to the G20 Finance Ministers and Central Bank Governors on So-called Stablecoins," Financial Action Task Force, June 2020, 11.
[86] For example, the U.S. Treasury's Office of Foreign Assets Control (OFAC) used public blockchain tracing to identify and sanction a nested cryptocurrency exchange that was facilitating a substantial portion of cryptocurrency ransomware activity. *See* "OFAC takes first action against cryptocurrency exchange and issues updated ransomware advisory," TRM, September 21, 2021.

by excessive regulation. Regulations should be developed with a forward-thinking mindset, with government working with industry to contemplate future advances in technology.

4. Opportunities to simplify and strengthen stablecoin regulation

Instead of building an entirely new federal regulatory regime for stablecoins, regulators should consider enhancements to the current regime, which involve time-tested state and federal frameworks. At the same time, an option at the federal level should be available for companies that wish to gain the nationwide legal certainty that comes with a federal-level special purpose charter from a national banking regulator.

a) Build off existing state regulatory approaches

As discussed in Section 2a, states regulate payment systems through money transmission licensing laws. These could be improved through the adoption of uniform standards across all 50 states that simplify and align regulatory obligations for U.S.-headquartered, U.S. dollar-pegged stablecoin payments systems.

Additionally, more states should follow the lead of those states that have adopted laws that allow stablecoin companies to qualify for state-level special purpose charters. These regulatory frameworks could feature:

- A 1:1 reserve ratio whereby the amount of dollars in reserve must equal or exceed the number of stablecoins outstanding.
- Regulatory oversight over the establishment and maintenance of stablecoin reserves.
- Segregation of reserves from corporate assets held in a bankruptcy remote vehicle.

A growing number of states are already implementing frameworks incorporating one or more of these features.[87]

State regulators and legislatures could also define stablecoins as non-securities under state law and stay involved in the federal regulatory process to ensure that the SEC does not inappropriately classify stablecoins that are a type of digital payments instrument as securities. Working groups could be established to ensure that state regulators coordinate oversight efforts with federal regulators.

In the absence of a federal-level special purpose charter for stablecoin companies, the U.S. Department of the Treasury (Treasury) could be granted the authority to advance the interests of state-level stablecoin regulators in the international regulatory fora. For example, in the U.S.'s insurance regulatory paradigm, which is led by state regulatory regimes, Treasury plays a similar role through the Federal Insurance Office.

b) Allow entities the option of a federal charter

[87] "Special Purpose Depository Institutions," Wyoming Division of Banking, accessed October 6, 2021.

The federal government should allow stablecoin companies that wish to obtain a federal-level special purpose charter to do so.[88] A federal-level special purpose charter option could be especially beneficial to larger stablecoin companies seeking a national-level regulatory framework across the U.S. and could enable them access to existing financial infrastructure already available to companies that provide similar financial services. However, given the minimal risk that stablecoins currently pose to the financial system, we believe that it would be inappropriate to require existing U.S.-headquartered stablecoin companies to obtain such a charter at this time.

We also believe that the Federal Reserve System (Federal Reserve) should grant well-regulated stablecoin companies access to Federal Reserve payments infrastructure and that it should explore providing properly regulated and capitalized stablecoin companies with the ability to back stablecoins with central bank reserves. A stablecoin company could also be allowed to operate as a full-reserve bank under the supervision of the Federal Reserve. Overall, we believe that as stablecoin companies built upon open blockchains become integrated with the U.S. financial system, it will be important for stakeholders to pay close attention to any major operational risks related to underlying networks that could emerge.[89]

c) Simplify the tax treatment of stablecoin transactions

The Internal Revenue Service (IRS) has not addressed the tax treatment of stablecoins individually, with the result that the general guidance applicable to digital assets applies. Under this guidance, taxpayers must calculate and remit tax on the gains (or losses) on every transaction in stablecoins.[90] Given that the value of stablecoins often fluctuate within a narrow band, we believe it is important for the IRS to provide clarity regarding the tax treatment of small differences between a stablecoin's value at the time of purchase and its value at the time of sale. Collecting this miniscule amount of revenue is arguably not worth the administrative burden placed on taxpayers and the IRS.

5. Conclusion

Blockchain technology is changing the global financial system to create a more technologically advanced and inclusive financial future, and stablecoins are a tool driving this change. Regulators have a unique opportunity to establish the U.S. as the leader in stablecoin innovation by adopting a regulatory regime that is principles-based, flexible, and tailored to the minimal risk that stablecoins present to the financial system. To do so, we recommend that existing federal- and state- level regulatory regimes remain in place, allowing for stablecoin payments systems to be regulated in the same way that other retail-focused digital payment businesses are regulated.

[88] The OCC has already shown their willingness to do so by granting preliminary conditional approval for some virtual currency businesses. Letter from Stephen Lybarger, OCC, to Daniel Burstein, General Counsel and CCO of Paxos, April 23, 2021. *See also* Letter from Stephen Lybarger, OCC, to Nathan McCauley, President & Director, Anchorage Trust Company, January 13, 2021. *See also* Letter from Stephen Lybarger, OCC, to Greg Gilman, Founder & Executive Chair, Audaces Fortuna Inc., February 4, 2021.
[89] Timothy Massad, "Regulating stablecoins isn't just about avoiding systemic risk," *Brookings Institution*, October 5, 2021.
[90] *See* IRS Notice 2014-21, 2014-16 I.R.B. 938.

At the same time, we believe opportunities exist to improve the U.S. regulatory approach towards stablecoins. Specifically, we recommend that:

- Federal agencies provide clarity that most stablecoins are a type of retail-focused digital payments instrument, not an investment product.
- The tax treatment of stablecoin transactions be simplified due to their stable-value nature.
- State governments and federal agencies work to expand upon the best practices of states that have enacted laws allowing well-designed stablecoin payments system businesses to qualify for state-level special purpose charters.
- Federal regulators create a federal-level special purpose charter for stablecoin companies that meet certain regulatory requirements, and policymakers consider providing properly regulated entities with the ability to back stablecoins with U.S. central bank reserves.

***

We appreciate the opportunity to share our views on stablecoins given our members' experiences in this dynamic, growing industry.

Very truly yours,

Perianne Boring
Founder and President

Teana Baker-Taylor
Chief Policy Officer

CC:

Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation

Michael Hsu
Acting Comptroller of the Currency
Office of the Comptroller of the Currency

Rohit Chopra
Director
Consumer Financial Protection Bureau

Sandra Thompson
Acting Director
Federal Housing Finance Authority

Todd Harper
Chairman
National Credit Union Administration

Thomas Workman
Independent Member with Insurance Expertise
Financial Stability Oversight Council

J. Nellie Liang
Under Secretary for Domestic Finance
U.S. Department of the Treasury

Dino Falaschetti
Director
Office of Financial Research

Steven Seitz
Director
Federal Insurance Office

Eric Cioppa
Superintendent
Maine Bureau of Insurance

Charles Cooper
Commissioner
Texas Department of Banking

Melanie Lubin
Securities Commissioner
Office of the Attorney General of Maryland, Securities Division

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STATEMENT FOR THE RECORD
by
WILLIAM MICHAEL CUNNINGHAM
and
CREATIVE INVESTMENT RESEARCH
Submitted to the
U.S. House Committee on Financial Services for a hearing entitled, "Virtual Hearing - Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins."
February 8, 2022

William Michael Cunningham and Creative Investment Research (CIR) submit the following statement for the record to the hearing entitled, "Digital Assets and the Future of Finance: Understanding the Challenges and Benefits of Financial Innovation in the United States."

We thank the Committee for this opportunity. We urge the Committee to continue to get opinions from a culturally and economically diverse set of persons and feel this is especially important as you seek to maintain your position as "a leader in highlighting issues related to cryptocurrency and financial technology." As the Committee noted,

> *"The past decade has brought a wave of financial innovation, including an explosive growth of digital assets made possible by advances in cryptography and distributed ledger technology."*

Mr. Cunningham notes that the President's Working Group on Financial Markets report on Stablecoins[1] excluded consideration of authentic African American viewpoints, relying on opinions from industry participants and "community" organizations like Better Markets, the Center or Responsible Lending and the National Community Reinvestment Coalition, each of which is self-interested, biased, ethnically and ethically compromised, managed by and representing the interests of non-minority individuals.[2]

[1] President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency's Report on Stablecoins, (Nov. 2021). Online at: https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf

[2] We not that, according to the Philadelphia Inquirer, "It's no easier for Black Philadelphians to become homeowners now than it was 30 years ago," despite the billions of dollars in "community development" funding these three organizations have received. See: https://www.inquirer.com/real-estate/housing/home-ownership-gap-black-philadelphia-fed-20211213.html

Given the fact that incompetence, discrimination and exclusionary practices based on race are prevalent in investment and finance, including at regulatory bodies, we decline to directly address the issues raised, having done so over the past 30 years. We note our answers to the issues posed by reference to the following:

Talk to the Government Blockchain Association on the Future of Money
https://youtu.be/n1i4J8df0t0

Statement for the Record on Crypto Inclusion Myths
https://www.prlog.org/12899511-creative-investment-research-issues-statement-for-the-record-on-crypto-inclusion-myths.html

Blockchain, Cryptocurrency and the Future of Monetary Policy
https://www.prlog.org/12785779-blockchain-cryptocurrency-and-the-future-of-monetary-policy.html

Is FedCoin, a US Government-issued cryptocurrency, feasible?
https://www.prlog.org/12772509-is-fedcoin-us-government-issued-cryptocurrency-feasible.html

Comments to the Reserve Bank of India on Blockchain, Crypto
https://www.prlog.org/12765825-comments-to-the-reserve-bank-of-india-on-blockchain-crypto.html

We contend that these exclusionary practices based on the race of the individuals actually controlling an organization, are inappropriate. This is especially relevant for a technology like digital currency.

Mr. Cunningham states that:

> *"It is critical to understand that bitcoin was created in direct response to the failure of global regulators to protect the public in the years leading up to the financial crisis of 2007/2008. Thus, the social and monetary functionality of cryptocurrency is superior to that of paper money. Eventually, cryptocurrency is going to dominate."*[3]

Mr. Cunningham (WMC) has long been concerned with the failure of bank and financial institution regulatory agencies to protect the public interest.

[3] From *Blockchain, Cryptocurrency and the Future of Monetary Policy*. Copywritten research report provided in 2019 to the House Financial Services Committee on a confidential, not for distribution basis.
https://www.prlog.org/12785779-blockchain-cryptocurrency-and-the-future-of-monetary-policy.html

We base this on the following:

- On July 3, 1993, WMC wrote to SEC Commissioner Mary Schapiro to notify the Commission about a certain, specific investing "scam." A timely warning was not issued to the investing public and members of the public were damaged. See: https://www.creativeinvest.com/SECNigerianLetter.pdf
- WMC designed the first mortgage security backed by home mortgage loans to low- and moderate-income persons and originated by minority-owned institutions. (See: Security Backed Exclusively by Minority Loans, at https://www.creativeinvest.com/mbsarticle.html)
- In October, 1995, the Washington Gas Light (WGL) Company retained WMC to create mortgage-backed securities (MBS) consisting of one to four family residential home loans originated by minority-owned financial institutions serving areas of high social need. Mr. Cunningham developed a completely original approach that involved geocoding and mapping, for the first time, the location of every loan in an MBS pool and tying that location to social data. A sample map WMC created in 1997 for this process is attached as Appendix A.
- On April 30, 1997, in Case 97-1256 at the US Court of Appeals for the DC Circuit, Mr. Cunningham opposed the merger of Citigroup and Travelers and the elimination of the Glass–Steagall Act.
- In November, 1997 and, again in December, 2003, WMC wrote to the Division of Market Regulation at the Securities and Exchange Commission, on behalf of WMC and Creative Investment Research to request that CIR be considered a nationally recognized statistical rating organization ("NRSRO"). WMC requested this status only with respect to rating securities issued by financial institutions owned by women and minorities. WMC never received a reply from the Commission. We have attached a copy of a letter sent to Ms. Nazareth, Director, Division of Market Regulation, Securities and Exchange Commission, as Appendix 1.
- On June 15, 2000, WMC testified before the House Financial Services Committee of the U.S. Congress on ways to improve the supervision and regulation of government sponsored enterprises, Fannie Mae and Freddie Mac. See: https://www.creativeinvest.com/fnma/
- In 2001, WMC designed an investment vehicle for victims of predatory lending. (See https://www.creativeinvest.com/PropertyFlipping.pdf)
- On Monday, April 11, 2005, WMC testified before Judge William H. Pauley III in the U.S. District Court for the Southern District of New York on behalf of the public at a fairness hearing regarding the $1.4 billion-dollar Global Research Analyst Settlement. See: https://creativeinvest.com/fairness.html

- On December 22, 2005, WMC issued a strongly worded warning that system-wide economic and market failure was a growing possibility in a meeting with Ms. Elaine M. Hartmann of the Division of Market Regulation at the SEC.
- On February 6, 2006, statistical models created by WMC using the Fully Adjusted Return ® Methodology signaled the probability of system-wide economic and market failure. (See page 2: http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf)
- On June 18, 2009, WMC testified before the House Ways and Means Select Revenue Measures Subcommittee at a joint hearing with the Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee concerning ways to improve the New Markets Tax Credit Program. See: https://www.creativeinvest.com/nmtctestimony.html
- On January 25, 2012, WMC submitted a "Friend of the Court" brief in a case before the United States Court of Appeals for the Second Circuit (Case 11-5227). As a friend to the Court, Mr. Cunningham provides an independent, objective and unbiased view in support of broad public interests. His education and experience uniquely positioned him to provide objective, independent research and opinions concerning the issues central to the case.
- Mr. Cunningham was in the pool of Corporate Governance Advisors and Diversity Investing Advisors to CalPERS. He is currently under contract for Portfolio Assistance (Non-Fiduciary) Investment Consulting Spring-Fed Pool 2020 to the fund. See: http://www.creativeinvest.com/Calpers1.pdf http://www.creativeinvest.com/Calpers2.pdf and http://www.creativeinvest.com/Calpers3.pdf
- Creative Investment Research was one of the first signatories to the UN Global Principles for Responsible Investment (www.unpri.org). See: http://www.creativeinvest.com/PRINews2009land.jpg

Mr. Cunningham has a long track record of analyzing proposed regulatory agency rules:

- Our 2003 comments on proposed proxy voting rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as director. https://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf
- See: Comments on Proposed Rule: Internet Availability of Proxy Materials Release Nos. 34-52926 IC-27182 File No. S7-10-05. Confirmed that system-wide economic and market failure was a growing possibility. (See page 2: http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf)

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- Shareholder Proposals Relating to the Election of Directors. Release No. 34-56161 File No. S7-17-07 https://www.sec.gov/comments/s7-16-07/s71607-495.pdf
- We have requested that the U.S. Securities and Exchange Commission (SEC) develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful information concerning BLM Pledge fulfillment. See: https://www.sec.gov/rules/petitions/2021/petn4-774.pdf

Mr. Cunningham has been concerned with using new financial technologies to maximize social and financial return.[4] As his record shows, over the past 30 years, he has sought to protect the public by working with private sector and Federal regulatory agencies, including the Federal Reserve Board (FRB), the Securities and Exchange Commission (SEC), the Federal Deposit Insurance Corporation (FDIC), the Financial Crisis Inquiry Commission (FCIC), the U.S. Department of Justice (DOJ), the Consumer Financial Protection Bureau (CFPB), the Federal Housing Finance Agency (FHFA), the Department of Commerce (Minority Business Development Agency) and the US Treasury, as an employee or as a contractor. Despite his education and experience, all offers to provide consulting services and all employment applications have been denied (due to age, racial and class discrimination.) Further attempts to work with these institutions would be futile. This leaves Mr. Cunningham no option but to appeal to this Committee in order to have his independent, objective technical knowledge and experience given consideration. Mr. Cunningham's interest in this matter stems from his role as an economist and an expert in marketplace ethics and rests upon his status as a citizen of the United States.

As Mr. Cunningham demonstrates, inadequate consideration of the public interest has clearly damaged the public and investors.[5] Current regulatory practices protect the monetary interest of a narrow set of non-minority persons, fail to protect the interest of the general public, and damage the Country's long term economic prospects.

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[4] Bitcoin and Blockchain Explained IN 30 MINUTES FOR FREE. https://www.udemy.com/course/bitcoin-explained/

[5] For example, see: Fed Unveils Stricter Trading Rules Amid Fallout From Ethics Scandal. Jeanna Smialek, Oct. 21, 2021. The New York Times. Online at: https://www.nytimes.com/2021/10/21/business/federal-reserve-trading-ethics.html and Bankers Cast Doubt On Key Rate Amid Crisis https://www.wsj.com/articles/SB120831164167818299?reflink=desktopwebshare_twitter via @WSJ

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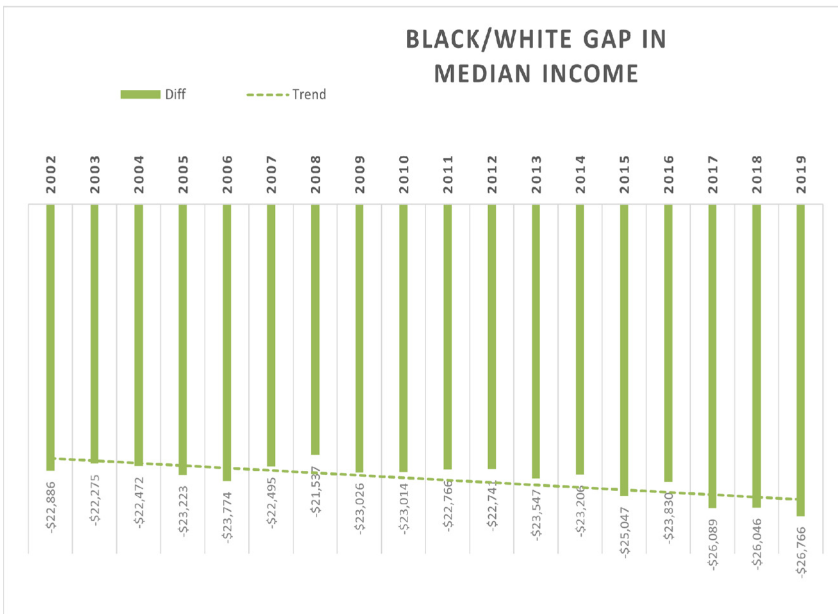
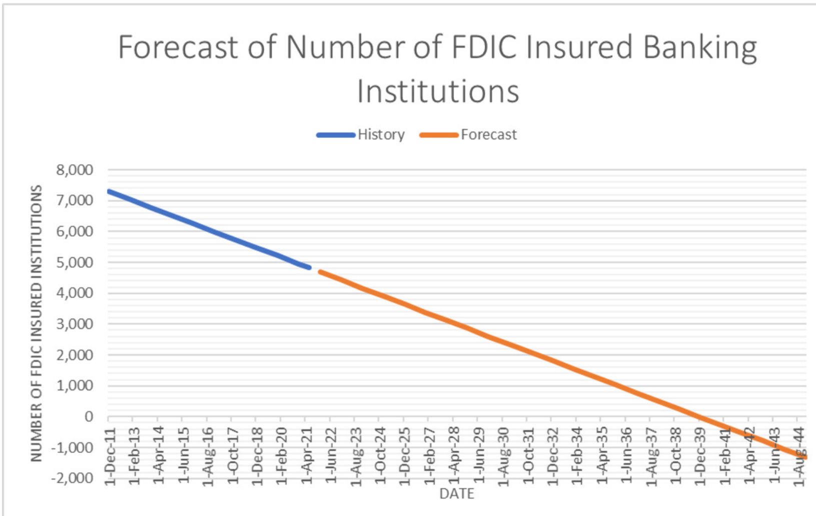
Inclusion Myths

We warn the Committee not to believe, at face value, claims by participants in this field that rest upon the ability of these new technologies to increase financial inclusion. These are the same faulty arguments used to promote subprime lending in the years leading up to the financial crisis of 2008. We note that there is no objective, fully independent data to support this contention, thus, we consider these statements false.



Cryptocurrency and Industry Concentration Issues

Regulatory ethical failings have real implications for the banking industry and for the public. Regulators may have abdicated their responsibility to



consider the public interest, if that interest includes maintaining a competitive industry. Our forecast indicates that by 12/31/2039, if current trends continue in a linear manner, the number of FDIC insured institutions will be approximately 1-2. Note that, with growing competition from fintech firms and alternatives, like bitcoin, this may imply the wholesale exit of banking institutions from both the FDIC and Federal Reserve systems. This would not be in the public interest.

Functions of Money

Further, cryptocurrency and blockchain highlight the hidden function of money. The widely recognized main functions of money are as: a medium of exchange, a unit of account, a store of value. There is another function of money that is hidden and rarely discussed: as a means of social control. Crypto currency forces this function into the open.

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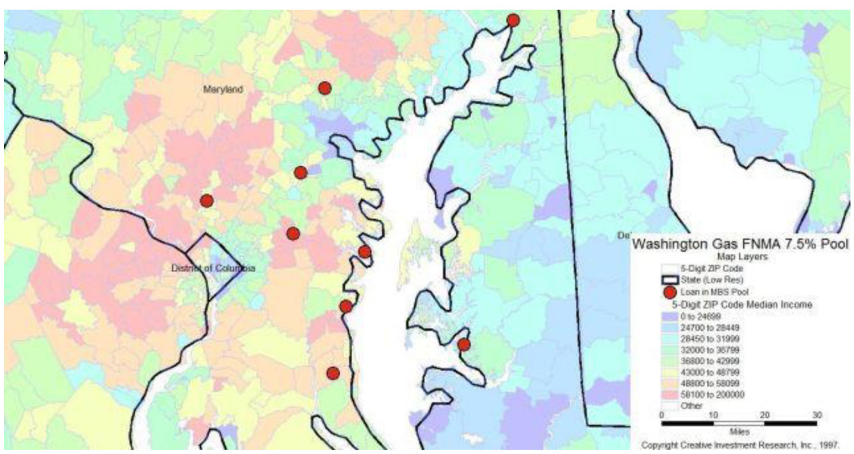
Appendix A

William Michael Cunningham manages an investment advisory and research firm, Creative Investment Research, founded in 1989 to expand the capacity of capital markets to provide capital, credit and financial services in minority and underserved areas and markets.

We have done so by creating new financial instruments and by applying existing financial market technology to underserved areas. The Community Development Financial Institution Fund of the US Department of the Treasury certified the firm as a Community Development Entity on August 29, 2003. The Small Business Administration certified the firm as an 8(a)-program participant on October 19, 2005. (We did not receive any benefit or revenue due to our participation in the 8(a) program.)

In 1991, Mr. Cunningham created the first systematic bank analysis system using social and financial data, the Fully Adjusted Return® methodology. In 1992, he developed the first CRA securitization, a Fannie Mae MBS security backed by home mortgage loans originated by minority banks and thrifts.



In 2001, he helped create the first predatory lending remediation/repair MBS security. [6]

Also see:

BLACK LIVES MATTER: CORPORATE AMERICA HAS PLEDGED $1.678 BILLION SO FAR. June 10, 2020.
https://www.blackenterprise.com/black-lives-matter-corporate-america-has-pledged-1-678-billion-so-far/

BLACK WOMENOMICS Maternal Mortality Reparation Facility
https://blackwomenomics.com/

CHILD TAX CREDIT https://www.childtaxcredit.net/

FIFTEEN DOLLAR MINIMUM WAGE https://fifteendollarminimumwage.com/

THE FAIRNESS ECONOMY https://thefairnesseconomy.com/

The Crisis in Black Housing
https://drive.google.com/file/d/11jfEtWfQY5Rpdbpw0s6stHhawY0iero6/view

6

Pool	**Client**	**Originator**	**Social Characteristics**
FN374870	Faith-based Pension Fund	National Mortgage Broker	Mortgages originated by minority and women-owned financial institutions serving areas of high social need.
FN296479			
FN300249			
GN440280	Utility Company Pension Fund		
FN374869		Minority-owned financial institutions	
FN376162			
FN254066	Faith-based Pension Fund	Local bank	Predatory lending remediation

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Appendix B

December 8, 2005

Ms. Elaine M. Hartmann
Division of Market Regulation
U.S. Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549

Dear Ms. Hartmann,

Creative Investment Research (CIR) has requested that the Division of Market Regulation not recommend enforcement action to the U.S. Securities and Exchange Commission if CIR is recognized as a Nationally Recognized Statistical Rating Organization (NRSRO) for purposes of applying Rule 15c3-1 under the Securities and Exchange Act of 1934, as amended and codified at 17 C.F.R. 240.15c3-1 with respect to rating short term debt vehicles issued by women and minority owned financial institutions.

As part of the NRSRO recognition process, we have provided you and your staff with information regarding our qualifications, including confidential, nonpublic information on our trade secret protected Fully Adjusted Return ® methodology.

Thank you.

Sincerely,

William Michael Cunningham
CEO and Social Investment Advisor

Sample page below

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Creative Investment Research, Inc. Minority Bank & Thrift Report Page No.:71

Dryades Saving Bank

233 Carondelet St
New Orleans LA 70130
Phone: (504) 581-5891
Fax: (504) 598-7233

Branches: 4
Employees: 54
Ethnic Group: Black

Route #: 265070516 Certificate #: 1470512650 INSTTYPE: Savings Bank

Community Reinvestment Act Rating:

Latest Rating: Outstanding
Rating t-1: Outstanding
Rating t-2: Satisfactory
Rating t-3: Satisfactory

Management

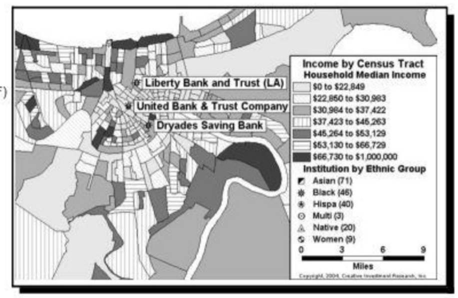
President: Virgil Robinson
CFO: Frank J Oliveri
Loan Officer: Tomorr LeBeouf
Operations Officer: Hedy Hebert

Fully Adjusted Return *(TM)*: 173

Index of social and financial performance. Range 300 to 0. (Higher is better.)

Regulatory and Business Status

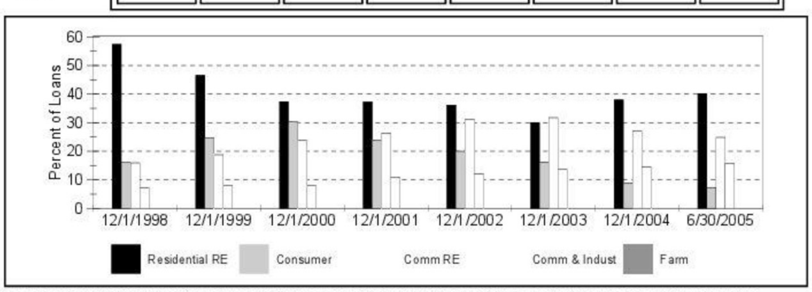
Trading Status: Not Publicly Traded
Insurance Type: Savings Association Insurance Fund(SAIF)
Holding Company: Dryades Bancorp, Inc.



Social Data COUNTY: Orleans

Unemployment, %, 7/1/2005:	5.60
Population, 7/1/04:	462,269
Population change, % 2000 to 2004:	-4.6 %
Offices of FDIC-Insured Inst, 8/22/05:	108
Minority population, % of total in County:	73.4 %
Per Capital personal income, 2003:	$30,152
Minority firms in County, % of total, 1997:	28.6 %
Women-owned firms in County, % of total, 1997:	26.6 %

Year	12/1/1998	12/1/1999	12/1/2000	12/1/2001	12/1/2002	12/1/2003	12/1/2004	6/30/2005
Assets	$88,946	$95,937	$105,717	$122,844	$123,349	$92,773	$103,456	$111,051
GrLns	$68,952	$74,217	$82,735	$76,801	$61,982	$56,390	$62,766	$66,165
Deposits	$79,132	$83,939	$87,046	$116,073	$114,874	$75,938	$86,965	$94,535
Equity	$6,112	$5,886	$5,779	$5,832	$7,119	$8,484	$7,046	$6,978
Salaries	$2,697	$3,039	$3,151	$3,132	$2,921	$2,793	$2,839	$1,428
Net Inc.	$365	$292	$3	($44)	$302	$1,733	($427)	($4)
Net Ch	0.14	0.16	0.61	0.43	0.30	2.16	0.66	1.35
Offs%	0.56	0.82	1.42	1.03	1.50	2.83	2.23	1.34
NonPerfLns %	0.44	0.32	0.00	-0.04	0.23	1.71	-0.42	-0.01
ROA	6.21	4.85	0.05	-0.75	4.66	20.00	-5.35	-0.11
ROE								



Credit Union National Association
CUNA

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE
Suite 300
Washington, DC 20003-3799

February 8, 2022

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairwoman Waters and Ranking Member McHenry,

On behalf of the Credit Union National Association (CUNA), I am writing in regard to the hearing entitled, "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins." CUNA represents America's credit unions and their 130 million members.

The topic of today's hearing is President's Working Group on Financial Markets' Report on Stablecoins. We appreciate the Committee's examination of this report and its recommendations because cryptocurrency and digital assets and platforms created through blockchain technology are poised to create major disruptions in the delivery of financial services. We have significant concern with the potential for regulatory arbitrage and consumer harm if these technologies and platforms are not subject to substantial regulation.

As you know, credit unions are subject to significant consumer protection and safety and soundness regulation. However, the crypto and digital currency sectors operate largely outside of the traditional financial safeguards and generally without the stabilization and protections that financial intermediaries generally provide. In fact, the fundamental innovation of cryptocurrency is the elimination of the financial intermediary. Unfortunately, when there is no financial intermediary, the functions that they provide also are lost, presenting users of this technology with significant risk: just ask bitcoin owners who have lost or forgotten their digital wallet password.

The digital ledger technology (DLT) underpinning digital currency will allow many industries to innovate but we see no reason why innovation should change the government's role in overseeing an industry that uses DLT. The fundamental issue with DLT as applied to the delivery of financial services is that it disintermediates financial services providers and this is where the government regulates financial services. Eliminating or weakening the backbone of the U.S. and global economy will have consequences and we think that these consequences should be understood before consumers and the economy are harmed.

Congress should explore ways to regulate the delivery of financial services using digital currencies to ensure that consumers are protected in the same way if they received financial services from a financial institution. Furthermore, Congress should look for ways enable credit unions and other financial institution to provide digital asset related services, so that these services can be properly overseen by Federal regulators.

On behalf of America's credit unions and their 130 million members, thank you for your consideration of our views and for holding this important hearing.

Sincerely,

Jim Nussle
President & CEO

ELECTRONIC TRANSACTIONS ASSOCIATION
1620 L Street NW, Suite 1020
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electran.org

February 8, 2022

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services
Washington, DC 20515

Dear Chairwoman Waters and Ranking Member McHenry:

On behalf of the Electronic Transactions Association (ETA), we appreciate the opportunity to submit this statement for the record before the Committee's hearing, "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins."

As the trade association that represents the breadth of the payments industry,[1] the Electronic Transactions Association (ETA) has deep expertise in payments technology, including the use of cryptocurrencies, blockchain, and other crypto-related technologies to facilitate payment transactions (cryptoassets). At ETA, we are engaged in ongoing conversations within the industry and with policymakers about the promise and challenges of cryptoassets, and we believe there is a common set of principles against which any proposed governmental policies should be measured. In this regard, the payments industry has been a leader in developing industry best practices for mitigating risk and protecting the payments ecosystem.

As policymakers consider new laws and regulations for cryptoassets, they should carefully consider the following principles and ensure that any proposal best serves the needs of consumers and businesses, furthers financial inclusion, preserves and strengthens the financial system, minimizes fraud and money laundering, and ensures that consumers and businesses continue to have access to a robust and innovative array of secure banking and payment options.

1. **Properly Defining Cryptoassets:** Developing appropriate and functional definitions of cryptoassets is a critical first step in ensuring clarity about the regulatory requirements that are applicable to the technology. Given that new technologies can be deployed in many different ways, and that new use cases are constantly being developed, cryptoassets should be defined and regulated based on the underlying activity or use case. Adopting tailored definitions for specific activities and use cases will balance the need to appropriately regulate activity against the harms that might arise from sweeping definitions that inadvertently regulate other activities and use cases, while encouraging innovation that benefits consumers, businesses, and the economy.

[1] ETA is the world's leading advocacy and trade association for the payments industry. ETA's members include banks, mobile payment service providers, mobile wallet providers, money transmitters, and non-bank financial technology companies (fintech) that provide access to credit, primarily to small businesses, either directly or in partnership with other lenders. ETA member companies are creating innovative offerings in financial services and are revolutionizing the way commerce is conducted with safe, convenient, and rewarding payment solutions and lending alternatives – facilitating over $22 trillion in payments in 2019 worldwide.

ELECTRONIC TRANSACTIONS ASSOCIATION
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2. **Tailoring Regulations to the Risk Profile of the Participant/Activity:** Appropriate regulation of cryptoassets is key to unlocking their potential while ensuring the safety and soundness of the payments ecosystem. Entities engaging with cryptoassets should be subject to regulation that is tailored to the risks that they or the activity in which they are engaged poses to the payments ecosystem. Appropriate regulation of cryptoassets should consider potential harm to consumers as well as safety, soundness, and financial stability risks.

3. **Ensuring Consumer Protection:** The public policy governing cryptoassets should include a framework of standards and rules that appropriately safeguard the privacy and security of every transaction, protect consumers' interests, and give consumers confidence to use the technology for in-person and online transactions. Policymakers should also ensure that consumers understand those protections and how they may differ from those offered by other payment methods. The ability to identify and reduce fraud is critical and should be part of the regulatory framework.

4. **Harmonizing With Existing Regulatory Frameworks:** The payments industry is heavily regulated, and the adoption of any new laws or regulations governing cryptoassets should be designed to fit within this established, robust, regulatory framework. This framework includes federal and state laws relevant to anti-money laundering, economic sanctions, and other anti-fraud and consumer protection requirements. New public policies for cryptoassets should complement, and not conflict with, existing laws and regulations as well as private sector rules and practices.

5. **Encouraging Responsible Innovation:** Continual investment in innovation is at the heart of past, present, and future improvements to the financial ecosystem. Our financial system has benefited greatly from the development of new technologies and capabilities, which serve to strengthen cybersecurity and consumer protection, increase efficiencies, and expand access to financial services. As a technology, cryptoassets have the potential to further many of these developments and promote new innovation and developments. Accordingly, any regulation of cryptoassets should consider the technology's promise to improve existing capabilities while serving as a catalyst and platform for continued innovation.

We appreciate the opportunity to submit this letter for the record and the Committee's leadership on this topic. If you have any questions, please contact me or ETA's Senior Vice President of Government Affairs, Scott Talbott, at stalbott@electran.org

Sincerely,

Jeff Patchen
Senior Manager of Government Affairs
Electronic Transactions Association

ICBA INDEPENDENT COMMUNITY BANKERS of AMERICA®

February 8, 2022

Enhanced Regulation of Digital Assets Will Promote Responsible Innovation

The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing titled: "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins."

We appreciate the Committee's examination of fundamental issues related to stablecoins and are pleased to share the community bank perspective. To ensure that innovation is undertaken safely, ICBA advocates for a comprehensive, coordinated regulatory approach for the reasons described below.

Community Banks and Digital Assets

Wider adoption of digital assets, including stablecoins and other cryptocurrencies, is altering global digital commerce and the global financial system. Community banks keep pace with innovation to remain viable, relevant and continue to serve their communities. Numerous financial service providers, including financial technology companies, now offer consumers and businesses access to cryptocurrency-related activities, such as investments, lending, and custodial services. Although stablecoins and other cryptocurrencies are still not widely used for payments, several crypto companies are developing solutions to enable crypto payments for consumers and businesses. Community banks are beginning to explore offering digital assets services to meet customer demand and want to ensure they can do so safely.

ICBA is working with community bankers to educate their staffs on all forms of digital assets, follow market and regulatory developments, and evaluate their exposure to these assets through customer activities. Community bank involvement, as regulated financial institutions, will help mitigate risks presented by stablecoins and other cryptocurrencies, provided it can be done under a rigorous and thoughtful regulatory framework.

Community banks have a strong interest in ensuring that digital assets such as stablecoins do not create systemic, investor, or consumer risk. As described below, ICBA is concerned with stablecoins' potential risks to end-users, the financial system, and national security. These risks must be addressed by appropriate safety and soundness requirements.

Stablecoins

Stablecoins are digital assets that are issued and transferred using distributed ledger technologies and are purported to maintain a stable value relative to a national currency or other reference asset or assets. ICBA is concerned that stablecoins, including those backed by fiat currencies, may erode monetary authority, threaten financial stability, and risk community bank disintermediation. This is particularly true of privately issued stablecoins.

The President's Working Group on Financial Markets (PWG) report on digital assets rightly reflects ICBA concerns that continued, rapid stablecoin growth creates accelerating risks for consumers, the financial system, and the broader economy. In addition, the November 2021 Financial Stability Report of the Board of Governors of the Federal Reserve, quoted below, identifies the following risks associated with stablecoins:

- "Certain stablecoins, including the largest ones, promise to be redeemable at any time at a stable value in U.S. dollars but are, in part, backed by assets that may lose value or become illiquid. **If the assets backing a stablecoin fall in value, the issuer may not be able to meet redemptions at the promised stable value."**

- "Accordingly, these stablecoins have structural vulnerabilities similar to (…) certain money market funds and are susceptible to runs.

- "These vulnerabilities may be exacerbated by a lack of transparency and governance standards regarding the assets backing stablecoins**. The potential use of stablecoins in payments and their capacity to grow can also pose risks to payment and financial systems."**

To amplify the analysis of the Federal Reserve, stablecoins create the risk of a destabilizing run on redemptions which could ripple through the financial system. This risk is compounded by a lack of transparency into reserves backing stablecoins, which is needed to reassure investors in times of uncertainty. Moreover, the dramatically increasing scale of stablecoins in circulation represents a concentration of economic power and risk, potentially distorting American finance and commerce.

Policy Recommendations

ICBA encourages policymakers to harmonize regulations to ensure strong, clear, and consistent oversight of all cryptocurrency providers, including those that deal in stablecoin.

- Congress should act to ensure that stablecoins are subject to appropriate federal prudential oversight. Any regulatory regime applied to cryptocurrency, including stablecoin, should be comparable to the same regulations applicable to traditional, functionally similar payments products and services offered by the banking system.

- The scope of regulation should include capital adequacy and reserves; activity restrictions; due diligence; information security and privacy; business resiliency; ownership and control of data; anti-money laundering and anti-terrorist financing; reporting and maintenance of books and records; consumer protections; safeguarding customer information; vendor and third-party management; and ongoing examination.

- A more comprehensive, coordinated regulatory approach by banking and market regulators, including the Securities and Exchange Commission and the Commodity Futures Trading Commission, could help address risks, dispel confusion in the marketplace, and prompt more community banks to explore digital asset products and services to address customer needs. Stablecoin companies are not subject to comprehensive consolidated supervision, which allows for risks to multiply and creates an unequal playing field with banks.

- The harmonization of regulations will not only address risk—the additional clarity can level the playing field and create opportunities for more community banks to consider offering digital products and services, including stablecoin. Without such information, many banks may choose not to engage in digital asset activities.

- Collaboration can also help to ensure that the development of digital assets will not harm the integrity of the U.S. financial system by disintermediating community banks. Without harmonization among all the banking regulators, community banks that are not regulated by the OCC may find they are at a competitive disadvantage relative to their OCC-regulated peers and non-bank digital asset companies.

- Stablecoins must be brought within the regulatory perimeter. Appropriate federal oversight is needed to close regulatory gaps and mitigate the risk of regulatory arbitrage regardless of how these digital assets are classified by policy makers. The regulatory framework should address risks posed by any entity within a stablecoin arrangement that participates in the creation, transfer, or storage of stablecoins. Unregulated entities should not be permitted to issue stablecoins.

- A consistent federal regulatory framework for stablecoins should balance their benefits and risks and preserve the separation of banking and commerce.

Decentralized Finance

A further reason for regulation of stablecoins is their role in enabling the rise of a shadow banking system known as decentralized finance (DeFi). DeFi is a growing ecosystem of financial applications that run on public blockchains, such as Ethereum. DeFi applications, known as dApps, rely on smart contracts – or complex automated programming most consumers would find difficult, if not impossible, to evaluate and understand – to execute specific functions in an effort to replicate traditional products and services like payments and lending. However, DeFi is designed to deliver this variety of financial services without the use of centralized parties, such as banks, insurance companies, or brokerages. DeFi relies on stablecoins to function.

Policymakers must recognize that DeFi threatens to disintermediate community banks and create a shadow banking system filled with unregulated platforms that pose risks to consumers, the financial system, and U.S. national security. DeFi protocols are also frequent targets of hacks and other malicious activity that result in substantial losses for users. Last August, $600 million was stolen from Poly Network in a hack, though the funds were later recovered, and just last week, $320 was stolen from Wormhole. Between October 2020 and April 2021, nearly 7,000 consumers filed complaints with the Federal Trade Commission reporting crypto scam losses exceeding $80 million.

For these reasons, ICBA encourages regulators to collaborate on a comprehensive approach to DeFi to address the significant risks it poses as a shadow banking system.

Special-Purpose Bank Charters

ICBA strongly opposes granting special-purpose bank charters to stablecoin or other cryptocurrency companies that do not fully meet the requirements of federally insured chartered banks. These novel charters for non-banks firms raise a number of regulatory concerns—such as violation of the long-standing principle of the separation of banking and commerce, lack of application of traditional banking statutes and regulations governing safety and soundness and consumer protection, and the potential introduction of systemic risk into the payments system. We welcome the choice of certain stablecoin companies to pursue a standard bank charter.

Closing

ICBA and community bankers look forward to continuing to work with policymakers to balance the benefits of innovation in digital assets with their safety and soundness risks.

Thank you for your consideration of the community bank perspective.

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National Association of Federally-Insured Credit Unions

February 7, 2022

The Honorable Maxine Waters	The Honorable Patrick McHenry
Chairwoman	Ranking Member
House Financial Services Committee	House Financial Services Committee
Unite States House of Representatives	United States House of Representatives
Washington, DC 20515	Washington, DC 20515

Re: Tomorrow's Hearing: "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins"

Dear Chairwoman Waters and Ranking Member McHenry:

I write to you today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts on issues of importance to credit unions ahead of tomorrow's hearing on the President's Working Group (PWG) Report on Stablecoins. NAFCU advocates for all federally-insured not-for profit credit unions that, in turn, serve over 127 million consumers with personal and small business financial service products.

NAFCU appreciates the continued work of the Committee in examining the integration of digital assets into traditional financial products. Recent years have seen increased interest in cryptocurrencies, with prices reaching new highs as well as experiencing pullbacks. Notwithstanding these fluctuations, distributed ledger technology and other technologies that support a broad ecosystem of digital assets offer an array of potential operational efficiencies. For example, the ability to facilitate payment transactions that support smart contracts, either through use of stablecoins or other digital assets, may help members with specific business needs and potentially reduce credit unions' operational costs. Most importantly, digital asset technologies can be designed with strong auditability features, which can enhance regulatory compliance and reduce instances of human error, fraud, and other misconduct. However, the absence of a clear regulatory environment and appropriate supervisory framework poses risks to the adoption of these otherwise promising technologies.

The PWG on Financial Markets Report on Stablecoins (the Report) was an important first step towards bringing rules and regulation to emergent stablecoin adoption. The report recommended Congress enact legislation requiring all payment stablecoin issuers to be insured depository institutions. In later describing American depositors' access to federal deposit insurance and their financial institutions' access to emergency liquidity and Federal Reserve services, the Report adopts and cites the *Federal Deposit Insurance Act* definition of an insured depository institution. By adopting this narrow definition, which includes banks and savings associations but not credit unions, the Report risks legislators and other regulators interpreting the Report as recommending that Congress enact legislation requiring a stablecoin issuer to obtain a bank charter – not either a bank charter or a credit union charter. This arbitrary approach, if left unchecked, will result in competitive disadvantages, market distortions, and reduced innovation by excluding an entire class of federally insured and comprehensively supervised depository institutions from new markets for innovative products and services. Establishing barriers to credit union engagement with digital assets would also undercut many of the financial inclusion benefits that may be realized through related technologies given that the credit union industry has a long history of prioritizing the needs of underserved and low-income communities. Accordingly, we urge Congress to explore ways to provide regulatory certainty and parity across the financial services system and ensure a level playing field for all. We urge you to ensure the needs of credit unions are considered in any legislative approach you consider in the future.

We thank you for the opportunity to share our thoughts and look forward to continuing to work with you on including emerging technologies into financial services. Should you have any questions or require any additional information, please contact me or Lewis Plush, NAFCU's Associate Director of Legislative Affairs, at (703) 258-4981 or lplush@nafcu.org.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the U.S. House Committee on Financial Services

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
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NASAA

January 28, 2022

The Honorable Sherrod Brown
Chairman
U.S. Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20515

The Honorable Patrick Toomey
Ranking Member
U.S. Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20515

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services (D)
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services (R)
4340 O'Neill House Office Building
Washington, D.C. 20024

Re: NASAA's Core Principles for Evaluating Federal Legislation Relating to Digital Assets

Dear Chairman Brown, Chairwoman Waters, and Ranking Members Toomey and McHenry:

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[1] I am writing to commend you and your colleagues for your efforts, particularly in 2021, to identify and advance the right mix of legislative proposals that responds appropriately to the emergence and growth of digital assets and associated technologies. As you continue these important efforts in 2022, I want to urge you and your colleagues to consider NASAA's core principles for evaluating federal legislation relating to digital assets.

As you know, at NASAA, we believe in prioritizing investor protection and supporting inclusion and innovation. We have ample experience and expertise in the difficult work of maintaining an even playing field in our capital markets for all types of investment products, professionals, practices, and technologies, new and old. By way of example, during the 35 years that I have been with NASAA and the Maryland Securities Division, I personally have used the elasticity of the securities regulatory framework to support and otherwise address all kinds of new approaches to capital formation and investment, including online crowdfunding.

As you also know, we continue to work hard to ensure that the latest innovations in our capital markets occur within the well-established regulatory framework that supports investor

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grassroots investor protection and efficient capital formation.

protection and capital formation.[2] Relatedly, we are enclosing a copy of *NASAA's Core Principles for Evaluating Federal Legislation Relating to Digital Assets*. NASAA opposes federal legislation that is inconsistent with these principles and urges Congress to do the same.

Thank you for your time and consideration. Should you have any questions regarding NASAA's principles, please do not hesitate to contact me or Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at khutchens@nasaa.org.

Sincerely,

Melanie Senter Lubin

Melanie Senter Lubin
NASAA President
Maryland Securities Commissioner

Enclosure

[2] *See, e.g.*, NASAA Reveals Top Investor Threats for 2022 (Jan. 10, 2022); NASAA Announces Top Investor Threats for 2021 (Mar. 3, 2021); NASAA Announces Speakers and Agenda for 2021 Fintech and Cybersecurity Symposium (Dec. 7, 2021); NASAA Announces Agenda for Fintech and Cybersecurity Symposium (Oct. 14, 2020); NASAA Announces Agenda for Fintech and Cybersecurity Symposium (Oct. 4, 2019); NASAA Updates Coordinated Crypto Crackdown (Aug. 7, 2019); NASAA Updates Coordinated Crypto Crackdown (Aug. 28, 2018); NASAA Announces Agenda and Speakers for 2018 Fintech Forum (May 10, 2018); Speakers Announced for NASAA Public Policy Roundtable (Apr. 9, 2018); Rise of Fintech Raises New Concerns for Securities Regulators (Feb. 15, 2018). *See also* Amanda Senn, Alabama Securities Commission Chief Deputy Director and NASAA Cybersecurity Committee Chair, Cybercriminals and Fraudsters: How Bad Actors Are Exploiting the Financial System During the COVID-19 Pandemic (June 16, 2020).

NASAA
NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

NASAA'S CORE PRINCIPLES FOR EVALUATING FEDERAL LEGISLATION RELATING TO DIGITAL ASSETS

Introduction: For over a century, state securities regulators have been on the frontlines of innovations that have made our capital markets safer, more efficient, and more inclusive. Today, securities regulators continue to work hard to ensure that the latest innovations occur within the well-established regulatory framework for supporting investor protection and responsible capital formation. NASAA, the voice of state securities regulators, is publishing its core principles for evaluating proposed federal legislation relating to digital assets and associated technologies. The principles reflect input from academics, industry representatives, investors, and other stakeholders. NASAA opposes federal legislation that is inconsistent with these principles and urges Congress to do the same.

NASAA's Principles: NASAA supports investor protection, innovation, and inclusion. In our view, policymakers must:

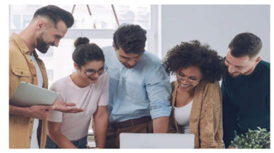
- **Protect investors by encouraging compliance within the existing regulatory framework.** The best path forward is to encourage compliance with existing securities laws and, if needed, engagement with regulators on requests for limited relief. Such engagement would be a fraction of the cost, ultimately born by taxpayers and investors, of legislation that would force regulators to develop new rules, forms, and similar resources exclusively for digital assets.
- **Protect investors and support lasting use of innovations by encouraging registration.** The best way to protect investors and promote innovation is to urge unregistered participants to register themselves and their activities, products, and professionals promptly. Registration triggers processes whereby investors receive important information and regulators can examine activities, entities, products, and professionals for compliance. These processes foster trust, which in turn attracts capital and customers.
- **Protect investors and support innovation by fostering better regulatory coordination.** Regulators, particularly state securities regulators, the SEC, and the CFTC, communicate about and agree on many issues. However, more can be done on that front. Federal agencies, including the SEC, CFTC, and GAO, must seek input from state securities regulators before issuing reports, especially reports to Congress. Working groups, task forces, and similar bodies must include state securities regulators.
- **Support inclusion and protect investors by encouraging informed, goal-oriented investment decision-making.** Regulators must continue to expand awareness of our capital markets among people of all ages and backgrounds, ensure disclosures and educational resources are available, and encourage investors to take the time to understand investments and their risks. Speculative or impulse investing, particularly when it poses excessive financial risk to the investor in the short term, can have devastating consequences.

Contact Us
Kristen Hutchens
NASAA Policy & Government Affairs
khutchens@nasaa.org

Learn More
Explainer: pp. 2-3
NASAA Resources: p. 3

NASAA's Core Principles for Evaluating Federal Legislation Relating to Digital Assets

Protect investors by encouraging compliance within the existing regulatory framework.



- The securities regulatory framework in the United States has long facilitated innovation. Examples include changes in investment products, communication platforms, and business models that governments, businesses, and people have used and, in many cases, still use.
- The best path forward is to encourage compliance with existing securities laws and, if needed, engagement with regulators on requests for limited relief. Regulators, who have long recognized that compliance and innovation are not mutually exclusive, carefully consider requests for relief and support an even playing field for all market participants.
- No compelling reason exists that would justify Congress injecting more complexity into the regulatory compliance and examination processes, particularly when existing legal terms (for example, investment contract) are applicable. Ultimately, taxpayers and investors would bear the costs of unnecessary changes.
- Adopting legislation with new legal terms exclusively for digital assets and associated activities, platforms, and professionals would necessitate the preparation of new rules, forms, and other resources, which in turn would necessitate the preparation of new policies and procedures by regulated entities and professionals. Additionally, new statutory terms would trigger significant work for professionals focused on investor education.
- Regulators are skilled at making appropriate adjustments to the securities regulatory framework by, for example, creating or updating existing rules and forms.

Protect investors and support lasting use of innovations by encouraging registration.

- Encouraging registration is the single most effective way for Congress to protect investors and promote innovation. Unregistered participants must register themselves and their activities, products, and professionals as promptly as possible with the appropriate state and federal regulators. Registration triggers two important processes. First, as a result of registration, investors receive important disclosure information, including conflicts, fees, and risks. Second, regulators can examine activities, entities, products, and professionals for compliance. These processes foster trust, which in turn attracts capital and consumers.
- New regulatory bodies, such as a self-regulatory organization (SRO) exclusive to digital assets and digital assets participants, are unnecessary. The existing regulatory framework includes state and federal agencies and other organizations with significant experience and expertise relevant to digital assets. In the case of state securities regulators, NASAA and many of its members have made considerable investments in investor, industry, and regulator resources to address the emergence and growth of the digital assets industry.
- SROs typically fund themselves through income sources such as membership fees and data subscriptions. Inevitably, the SRO and its members would share or pass on their expenses to third parties such as peer regulators and investors.

Protect investors and support innovation by fostering better regulatory coordination.

- Regulators, particularly state securities regulators, the SEC, and the CFTC, communicate about and agree on many issues. However, more can be done on that front.
- Federal agencies, including the SEC, CFTC, and GAO, must seek input from state securities regulators before issuing reports, especially reports to Congress. Working groups, task forces, and similar bodies working on digital assets and related issues must include representation from state securities regulators. The insights and opinions of state securities regulators reflect their positions on the frontlines of protecting Main Street investors and engaging with small business owners.
- Congress must act swiftly to pass the Empowering States to Protect Seniors from Bad Actors Act. This bicameral, bipartisan legislation would establish a grant program, administered by the SEC, that would enhance existing efforts by state securities regulators to protect older investors. Among other benefits, this program would strengthen state-federal coordination and allow state securities regulators to seek funds that could be used to protect investors from frauds associated with digital assets.
- NASAA releases an annual list of top investor threats based on the results of a survey that invites North American state and provincial securities regulators to identify the most problematic products, practices, or schemes. Investments tied to digital assets are the top threat to investors for 2022.

Support inclusion and protect investors by encouraging informed, goal-oriented investment decision-making.

- Regulators must continue to expand awareness of our capital markets among people of all ages and backgrounds. In these efforts, regulators must be even more strategic, agile, and creative in their communications and outreach.
- Regulators must continue to ensure disclosures and educational resources are available. Educational resources must encourage investors to understand how an investment works and evaluate the risks associated with buying, selling, or holding it.
- Speculative or impulse investing in any type of investment, particularly ones that pose excessive financial risks to the investor in the short term, can have devastating consequences for individuals, families, businesses, and the capital markets.

NASAA Resources for Federal Lawmakers and Their Constituents

- **Enforcement**
  - Operation Cryptosweep
  - Enforcement Statistics
  - Top Investor Threats
- **Policy Center**
  - Legislative Agenda
  - Congressional Testimony
  - Letters
- **Investor Education**
  - DeFi and Digital Assets
  - Online Trading
  - Millennial Money

About NASAA. In the United States, NASAA is the voice of state securities regulators responsible for efficient capital formation and grass-roots investor protection. Their fundamental mission is protecting investors who purchase securities or investment advice, and their jurisdiction extends to a wide variety of issuers and intermediaries who offer and sell securities to the public. NASAA members license firms and their agents, investigate violations of state and provincial law, file enforcement actions when appropriate, and educate the public about investment fraud. Visit nasaa.org.

United States House of Representatives
Committee on Financial Services
Hearing on "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins"

Tuesday, February 8, 2022

Responses from Under Secretary for Domestic Finance Nellie Liang

Representative Maxine Waters (D-CA), Chairwoman

PWG Report Recommendations

1. Under Secretary Liang, the PWG Report on Stablecoins highlighted the concern for regulators that this subset of cryptocurrencies supposedly backed by reserve currencies may not be fully backed. Additionally, the report raised potential financial stability concerns because of their rapidly growing size, with stablecoins growing from $30 billion to over $170 billion this year and are projected to grow roughly tenfold to $1 trillion by 2025. However, one of your recommendations is to make stablecoin issuers become fully insured depository institutions. Critics of this proposal have expressed concern that requiring a stablecoin issuer to have a banking charter, backed by FDIC deposit insurance, would validate private money in the form of stablecoins, to the detriment of the U.S. dollar and its role as the global reserve currency, and the Fed's ability to conduct monetary policy.

    a. Can you elaborate on the PWG proposal that stablecoin issuers must be insured depository institutions?

        - **Answer: The PWG Report on Stablecoins identified regulatory gaps with respect to three prudential risks. First, the risk that stablecoins could be subject to runs that would harm users and the broader financial system. Second, payment system risks related to the mechanisms used to store or transfer stablecoins. And third, concerns related to concentration of economic power if stablecoins were to increase significantly. The PWG Report recommended limiting stablecoin issuance to insured depository institutions (IDIs) because IDIs are subject to a tested regulatory framework that would help to mitigate these three prudential risks.**

    b. Are you concerned that the PWG proposal offers implicit government support to stablecoins, encouraging their growth and thus broadening the systemic implications of a run?

        - **Answer: Stablecoins are already growing exponentially. Over the last two years, the market capitalization of stablecoins has grown exponentially from under $10 billion to approximately $190 billion today. Furthermore, stablecoin issuers are not subject to oversight on a consistent or comprehensive basis, with some stablecoin issuers**

effectively operating outside of the prudential regulatory perimeter. Even where a stablecoin issuer is subject to prudential oversight, supervisors may have limited insight into the broader "stablecoin arrangement" that supports the use of the stablecoin as a means of payment. Under these circumstances, the PWG report indicated that the key policy objective is to ensure that stablecoins are subject to appropriate and effective oversight.

c. Has the PWG considered alternatives to offering deposit insurance to stablecoins, such as the establishment of a licensing regime that assesses the impact that a run on a stablecoin might have for financial stability or the evaluation of specific stablecoins as a systemic risk by the FSOC?

- **Answer: The PWG Report recommended requiring stablecoin issuers to become insured depository institutions (IDIs); however, this does not necessarily imply that stablecoins themselves would or should be covered by deposit insurance. As an IDI, a stablecoin issuer would be subject to a regulatory and supervisory framework that would help to address the prudential risks identified in the PWG Report. Elements of this framework include supervision at the depository institution and holding company level; capital, liquidity, and other prudential standards; a special resolution framework; and activity and affiliation limits. Whether stablecoins themselves should be covered by deposit insurance is a complex question, which could be considered further as part of the legislative process or by the FDIC.**

d. Considering that stablecoins can be used as a form of payment that in many ways mimic private money, in your view, how can Congress ensure that stablecoin issuers will in no way undermine the value of the U.S. dollar as the leading currency of our global economy?

- **Answer: The global role of the dollar reflects a range of factors, including the strength of our economy, the depth and breadth of our financial markets, and our longstanding commitment to the rule of law. However, stablecoins that are not well-designed or appropriately regulated may be subject to runs or payment system disruptions that are harmful to users, the payment system, and the broader economy. Ensuring that stablecoins are subject to prudential oversight on a consistent and comprehensive basis will mitigate these risks.**

2. Under Secretary Liang, the PWG report highlights several policy issues relevant to digital wallets. One policy concern is the threat of systemic risk if the failure of a wallet custodian spills over to the traditional financial system and the real economy. In addition, the

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combination of custodial wallet holder hosting with some other stablecoin-related role, such as an issuer, could result in an excessive concentration of economic power that could lead to concentrations of economic power in the real economy and decreased competition.[1] Therefore, the PWG has recommended that custodial wallet holders be subject to "appropriate federal oversight" that could restrict services, impose reserve and capital requirements, and establish and enforce compliance standards, and more.[2] These recommendations appear to target centralized custodial wallets, such as wallets on traditional exchanges like Coinbase, and excludes non-custodial decentralized wallets, which allow pure peer-to-peer digital transactions.[3]

a. Can you elaborate on this distinction and their associated risks?

- **Answer: Users of digital assets may hold their own private keys directly or may rely on other intermediaries – like custodial wallets - to hold custody of their assets. A "custodial wallet" is an intermediary that holds assets on behalf of its customers and may also play a key role in facilitating transfers of assets. Because they are responsible for the holding or safekeeping of customer assets, customers may be at risk of loss due to theft, misuse, or in the event of a hack.**

  Given the central role that custodial wallet providers play within a stablecoin arrangement, and the risks attendant to the relationship between custodial wallet providers and stablecoin users, the PWG Report recommended that custodial wallets be subject to appropriate federal oversight, including the authority to restrict these service providers from lending customer stablecoins, and to require compliance with appropriate risk-management, liquidity, and capital requirements. In addition, to address concerns about concentration of economic power, the PWG recommended that Congress consider other standards for custodial wallet providers, such as limits on affiliation with commercial entities or on use of users' transaction data.

  We appreciate that there may be other concerns related to other mechanisms for transmission and storage, such as peer-to-peer platforms, which is why the PWG report recommended that supervisors have some authority to establish risk-management

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[1] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins,* at 14 (Nov. 2021).
[2] *Id.* at 17.
[3] *Biden Administration Signals Focus on Cryptocurrency as President's Working Group Issues Report on Stablecoin*, McGuireWoods (Dec. 7, 2021); see also Tiago Serôdio, *Custodial vs Non-Custodial Wallets: Why are they important?*, Medium (June 29, 2021).

standards for other parties that are critical to the functioning of the stablecoin arrangement.

3. Under Secretary Liang, in the absence of Congressional action, the Report recommends increasing federal oversight of stablecoin issuers by using authority by the Financial Stability Oversight Council (FSOC) to designate payments, clearing and settlement activities as important to the financial system. However, that authority hasn't been used before.[4]

   a. In your view, do you think the FSOC is currently well-suited to deploy these duties in regard to stablecoins?

      - **Answer: As described in the PWG *Report on Stablecoins*, the Council could consider steps available to it to address the risks outlined in the report. Such steps may include the designation of payment, clearing, and settlement (PCS) activities conducted by financial institutions as, or as likely to become, systemically important. Designation would permit the appropriate agency to establish risk-management standards for financial institutions that engage in designated PCS activities. In addition, the Council potentially could address stablecoin arrangements using its authority to designate systemically important financial market utilities (FMUs), subjecting those arrangements to consolidated supervision. The Council also has authority to designate nonbank financial companies for Federal Reserve supervision, pursuant to its authority in Title I of the Dodd-Frank Act. As noted in its 2021 annual report, the Council can consider steps available to address risks outlined in the PWG report. As Treasury's work on stablecoins progresses, it may evaluate how FSOC's designation authorities could apply to stablecoin arrangements and whether there are potential gaps in its authority.**

   b. In your view, should antitrust regulators look more closely at large technology companies who may be looking to leverage their networks to increase their customer base for stablecoin products and services?

      - **Answer: As described in the PWG Report, stablecoins raise key questions about concentration of economic power. In particular, it is possible that very large stablecoin issuers could pose risks to financial stability. To the extent that a stablecoin obtains monopoly power as a provider of payment services, users may experience poorer service or higher prices. In addition, relationships between a stablecoin and a**

[4] *POLITICO Pro Q&A: Treasury Undersecretary Nellie Liang*, Politico (Nov. 17, 2021)

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large commercial company could result in either the stablecoin or the commercial company having an unfair competitive advantage relative to peers. Treasury supports efforts by all regulatory agencies to ensure that stablecoins comply with antitrust and other existing laws.

4. Under Secretary Liang, the PWG Report on Stablecoins acknowledges the applicable existing regulatory frameworks by stating that the market regulators – the SEC and the CFTC – have broad enforcement, rulemaking, and oversight authorities over digital assets, including stablecoins, especially in relation to market integrity and investor protection risks and "speculative digital asset trading."[5] Both market regulators were part of the PWG Report.

   a. In your view, what are the appropriate strategies these regulators can adopt in ensuring there are appropriate disclosures for users of these products?

      - **Answer: Treasury supports efforts by the SEC, CFTC, and other regulatory agencies to ensure that stablecoins, digital assets, and digital asset intermediaries comply with existing laws. Depending on the facts and circumstances, a stablecoin may constitute a security, commodity, and/or derivative implicating the jurisdiction of the SEC, and be subject to the U.S. federal securities laws, or implicating the jurisdiction of the CFTC, and be subject to the Commodity Exchange Act. In such cases, these products and intermediaries are required to comply with securities laws and the Commodity Exchange Act, including applicable disclosure requirements. These requirements would help address risks such as information asymmetries and protect investors.**

Stablecoin Uses and Risks

5. Under Secretary Liang, financial regulatory experts have stated that an effective payment settlement system requires four things: low fees, predictability, exchangeability for goods and services, and consistent high speed.[6] Presently, there is a consensus among most experts that stablecoin does not meet all of those objectives.[7]

   a. In their present condition, do you believe that stablecoins are an effective payment settlement system?

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[5] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 1 (Nov. 2021).
[6] See e.g. *SBC Stablecoins Hearing – Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?*, SIFMA (Dec. 14, 2021).
[7] Editorial Board, *Stablecoins may not be stable. That's a problem.*, The Washington Post (Nov. 8, 2021); *Stablecoins are not that stable: what regulatory approach?*, Finextra (July 30, 2021).

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- **Answer: Currently, one of the common uses of stablecoins is to facilitate trading in other digital assets. However, stablecoin proponents believe they could become more widely used as a means of payment by households and businesses, and companies are pursuing this opportunity. Moreover, due to network effects or relationships between stablecoins and existing platforms, this transition to a broader use case could occur rapidly. Under these circumstances, it is critical to ensure that stablecoins are subject to appropriate oversight on a consistent and comprehensive basis.**

b. Compared to our traditional finance system, what advantages and disadvantages do stablecoins have?

- **Answer: The current payment system in the US is relatively slow and expensive, and the private sector and Federal Reserve have been developing new technologies to make it more efficient Stablecoins that are well-designed and well-regulated could through a new technology potentially contribute to making the payment system less expensive, faster, and more inclusive. Stablecoins, however, are not subject to consistent and comprehensive oversight – which means that stablecoins may be susceptible to runs, or disruptions to the mechanisms that are used to store or transfer stablecoins. For this reason, it is critical that Congress pass legislation to ensure that stablecoins are subject to appropriate prudential oversight.**

6. Under Secretary Liang, as you know, stablecoins are cryptocurrencies pegged to a stable value such as fiat currency, unlike other cryptocurrencies like Bitcoin, which are not tied to any currency and therefore can fluctuate in price and be highly volatile. However, stablecoins are not necessarily fully backed by reserve assets, and can pose risks to the economy. Reserve composition allows the users of stablecoins to know what is upholding and, in a way, protecting the funds they invest.

a. Could you please explain how reserve composition of stablecoins are both similar to and different from fiat currency that is held at insured depository institutions?

- **Answer: Currently, stablecoin issuers are not subject to standardized regulatory rules regarding disclosure of reserve assets. This makes it difficult to be certain about how stablecoin reserves compare to typical commercial bank assets. In general, however, stablecoin issuers suggest that their stablecoins are backed by assets such as US Treasuries, commercial bank deposits, and cash. By contrast, because of the role that commercial banks play in credit creation, commercial bank assets often include loans to households and businesses.**

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b. How do stablecoins compare to other non-bank financial products such as swaps, exchange traded funds, or money market funds?

- **Answer: Financial products serve a range of purposes: They can be used to hedge risks, make speculative bets, or serve as a store of value or medium of exchange. Swaps and exchange traded funds are typically used for hedging or speculation, while money market mutual funds are used as a store of value. In contrast, stablecoins are generally used as a medium of exchange.**

Financial Inclusion and Stablecoins

7. Under Secretary Liang, some digital assets industry stakeholders have suggested that stablecoins have the potential to support the financial inclusion of historically excluded or underserved populations.[8] They emphasize that stablecoins may be able to provide low- income and unbanked communities with access to banking and digital payments services and could provide the benefits of digital transactions for small, mom-and-pop businesses, such as street vendors, but industry stakeholders have not provided specifics on how this would work. Meanwhile, others point out that any shift to a more cashless economy, encouraged partly by the proliferation of digital currencies, would harm the economically marginalized communities with limited digital access and financial literacy.[9]

a. What is the uptake and use of stablecoins among low-income and unbanked households? And for communities of color?

- **Answer: I am not aware of data on the use of stablecoins by consumer demographics.**

b. In your view, is the global financial system becoming more inclusive with the continued proliferation of digital currencies and payments, or are low-income and unbanked users getting left behind?

- **Answer: The development of digital currencies is ongoing and while growing rapidly, they are not used by many households. If digital currencies are well-designed and appropriately regulated, they might help contribute to a more inclusive financial system if they make payments cheaper and faster. But in the absence of appropriate policy**

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[8] *See e.g.* How Digital Dollar Stablecoins Can Help Bring More Consumers into the Financial System, Blockchain Association (last accessed Feb. 4, 2022).
[9] *'Future of Money' economist says the end of cash is coming—here's what could replace it,* CNBC (Nov. 11, 2021).

measures, there are risks of certain communities being given access to sub-standard, or higher-risk and higher-cost, products. Digital asset policy should reduce risks to users while offering opportunities for users, including low-income and unbanked users. Agencies have begun working on an effort to educate consumers about digital assets through the Financial Literacy Education Commission.

c. If we transition to a cashless economy, how would this system work for communities traditionally left out of the banking system, including those who don't have a bank account today?

- **Answer: It is important to expand access to efficient payments for those who are un- or under-banked in the current system or in a cashless economy. For this reason, Treasury is engaged in a range of initiatives to help to broaden access to the payment system and other financial services.**

8. Under Secretary Liang, in an opinion piece entitled "How Crypto Became the New Subprime" by the Nobel prize winning economist Paul Krugman in The New York Times, Mr. Krugman points to parallels between cryptocurrencies and the subprime crisis of the 2000s. He highlights that while cryptocurrencies may not threaten the entire financial system, the risks fall disproportionally on individuals who are "poorly positioned to handle the downside."[10] Subprime mortgage lending was hailed as a way to offer homeownership opportunities to historically excluded groups. Similarly, cryptocurrencies are presenting investing opportunities to diverse communities.

a. What lessons from the subprime crisis of the 2000s can Congress apply to the volatile cryptocurrency market, especially in light of the January crypto crash?

- **Answer: High cost, risky financial products sold to consumers who were not able to adequately assess the risks of these products, that in many cases were aggressively and inappropriately marketed to them, as well as broad underpricing of risks and excessive leverage at financial institutions, ultimately led to a financial crisis and deep recession. Today, it is critical to ensure that investors in digital assets understand the risks of digital asset investments and are protected from bad actors in the marketplace. This requires appropriate disclosures, and rules against the marketing of digital assets in ways that are false or misleading, as well as enforcement to address outright scams and frauds. The SEC and CFTC have significant**

[10] *How Crypto Became the New Subprime,* The New York Times (Jan. 27, 2022).

authorities with respect to investor protection matters, and Treasury fully supports the efforts of these agencies to ensure that digital assets comply with existing investor protection laws.

b. What are your thoughts on the possibility that low- and moderate-income people, including investors of color, could be the ones left holding the bag if the cryptocurrency industry collapses?

- **Answer: Our regulatory framework should provide for appropriate consumer protections, while enabling a robust marketplace, as well as clear disclosures and investor education. Given that more than one third of current owners report having little or no understanding of how virtual currency works, there is a real risk that low- and moderate-income investors, and less-experienced investors, will take on risks that they do not understand and are not prepared to bear. Agencies have begun working on an effort to educate consumers about digital assets through the Financial Literacy Education Commission, and this issue will receive further attention in the forthcoming report on consumer, business, and investor protection that the President's Executive Order on Digital Assets has charged Treasury to produce.**

c. What would be the federal government's role in the collapse of the cryptocurrency industry?

- **Answer: It is critical to ensure that investors in digital assets understand that digital asset investments can be volatile and involve significant risk of loss; investors should not assume that the government would intervene to support digital asset markets**

Crypto Advertising Targeting Vulnerable Communities

9. Under Secretary Liang, the cryptocurrency industry has gotten in trouble for providing false, misleading, and overhyped advertising around the globe for unregistered products. Singapore issued new guidelines prohibiting crypto firms from advertising on "any public channel," including TV, billboards, and social media. The UK has announced plans to amend its financial promotion legislation to include cryptocurrency to crack down on "misleading" advertising. Spain now requires cryptocurrency companies to "advertise responsibly."[11] Here in the U.S., Staples Center in Los Angeles was recently rebranded as the Crypto.com Arena, and the actor Matt Damon has been touting that "fortune favors

[11] *See* International Investment, *UK joins Spain and Singapore in crypto advertising crackdown* (Jan. 18. 2022).

the brave," leading some advocates to argue that the industry is deceptively targeting young people and investors of color who are increasingly investing in these products.

a. The SEC, CFTC, FTC, and CFPB have the ability to crack down on false and misleading activities in this space, including deceptive advertising. Are regulators working together to prioritize the problem of misleading advertising from cryptocurrency companies, including stablecoin issuers?

- **Answer: Treasury fully supports efforts by the SEC, CFTC, FTC, and CFPB to ensure that stablecoins and other digital assets comply with existing laws. While questions about priorities of specific agencies are best addressed by those agencies, digital assets have become a central focus of the federal financial regulators, including through efforts being coordinated by the Financial Stability Oversight Council. Agencies have begun working on an effort to educate consumers about digital assets through the Financial Literacy Education Commission.**

<u>Consumer Privacy Considerations</u>

10. Under Secretary Liang, there is concern that given the complexity of stablecoin arrangements, users may not be aware or be able to tolerate high risks and may be especially vulnerable to fraud and manipulation. The volatility of cryptocurrency assets' valuations may result in both large gains and losses, the risk of which may not be well understood by users of these products, in part due to a lack of appropriate disclosures. Furthermore, these assets operate outside the traditional financial system and may not offer common transaction protections such as halting suspicious transactions or recovering lost authentication methods.

a. Since the release of the Report on stablecoins, are you aware of any improvements made by stablecoin issuers to user interface to address these consumer protection concerns?

- **Answer: Stablecoins are a rapidly evolving product, and it is possible that since the publication of the PWG Report, some stablecoins may have changed in ways that address certain consumer protection or other concerns. Nevertheless, it is critical to ensure that stablecoins are subject to appropriate regulatory oversight, to ensure that concerns about investor protection, financial stability, and other policy objectives are addressed on a comprehensive and consistent basis.**

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11. Under Secretary Liang, stablecoins may pose risks related to data privacy, protection, and portability. Stablecoin users may not have information about how their personal data will be secured by the issuer and the participants in the ecosystem and how that data will be collected, stored, and shared by the issuer, other participants, or with third parties.[12] Ultimately, data should be protected and available to their owners.

    a. In your experience, is there a tendency for most stablecoin issuers and exchanges to shift the risk related to cybersecurity to the user?

        - **Answer: Issuers and exchanges should have appropriate controls in place to ensure the security and reliability of their services and users' data, as well as provide transparency on how they handle users' data subject to their agreements with users and applicable laws. Users should also practice good cyber hygiene, including strong passwords, and multi-factor authentication where available.**

    b. In your view, how can Congress ensure that companies protect stablecoin users during financial transactions, like bank transfers or payments that are authorized by a consumer from their bank account, from theft, fraud, hacks, and other cyber-enabled financial crimes?

        - **Answer: This is an important question, and one that we will continue to evaluate. We look forward to engaging with you and your staff on this topic.**

<u>Recent Developments in Digital Assets</u>

12. Under Secretary Liang, in January of this year, the U.S. Federal Reserve released its long-awaited report evaluating the potential costs and benefits of central bank digital currencies (CBDC). As the report highlights, a U.S. CBDC has the potential to create significant improvements in financial inclusion if the Federal Reserve can also address consumer privacy and cybersecurity concerns. Additionally, earlier this month, the Federal Reserve Bank of Boston, in partnership with the Digital Currency Initiative at the Massachusetts Institute of Technology, released findings on their technological research of a CBDC, including a description of a theoretical CBDC transaction processor. All these researchers are investigating if a CBDC would provide a safe and less-volatile alternative to stablecoins.

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[12] G7 Working Group on Stablecoins, *Investigating the impact of global stablecoins*, Bank for International Settlements (Oct. 2021).

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a. What is your view on the challenges and benefits associated with the issuance of CBDC?

- **Answer: A U.S. CBDC could have a broad range of implications for the economy and financial stability; the U.S. payments system; financial inclusion; privacy and other user rights; and the global role of the dollar. Critically, these implications are likely highly sensitive to the way that the CBDC is designed and implemented. The Treasury Department is closely examining these matters, and will report its findings in the report on the future of money and payment systems being prepared in response to Section 4 of President Biden's recent Executive Order on Digital Assets.**

b. Do you believe a CBDC would provide an alternative that should remove the need for stablecoins, or should they co-exist in your view?

- **Answer: The relationship between stablecoins and CBDC would likely depend on the design of the CBDC. A CBDC that is widely available might somewhat reduce demand for stablecoins, while one that is narrowly available would be more likely to leave demand for stablecoins unchanged. It is also possible that stablecoins and CBDC could co-exist. Treasury is carefully considering these matters, and will report its findings in the report on the future of money and payment systems being prepared in response to Section 4 of President Biden's recent Executive Order on Digital Assets. One key difference is that CBDC would be a liability of the central bank while stablecoins would not be.**

c. Do you think the proliferation of stablecoins has implications for monetary policy transmission, and if so, how might a CBDC counteract that effect?

- **Answer: The Board of Governors of the Federal Reserve System is seeking comment on issues related to CBDCs and, as part of this notice, observed that stablecoins may be a part of a future landscape of money and payments. As discussed above, and as required under the recent Executive Order, Treasury will be considering questions regarding CBDCs and the future of money broadly.**

13. Under Secretary Liang, different stakeholders from industry, advocacy, and academia have given their own opinions about which federal agency or agencies should have jurisdiction about regulating the digital assets space. Some have argued for the FSOC to be a more robust regulator, while others want an entirely new federal agency to oversee

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all things digital assets, such as cryptocurrencies, stablecoins, and non-fungible tokens, or NFTs. Your proposal suggests that for stablecoins specifically, a prudential regulator should oversee these products.

a. In your view, how do you think non-stablecoin products such as Bitcoin or NFTs should be regulated at the federal level?

- **Answer: There is a broad range of non-stablecoin products, including some that serve as investment products and others that are analogous to commodities or commodity futures. Treasury believes that these digital assets should be regulated based on the economic function they serve rather than on the basis of underlying technological infrastructure.**

b. What drawbacks and benefits does your regulatory path create for consumers and investors who use both stablecoins but also other cryptocurrencies that are not pegged by reserve assets?

- **Answer: It is critical to ensure that all digital assets are subject to appropriate regulatory oversight, including both stablecoins and other cryptocurrencies. While Treasury believes that the SEC and CFTC have substantial authorities that can be used to protect against consumer and investor risk, we are also carefully considering whether additional measures are needed in the context of the reports tasked by President Biden's recent Executive Order on Digital Assets.**

14. Under Secretary Liang, on January 31, 2022, Silvergate, a technology- focused bank, confirmed its purchase of technology and other assets from Diem, the stablecoin project from Meta Platforms, or Facebook, which was first announced as Libra in June 2019. This is of interest because the PWG Report raises the risks posed by the concentration of economic power in certain segments of our market, and the need to separate banking from commerce. While Facebook may have moved away from their stablecoin project for now, there is considerable worry that commercial companies can push products and services that would mirror private money, potentially leading to interoperable financial systems that could harm consumers and investors.

a. What trends are you seeing in terms of the consolidation of economic power in the stablecoin market, including commercial companies entering this space?

- **The PWG report discusses the current stablecoin market and uses, as well as potential future uses. Stablecoin arrangements have grown, and may continue to grow, rapidly. Moreover, the transition to broader use of stablecoins as a means of payment could occur rapidly**

due to network effects or relationships between stablecoins and existing user bases or platforms.

b. Were you surprised that Facebook abandoned its plans for Diem?

- **The PWG report considered the risks and benefits of, and made recommendations for prudential regulations for, stablecoins in general, not a particular issuer.**

c. Do you think commercial companies like Facebook should be able to issue stablecoins? And should they be allowed to host digital custodial wallets?

- **Answer: To address the prudential risks of stablecoins, the PWG recommends that stablecoins be issued by insured depository institutions. As an insured depository institution, an issuer of stablecoins would be subject to restrictions on activities and transactions with affiliates. The report also clarifies that the holding companies of stablecoin issuers, like the holding companies of most insured depository institutions, would be subject to consolidated supervision and regulation and activities restrictions as bank holding companies. These restrictions would prevent a stablecoin issuer from affiliating with a commercial company.**

  In addition, to further address concerns about concentration of economic power, the PWG recommended that Congress consider other standards for custodial wallet providers, such as limits on affiliation with commercial entities or on use of users' transaction data.

15. Under Secretary Liang, stablecoins are oftentimes used to buy and sell other cryptocurrencies, like Bitcoin. In January 2022, the cryptocurrency market plunged to a five-month low to below $40,000 in what has been called the Bitcoin Crash of 2022.[13] The collapse saw as much round $1.2 trillion in wealth wiped from the combined cryptocurrency market.[14]

    a. Do you have data on what percentage of Bitcoin and Ethereum holders are regular people operating as retail investors, as opposed to large financial entities?

[13] *Bitcoin Crash Of 2022*, Forbes (Jan. 24, 2022).
[14] *Crypto Price Crash: Bitcoin, Ethereum, BNB, Solana, Cardano And XRP Suddenly In Freefall*, Forbes (Jan. 20, 2022).

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- **Answer: One study suggests that the ownership of Bitcoin is concentrated. The balances held at intermediaries the end of 2020 was about 5.5 million bitcoins, roughly one-third of Bitcoin in circulation. Individual investors held 8.5 million bitcoins by the end of 2020. The individual holdings are highly concentrated: the top 1000 investors control about 3 million BTC and the top 10,000 investors own around 5 million bitcoins.[15]**

  Ethereum coins follows the same distribution patterns of Bitcoin, with a relatively small number of holders owning the majority of available currency. In May 2019, the top 500 holders of Ether controlled 33% of the total Ether market.

b. Do you know what potential impacts this crash will have on regular people operating as retail investors in our country and the rest of the world?

- **Answer: The price of Bitcoin is volatile, and investors could suffer significant losses. It is important that investors have the information necessary to assess the risk and return of such an investment, and that there are appropriate protections against fraud and manipulation. While ownership appears to be concentrated at larger investors, losses would also be borne by small retail investors. Whether losses would have broader effects would depend on the extent of leverage used to purchase Bitcoin, where losses could lead to fire sales. But there is little evidence on how leveraged investors are in Bitcoin or other cryptocurrencies and how exposed they would be to a crash. I would encourage further research to better understand the overall financial health and portfolio of ordinary investors investing in cryptocurrency.**

c. If Congress moves forward with your proposal of bringing stablecoins into the prudential regulatory perimeter, do you believe that non-stablecoin cryptocurrencies would become less volatile?

- **Answer: Today, stablecoins are primarily used in the United States to facilitate trading, lending, or borrowing of other digital assets, predominantly on or through digital asset trading platforms. For example, stablecoins may serve as a "cash leg" to facilitate the purchase or sale of another digital asset, typically a digital asset with**

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[15] Blockchain analysis of the bitcoin market, Igor Makarov and Antoinette Schoar, National Bureau of Economic Research, Working Paper 29396 http://www.nber.org/papers/w29396.

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more price volatility. Requiring stablecoin issuers to be insured depository institutions would help address the risks identified in the report, including run risk, payments risks, and risk of excessive concentration of economic power. In other words, stablecoins that meet heightened standards would be more stable. It is unclear what effect this would have on the price volatility of other digital assets.

Environmental Concerns in Digital Assets

16. Under Secretary Liang, a topic of concern is the climate change related to cryptocurrency mining. Certain stablecoins, such as the Pax Dollar, which operates on the Ethereum blockchain, use Proof of Work mining, a process that Bitcoin also uses that has been shown to be so resource intensive that it generates a similar carbon footprint as those of countries, such as Argentina and Sweden.

    a. Do you believe that Proof of Work mining activities pose a negative environmental impact? If so, what recommendations if any do you have for Congress in addressing this impact?

        - **Answer: Please see my answer below.**

    b. What steps, if any, should stablecoin issuers like Paxos take to mitigate the harmful climate impacts of crypto mining – which include excess energy consumption and electronic waste?

        - **Answer: I am aware of concerns about the significant energy consumed by proof-of-work models used by some digital assets. Climate impacts are an important issue and will be considered in the interagency review led by the Office of Science Technology and Policy pursuant to the recent Executive Order on Ensuring Responsible Development of Digital Assets.**

    c. Was mitigating the climate impact of stablecoin products and other cryptocurrencies a priority for Treasury and the other agencies who authored this report? If not, why not?

        - **Answer: The PWG stablecoin report focused on the prudential risk of stablecoins. The climate impact of cryptocurrencies, such as Bitcoin, also is an important issue. I will note that the climate-related impacts of distributed ledger technology will be considered as part of an interagency review led by the Office of Science Technology and Policy pursuant to the recent Executive Order on Ensuring Responsible Development of Digital Assets.**

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The Use of Stablecoins in DeFi Activities

17. Under Secretary Liang, Decentralized Finance, or DeFi, is an especially fast-growing area within the digital asset industry, reportedly reaching more than $100 billion in size in November 2021, up from around $21 billion only a year ago. DeFi generally refers to the use of digital assets and blockchain technology to replicate and replace conventional delivery of financial services without central financial intermediaries such as brokerages, exchanges, transfer agents, or banks. As your PWG Report states, stablecoins are used widely in the DeFi ecosystem, enabling users to invest these stablecoins for yield on their digital assets in the DeFi market while reducing the adverse effects of market volatility. However, SEC Commissioner Crenshaw recently warned that DeFi is risky, with DeFi promoters dismissing their legal obligations, and that investors may lose their money as they are not provided with the detail needed to assess risk likelihood and severity.[16]

    a. Can you discuss how DeFi provides risks of fraud, misappropriation, and conflicts of interest, including those arising from misleading disclosures?

        - **Answer: Treasury agrees that DeFi arrangements may present risks of fraud, misappropriation, and conflicts of interest, and highlighted concerns in these areas in the stablecoin report published by the President's Working Group on Financial Markets. We also identified DeFi as an illicit financing risk given its use by illicit actors to move and attempt to conceal illicit proceeds in Treasury's 2022 National Money Laundering Risk Assessment. Certain DeFi arrangements may fall within the SEC's jurisdiction under the federal securities laws or the CFTC's jurisdiction under the Commodity Exchange Act. Where this is the case, Treasury fully supports efforts by these agencies to ensure that DeFi arrangements comply with existing laws. In addition, President Biden's recent Executive Order on digital assets directs Treasury to publish a report on consumer, investor, and business risks related to DeFi and other aspects of digital markets, including recommendations for additional measures to address such risks.**

    b. Many DeFi exchanges and apps highlight the fact that they've been designed to avoid global anti-money laundering, sanctions, and fraud laws and regulations. They can collect fees, but not the identities of their users. If stablecoins are a primary value or store of value that is transmitted across these platforms, should Bank Secrecy Act, sanctions, and other financial crime standards be applied?

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[16] Securities and Exchange Commission, *Statement on DeFi Risks, Regulations, and Opportunities by Commissioner Crenshaw* (Nov. 9, 2021).

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- **Answer: The Financial Action Task Force, the global standard-setting body for anti-money laundering and countering the financing of terrorism (AML/CFT), in fall 2021 noted in updated guidance on the application of the international AML/CFT standards that the creators, owners, and operators or some other persons who maintain control or sufficient influence in DeFi exchanges could have AML/CFT obligations if they are providing covered financial services. In the United States, FinCEN clarified in 2019 that when decentralized applications, including DeFi exchanges, engage in money transmission services involving "convertible virtual currency" (CVC), they are operating as a money transmitter – a type of money services business (MSB) – and must abide by applicable AML/CFT obligations. The U.S. AML/CFT framework is focused on the underlying financial services being provided, not the technology or asset, like stablecoins, used to provide it. Please see below for information on AML/CFT obligations for participants in stablecoin arrangements.**

c. How should stablecoin issuers and agents address these concerns?

- **Answer: In the United States, most stablecoins are considered CVC and treated as "value that substitutes for currency" under FinCEN's regulations. All CVC financial service providers engaged in money transmission services, which can include stablecoin administrators and other participants in stablecoin arrangements, must register as MSBs with FinCEN. They must also comply with FinCEN's regulations, issued pursuant to authority under the BSA, which require that MSBs maintain AML programs, report cash transactions of $10,000 or more, file suspicious activity reports (SARs) on certain suspected illegal activity, and comply with various other obligations. The Office of Foreign Assets Control (OFAC) has provided guidance on how the virtual currency industry can comply with sanctions obligations and has clarified through FAQs that sanctions obligations apply the same to CVC transactions as fiat currency transactions.**

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Representative Nikema Williams (D-GA)

The financial services sector is ever-changing, but what must never change is our commitment to responsibly bring more people into the financial system. As we evaluate stablecoins, financial inclusion and consumer protection must be our top priorities.

1. Under Secretary Liang, can you tell us more about the extent to which low- income or unbanked households, seniors, and communities of color have made use of stablecoins? What use cases exist now, and how do you foresee stablecoins being used in the future?

    - **Answer: We are not aware of systematic data on the use of stablecoins by low-income or unbanked households, seniors, and communities. We are aware, however, that recent years have seen a dramatic rise in the number and value of cryptocurrency frauds and scams. The FTC noted in 2021, there were almost 40,000 cryptocurrency fraud complaints in the U.S. totaling about $750 million. through the Financial Literacy Education Commission, Treasury and other agencies have begun working on an effort to educate consumers about digital assets.**

2. What factors should be kept in mind to ensure folks who may have limited financial literacy or barriers to using technology can experience financial inclusion in an increasingly digital economy while not falling prey to speculative products?

    - **Answer: There are many safe and affordable financial products and services available to consumers with less financial knowledge and skill, as well as less technology access. For example, the FDIC provides resources for individuals to find an FDIC-insured bank account through its #GetBanked campaign[17] and the NCUA informs consumers about using credit unions at mycreditunion.gov. As mentioned above, the Financial Literacy Education Commission is also working on an effort to produce resources for consumers to better understand digital assets.**

3. What factors should we consider in an increasingly digital economy to maximize economic well-being and consumer protection for those unbanked and underbanked?

    - **Answer: The economic well-being of unbanked and underbanked consumers will be best supported when there is a robust marketplace to support consumer choice, sound consumer protections, and**

[17] FDIC: GetBanked - Learn How to Open an Account at an FDIC-Insured Bank, https://www.fdic.gov/getbanked/index.html

opportunities for consumers to access high-quality information, education, and guidance to enable their financial choices.

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Representative French Hill (R-AK)

1. The PWG report mentions several steps that FSOC can take in the absence of legislation, including "*requirements in relation to the assets backing the stablecoin.*"

    a. Can you elaborate on what kinds of requirements FSOC believes it already has the authority to impose under its FSOC designation powers, versus what are things that can only be done by Congress?

    - **Answer: As described in the PWG *Report on Stablecoins*, the Council could consider steps available to it to address the risks outlined in the report. Such steps may include the designation of payment, clearing, and settlement (PCS) activities conducted by financial institutions as, or as likely to become, systemically important. Designation would permit the appropriate agency to establish risk-management standards for financial institutions that engage in designated PCS activities. In addition, the Council potentially could address stablecoin arrangements using its authority to designate systemically important financial market utilities (FMUs), subjecting those arrangements to consolidated supervision. The Council also has authority to designate nonbank financial companies for Federal Reserve supervision, pursuant to its authority in Title I of the Dodd-Frank Act. As noted in its 2021 annual report, the Council will be prepared to consider steps available to it to address risks outlined in the PWG report in the event comprehensive legislation is not enacted. As Treasury's work on stablecoins progresses, it may evaluate how FSOC's designation authorities could apply to stablecoin arrangements and whether there are potential gaps in its authority.**

FSOC Designation

The PWG report recommends that FSOC, in absence of congressional action, take either an activities-based or entity-based approach to designate stablecoin arrangements as systemically important. As you know, an FSOC designation comes with enhanced supervision and prudential standards by the Fed. According to the report, this means that designation would allow an agency to establish risk management standards for financial institutions that engage in designated payment, clearing, and settlement activities within stablecoin arrangements, including "*requirements in relation to the assets backing the stablecoin, requirements related to the operation of the stablecoin arrangement, and other prudential standards.*"

2. The report suggests that FSOC could take an entity-based approach by either designating stablecoin arrangements as Systemically Important Financial Market Utilities (SIFMUs) or by designating them as systemically important nonbank financial institutions (SIFIs).

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a. Can you elaborate on how FSOC is thinking about these potential entity-based approaches to designating stablecoin arrangements?

- **Answer: Please see my answer below.**

b. When would it make sense to take an entity-based vs. activity-based approach?

- **Answer: Please see my answer below.**

c. Given that FSOC's authority to designate SIFMUs (Sec. 804) and nonbank financial institutions (Sec. 113) stems from different parts of Dodd Frank, what are the differences in how FSOC would use its enhanced authorities if it designates stablecoins as SIFMU vs. SIFI vs. a systemically important activity?

- **Answer: To address prudential risks associated with the use of stablecoins as a means of payment, the PWG *Report on Stablecoins* recommends that Congress act promptly to ensure that payment stablecoins are subject to appropriate federal prudential oversight on a consistent and comprehensive basis. In the absence of Congressional action, the report recommends that the Council consider steps available to it to address the risks outlined in the report. As noted in its 2021 annual report, the Council will be prepared to consider steps available to it to address risks outlined in the PWG report in the event comprehensive legislation is not enacted. As Treasury's work on stablecoins progresses, it may evaluate how FSOC's designation authorities with respect to payment, clearing, and settlement activities; financial market utilities; or nonbank financial companies may potentially apply to stablecoin arrangements. Should the Council act, it will do so consistent with its statutory authorities and in a manner that efficiently and effectively mitigates the identified risks.**

3. The report recommends that FSOC designate "*payment, clearing, and settlement activities within stablecoin arrangements as, or likely to become, systemically important.*"

a. In the 12 years since Dodd Frank, has FSOC ever designated something as "*likely to become systemically important*"?

- **Answer: The Council has never designated a payment, clearing, or settlement activity as, or as likely to become, systemically important. However, in 2012, the Council designated eight financial market**

utilities as systemically important. The bases for those designations are available at https://home.treasury.gov/system/files/261/here.pdf.

b. What are the factors that FSOC would look at to determine whether it's appropriate to designate something as "*likely to become…?*"

- **Answer: Section 804 of the Dodd-Frank Act specifies the considerations that the Council shall consider in determining whether a financial market utility or payment, clearing, or settlement activity is, or is likely to become, systemically important. Those considerations are:**
    - **(A) The aggregate monetary value of transactions processed by the financial market utility or carried out through the payment, clearing, or settlement activity.**
    - **(B) The aggregate exposure of the financial market utility or a financial institution engaged in payment, clearing, or settlement activities to its counterparties.**
    - **(C) The relationship, interdependencies, or other interactions of the financial market utility or payment, clearing, or settlement activity with other financial market utilities or payment, clearing, or settlement activities.**
    - **(D) The effect that the failure of or a disruption to the financial market utility or payment, clearing, or settlement activity would have on critical markets, financial institutions, or the broader financial system.**
    - **(E) Any other factors that the Council deems appropriate.**

  Should the Council take any action, it would do so consistent with the processes and requirements under the Dodd-Frank Act.

c. What would happen if the entity or activity never actually became systemically important? Would there be an exit process for that designation? Will you commit to establishing one?

- **Answer: Section 804 of the Dodd-Frank Act states that the Council "shall rescind a designation of systemic importance for a designated financial market utility or designated activity if the Council determines that a designated utility or activity no longer meets the standards for systemic importance." If a designated financial market utility or payment, clearing, or settlement activity no longer meets the standards for designation set forth in the statute, the Council would rescind the designation consistent with the statute.**

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d. The report states that "*any [FSOC] designation would follow a transparent process.*" Can you describe what this process looks like?

- **Answer: Any action by the Council would be consistent with the considerations and processes identified in the statute and any applicable guidance or rules. Section 804 of the Dodd-Frank Act, for example, specifies the process for interagency consultation, advanced notice to certain entities, and an opportunity for a hearing.**

<u>Different Types of Stablecoins</u>

4. The PWG report focused almost exclusively on payment stablecoins, but of course there are many kinds of stablecoin arrangements out there, such as those that are interest bearing versus others that act more like a medium of exchange (non-interest bearing and designed to maintain a stable value, usually against a reference currency).

   a. Do you believe stablecoins should be treated differently based on their use cases and underlying collateral structures?

   - **Answer: The PWG Report described stablecoins as those instruments that are generally created, or "minted," in exchange for fiat currency that an issuer receives from a user or third-party. To maintain a stable value relative to fiat currency, many stablecoins offer a promise or expectation that the coin can be redeemed at par upon request. These stablecoins are often advertised as being supported or backed by a variety of "reserve assets." Stablecoins that are purportedly convertible for an underlying fiat currency are distinct from a smaller subset of stablecoin arrangements that use other means to attempt to stabilize the price of the instrument (sometimes referred to as "synthetic" or "algorithmic" stablecoins) or are convertible for other assets. Because of their more widespread adoption, the discussion in the PWG report focuses on stablecoins that are convertible for fiat currency.**

     This promise of stability is what enables stablecoins to potentially be used as a means of payment and what makes stablecoins vulnerable to runs. To mitigate these and other risks, the PWG recommends that stablecoins be issued by insured depository institutions.

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b. Asked in a different way, do you believe it makes sense to apply a bank-like regulatory regime with deposit insurance to, for example, a non-interest bearing, 1-for-1, fiat collateralized stablecoin that operates more like a B2B payment rail than a money market fund?

   - **Answer: The PWG Report identified regulatory gaps with respect to three prudential risks. First, the risk that stablecoins could be subject to runs that would harm users and the broader financial system. Second, payment system risks related to the mechanisms used to store or transfer stablecoins. And third, concerns related to concentration of economic power. The PWG Report recommended limiting stablecoin issuance to insured depository institutions (IDIs) because IDIs are subject to a tested and flexible regulatory framework that would help to mitigate concerns in each of these three areas. The report does not take a position on whether stablecoins or any particular stablecoin could or should be insured.**

c. Outgoing FDIC Chair McWilliams noted in her remarks last week that she believes bank- issued stablecoins closely resemble digital representations of "deposits" under the Federal Deposit Insurance Act. This begs the question of whether stablecoins could be eligible for deposit insurance.

   i. Do you agree with Chair McWilliams? If not, why? If so, would you support the FDIC promulgating amendments to deposit insurance rules?

      - **Answer: Whether stablecoins themselves should be covered by deposit insurance is a complex question, which is being considered by the FDIC and could be considered further as part of the legislative process.**

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Representative Anthony Gonzalez (R-OH)

1. The PWG has recommended that stablecoin issuers be limited to insured depository institutions. Could you clarify that the term insured depository institution includes federally insured credit unions as I see that you engaged with credit union groups for the report?

   - **Answer: The term "insured depository institution" is defined in the PWG report by reference to the Federal Deposit Insurance Act. Credit unions are member-owned and provide services to their members who have a "common bond," rather than the general public. As such, they provide more limited services that are tailored to the needs of their members, and are subject to more tailored supervision and regulation relative to other depository institutions.**