August 8, 2022

Department of the Treasury
Natalia Li
Deputy Director
Office of Financial Institutions Policy
1500 Pennsylvania Ave, NW
Washington, DC 20220

Re: Request for Comment on Ensuring Responsible Development of Digital Assets (87 FR 40881)

Colleagues:

The American Bankers Association (ABA)1 welcomes the opportunity to respond to the request by the Treasury Department for information and comment concerning the responsible development of digital assets (RFC)2.

When Executive Order 14067 “Ensuring Responsible Development of Digital Assets” (EO)3 was released in March 2022, ABA looked forward to continuing its engagement with the Administration, government agencies, bank regulators, and Congress to consider the implications of these important and complex policy decisions. We continue to share the Administration’s interest in responsible financial innovation. Ensuring that consumers, investors, and businesses are protected from the potential financial risks posed by digital assets should be a priority for the government, and we believe that can only be achieved through careful coordination with the private sector, including the banking industry.

Blockchain technology has potential for application in financial services that, over time, may lead to enhanced efficiencies, new products, and new ways to deliver traditional products. The fundamental characteristics of blockchain, including immutability and transparency, are relevant and valued in the financial services market, and many banks are exploring potential uses. Critically, banks are undertaking this research and innovation responsibly and within a regulatory framework that ensures consumer protection and limits systemic risk. The same cannot necessarily be said for non-banks.

1 The American Bankers Association is the voice of the nation’s $24 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $19.9 trillion in deposits and extend nearly $11.4 trillion in loans.
The digital asset market includes a range of instruments—from speculative and highly price volatile cryptocurrencies (e.g., bitcoin and ether), to so-called stablecoins that are backed by a collection of assets (e.g., USDC and Tether), to digital representations of customer deposits on a blockchain. Each category of digital asset, and really, each specific token or coin, has unique risk characteristics depending on its issuer and use case. Many of these assets look like traditional financial products, which may create consumer expectations about the protections afforded them and regulations the products are subject to.

Particularly for stablecoins, where the token is marketed as maintaining a 1:1 peg to the US Dollar, the product looks and feels like a dollar in a deposit account with all of the protections that come from FDIC insurance and regulatory supervision of the banking industry. However, we know that is not the case. Non-bank stablecoin issuers are not subject to a comprehensive regulatory framework, and consumers who choose to purchase these stablecoins are subject to the credit risk of the issuer. While banks are also subject to credit risk, the combination of FDIC insurance and comprehensive supervision ensures appropriate risk management that protects consumers’ deposits.

The digital asset marketplace is changing rapidly. When the EO was released, the total market capitalization of all cryptocurrencies (including stablecoins) was around $2 trillion⁴, down from its peak of over $3 trillion⁵ reached in November 2021. Since then, the digital asset market has continued to lose value (~$1.1 trillion as of July 29, 2022⁶), and many consumers and investors have lost considerable savings. Some crypto companies⁷ have suspended the ability for consumers to withdraw their funds and ultimately filed for bankruptcy, calling into question whether those consumers will ever be made whole. In at least one insolvency proceeding of a non-bank, the court has made a preliminary decision to treat customer assets as property of the bankrupt estate available for satisfaction of claims of general creditors. In connection with another insolvency, concerns have been raised with regard to misrepresentation as to whether customer cash deposits were FDIC insured and under what conditions that FDIC insurance would apply. Other crypto companies⁸ have sought emergency loans to stay afloat. What all of these crypto companies have in common is that they are not subject to consolidated federal regulation and supervision. The risks these non-banks’ unregulated operations pose to consumers have become clear.

We are concerned that very little activity seems to have been undertaken since the EO was issued to rein in these non-bank crypto companies. At the same time, bank regulators have taken a very cautious approach, instructing banks to seek formal non-objection⁹ to any activities in the digital asset market.

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⁴ https://www.statista.com/statistics/730876/cryptocurrency-market-value/
⁵ https://www.statista.com/statistics/730876/cryptocurrency-market-value/
⁶ https://coinmarketcap.com/charts/
⁷ See, e.g., https://www.ft.com/content/8d6dee7d-2530-4663-a0a2-e469686baca5; https://www.ft.com/content/8e4538cc-e8c5-4cc2-9448-053074f72f67; https://www.washingtonpost.com/business/2022/07/06/voyager-bankruptcy-three-arrows/;
The combination of these two approaches—inaaction on the one hand to bring into the regulatory perimeter non-bank crypto companies, and limitation on the other of banks’ ability to engage responsibly in the digital asset market—creates an environment that makes it nearly impossible for responsible financial innovation to occur in this space, causing it to remain in the Wild West.

Digital assets have the potential to be a catalyst for change in traditional financial markets, with significant implications for our financial system, economy, markets, and most importantly for the American consumer. Banks are actively evaluating ways to compete safely and responsibly in the digital asset market, and we look forward to working with all stakeholders to ensure that outcome.

Below we respond directly to several topics posed in the RFC. In addition, please see the following statements and comment letters ABA has previously submitted on digital assets, which are applicable to the RFC.

- Response to the Department of Commerce Request for Comment on Developing a Framework on Competitiveness of Digital Asset Technologies, June 30, 2022
- Joint Trades Letter to Treasury Department, OCC, FDIC and Federal Reserve on SEC SAB 121, June 23, 2022
- Response to the Federal Reserve Board’s discussion paper, Money and Payments: The U.S. Dollar in the Age of Digital Transformation, May 20, 2022
- Statement for the Record before the U.S. Senate Committee on Banking, Housing, and Urban Affairs Hearing titled Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?, Dec 14, 2021
- Letter to the Basel Committee on Banking Supervision in response to the Consultative Document - Prudential Treatment of Cryptoasset Exposures, Sept 10, 2021
- Response to the Federal Deposit Insurance Corporation Request for Information and Comment on Digital Assets, July 15, 2021

(A) Adoption to Date and Mass Adoption
This RFC asks about factors that would further facilitate mass adoption of digital assets. In June 2022, ABA responded to the International Trade Administration’s RFC on Developing a Framework on Competitiveness of Digital Asset Technologies. We believe several of the themes discussed in that comment apply directly to the potential for increased adoption of digital assets:

1. Regulatory clarity and a level regulatory playing field for banks and non-banks will enhance competitiveness of the digital asset market; and
2. SEC Staff Accounting Bulletin 121 (SAB 121) inhibits banks’ ability to compete in aspects of the digital asset market.
Regulatory clarity and a level regulatory playing field for banks and non-banks will enhance innovation and competitiveness of the digital asset market.

Although the digital asset market continues to develop at a rapid pace, there remains significant uncertainty related to the regulation of digital assets. As a first step in providing certainty, regulators should develop clear definitions of digital asset products that group assets by risk. For example, use of distributed ledger technology for deposits by a bank on a permissioned, private blockchain presents very different risks than use of an unpermissioned, public blockchain. Regulatory clarity that defines the rules of the road for bank and non-bank participation is critical to ensuring continued financial innovation.

Given the regulatory uncertainty surrounding the framework applicable to digital assets, banks have moved more carefully to market than many of the less regulated providers of these services. Such non-bank market entrants are not subject to prudential regulation and examination and are not subject to robust capital and liquidity requirements. As recent events have made clear, this unregulated activity can expose consumers and counterparties to harm.

Banks are subject to a comprehensive regulatory framework and consolidated supervision that enables careful implementation of digital asset activities. Backed by a culture of risk management and compliance, and subject to supervision and examination, banks are better equipped to identify any risks and remediate them in a timely manner that mitigates harm to consumers and other market participants.

This level of oversight and supervision should be applied to banks and non-banks engaged in digital asset activities alike to ensure all customers are protected equally, regardless of where they engage with the financial marketplace. As non-bank technology firms begin offering banking products and services through digital channels, regulators should coordinate their efforts to bring these companies into the regulatory perimeter, to the extent the activity falls within their jurisdiction, to ensure that these activities are appropriately monitored, emerging risks adequately captured, and all applicable legal requirements are established and met.

Financial innovation in the United States comes from a place of strength. Unlike many other countries, the United States has a well-developed and robust financial system that is the backbone of our economy and markets. Nearly every worker and person receiving government benefits is paid through Direct Deposit, with access to good, spendable funds on or before their pay or benefit date, indicating that essentially every dollar of income in the U.S. is digital. As they have done for over two centuries, American banks today provide a broad array of essential financial and economic functions that benefit their communities, most notably, safekeeping deposits and making loans.

For new payment types - like those enabled by crypto - to become safe and commonly accepted methods of payment, the trust of all parties to the transaction is required, and trust is earned through the stability and predictability that comes from well-regulated markets. Banks must have consistent guidance from regulators that does not put them at a disadvantage relative to lesser-regulated competitors. We urge policymakers to monitor actions by regulators that prevent the kind of harmonization of expectations that would create a predictable, regulated marketplace for new assets.

The “whole of government approach” to developing a common understanding and consistent application of laws, regulations, and guidance will support responsible innovation in the digital asset
market. Further, the overall stability of the global financial system will benefit from the transparency and disciplined risk management that will result by conducting a significant share of the digital asset market through supervised financial institutions, as opposed to having such activity operated outside the regulated banking system.

**SEC Staff Accounting Bulletin 121 (SAB 121) inhibits banks’ ability to compete in aspects of the digital asset market.**

ABA has serious concerns with the applicability of the SEC’s SAB 121 to regulated banking organizations that safeguard “cryptoassets.” The accounting approach articulated in SAB 121 puts banks at a competitive disadvantage in providing cryptocurrency custody services relative to providers that are not prudentially regulated. Preventing regulated banks from entering the cryptocurrency custody market pushes digital asset activity outside the regulatory perimeter, making it less safe for consumers.

The staff of the Office of the Chief Accountant of the SEC issued SAB 121 on March 31, 2022. SAB 121 requires, in many cases, an SEC registrant to record a liability and a corresponding asset representing an obligation to safeguard cryptoassets it holds for platform users. The obligation is measured at the fair value of the related cryptoassets. Effectively, SAB 121 would bring the value of cryptoassets a bank holds in custody on behalf of their clients onto the bank’s balance sheet. The attendant consequences of balance sheet recognition for capital, liquidity and other requirements could prevent banking organizations from being able to offer competitive digital asset-related products and services.

This guidance has raised a number of policy, scope, and legal questions given its potential broad long-term impact on banks. In particular, a potential reading of SAB 121 by the SEC that includes banking organizations’ safekeeping activities related to cryptoassets would effectively preclude the organizations from serving clients seeking digital asset custody services. Moreover, such a reading would work at cross-purposes with, if not largely undermine, the efforts of the ongoing governmental project to define the regulatory perimeter for cryptoassets, including by making it effectively impossible for digital native firms to become subject to federal prudential regulation. Further, the guidance seems to ignore the fact that banks can and have successfully custodied a variety of assets, e.g., bearer bonds, despite the different risks involved.

Absent a holistic approach that takes into account the existing regulatory framework for banking organizations, there would be few (if any) regulated banking organizations in the world available to provide cryptoasset custody services at scale for U.S. investors.\(^\text{11}\)

**(B) Opportunities for Consumers, Investors, and Business**

Blockchain technology has potential for application in financial services that, over time, may lead to enhanced efficiencies, new products, and new ways to deliver traditional products. The fundamental characteristics of blockchain, including immutability and transparency, are relevant and valued in the

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\(^10\) SAB 121 defines “cryptoassets” as “a digital asset that is issued and/or transferred using distributed ledger or blockchain technology using cryptographic techniques.”

\(^11\) This result would affect custody services globally because U.S. banking organizations provide custody services around the world, and SAB 121 would apply to foreign private issuers that file financial statements with the SEC.
financial services market, and many banks are exploring potential uses. Critically, banks are undertaking this research and innovation responsibly and within a regulatory framework that ensures consumer protection and limits systemic risk.

We have seen several banking industry initiatives designed to tokenize bank customers’ deposits, such as JPMCoin and USDF. In addition, the Regulated Liability Network (RLN) proposes to tokenize commercial bank, central bank, and electronic money on the same chain in order to deliver digital money based on national currency units (e.g., denominated in U.S. dollars). The availability of these digital assets, when delivered safely through a robust regulatory framework, may lead to financial services innovation.

(C) General Risks in Digital Assets Financial Markets

ABA notes some important risks with respect to:

- market transparency,
- technological risks (including attacks, bugs, and network congestion), smart contract design and security,
- settlement and custody,
- risk management practices, and
- jurisdictional and legal conditions.

We believe, however, that these risks are most clearly understood, not in the abstract, but as risks to specific cohorts of market participants as framed in the next question raised in the RFC. For this reason, we discuss these risks in the responses to Question D, Risks to Consumers, Investors, and Businesses.

Notwithstanding the comment above, there are several risks related to the potential issuance of a U.S. Central Bank Digital Currency (CBDC), and we will discuss them here. ABA believes strongly that the purported benefits of a CBDC are uncertain and unlikely to be realized, while the costs are real and acute.

Contrary to popular belief, a U.S. CBDC is not necessary to “digitize the dollar,” as the dollar is largely digital today. However, the issuance of a CBDC would fundamentally rewire our banking and financial system by changing the relationship between citizens and the Federal Reserve. The Federal Reserve notes this in its recent Financial Stability Report, highlighting that “[a] CBDC could fundamentally change the structure of the U.S. financial system, altering the roles and responsibilities of the private sector and the central bank.”

There are many proposed designs for a CBDC, and the design choices have a significant impact on the potential risks and benefits associated with each. For purposes of its discussion paper, the Federal Reserve has defined a CBDC as “a digital liability of a central bank that is widely available to the general

This approach has helped focus the discussion on the intermediated CBDC model, where a CBDC would be delivered through private-sector financial institutions, but where individual holdings would sit at the Federal Reserve. Importantly, this definition would preclude “direct”\textsuperscript{15} and “wholesale”\textsuperscript{16} designs of CBDC. Our view that the potential benefits of a CBDC do not outweigh the risks is based on our evaluation of this intermediated model. Other models for a U.S. CBDC may be presented in the future, and they would each need to be evaluated on their own merits.

Proponents of CBDC are driven by several laudable goals like financial inclusion and promoting the U.S. dollar’s international role as a reserve currency and a medium of exchange for international trade. ABA supports these important goals; however, we do not believe that a CBDC is well-positioned to accomplish them. In many cases, there are initiatives already underway that address these goals.

There are also significant trade-offs that must be made between different design choices. These trade-offs are likely to undermine many of the key goals of a CBDC and make it essentially impossible for a CBDC to fulfill all the various purposes for which it is currently being discussed. It is for these reasons that it is necessary to perform a careful analysis of whether the goals of a CBDC might best be accomplished through regulated commercial models that are already available or under development before any decisions are made to launch a CBDC. Such analysis should cover a broad range of models, which could meet the objectives that policymakers seek to achieve through a potential CBDC.

The risks associated with issuing a CBDC are often downplayed but are real and likely to undermine any possible benefit that a CBDC would have. Most importantly, every construction of CBDC requires moving funds from banks to the Federal Reserve. Regardless of the model chosen, a CBDC is a direct liability of the central bank. According to the Federal Reserve, “[a] widely available CBDC could serve as a close substitute for commercial bank deposits or other low-risk assets such as government MMFs and Treasury bills. A shift away from these assets could reduce credit availability or raise credit costs for households, businesses, and governments.”\textsuperscript{17} In effect, a CBDC would serve as an advantaged competitor to retail bank deposits that would move money away from banks and into accounts at the Federal Reserve, severely limiting the ability of commercial banks to lend funds back into the economy. A CBDC would remove a key source of bank funding for making loans that could harm consumers and businesses.

Brunnermeier and Niepelt\textsuperscript{18} have argued that this replacement risk could be addressed by a swap or transfer of CBDCs with bank deposits. This would neutralize the deposit loss for banks from the switch to CBDCs and, hence, not impact their funding to supply credit. This would also help neutralize any impact

\textsuperscript{15} A “direct” CBDC means a liability of the central bank held directly by a member of the public, unlike a commercial bank deposit, which is a liability of the commercial bank owed to its customer.
\textsuperscript{16} A “wholesale” CBDC means a CBDC designed for use among financial intermediaries only.
\textsuperscript{17} Financial Stability Report, supra n.4, at 44
on monetary policy. Unfortunately, there is no clarity regarding the contractual agreement between the Federal Reserve and banks for such swaps—Would this be a loan from the Fed? What would be the interest rate charged by the Federal Reserve for such loans? What would be the term of these loans (to replicate the duration of different types of deposit accounts)? In addition to fundamentally altering the asset/liability management (ALM) process for the U.S. banking system, there are numerous other important considerations that would likely render it difficult for the Federal Reserve to fully replace the lost deposits for banks. For example, deposit flows to banks are not stationary, and it would just not be possible for the Federal Reserve to replicate the dynamics of these flows. To the extent that non-banks would offer CBDC wallets, and customers move their deposits from commercial bank deposits to non-bank wallets, how would the Federal Reserve conduct CBDC-deposit swaps with non-banks?

For more information on ABA’s views on CBDC, please refer to ABA’s recent comment on the Federal Reserve Board’s discussion paper Money and Payments: The U.S. Dollar in the Age of Digital Transformation.

(D) Risks to Consumers, Investors, and Businesses

Consumers, investors, and businesses face many common risks in dealing with financial assets, and those risks are demonstrably present in markets for digital assets. Some digital assets (e.g., properly backed, redeemable stablecoins issued by regulated financial institutions) should, in theory, present negligible market risk, though stability of their values, depends on technology and protocols functioning as intended, and the risks to that functionality has proven to be real. Moreover, the underlying complexities create risks of unexpected consequences, even when all the moving parts function properly. An appropriate regulatory and supervisory regime should address the known and anticipated risks with a balanced approach to preserve the benefits and opportunities that digital assets promise.

Perhaps the most obvious risk from fraud would involve the creation of a fictitious digital asset that is then offered to market participants in exchange for value. If the only evidence of ownership or control of the asset is a screen showing a digital ledger, or if the ledger is the only assurance that reserve assets backing a stablecoin are segregated for the benefit of holders of the stablecoin, then accuracy of the ledger must somehow be assured. Within a digital community of participants who are familiar with and able to rely on a secure shared digital ledger or similar database, these risks may be controlled to a degree acceptable to those participants, and they may be able to manage any residual operational risks to protect their individual interests.

The potential benefits of many digital assets implicitly depend, however, on ease of secure, reliable use well beyond market participants who have such a high level of technological skill. In a truly

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19 It would also be important to assess the impact on banks’ funding costs and deposit rate today are driven by banks competing in the open marketplace.


21 Money and Payments: The U.S. Dollar in the Age of Digital Transformation, supra n.6

22 https://www.nytimes.com/2022/05/12/business/dealbook/terra-crypto-stablecoin.html

23 ABA believes it likely that this concern exists at least in the near term and that it will have significant relevance to near-term availability of the promised benefits of many digital assets. As with other technological innovations, the breadth of competency will not be static – drivers of early horseless carriages were self-reliant in engine mechanics.
decentralized autonomous environment, there is no identifiable person or entity accountable for the reliable function of the protocol. The ability of a fraudulent operator to simulate the appearance of a legitimate digital asset protocol or product means that a security element transparent and sophisticated enough to protect users against deception is needed.

Furthermore, the market has experienced fraud resulting from user error (e.g., deception resulting from social engineering such as phishing attacks).\textsuperscript{24} In such situations, technology, protocols, and counterparties (other than the fraud perpetrator) can all operate in a legal manner, consistent with all applicable protocols, yet result in a financial loss. Given the enhanced speed of final payment/transaction closure that digital asset technologies offer, the frequency (and possibly the magnitude) of such losses may increase without mitigating steps. Market participant education is clearly part of the solution, but operational controls for issuers, custodians, and other intermediaries should also play a role. Such measures might resemble the divisions of operational control and functions practiced by financial institutions dealing with all types of assets, for example preventing authority over asset transfers and payments from being concentrated in too few hands.\textsuperscript{25}

As the preceding discussion makes clear, a foundation of the appropriate function of the digital asset marketplace must be that assets, protocols, and technical platforms operate as intended, and as understood by market participants broadly. In addition, if an asset such as a stablecoin is structured to depend on liquid, stable reserves of fiat currency, then those reserves should be available on demand of the stablecoin holder without market risk, settlement risk, operational risk, or legal risk. The value of the reserve asset must at all times support the market value of the stablecoins outstanding. Even generally liquid, high-quality assets present a degree of market risk, even if relatively small, that must be addressed in the context of instruments serving as a means of payment – overcollateralization, liquidity reserves, or other means must be added to address the risk.\textsuperscript{26} If a stablecoin depends upon redemption or conversion to fiat currency on demand based on support from liquid reserves, redemption will be delayed if liquidating those reserves requires longer than intraday settlement.\textsuperscript{27}

The Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organization of Securities Commissions (IOSCO) recently issued their “guidance on the application of the Principles for financial market infrastructures (PFMI) to stablecoin arrangements (SAs) that are considered systematically important financial market infrastructures (FMIs), including the entities integral to such arrangements”.\textsuperscript{28} The guidance highlights stablecoins’ role as a means of payment as its core function. Our presumption is that Congress, policy makers, and regulatory authorities (many of whom are actively engaged in these and related international standard setting bodies) would be far above the general population, but ongoing innovations removed those barriers to wider adoption of automobiles.


\textsuperscript{25} The discussion preceding this footnote covers various technological, design, legal, and security issues, as raised in the preceding section.

\textsuperscript{26} Obviously adding a back-up liquidity provider may address the possible collateral shortfall, but the liquidity provider itself is a source of credit risk to the extent of its obligation.

\textsuperscript{27} Even short-term US Treasury securities would typically settle T+1.

\textsuperscript{28} https://www.bis.org/cpmi/publ/d198.htm.
studying these principles to inform the collective approach to regulating stablecoins. In the context of the settlement aspect of stablecoins, the PFMIs address ‘settlement finality’ and ‘money settlements’, and with respect to the latter, Principle 9 states that “[a]n FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimize and strictly control the credit and liquidity risk arising from the use of commercial bank money”.29

These concerns clearly demonstrate that the details of the parties’ legal rights and obligations, as well as the relevant market, settlement, and operational risks, are critical for consumers, investors, and businesses to understand. Arrangements that offer a relatively high degree of certainty when governed by the laws of a given jurisdiction may produce different (or uncertain) results when subject to another jurisdiction’s laws. These questions point to the need for adequate disclosures, appropriately adapted to the sophistication of consumer or commercial market participants, of all of the attendant risks. Such disclosures are necessary, though alone are insufficient, for the long-term health of digital asset markets and the practical realization of their promised benefits. Moreover, ABA believes that some fundamental disclosures of these risks are not dependent on the characterization of a digital asset as a “security,” a “commodity,” or a “derivative,” or as none of these.

Conclusion

ABA appreciates the opportunity to provide comments on the Department of Treasury RFC on responsible development of digital assets. Digital assets represent a rapidly developing marketplace, and banks are actively evaluating ways to safely and responsibly compete.

Sincerely,

Brooke Ybarra

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29 Page 18, section 3.5.1 of the stablecoin PFMIs.