Statement for the Record

On Behalf of the

American Bankers Association

before the

Subcommittee on Digital Assets, Financial Technology and Inclusion

Of the

House Financial Services Committee

March 9, 2023

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The American Bankers Association (ABA) appreciates the opportunity to provide a Statement for the Record for this hearing, *Coincidence or Coordinated? The Administration's Attack on the Digital Asset Ecosystem*. ABA is the voice of the nation's $23.6 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 $12.2 trillion in loans.

The digital asset marketplace, comprising cryptocurrency and stablecoin and the firms that support the digital asset transactions, is changing rapidly. In November 2021, the total market capitalization of all cryptocurrencies (including stablecoins) peaked at around US$3 trillion.[1] Since then, in the face of several high-profile events, the digital asset market precipitously collapsed in value (total market cap is ~US$1.03 trillion as of March 6, 2023),[2] and many consumers and investors have been adversely impacted. Some crypto companies[3] 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 bankruptcy 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 companies[4] 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.

Congress is right to focus on the digital asset ecosystem to better understand how the various entities in the market operate, what risks those operations present, and therefore what

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[1] https://www.statista.com/statistics/730876/cryptocurrency-maket-value/
[2] https://coinmarketcap.com/charts/
[3] See, e.g., https://www.ft.com/content/8d6dee7d-2cc9-4663-a0a2-e469686baca5; https://www.ft.com/content/8e4538cc-e8c5-4cc2-9448-053074f72f67; https://www.washingtonpost.com/business/2022/07/06/voyager-bankruptcy-three-arrows/
[4] See, e.g., https://www.wsj.com/livecoverage/global-stocks-markets-dow-update-06-17-2022/card/crypto-lender-babel-finance-freezes-all-account-withdrawals-cGRgPdUuSJYISZtj5dhg; https://www.bloomberg.com/news/articles/2022-07-25/zipmex-aims-to-raise-at-least-50-million-to-mend-balance-sheet

regulations or legislation is necessary to ensure consumer and investor protection and financial stability without inhibiting innovation.

The digital asset ecosystem encompasses a broad range of entities, assets, and activities. It is important to distinguish among the different aspects as each carries varying levels of risk; however, often digital assets are categorized broadly without regard for the particular characteristics of a specific type of digital asset. At the most foundational level, policymakers must understand that distributed ledger technology (DLT) or blockchain technology is different than cryptocurrencies. While cryptocurrencies operate on DLT, there is potential value in DLT separate and apart from cryptocurrency activity. 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.

Defining important terms and developing a comprehensive and harmonized lexicon for the various types of digital assets and entities active within the digital asset ecosystem, and supporting infrastructures, will help authorities more effectively target the unique risks that each present. Policymakers must distinguish among digital assets, cryptocurrencies, and tokenized assets, as well as the underlying DLT and blockchain infrastructure, which may differ in use across functions and activities, when they apply existing (or develop new) regulatory frameworks for them. Traditional banking products and activities utilizing DLT, blockchain, or other novel technologies provided by federally insured or regulated banks or subsidiaries of bank and financial holding companies do not present the risks presented by non-bank digital asset service providers and non-bank issued cryptocurrencies or related activities because banks and the regulatory structure in which they operate are designed to effectively manage risks. Further, legal instruments are independent from the arbitrary technology used to represent them. For example, a deposit recorded on a traditional ledger today is the same as one recorded on a blockchain.

Regulatory clarity that defines the rules of the road for bank digital asset activity, in cases where the law does not already cover the underlying activity, is critical to ensuring continued financial innovation. Banking regulators have instructed banks to proceed into the digital asset ecosystem with extreme caution, requiring advanced supervisory notice and formal approval[5], which is an atypical standard for many product and technology implementations. Given the regulatory uncertainty and regulators' concern, banks have moved more carefully to market than many of the less regulated providers of these services. Such non-bank financial institutions 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.

We strongly recommend Congress and regulators apply the principle of "same activity, same risk, same regulation" to develop a framework for digital asset regulation, seeking to apply existing financial system safeguards to the digital asset ecosystem and filling in gaps with new legislation, as necessary. The United States has a number of existing laws and regulations that may be applicable to activities (e.g., custody, deposit-like accounts, lending, payments) taking place in the digital asset ecosystem. Applying the principle of "same activity, same risk, same

[5] https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html;
https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdf;
https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm.

regulation" will help ensure that all customers are protected equally, regardless of where they engage with the financial marketplace and that the financial system remains strong, safe, and competitive.

In particular, entities performing bank-like activities should be subject to bank-like regulation that provides for robust consumer protections, anti-money laundering procedures, and capital and liquidity controls. Similarly, entities performing market activities should be subject to relevant and appropriate market regulations. 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 well equipped to identify risks and mitigate them in a timely manner. Banks are evaluating several ways to responsibly engage in the digital asset ecosystem, and much of their activity can be grouped into three categories:

1. Providing digital asset custody services;
2. Providing traditional banking products and services utilizing DLT, blockchain, or other novel technologies; and
3. Providing banking services for entities in the digital asset ecosystem.

We urge Congress and regulators to clarify that it is generally permissible for banks acting in a safe and sound manner to engage in these activities, which will enable financial innovation to the benefit of US consumers and the broader economy.

Providing digital asset custody services. Banks have long provided safe and well-regulated custody services to investors in securities and other assets. Prudential regulators appear to be taking a case-by-case approach to permitting banks to provide custody services for digital assets. Further, in March 2022, the SEC released Staff Accounting Bulletin 121 (SAB 121) to address perceived risks to publicly-traded companies that safeguard crypto-assets for their customers. SAB 121 requires a company that has perceived technological, legal or regulatory risk to record a liability and asset for the fair value of the crypto-assets. SAB 121 effectively precludes banks from offering digital asset custody at scale, in part because placing value of client assets on balance sheet will trip prudential requirements such as capital, liquidity, and other mandates.

The combination of prudential regulators' caution and SAB 121 means few banks are currently offering custody services for digital assets, leaving consumers with few options for a safe, well-regulated custody service for digital assets. Many have turned to non-bank market entrants that 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.

Providing traditional banking products and activities utilizing DLT, blockchain, or other novel technologies. Banks stand ready to innovate, but the banking regulators do not appear to have appropriately distinguished between traditional bank activities using DLT or blockchain, such as tokenizing existing bank liabilities (e.g., deposits) or securities, and non-bank issued cryptocurrencies, which present very different risks given the inherent design of the various activities. The National Credit Union Administration acknowledged the potential benefits from credit unions' use of DLT and issued a letter in May 2022 clarifying that credit unions may appropriately use DLT as an underlying technology.[6]

[6] https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/federally-insured-credit-union-use-distributed-ledger-technologies

The use of DLT for traditional banking activities, such as tokenized deposits, or for infrastructure uses, may result in increased efficiencies and security that benefit consumers. Banks are responsibly evaluating this technology, and we urge Congress and regulators not to throw the proverbial baby out with the bathwater by restricting banks' ability to leverage DLT in a safe and sound manner. Innovation such as the use of DLT for improved internal recordkeeping and trade settlement should not trigger additional regulation that is intended to address risk associated with novel digital asset activity. Under the existing regulatory framework and effective robust risk management function of banks, traditional banking activities using new technology are well-managed by banks with well-established controls for product development, and banks can manage the risks of traditional banking activities using DLT or blockchain.

Providing banking services for entities in the digital asset ecosystem. Banks should be able to bank – or not bank – any legal business so long as they do so in a safe and sound manner and don't discriminate unlawfully. Recent guidance from banking regulators has sought to remind banks of the risk present in a range of digital asset activities, including liquidity risk that may result from holding a high concentration of deposits from crypto entities. The guidance has been clear to note that banks are not prohibited from banking crypto businesses. It is imperative that banks can continue to make the choices that are best for their customers, communities, and business plan.

Banks have a critical role to play in the digital asset ecosystem, which has 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.