

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
April 19, 2023



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The American Bankers Association (ABA) appreciates the opportunity to provide a Statement for the Record for this hearing, *Understanding Stablecoins' Role in Payments and the Need for Legislation*. 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 stablecoins 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 has fluctuated wildly in value (total market cap is ~US\$1.23 trillion as of April 11, 2023),² and many consumers and investors have been adversely impacted. A subset of digital assets known as stablecoins endeavor to avoid these swings in price by pegging their value to some external reference point, such as the U.S. dollar or gold.³ This stability is pursued through the use of collateral reserves or algorithmic formulae to control supply.⁴ Popular use cases are payments (including cross-border transfers), access to digital assets, and storage of value.⁵

Again, ABA is grateful for the chance to enter our perspective into the record; our comments are based on the draft bill circulated in September 2022. We have organized our feedback into four sections: 1) areas of broad support, 2) areas of significant concern, 3) areas of mixed support / concern, and 4) additional observations. We are happy to discuss this feedback and answer any questions you may have and look forward to partnering on this important legislative initiative.

¹ <https://www.statista.com/statistics/730876/cryptocurrency-maket-value/>

² <https://coinmarketcap.com/charts/>

³ <https://www.investopedia.com/terms/s/stablecoin.asp>

⁴ Id.

⁵ <https://algorand.com/resources/blog/stablecoin-use-cases-on-algorand>

Areas of Broad Support

1. The bill distinguishes bank tokenized deposits from payment stablecoins. This concept can be clarified and reinforced with adjustments to the definition of payment stablecoin. Rather than representing a new financial product, bank tokenized deposits are a different technological means of evidencing and recording a deposit claim against a bank for fiat amounts on blockchain or using distributed ledger technology. Banks and bank deposits, including tokenized deposits, are already subject to comprehensive existing bank regulation that includes appropriate technology and operational risk management, as well as prudential regulation pertaining to capital and liquidity requirements.
2. The bill includes requirements for custody and safekeeping services, to include segregation requirements and commingling prohibitions. A comprehensive regulatory framework for the custody of stablecoins, including corporate governance controls, audit standards, capital and liquidity requirements, and disclosure requirements, is critical to ensuring financial stability, as well as appropriate consumer and investor protections.
3. The bill limits the activities of payment stablecoin issuers to issuing, redemption, managing reserves, providing custodial or safekeeping services, and other limited functions that directly support the work of issuing and redeeming payment stablecoins, and the bill restricts transactions between affiliates of payment stablecoin issuers. We need look no further than the recent collapse of FTX, where the combination of unregulated and unsupervised activities within a single corporate structure contributed to the resulting consumer harm. In particular, the combination of custody activities with trading and exchange activities at FTX enabled a situation where customer funds were not segregated and were misused. The proper safekeeping of customer assets is foundational to the protection of the customer, and the mitigation of financial stability risk and cannot be safely undertaken if commingled with market facing activities.
4. The bill applies the Gramm-Leach-Bliley Act to licensed nonbank entities, including state qualified payment stablecoin issuers.
5. The bill requires a public comment period prior to a nonbank becoming a licensed nonbank entity.
6. The bill requires prior approval by federal payment stablecoin regulators for mergers and acquisitions of payment stablecoin issuers, including a public comment process.
7. The bill articulates that payment stablecoins are not subject to deposit insurance and requires clear disclosure to that effect.

Areas of Significant Concern

1. While the bill establishes a federal framework for supervision of licensed nonbank entities, the regulation is not as robust as that provided for in a bank charter. In addition to allowing nonbank entities to apply for a license to issue payment stablecoins from the

Fed, the bill would allow nonbanks to become State Qualified Payment Stablecoin Issuers by seeking approval from a state regulator and thereafter simply registering with the Fed. The Fed does not appear to have discretion to approve or reject these state qualified nonbanks. **A federal banking regulator must have adequate authority to license and supervise non-bank stablecoin issuers, and the proposed state-based model is insufficient.**

- a. Stablecoin issuance is, in effect, a monetary exercise comparable to what banks do, and it should be regulated accordingly. Adequate authority should include discretion of whether or not to approve applications, regular examinations, oversight of parent/holding company, prompt corrective action, and insolvency/receivership administration. Robust supervision should include requirements for consumer protections, data privacy, data security, governance, audits, reserves, redemption, vendor management/third-party risk, capital, liquidity, and BSA/AML/CFT programs. These regulatory principles are already part of the established banking regulatory framework. Creating a separate, parallel system is inefficient and risks creating unintended loopholes or omissions. Indeed, the draft bill does not appear to adequately address many of these critical components for licensed nonbank entities or for state qualified payment stablecoin issuers.
- b. In particular, while the bill requires joint rulemaking by the Federal payment stablecoin regulators for critical aspects of the regulatory framework, additional subsections of the bill should be subject to joint rulemaking, and 180 days may be insufficient for development of a robust rule. A coordinated approach by federal banking regulators is critical to ensure a level playing field. Section 102 (d) (1) indicates joint rulemaking pursuant to paragraph (3 - tailoring), (5 - redemptions), or (7 – mergers & acquisitions) or subparagraph (A – capital requirements), (B – liquidity requirements), or (C – risk management requirements) of paragraph (10). These references appear to exclude rulemaking related to supervision, which would include the provision of reports and examination schedules; reserve requirements, including rules around disclosure; and risk management for contracted services, which address third party risk management. If licensed nonbank entities are to issue payment stablecoins, Federal payment stablecoin regulators must have rulemaking authority over these critical aspects of supervision.
- c. While paragraph D on Regulation of Payment Stablecoin Issuers attempts to capture a wide range of supervisory topics, we note a few omissions relative to bank regulation that are applicable to payment stablecoin issuance.
 - i. There is no requirement for public disclosure of periodic financial disclosure or third-party audits of those disclosures for payment stablecoin issuers, reporting akin to bank call reports.
 - ii. While the bill provides that the Board can supervise or examine a licensed nonbank entity (including a registered state qualified payment stablecoin issuer) and each subsidiary thereof. This authority should extend to the parent or holding company.
 - iii. The bill subjects “contracted parties” to regulation and supervision by Federal payment stablecoin regulator with enforcement as if such person

were a licensed nonbank entity. The legislation should further place third party risk management requirements, such as due diligence and ongoing risk monitoring, on the payment stablecoin issuer, in the same way as banks have third party risk management requirements for their vendor relationships.

- iv. It is not clear if payment stablecoin issuers, including licensed nonbank entities and registered state qualified payment stablecoin issuers, will be subject to supervision by the Consumer Financial Protection Bureau.
 - v. The bill does not include provisions for Federal payment stablecoin regulators to compel prompt correct action or processes related to insolvency and receivership of a payment stablecoin issuer.
- d. The concept of a state path to stablecoin issuance creates a regulatory arbitrage opportunity for nonbank entities to shop for the best regulatory regime by state. While the bill applies a framework for federal supervision to registered state qualified payment stablecoin issuers, there are no operational or safety and soundness guidelines that state payment stablecoin regulators must follow in order to qualify nonbank entities.
- e. Further, the Federal Reserve does not appear to have discretion to reject these qualified state payment stablecoin issuers from becoming registered with introduces an unacceptable level of risk to the financial system. In addition to the lack of Federal Reserve discretion, we note there is no public comment period as part of the registration process for a state qualified payment stablecoin issuer. We note the importance of the Federal Reserve exercising authority over the state chartered or licensed entities seeking to operate in the stablecoin and digital asset space as the Fed recently identified a lack of risk management and controls in denying Custodia Bank's application to become a member of the Federal Reserve.⁶ Under this bill, the Fed would have had no such discretion.
- f. The bill indicates the Fed should rely on existing materials to the extent possible in supervising licensed nonbank entities. In particular, the Fed should rely on state examinations/reports or examinations/reports from other federal regulators. The reliance on other documents limits the ability of the Fed to conduct equivalent oversight to that of banks.
- g. In addition, the bill does not appear to apply the Bank Secrecy Act to state qualified payment stablecoin issuers. Section 103 (d) (2) indicates State qualified payment stablecoin issuer shall be considered a licensed nonbank entity for purposes of subsections (d – Regulation of Payment Stablecoin Issuers) and (g - Treatment Under the Bank Holding Company Act of 1956 and Similar Provisions) of section 102. The BSA requirements are included in Section 102 (f).
2. The bill creates a category of nonbank entities eligible for Federal Reserve master accounts. The entities proposed to be eligible would not have a bank charter and therefore not be subject to the robust oversight provided for in a bank charter that helps ensure the ongoing safety and stability of the payment system. **Entities without a banking charter and federal regulator must be ineligible for master accounts at the Federal Reserve.**

⁶ <https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf>

Further, once licensed nonbank entities are granted access to Federal Reserve master accounts, the bill appears to allow those entities to back a stablecoin exclusively using central bank reserve deposits.

- a. In effect, this provision risks creating an investment fund of risk-free assets, potentially depleting investments in other assets, such as short-term corporate debt, US Treasuries, and bank deposits, which contribute to funding the economy.
- b. This particular risk may be mitigated by requiring that assets backing stablecoin cannot include central bank reserve deposits, and by making Fed credit available only with proper collateral on an over-collateralized basis, aligned with the restrictions generally applicable to provision of Fed credit today.

Areas Requiring Further Work

1. The bill lists several high-level factors that should be used to evaluate applications to be a payment stablecoin issuer, but these should be more specific. Factors for evaluating an application should include risk and compliance management and BSA/AML plans and experience. These concepts may be intended to be part the “financial resources, managerial or technical expertise, and governance” factor, but they should be called out more specifically.
2. While the bill prohibits a non-financial commercial company from controlling the licensed nonbank entity, non-financial commercial company is not defined and does not align with the limitations in the Bank Holding Company Act.
3. The bill articulates clear requirements for payment stablecoin reserves, including a prohibition on rehypothecation. However, reserve disclosure requires attestation, rather than third party audit and there is no provision for public disclosure of the payment stablecoin issuer’s balance sheet. Further, the bill is silent on the permissibility for stablecoin to generate yield or earn interest.
4. The timelines provided in the bill for the Federal Reserve to render decisions on nonbank applications is short and approval is automatically triggered beyond 90 days. Given these are new and complex financial products, additional time may be needed to properly assess applications.

Additional Observations

1. The draft bill requires IDI participation in the stablecoin ecosystem in several ways, e.g., custody and holding reserves, all of which are challenged given current federal banking regulator and SEC guidance. For banks to engage productively in this market, which will help ensure consumer protection and financial stability, banks need clarity around the legal permissibility to perform activities like custody and holding reserves or other deposits for stablecoin issuers. Further, the SEC’s Staff Accounting Bulletin 121 limits the likelihood of banks to offer custody of digital assets, given the disadvantageous accounting treatment.

2. Section 102 (d) (5) covers the payment stablecoin issuers obligation related to redemptions. This provision would apply to the payment stablecoin issuer, and it is unclear what the role of the issuer versus an exchange would be for redemptions. For consumers, who are more likely to buy and redeem stablecoin on a third-party exchange, what rules are applied to those entities?
3. Similarly, it's not clear that a payment stablecoin issuer would have a contractual relationship with all relevant third parties that require risk management, such as exchanges (where stablecoins are likely to be redeemed by most consumers) and custodians.
4. The definition of digital asset is broad, which risks assuming all digital assets share the same risk characteristics. 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 more effectively target the unique risks that each present. For example, the volatility and related risks often cited in connection with “digital assets” or “crypto assets” refers to risks presented by non-bank issued cryptocurrencies and stablecoins (e.g., bitcoin and Tether), which operate on wholly different infrastructures and mechanisms of operation but are comparatively different when using a distributed ledger network for use-cases other than cryptocurrencies. 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 crypto-asset service providers and non-bank issued cryptocurrencies or related activities because banks appropriately manage their risks and are subject to a comprehensive regulatory framework and consolidated supervision, audits and examinations.
5. Title II on the so-called Digital Dollar included in the September 2022 draft is unrelated and should be removed. Further, any review of a CBDC should be specific to the model (e.g., retail, intermediated, or wholesale) under which it will be offered.
6. Finally, we would like to refer the committee to the strong work taking place in the international community to develop standards and regulation around digital asset activity. On October 11, 2022, the Financial Stability Board issued a framework for the international regulation of crypto-asset activities (Framework).⁷ The Framework covers the recommendations issued in two FSB consultative reports: (1) Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets (CA Recommendations);⁸ and (2) Review of the FSB High-level Recommendations of the Regulation, Supervision and

⁷ Financial Stability Board, International Regulation of Crypto-asset Activities, A proposed framework – questions for consultation (October 11, 2022), (“Framework”), <https://www.fsb.org/2022/10/international-regulation-of-crypto-asset-activities-a-proposed-framework-questions-for-consultation/>

⁸ Financial Stability Board, Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets (October 11, 2022), (“CA Recommendations”), <https://www.fsb.org/2022/10/regulation-supervision-and-oversight-of-crypto-asset-activities-and-markets-consultative-report/>

Oversight of “Global Stablecoin” Arrangements (GSC Recommendations).⁹ ABA is supportive of these recommendations overall. In our view, they provide a useful, principles-based approach to guide the international community in applying existing market and prudential regulation to a novel category of financial activity, and in filling gaps by developing new standards and guidance, as Recommendations). ABA is supportive of these recommendations overall. In our view, they provide a useful, principles-based approach to guide the international community in applying existing market and prudential regulation to a novel category of financial activity, and in filling gaps by developing new standards and guidance, as necessary.

Stablecoin issuers behave in many instances like a bank in that they facilitate payments, connect to investment platforms, and store value. This drives the need to supervise these entities in the same manner as highly regulated financial institutions of similar scale. The United States has 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 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.

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. This includes stablecoins. Banks are actively evaluating ways to compete safely and responsibly in the digital asset market, and we urge Congress to apply those same standards to non-bank participants. We look forward to working with all stakeholders to ensure that outcome.

⁹ Financial Stability Board, Review of the FSB High-level Recommendations of the Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements (October 11, 2022), (“GSC Recommendations”) <https://www.fsb.org/2022/10/review-of-the-fsb-high-level-recommendations-of-the-regulation-supervision-and-oversight-of-global-stablecoin-arrangements-consultative-report/>