



FedFin Client Report

Monday, December 28, 2020

PWG Takes Tough Stand for Sweeping Stablecoin Structure, Holder, Stability Protections

Client Report: CRYPTO16

Executive Summary

Late Wednesday, the President's Working Group on Financial Markets (PWG) issued yet another unprecedented U.S. policy statement, following one on MMF reform ([see Client Report MMF16](#)) just the day before with a [statement](#) from Treasury, the FRB, SEC, and CFTC on U.S. stablecoin policy. As with the MMF paper, this statement establishes policy cleared with Janet Yellen and sure to guide the U.S. well into 2021 while the global framework most [recently laid out](#) by G7 finance ministers and central bankers advances. Reflecting the FSB's [final](#) stablecoin policy ([see FSM Report CRYPTO14](#)), the PWG for the first time expressly commits the U.S. to the FSB's "like-kind function, like-kind rule" construct deployed for global stablecoins such as Diem (once Libra). However, the PWG goes on to adopt this framework for any stablecoin with a U.S. "nexus." As detailed in this report, the PWG's construct is in fact more prescriptive for stablecoin providers than for like-kind providers of retail payment services denominated in fiat currency. Reflecting a significant Fed concern, the PWG also lays out restrictions for any stablecoin not fully convertible into U.S. dollars or with values set by currency baskets. The U.S. also preliminarily takes a stand in favor of subsidiarization or other steps to ensure that any provider of stablecoins in the U.S. is directly accountable under U.S. law and rule.

However, many of the PWG's most prescriptive standards are aimed at larger stablecoin providers, making it unclear if small offering such as those facilitated by recent OCC chartering decisions would be considered acceptable. We expect this not to be the case for the Biden Administration, which is likely to adopt an approach still more demanding than the PWG. Congressional Democrats are likely also to pursue still more sweeping demands such as [mandatory bank charters](#) for stablecoin providers.

Analysis

Described as an "initial" statement, the PWG policy applies to the digital assets in stablecoins and stablecoin "arrangements" (e.g., infrastructure, custody, trading platforms, governance) that involve the U.S. in any way, generally focusing on retail payments. As with most statements on stablecoin, the PWG readily acknowledges that stablecoins may significantly improve efficiency,

Federal Financial Analytics, Inc.
2101 L Street, NW – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com

competition, and inclusion. That said, the statement focuses on an array of risks that it concludes requires effective mitigation prior to stablecoin issuance in any significant fashion. U.S. policy now stipulates that:

- Stablecoin arrangements must comply with applicable U.S. law and rule as well as relevant supervisory requirements.
- Legal constraints are especially important for AML, CFT, and sanctions obligations before launch. Providers must also be able to verify the identity of all transaction parties, including those using unhosted wallets. This provision expands on an urgent [FinCEN proposal](#) addressing only certain types of virtual-currency transactions.
- Stablecoins may be securities, commodities, or derivatives, with this aspect of the policy reinforcing a precedent-setting case recently [filed by the SEC against a cryptocurrency provider](#). Facts and circumstances determine applicable classification, with holder rights the key criterion for determining applicable law.
- A stablecoin adopted on a significant retail payment-system scale requires additional safeguards. Providers are encouraged to align with key principles detailed in the statement such as design features that reduce systemic risk, with particular attention to safeguarding reserve assets. The statement details how this is to be done (e.g., a 1:1 reserve ratio comprised of dollar-denominated, high-quality assets along with additional loss-absorbing buffers). This is significantly more demanding than the reserve framework established in a recent OCC order ([see FSM Report CRYPTO15](#)). Stablecoin arrangements should also have enforceable direct claims by holders against the issuers or reserve assets that significantly reduce risk to holders (e.g., reserves should be bankruptcy-remote). Applicable disclosures to holders are also detailed; these would cover matters such as ultimate accountability, conflicts of interest, and clear error-resolution, consumer protection, and data safeguards.
- Stablecoin providers must also ensure operational resilience, cyber-security protections, and data safeguards. Business-continuity management is also required, as are data-management systems also detailed by the PWG.
- Additional limits may be needed for stablecoins that are not equivalent to dollars in terms of conversion and valuation. These limitations are not detailed.
- Stablecoin providers in the U.S. may be required to established U.S.-domiciled entities, rely on U.S.-regulated entities as intermediaries, and come under additional, unstated restrictions.