



Financial Services Management

Federal Stablecoin Standards

Cite

Discussion Draft, Stablecoin Transparency of Reserves and Uniform Safe Transactions (TRUST) Act

Recommended Distribution:
Policy, Legal, Government Relations

Websites:

https://www.banking.senate.gov/imo/media/doc/the_stablecoin_trust_act.pdf

Impact Assessment

- Light-touch federal standards would apply to fully reserved, licensed payment-stablecoin issuers. Other forms of stablecoins and virtual currency would not fall under any rules.
- Required reserves need not also be sterile.
- Banks could house their payment-stablecoin operations in similar entities or offer these coins without like-kind reserve requirements under banking regulation.
- Nonbank licensed issuers would gain payment-system access without Fed discretion even though OCC standards governing these companies are circumscribed in numerous ways.

Overview

Sharp disruptions in cryptoasset markets, and especially those for stablecoins, have energized calls for rapid U.S. statutory and regulatory action along lines initially laid out by the President's Working Group on Financial Markets (PWG).¹ The most comprehensive stablecoin legislative proposal so far is the Stablecoin TRUST Act, a discussion draft released by Senate Banking Ranking Member Toomey (R-PA). Setting the parameters for what Republicans support and thus what might pass the Senate, the draft differs in many ways from the PWG's approach. It would allow nonbanks to offer stablecoins as mediums of exchange under OCC licenses as long as the entity holds dollar-for-dollar high quality reserves against outstanding coins and discloses both these assets and the results of quarterly reviews by an independent accountant. The prudential rules governing these nonbank issuers would be considerably less onerous than those governing insured depository institutions, which could choose to house their payment stablecoins in a separate unit under these light-touch rules or in the bank under applicable banking standards and without reserve requirements specific to stablecoin balances. Beyond disclosure, no consumer-protection

¹ See *Client Report CRYPTO21*, November 2, 2021.

standards would apply to nonbank issuers or stablecoin operations housed in IDI affiliates and there would be nothing akin to the CRA.

Impact

Sen. Toomey's approach clearly heeds PWG warnings about the risk of payment instruments outside the regulatory perimeter, but the boundaries he builds for these instruments are considerably less daunting than would be applied if, as the PWG recommended, only IDIs could offer stablecoins and the raft of banking rules thus governed these offerings. Further, the draft bill applies only to stablecoins used as a medium of exchange, allowing many other forms of stablecoins – including the algorithmic ones that recently experienced extreme stress – to continue outside the reach of federal standards. Some aspects of these other virtual currencies might fall under the SEC if their activities triggered the Commission's enforcement policy related to investments, but the Commission's approach governs only investor protection, not prudential standards. Crypto-currency exchanges would also remain outside the reach of federal regulation unless the FSOC designates these firms and/or their activities or practices to be systemic, as the PWG explored and some in Congress recommend.

The Toomey measure appears to intend parity between nonbank and IDI payment stablecoin operations by allowing IDIs to create segregated entities that could operate with the minimal capital and prudential standards mandated for nonbanks. However, consolidated regulation would sharply limit the benefits of these special-purpose entities for most IDIs, making the key competitive question the extent to which 100 percent reserve requirements are like-kind buffers against risk in terms not only of resilience, but also issuer cost even after bank rules are considered. It seems likely that IDIs would continue to operate at a disadvantage to nonbanks since the draft bill does not require much capital against these reserves or that they be "sterile" (i.e., not rehypothecated for additional profit).

As noted, the measure includes no consumer or community requirements. It does, however, permit the payment-system access now limited to banks without many of the regulatory requirements that bolster the franchise-value benefits of payment-system access. The bill also omits CRA standards designed to reflect both this benefit and that related to discount-window access.

What's Next

The discussion draft was released on May 3. A somewhat-similar draft from Rep. Josh Gottheimer (D-NJ) is also circulating in the House.

It seems likely that this bill will need considerable change before Senate Banking Chairman Brown (D-OH) supports it, but other Democrats have pressed for a similarly light-touch approach to stablecoin standards. If the draft bill advances past committee and towards legislative action, it sets the parameters for initiatives regulators may pursue in expectation that – while their actions press the boundaries of current law – they are not so controversial as to be overturned on Capitol Hill.

Analysis

A. Definitions

Those key in the discussion draft are:

- a "payment stablecoin" would be a convertible virtual currency designed to be "widely used" as a medium of exchange issued by a centralized entity that does not "inherently" pay interest that is recorded on public DLT. As noted, many stablecoins would not come under this bill's sanctions and the language might also permit exemptions even for some payment-focused coins.
- a national limited payment stablecoin issuer would be an entity (including national and state trust banks) licensed and regulated as provided in the draft bill that issues payment stablecoins.

B. Framework

Payment stablecoins would be unlawful except for issuers that are:

- a money transmitting business authorized by a state to issue payment stablecoins;
- a national limited payment stablecoin issuer; or
- an IDI.

C. Issuance Disclosures

Issuers would need publicly to disclose the assets backing the stablecoin on a monthly basis as well as redemption policies (i.e., on demand or with a period) and quarterly attestations from a registered accountancy. These disclosures would then be submitted to Treasury which could establish a template by regulation and post one-page summaries.

D. National Issuers

These entities would be governed as follows:

These issuers would need to operate via application to the OCC for this license, with licenses authorizing both payment-related stablecoins and incidental activities (e.g., market-making). No other activities would be allowed. The OCC is given only limited discretion to reject these applications and the rules governing them would be limited to capital requirements of greater than six months of operating expenses and certain liquidity and risk-management standards. The OCC appears to have the authority to limit a licensed issuer from issuing payment stablecoins if its condition is of concern, but the discussion draft does not appear to provide for license revocation.

Licensed issuers would have to be granted payment-system access by Reserve Banks without any supervision by the Fed or, apparently, ability to terminate payment-system access if concerned with the issuer's financial condition.

As noted, the reserve assets backing these issuers' stablecoins with cash and cash-equivalent assets or dollar-denominated assets are eligible as high-quality liquid assets with a market value equal to at least 100 percent of the stablecoin's outstanding par value.

E. IDI Activities

Banks could establish a separate legal entity (including a trust bank) that would then come under the rules for national issuers that are not also IDIs for stablecoin purposes, subject to any additional rules and examination by their federal regulator that could adjust only for concerns at the stablecoin level by top-down or inter-affiliate restrictions.

F. Framework

Although payment stablecoins as defined in this discussion draft prohibit the payment of interest and thus could likely not be seen as investments, the draft bill would preemptively prevent that by an express exemption.

G. Framework

Treasury could not collect personal information about convertible virtual-currency transactions unless the information is covered by a judicial search warrant or voluntarily provided by a transaction customer and "legitimately" held by a financial institution or similar third party.