Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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At the height of what proved his fleeting power, the founder of a now-evaporated stablecoin said, "I never debate the poor." And, perhaps he doesn't have to – his was not among tall the fiat-currency wallets emptied in the course of this high-flying venture. Those were mostly in the virtual pockets of young and often minority households. Regardless, this statement is stark evidence of the difference between the social-welfare obligations demanded of banks and the get-it-while-you-can ethos embodied by this entrepreneur, Elon Musk, and all their acolytes. We demand much of banks because they take other people's money. The same obligations should bind stablecoins because they also take other people's money and thus need to be governed not just for safety and soundness, but also for equality and equity.

It might be argued that a community-service rationale isn't warranted for crypto-currency because stablecoin issuers are not intermediaries – indeed, this was a defense against new rules laid out at a recent hearing and it's the rationale behind the Toomey draft bill to craft a federal stablecoin construct, which eschews most prudential and any community obligations for nonbank stablecoin issuers.

Leaving aside the competitive inequity of a two-tier regulatory framework for the same business, there are three compelling public-welfare arguments for subjecting stablecoins and many other virtual currencies to critical components of bank regulation even if they don't emulate every aspect of a full-service bank.

First, taking money from other people and promising that they can get it back is deposit-taking even if the promise isn't accompanied by a promise also to pay interest on the funds taken in hand or to make loans. As the FDIC made clear last week, consumers no longer understand the difference between deposits with FDIC insurance and funds put at limitless risk. How could should they? In 2008, the FDIC was so spooked by risk across the financial system that it extended the mantle of a full-faith-and-credit guarantee to any obligation of any financial company. Bailout after bailout has also benefited nonbanks. There is thus an implicit guarantee behind the business of taking deposits and, like that behind the GSEs, the government should require companies that enjoy it to pay for it before taxpayers are again forced to pick up the tab.

The second reason to extend safety-and-soundness regulation to virtual currency is that a majority of Americans can't afford to lose even a very small amount of money. Financial decisions are inherently asymmetric – products are complicated, disclosures – where there are any – are opaque, and agreements are inscrutable. The purpose of regulation is to protect consumers from harm they cannot avoid when the harm is material to their safety or well-being. Thus, it's appropriate to regulate any financial product purporting to be a medium of exchange or storehouse of value in a manner akin to traditional deposits because consumers could lose a lot through absolutely no fault of their own beyond thinking that anything advertised on the Super Bowl must be legit. Rewrite

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any rule that's unduly burdensome for deposit-taking, but don't just waive them all when something new comes along.

And, finally, there's the question of moral obligation. We talk a lot about moral hazard and there's certainly a lot of that around and about stablecoins – see above. But, while central-bank and FDIC bailouts inculcated moral hazard, banking law and rule have long been predicated on what I would call moral obligation – that is, if you take from those who have little and do well thereby, you owe those from whom you take the best you can do to use their funds for the public good.

The law makes banks do this via the Community Reinvestment Act, and banks have come to understand that – dispute regulatory details as they do, the moral obligation of the CRA is an unbreakable duty. The same should be true for anyone else who takes funds from communities so that finance is a force of wealth not just for financiers, but also for the real economy on which the soundness of finance ultimately depends.