Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: February 14, 2022

Like all of you, we at FedFin spend a lot of time watching the U.S. Congress, but I'm increasingly wondering why. Sure, there's the blood and guts. Watching Congressional deliberations is more and more like being a spectator at a hockey game for the fights or NASCAR races for the next fiery crash. Does any of this carnage really matter? Not much when it comes to vital, urgent financial policy questions such as what money has come to be in the United States. With Congress mired in a never-ending cock fight, regulators hold the fate of finance mostly in their own fierce grip. Even without deployment of the Fed's nuclear CBDC option, two developments last week show clearly how much power regulators have to redefine U.S. digital currency.

First, there was outgoing FDIC Chair McWilliams' offhand suggestion in her final remarks that stablecoins have all the characteristics of fiat currency deposits and thus could be eligible for FDIC insurance under current law. As soon as he took the helm, Acting FDIC Chairman Gruenberg demanded tough cryptocurrency regulation, but he didn't rule out deposit status for at least some stablecoins if the agency was satisfied with their stability.

The impact of an FDIC decision deeming at least some stablecoins to be deposits is hard to over-estimate. As I detail in my book, what's actually in a bank deposit isn't what most people think they hold, i.e., a virtual pile of dollars. In fact, money in the bank is just that: "bank money." As Fed lawyers recently reaffirmed, bank money is a liability of the bank and thus only as good as the bank or, if it's backed by the FDIC, the full faith and credit of the U.S. Government.

Because there's never been anything else but dollars by which to value bank money, there's never been any question about whether this bank liability is due and payable in a sound currency sure to prove a lasting medium of exchange and storehouse of value. Now, this is an urgent and unanswered question, opening up a world of possibilities regarding financial instruments and the issuers thereof. For just one example, would the FDIC grant deposit status to stablecoins a class or to all depositories or to some of one or both based on what it likes best?

Second, we learned just how arbitrary these decisions can be when Senate Banking probed the question of one stablecoin's access to the payment system via a little-noticed decision by the Federal Reserve Bank of Kansas City. I take no position on whether Sarah Bloom Raskin erred in calling the company's wishes to the Reserve Bank's attention; what matters is that one company got something no one else yet has. Seemingly unaware of it, Chairman Powell in fact told a Wyoming senator how huge a decision this would be and why he's thus reluctant to make it.

Adding still more uncertainty to this critical strategic question, the Fed has actually issued a proposal to redefine who gets payment-system access. It contemplates allowing non-depositories entrée to vital financial-system infrastructure, but only when and if the Fed thinks the applicant is worthy. As we noted in our analysis, whether this would require full-scope adherence to the entire body of bank safety-and-soundness, consumer-protection, and activity restraints would apparently be left to those on high.

Thus, the power of the banking agencies under current law as they read it can, and we think will, define which digital currencies have market power and thus how well the fundamental engine of financial intermediation will function over the years to come. Congress may step in at some point to codify all these decisions or, worse, just talk on unless or until something goes very wrong. The history of U.S. financial standards has long been that regulators decide, Congress deliberates, and then statutory change comes too late to avert sometimes systemic-scale harm.

Still, we can't help ourselves. We'll thus analyze the Senate Banking stablecoin hearing this Tuesday just as we assessed HFSC session with Under-Secretary Liang. After all, one never knows what Congress asks of the regulators even if it can't decide what to do on its own.