



# *FedFin Client Report*

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Wednesday, April 19, 2023

## **Stablecoin Legislation Faces Long Odds**

Client Report: CRYPTO42

### **Executive Summary**

As we [anticipated](#), the HFSC Digital Asset Subcommittee hearing today on federal stablecoin legislation did not entertain bipartisan expressions of support for the draft noticed with the hearing [announcement](#). Indeed, both Subcommittee Chairman Hill (R-AR) and full committee Ranking Member Waters (D-CA) outlined numerous and often conflicting concerns likely to slow redrafting of a measure Chairman McHenry (R-NC) hopes will remain bipartisan in order to enhance the already-challenging odds of enactment in this Congress. As this report details, significant outstanding issues include the extent to which nonbank stablecoin issuers operate outside the full range of bank-like rules, the risks this presents, how best to address inclusion, and whether there should be federal preemption. In the course of the hearing, New York State Department of Financial Services Superintendent Harris countered assertions that Signature Bank was closed only because it was flush with crypto deposits and regulators don't like crypto deposits. These funds were said to be part of a larger run that forced closure.

### **Analysis**

#### ***Opening Statements***

Subcommittee Chairman Hill assured Democrats that the Republican-led bill before the subcommittee was by no means a “be-all end-all,” calling the posted legislation an “infant” and noting his and full Committee Chairman McHenry’s willingness to work across the aisle. He did, though, say that the draft legislation mitigates run risks, requires redemption requirements and monthly attestations, and implements risk management standards.

Subcommittee Ranking Member Lynch (D-MA) expressed deep skepticism over whether stablecoins are needed at all, arguing that Congress should consider advancing public-sector options such as FedNow and CBDC. He called the legislation before the committee “outdated” on grounds that it allows issuers access to master accounts and the discount window and does not address asset segregation and conflicts of interests between issuers and exchanges. He also took great issue with allowing nonbank entities to issue bank-like products without federal deposit insurance.

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Chairman McHenry emphasized the bipartisan efforts behind work on the bill in the last Congress and urged Congress to act quickly to implement stablecoin legislation. Ranking Member Waters acknowledged bipartisanship in the last Congress but said that events since then render the bill obsolete.

## **Testimony**

Adrienne Harris laid out New York's stablecoin framework and argued for a dual regulatory system comparable to the framework for banking. Austin Campbell of Columbia Business School echoed Ms. Harris's arguments, calling the current regulatory regime unworkable and warning that persistently unclear rules will push digital asset companies offshore. Jake Chervinsky of the Blockchain Association called on Congress to pass stablecoin legislation and raised concerns that failing to do so risks foreign dominance – particularly from China – as well as undermining the global status of the dollar. Dante Disparte, CSO of Circle, defended the stablecoin industry and his company's compliance track record. Delicia Reynolds Hand, Director of Financial Fairness at Consumer Reports, called for comprehensive regulation while sharply criticizing limitations the draft bill.

## **Q&A**

- **Federal Preemption:** Chairman Hill and Rep. Flood (R-NE) asked Ms. Harris what role state regulators should play; Ms. Harris reiterated that the dual regulatory framework could be applied to stablecoins. Rep. Torres (D-NY) said he would not support any federal stablecoin legislation that preempts New York, arguing that dual regulation should exist for stablecoins both on paper and in practice. Ranking Member Waters submitted for the record a question to Ms. Hand for her views on state stablecoin regulation and whether the Fed should pre-approve payment stablecoins.
- **Payment-System Access:** Rep. Flood emphasized the importance of leaving the pathway for becoming a stablecoin issuer open for new entrants, asking Mr. Disparte if he believes the path for nonbanks in the draft legislation achieves this goal; Mr. Disparte only said that this was a critical issue. Rep. Flood then asked how Congress should weigh giving nonbank entities access to the federal payments system; Mr. Disparte said the US is an international outlier, asserting also that FedNow will not work without nonbanks. Rep. Flood raised concern over whether nonbank payment system access would pose financial stability risks.
- **Like-Kind Regulation:** Ranking Member Lynch asked Ms. Hand to elaborate on the risks that arise from enabling bank-like activity from stablecoins without corresponding regulation; Ms. Hand advocated like-kind regulation and substantive consumer protections. Rep. Torres said stablecoin issuers operate differently than banks and should be regulated differently; Mr. Chervinsky agreed and said tailored regulation is possible.

- **Deposit Runs:** Ranking Member Waters asked Ms. Harris about how SBNY's failure related to crypto sector turmoil; Ms. Harris noted that the bank's depositor base was varied and that the bank run that shuttered it was not the product of crypto outflows.
- **Reserve Assets:** Rep. Lucas (R-OK) asked Mr. Campbell to elaborate on what kinds of underlying assets could back payment stablecoins; Mr. Campbell vouched fiat-backed assets but called crypto-backed and algorithmically backed method experimental. Ranking Member Waters asked Ms. Harris for her views; Ms. Harris defended her state's framework, noting robust capital requirements preventing any New York licensed entities from going bankrupt. Rep. Torres asked if stablecoin issuers should be fully reserved and if the reserves should consist fully of cash and cash equivalents; Ms. Harris said she did. He also asked her if stablecoin reserves should be verified both by self-attestations and by third party audits; Ms. Harris agreed. Rep. Davison asked Mr. Chervinsky if it is necessary for stablecoins to retain attributes of cash or have intermediate third parties facilitating transactions; Mr. Chervinsky argued that reproducing the benefits of cash in the digital space is crucial.
- **Dollar Dominance:** Reps. Hill, Timmons (R-SC), Houchin (R-IN), and Nickel (D-NC) raised concern over whether US dollar dominance would suffer if Congress does not enact stablecoin legislation, with Rep. Timmons asking Mr. Disparte if he believes a lack of regulatory clarity explains the exodus to foreign stablecoins; Mr. Disparte said the void of digital currency regulation in the US is in part fueling a race to the bottom, while Mr. Chervinsky said that the US could not ensure foreign stablecoins follow US principles and that failing to enact legislation would negatively impact US dollar dominance. Rep. Houchin asked Mr. Disparte and Mr. Campbell how the EU's regulatory regime works, noting concern that stablecoin issuers are leaving the US; Mr. Disparte noted that the EU's framework has numerous comparable aspects, such as segregation of funds and certain disclosure requirements.
- **Jurisdictional Conflict:** Chairman Hill took issue with the jurisdictional conflict between the SEC and CFTC. Mr. Disparte called this a "regulatory game of thrones." Chairman Hill asked Mr. Campbell if non-interest bearing stablecoins should be considered securities; he said no. Rep. Torres asked Ms. Harris if a separate crypto regulatory framework undercuts securities regulation; she said that it does not.
- **AML/KYC:** Rep. Sherman (D-CA) lambasted the crypto industry for its lack of AML and KYC requirements, asking about what would stop a race to the bottom; Ms. Hand stated that nothing in the legislation currently prevents this.
- **Asset Segregation:** Ranking Member Lynch asked Ms. Hand to explain how the draft legislation fails to address key stablecoin risks; Ms. Hand said a bill needs to provide limitations on comingling, self-dealing, and conflicts of interest.
- **Moral Hazard:** Rep. Casten (D-IL) argued that the legislation should give the Fed more discretion to reject non-bank stablecoin issuer applications, taking specific issue with Sec.

103 of the draft on grounds that it would create moral hazard by giving the Fed an obligation to backstop stablecoins.

- **Financial Inclusion:** Rep. Timmons mentioned that financial inclusion is currently included in the draft legislation and asked if it is important enough to be statutorily required; Mr. Campbell said safety and soundness as well as transparency are the most critical statutory considerations. Noting high fees in the traditional financial system, Rep. Torres asked if stablecoins can create a faster and better payment system; Mr. Chervinsky and Campbell agreed.