Statement for the Record

On Behalf of the

American Bankers Association

before the

Subcommittee on Digital Assets, Financial Technology and Inclusion

Of the

House Financial Services Committee

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The American Bankers Association (ABA)[1] appreciates the opportunity to provide a Statement for the Record for this hearing, *Putting the 'Stable' in 'Stablecoins:' How Legislation Will Help Stablecoins Achieve Their Promise*. Stablecoin issuance is, in effect, a monetary exercise comparable to what regulated banks do, and it should be supervised accordingly to ensure financial stability and consumer protection. We appreciate the House Financial Services Committee's work to develop legislation to regulate stablecoin issuers. Two pieces of draft legislation – H.R. __, To provide for the regulation of payment stablecoins, and for other purposes (Chairman's Draft) and H.R. __, To provide requirements for payment stablecoin issuers, research on a digital dollar, and for other purposes (Ranking Member's Draft) – are attached to this hearing, and we offer comments on both in this statement.

Stablecoins, which seek to maintain a 1-to-1 peg with a reference asset often by holding reserves as collateral, are unique among digital assets in that their intended stable value positions them as a functional alternative to a traditional deposit account. As such, it is critical that the stablecoin ecosystem, like the banking ecosystem, is subject to oversight that ensures financial stability and consumer protection. Such oversight must put the "stable in stablecoin," as the title of this hearing suggests. Unfortunately, despite agreeing with several areas of the draft, we do not believe the Chairman's Draft accomplishes that goal.

Areas of Support

We were pleased to see that both the Chairman's Draft and the Ranking Member's Draft do not create a category of nonbank entities eligible for Federal Reserve master accounts. Particularly given the regulatory gaps outlined below, it is critical to the ongoing safety and stability of the payment system that nonbank payment stablecoin issuers are not granted Federal Reserve master accounts.

[1] ABA is the voice of the nation's $23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.2 trillion in deposits and extend $12.2 trillion in loans.

In the Chairman's Draft, we were pleased to see proposed language to reduce Staff Accounting Bulletin (SAB) 121's impact on banks' ability to provide custody for digital assets. We are concerned that the language, as drafted, would not impact the current application of SAB 121 given the accounting bulletin in question does not use the word "custody" and the SEC is likely to take a narrow interpretation of any legislation. One potential fix may be the following edits to Sec. 9(b)(3): "to recognize a liability for any obligations related to activities or services performed for digital assets that the entity does not own if that liability would exceed the expense recognized in the income statement as a result of the corresponding obligation."

The Chairman's Draft also appropriately leaves out reference of central bank digital currency (CBDC). The Ranking Member's Draft includes a Title II on the so-called Digital Dollar, which is unrelated to a regulatory framework for stablecoin and should be removed. Further, any review of a CBDC should be specific to the model (e.g., retail, intermediated, or wholesale) under which it will be offered.

In addition, we strongly support that the Chairman's Draft distinguishes bank tokenized deposits from payment stablecoins. Rather than representing a new financial product, bank tokenized deposits are a different technological means of evidencing and recording a deposit claim against a bank for fiat amounts on blockchain or using distributed ledger technology. Banks and bank deposits, including tokenized deposits, are already subject to comprehensive existing bank regulation that includes appropriate technology and operational risk management, as well as prudential regulation pertaining to capital and liquidity requirements.

With that said, several definitions in the Chairman's Draft's Section 2 could use refinement to ensure the intent of Section 9 is realized.

- For instance, the definition of "digital asset" could be expanded to clarify that a digital asset is defined as "any digital representation of value that is transferred and stored electronically on a cryptographically-secured distributed ledger to which distinct ownership rights to such asset may be ascribed, provided that the term 'digital asset' shall not include the use of cryptographically-secured distributed ledgers solely for record keeping."
- Likewise, the definition of "Distributed Ledger" should include language "that provides that the term 'distributed ledger' shall not include any digital ledger where all transactions or information are verified exclusively by a single person (other than a person that is a group of natural persons), or group of affiliates sharing a common parent, that operates the digital ledger."
- The definition of "Payment Stablecoin" in Section 2 could be interpreted to include digital representations of assets, such as deposits, exclusively on private and permissioned distributed ledgers that utilize cryptographic technology. This can be solved by adding a new Section E to the definition to provide that the definition "does not include a deposit (as defined under Section 3 of the Federal Deposit Insurance Act), including digital representations of a deposit in any form." Finally, subsection (c) only covers where there is an "obligation" to redeem. This can be a complicated issue because

many payment stablecoin issuers don't have a direct legal obligation to redeem stablecoins despite holders thinking they do. This risk can be mitigated by expanding the definition to cover where there is a "representation" by the issuer that there is an obligation to redeem, even if the obligation may not be legally sound.

Areas of Concern

We have serious concerns that the Chairman's Draft does not adequately contemplate nor mitigate the potential risks to financial stability and consumers from stablecoins. Among our chief concerns with the regulatory framework contemplated are the following:

1. Stablecoins' potential to damage financial stability under the proposed structure
2. Significantly limited role for a federal regulator to approve and supervise payment stablecoin issuers
3. Critical gaps in the proposed regulatory framework

Stablecoins' Potential to Damage Financial Stability Under the Proposed Structure

Legislation is likely to legitimize payment stablecoins and payment stablecoin issuers in the view of many consumers and investors. Consumer acceptance of this legitimacy could very well lead to growth in the stablecoin market, making it all the more important that financial stability and consumer protection risks are addressed as part of any regulatory framework.

In the Chairman's Draft, financial stability is not included as a factor that regulators should consider when evaluating payment stablecoin issuer applications. The Ranking Member's Draft rightly includes "stability of the financial system" as a factor to be evaluated for approving these entities. Removal of that factor is a significant oversight that risks financial stability and the health of the broader economy. Rather than disallowing regulators from considering this factor, an assessment of the impact on financial stability should be the foundation of any evaluation.

While financial stability is included as part of the purpose for examinations the primary Federal payment stablecoin regulator may make of Federal qualified nonbank payment stablecoin issuers in the Chairman's Draft, there is no equivalent reference to or consideration of financial stability with respect to state qualified payment stablecoin issuers.

Moreover, as detailed further below, the Chairman's Draft does not apply numerous regulations intended to support financial stability and consumer protections, such as public financial disclosure, parent company supervision, activities restrictions, to payment stablecoin issuers.

Significantly Limited Role for a Federal Regulator to Approve and Supervise Payment Stablecoin Issuers

The Chairman's Draft imposes critical limits on the role of a federal regulator to approve and supervise state qualified payment stablecoin issuers. A federal regulator must have adequate authority to license and supervise nonbank stablecoin issuers, and the proposed state-based model is insufficient. The state path to stablecoin issuance included in the Chairman's Draft creates a regulatory arbitrage opportunity for nonbank entities to shop for the "best" regulatory regime by state.

Under the framework included in the Chairman's Draft, state qualified payment stablecoin issuers would not have a primary federal regulator. There would be no role for a federal regulator to approve or deny state qualified payment stablecoin applications, and there would be virtually no role for a federal regulator to conduct ongoing supervision and enforcement of state qualified payments stablecoin issuers. The Chairman's Draft limits a federal regulator's ongoing supervisory authority to only situations where a state payment stablecoin regulator enters into a memorandum of understanding with the Federal Reserve for the Fed to carry out the supervision, examination, and enforcement authority. Further, the Chairman's Draft limits the Federal Reserve's enforcement authority to exigent circumstances.

Some have defended this regulatory approach with comparisons to state-chartered banks, but the proposed state path for payment stablecoin issuers is not comparable to that of state-chartered banks. In fact, state-chartered banks have a primary federal regulator, either the Federal Reserve or the FDIC, who must approve the entity's application and participate in ongoing supervision. The proposed state qualified payment stablecoin issuer is similar in its oversight model to state-based money transmitter licenses, a model that is insufficient to mitigate the risks to financial stability and consumer protection posed by stablecoins.

We were pleased to see that the Ranking Member's Draft appropriately calls for federal regulator approval authority and ongoing supervision of state licensed payment stablecoin issuers. We have some concern over the bill's call for the Fed to rely on existing materials to the fullest extent possible in supervising licensed nonbank entities, in particular state examinations/reports or examinations/reports from other federal regulators. The reliance on other documents limits the ability of the Fed to conduct equivalent oversight to that of banks.

Critical Gaps in the Proposed Regulatory Framework

Both the Chairman's Draft and the Ranking Member's Draft leave critical gaps in the regulatory framework that would apply to payment stablecoin issuers. The ABA has concerns with the following gaps that would undermine financial stability and consumer protection:

- (Chairman's Draft and Ranking Member's Draft) There is no requirement for public disclosure of periodic financial statements or third-party audits of those disclosures for payment stablecoin issuers, reporting akin to bank call reports.
- (Chairman's Draft and Ranking Member's Draft) There is no requirement for third-party audit of payment stablecoin reserves. The Ranking Member's Draft requires monthly attestation by the payment stablecoin issuer CEO as to the reserves. The Chairman's Draft

requires monthly certification of reserves by the payment stablecoin issuer CEO and CFO and an annual review of reserve reports be conducted by a registered public accounting firm.

- (Chairman's Draft) The Chairman's Draft does not limit the activities of payment stablecoin issuers. The Ranking Member's Draft includes a provision to limit payment stablecoin issuer activities to issuing, redemption, managing reserves, providing custodial or safekeeping services, and other limited functions that directly support the work of issuing and redeeming payment stablecoins, and the Ranking Member's Draft restricts transactions between affiliates of payment stablecoin issuers. We need look no further than the recent collapse of FTX, where the combination of unregulated and unsupervised activities within a single corporate structure contributed to the resulting consumer harm. In particular, the combination of custody activities with trading and exchange activities at FTX enabled a situation where customer funds were not segregated and were misused. The proper safekeeping of customer assets is foundational to the protection of the customer, and the mitigation of financial stability risk and cannot be safely undertaken if commingled with market facing activities.

- (Chairman's Draft) The Chairman's Draft does not include requirements for custody and safekeeping services, to include segregation requirements and commingling prohibitions. A comprehensive regulatory framework for the custody of stablecoins, including corporate governance controls, audit standards, capital and liquidity requirements, and disclosure requirements, is critical to ensuring financial stability, as well as appropriate consumer and investor protections.

- (Chairman's Draft) The Chairman's Draft does not appear to apply the Gramm-Leach-Bliley Act to state qualified payment stablecoin issuers, which is critical to ensure consumers' data is appropriately protected.

- (Chairman's Draft and Ranking Member's Draft) Neither bill addresses third-party risk management, which stablecoin issuers should be compelled to perform in the same way as banks have third party risk management requirements for their vendor relationships.

- (Chairman's Draft and Ranking Member's Draft) There is no extension of supervisory authority to the parent or holding company of a payment stablecoin issuer.

- (Chairman's Draft) The Chairman's Draft does not prohibit or provide limitations on a non-financial commercial company owning or controlling a payment stablecoin issuer. These restrictions are critical to protect consumers from potential self-dealing or conflicts of interest. Moreover, the Chairman's Draft does not require prior approval by federal payment stablecoin regulators for mergers and acquisitions of payment stablecoin issuers.

- (Chairman's Draft and Ranking Member's Draft) It is not clear if payment stablecoin issuers will be subject to supervision by the Consumer Financial Protection Bureau or the regulations for which it has jurisdiction.

- (Chairman's Draft and Ranking Member's Draft) There are no provisions for Federal payment stablecoin regulators to compel prompt correct action or processes related to insolvency and receivership of a payment stablecoin issuer.
- (Chairman's Draft and Ranking Member's Draft) Neither draft contemplates interest, dividends, or other forms of renumeration. Given that the legislation is intended to create a regulatory framework for a payment system based upon stablecoins, there seems no reason why stablecoins should generate interest. The legislation does not contemplate that stablecoins are the equivalent of deposit, money market funds, or other securities products. Banning interest, dividends or other forms of renumeration would be consistent with the intent of the legislation.

Conclusion

Stablecoin issuers behave in many instances like a bank in that they facilitate payments, connect to investment platforms, and store value. This drives the need to supervise these entities in the same manner as highly regulated financial institutions of similar scale. The United States has existing laws and regulations that may be applicable to activities (e.g., custody, deposit-like accounts, lending, payments) taking place in the digital asset ecosystem. Applying the principle of "same activity, same risk, same regulation" will help ensure that all customers are protected equally, regardless of where they engage with the financial marketplace and that the financial system remains strong, safe, and competitive.