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Comment Letter to the U.S. Treasury Department regarding the Risks of Stablecoins

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August 8, 2022

Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

**Re: Request for Public Comment on
“Ensuring Responsible Development of
Digital Assets,” 87 Fed. Reg. 40881 (July
8, 2022)**

Thank you for inviting the public to provide comments in response to President Biden’s Executive Order No. 14067, “Ensuring Responsible Development of Digital Assets” (Mar. 9, 2022). In response to Parts III(C) and (D) of your request for comments, this letter addresses the significant risks that digital stablecoins currently pose to U.S. financial markets and investors as well as potential future dangers that stablecoins could create for our financial system, economy and society. For the reasons set forth below, this letter contends that (1) stablecoins presently pose significant risks to U.S. financial markets and investors, (2) stablecoins will create great dangers for our financial system, economy and society if they become a widely-accepted form of payment for consumer and commercial transactions, and (3) allowing Big Tech firms and other commercial enterprises to issue and distribute stablecoins would seriously undermine our nation’s longstanding policy of separating banking and commerce.

In view of the foregoing hazards, Congress and federal agencies should designate stablecoins as deposits and require all issuers and distributors of stablecoins to be chartered as FDIC-insured banks. In addition, Congress and federal agencies should reject proposals that would (i) allow uninsured banks to issue or distribute stablecoins, or (ii) regulate stablecoin providers in the same manner as money market funds, or (iii) provide pass-through federal deposit insurance coverage to customers of nonbank stablecoin providers.

1. Stablecoins currently pose significant risks to financial markets and investors.

A stablecoin is a digital asset whose issuer states that the stablecoin will maintain parity with a designated fiat currency. Most stablecoins are either asset-based stablecoins, which maintain reserves, or algorithmic stablecoins that depend on an arbitrage-based trading relationship with another digital coin.¹ In July 2022, more than 90% of outstanding stablecoins

¹ Mitsu Adachi et al., “Stablecoins’ role in crypto and beyond: functions, risks and policy,” §1, *Macprudential Bulletin No. 18* (European Central Bank, July 11, 2022), https://www.ecb.europa.eu/pub/financial-stability/macprudential-bulletin/html/ecb.mpbu202207_2~836f682ed7.en.html; Igor Markhov & Antoinette Schoar, “Cryptocurrencies and Decentralized Finance (DeFi)” (April 24, 2022), at 20-21, <https://ssrn.com/abstract=4104550>; see also Financial Stability Board, *Assessment of Risks to Financial Stability*

were asset-backed stablecoins, and over 99% of those stablecoins stated that they would maintain parity with the U.S. dollar.²

The volume of outstanding stablecoins mushroomed from less than \$5 billion in January 2020 to about \$150 billion in November 2021.³ The rapid expansion of the stablecoin market mirrored the explosive growth in aggregate market prices for cryptocurrencies, which rose from less than \$250 billion in January 2020 to almost \$3 trillion in November 2021.⁴ Following their peak in November, total market prices for cryptocurrencies fell to \$930 billion in June 2022 before recovering to \$1.1 trillion in July.⁵ Since the beginning of 2020, price trends in cryptocurrency markets have shown a strong correlation with price movements in U.S. securities markets.⁶

The stablecoin market has followed a somewhat different pattern in recent months, due to the growing significance of stablecoins as payment instruments and collateral for transactions in cryptocurrency markets. The volume of outstanding stablecoins increased from \$150 billion in November 2021 to \$183 billion in April 2022 before declining to less than \$143 billion at the end of July.⁷ The key event that disrupted the growth of the stablecoin market was the collapse of the algorithmic stablecoin Terra (along with its paired cryptocurrency Luna) during the second week of May. Terra's demise caused the volume of outstanding algorithmic stablecoins to decline from \$34 billion to \$12 billion by the end of July.⁸ Terra's downfall also had a significant impact on Tether, the largest asset-backed stablecoin. Due to concerns about the adequacy of Tether's reserves, Tether temporarily failed to maintain parity with the U.S. dollar, and the outstanding volume of Tether stablecoins declined from \$83 billion in May to less than \$66 billion at the end of July.⁹

from *Crypto-assets* (Feb. 16, 2022) [hereinafter FSB Report on Risks of Crypto-assets], <https://www.fsb.org/wp-content/uploads/P160222.pdf>.

² *The Block*, <https://www.theblock.co/data/decentralized-finance/stablecoins> (Graphs for “Total Fiat-backed Stablecoin Supply,” “Total Crypto-backed and Algorithmic Stablecoin Supply,” and “Share of Fiat Stablecoin Supply (in USD) by Currency”) (visited on Aug. 2, 2022).

³ *Id.* (“Total Stablecoin Supply” graph).

⁴ *The Block*, <https://www.theblock.co/data/crypto-markets/prices> (“Crypto Total Marketcap” graph) (visited on Aug. 2, 2022).

⁵ *Id.*

⁶ Scott Chipolina, “Crypto prices rise as traders dip back into digital asset market,” *Financial Times* (July 30, 2022), <https://www.ft.com/content/89312290-ce33-4f94-9789-07fc7d7ab853>; Alexandra Scaggs, “Crypto confirmed casino,” *Financial Times* (July 11, 2022) (discussing reasons for the strong correlation between cryptocurrency prices and the S&P 500 index since early 2020), <https://www.ft.com/content/57e783da-16cb-4d58-af7f-23ba87499ed5>; Karen Langley et al., “U.S. Stocks Rise, Giving S&P 500 Best Month Since 2020,” *Wall Street Journal* (July 29, 2022) (reporting that the S&P 500 index rose by 9.1% during July 2022 but was still 13% below its closing value at the end of 2021), <https://www.wsj.com/articles/global-stocks-markets-dow-update-07-29-2022-11659080320>; Akane Otani, “Stock Markets Post Worst Half of a Year in Over Five Decades,” *Wall Street Journal* (July 1, 2022) (stating that the S&P 500 index fell by 21% during the first half of 2022, “suffering its worst first half of a year since 1970”), <https://www.wsj.com/articles/markets-head-toward-worst-start-to-a-year-in-decades-11656551051>

⁷ *The Block*, <https://www.theblock.co/data/decentralized-finance/stablecoins> (“Total Stablecoin Supply” graph) (visited on Aug. 2, 2022).

⁸ *Id.* (“Total Crypto-backed and Algorithmic Stablecoin Supply” graph).

⁹ *Id.* (“Total Fiat-backed Stablecoin Supply” graph); see also Vicky Ge Huang, “More Hedge Funds Are Betting Against Tether as Crypto Melts Down,” *Wall Street Journal* (June 27, 2022), <https://www.wsj.com/articles/more-hedge-funds-are-betting-against-tether-as-crypto-melts-down-11656322200>.

Stablecoins play crucial roles in digital asset markets. Stablecoins are the most widely-accepted instruments for making payments or providing collateral for trading, borrowing, and lending transactions involving digital assets. Stablecoins provide the principal link between traditional financial markets and digital asset markets because participants usually convert their fiat money into stablecoins before engaging in transactions involving digital assets.¹⁰

The stablecoin market is highly concentrated. The three largest stablecoins – Tether, USD Coin (USDC), and Binance USD Coin (BUSD) – currently account for 90% of outstanding stablecoins.¹¹ All three of the largest stablecoins are closely connected to leading cryptocurrency exchanges. BUSD, the third-largest stablecoin, is issued by Binance, the world's largest cryptocurrency exchange. Binance offers trading and lending services to holders of BUSD and other stablecoins.¹²

USDC, the second-largest stablecoin, is issued by Centre, a consortium that is jointly owned (on an equal basis) by Circle and Coinbase. Coinbase is the world's seventh-largest cryptocurrency exchange, and it offers trading and lending services to holders of USDC and other stablecoins.¹³ Tether, the largest stablecoin, is owned by a holding company that also owns Bitfinex, the world's eighth-largest cryptocurrency exchange. Bitfinex offers trading and lending services to holders of Tether and other stablecoins.¹⁴

One indication of the growing significance of stablecoins within the crypto ecosystem is that stablecoins have more than doubled their share of all cryptocurrencies (from about 5% to

¹⁰ Adachi et al., *supra* note 1, § 2; “Crypto Assets and Decentralized Finance through a Financial Stability Lens,” Remarks by Lael Brainard, Vice Chair of the Federal Reserve Board (July 8, 2022), at 8; FSB Report on Risks of Crypto-assets, *supra* note 1, at 11-14

¹¹ On July 31, 2022, there were \$65.5 billion of outstanding Tether stablecoins, \$45.6 billion of outstanding USDC stablecoins, and \$17.9 billion of outstanding BUSD stablecoins. Those three stablecoins accounted for 90.5% of the \$142.5 billion total volume of outstanding stablecoins. *The Block*, <https://www.theblock.co/data/decentralized-finance/stablecoins> (“Total Stablecoin Supply” graph) (visited Aug. 2, 2022).

¹² “Binance Blog: What Is a Stablecoin? Here’s Where and How to Buy Them” (Feb. 17, 2022), <https://www.binance.com/en/blog/fiat/what-is-a-stablecoin-heres-where-and-how-to-buy-them-421499824684903322>; CoinMarketCap, “Top Cryptocurrency Spot Exchanges” (listing the world’s largest cryptocurrency exchanges), <https://coinmarketcap.com/rankings/exchanges/> (visited on Aug. 2, 2022).

¹³ “Circle blog: Coinbase and Circle co-found the CENTRE Consortium (Oct. 23, 2018), <https://www.circle.com/blog/coinbase-and-circle-co-found-the-centre-consortium>; “Coinbase blog: Coinbase and Circle announce the launch of USDC – a Digital Dollar” (Oct. 23, 2018), <https://blog.coinbase.com/coinbase-and-circle-announce-the-launch-of-usdc-a-digital-dollar-2ed6548d237>; CoinMarketCap, *supra* note 12; *see also* Circle Acquisition Public Limited Company, Form S-4 Registration Statement (Aug. 6, 2021), at F-13, F-53 (stating that Circle and Coinbase each own 50% of Centre, the consortium that controls USDC), https://www.sec.gov/Archives/edgar/data/1876042/000110465921101498/tm2123712-1_s4.htm.

¹⁴ CoinMarketCap, *supra* note 12; Zeke Faux, “Anyone Seen Tether’s Billions?”, *Bloomberg BusinessWeek* (Oct. 7, 2021), <https://www.bloomberg.com/news/features/2021-10-07/crypto-mystery-where-s-the-69-billion-backing-the-stablecoin-tether?sref=f7rH>; Kadhim Shubber & Siddharth Venkataramakrishnan, “Tether: the former plastic surgeon behind the crypto reserve currency,” *Financial Times* (July 15, 2021), <https://www.ft.com/content/4da3060c-8e1a-439f-a1d7-a6a4688ad6ca>; *In re: Tether and Bitfinex Crypto Asset Litigation*, 19 Civ. 9236 (KPF) (S.D.N.Y. Sept. 28, 2021), 2021 WL 4452181, at *2 (describing the joint control of Tether and Bitfinex by the same holding company).

more than 12%) since January 2020.¹⁵ Another and more ominous sign of the increasing importance of stablecoins is that the Terra stablecoin’s collapse triggered a series of failures among crypto firms. In early May 2022, Terra was the largest algorithmic stablecoin and had about \$18 billion of outstanding coins. Terraform Labs, which issued Terra, offered interest rates of up to 20% to investors who loaned their Terra stablecoins to the firm. During a “run on the bank” in the second week of May, Terra’s assets evaporated along with Terra’s sister cryptocurrency, Luna, which previously had a reported value of \$20 billion.¹⁶

The demise of Terra/Luna accelerated the sharp decline in cryptocurrency prices that was already underway. The crisis at Terra/Luna also led to the collapse of Three Arrows, a large hedge fund that invested primarily in cryptocurrencies. Three Arrows held highly leveraged positions in Terra, Luna, and other speculative tokens. Three Arrows also borrowed cryptocurrencies from investors and digital platforms and used those borrowed tokens to make additional speculative bets. Three Arrows became insolvent soon after the downfall of Terra/Luna.¹⁷

Three Arrows’ insolvency had a domino effect that caused the failures of prominent trading and lending platforms for cryptocurrencies. By the end of July 2022, Voyager Digital, Celsius, and Vault had been placed in insolvency proceedings. In addition to making high-risk loans to Three Arrows and other cryptocurrency investors, the failed platforms borrowed cryptocurrencies from investors at high interest rates and made additional risky bets with the borrowed tokens.¹⁸

¹⁵ See *supra* notes 3-7 and accompanying text (describing the relative sizes of the stablecoin market and all cryptocurrency markets).

¹⁶ Christian Davies & Song Jung-a, “\$40bn crypto collapse turns South Korea against the ‘Lunatic’ leader,” *Financial Times* (May 23, 2022), <https://www.ft.com/content/c46f767c-c8e3-47cf-b0a3-46d3b84498c3>; Olga Karif, “What Happens When a Crypto Blockchain Like Terra Dies (1),” *Bloomberg Law* (May 12, 2022); Alexander Osipovich & Caitlin Ostroff, “Crash of TerraUSD Shakes Crypto: ‘There Was a Run on the Bank’,” *Wall Street Journal* (May 12, 2022), <https://www.wsj.com/articles/crash-of-terrausd-shakes-crypto-there-was-a-run-on-the-bank-11652371839>.

¹⁷ Scott Chipolina & Adam Samson, “Crypto Hedge Fund Three Arrows Files for US bankruptcy,” *Financial Times* (July 2, 2022), <https://www.ft.com/content/8e4538cc-e8c5-4cc2-9448-053074f72f67>; David Z. Morris, “Satoshi Wept: How Crypto Replayed the 2008 Financial Crisis,” *CoinDesk* (July 12, 2022), <https://www.coindesk.com/layer2/2022/07/12/satoshi-wept-how-crypto-replayed-the-2008-financial-crisis/>; Serena Ng et al., “Crypto Hedge Fund Three Arrows Ordered by Court to Liquidate,” *Wall Street Journal* (June 29, 2022), <https://www.wsj.com/articles/crypto-fund-three-arrows-ordered-to-liquidate-by-court-11656506404>; Joanna Ossinger et al., “Three Arrows Founders, En Route to Dubai, Describe ‘LTCM Moment’,” *Bloomberg Law* (July 22, 2022); Caitlin Ostroff & Vicky Ge Huang, “Crypto’s Domino Effect Is Widening, Threatening More Pain,” *Wall Street Journal* (July 2, 2022), <https://www.wsj.com/articles/cryptos-domino-effect-is-widening-threatening-more-pain-11656754202>.

¹⁸ Eliot Brown & Yifan Wang, “Crypto Broker Voyager Digital Files for Bankruptcy Protection,” *Wall Street Journal* (July 6, 2022), <https://www.wsj.com/articles/crypto-broker-voyager-digital-files-for-bankruptcy-protection-11657098630>; Alexander Gladstone et al., “Crypto Crash Drags Lender Celsius into Bankruptcy,” *Wall Street Journal* (July 13, 2020), <https://www.wsj.com/articles/crypto-crash-drags-lender-celsius-network-into-bankruptcy-11657758483>; Vicky Ge Huang, “Peter Thiel-Backed Crypto Lender Vault Files for Protection Against Creditors,” *Wall Street Journal* (July 20, 2022), <https://www.wsj.com/articles/peter-thiel-backed-crypto-lender-vault-files-for-protection-against-creditors-11658337252>; Morris, *supra* note 17; Kadhim Shubber & Joshua Oliver, “Inside Celsius: how one of crypto’s biggest lenders ground to a halt,” *Financial Times* (July 13, 2022), <https://www.ft.com/content/4fa06516-119b-4722-946b-944e38b02f45>.

The crash in crypto markets that followed Terra/Luna’s downfall inflicted painful losses on millions of retail investors. Terra, Voyager, Celsius, and other crypto firms told retail investors that they could lend out their stablecoins and other cryptocurrencies and earn interest rates up to 20%. Some crypto firms, including Celsius and Voyager, falsely represented to customers that their investments would be as safe as deposits held by banks.¹⁹

Federal agencies have not issued investor protection rules for stablecoins and other cryptocurrencies, and the absence of such rules has made ordinary investors highly vulnerable to unfair and deceptive marketing practices by crypto firms. Vulnerabilities to abusive sales practices are greatest among low- and moderate-income (LMI) investors as well as investors who are less educated or members of minority communities. Survey results indicate that minority investors are more likely to invest in cryptocurrencies than white investors, and a similar gap exists between investors from LMI households without a college degree and investors who are wealthy and highly educated.²⁰ Sellers of crypto assets have intentionally targeted LMI households and minority communities with aggressive sales pitches (often featuring celebrity endorsements) that describe crypto investments as safer, more rewarding, and more inclusive than traditional financial products. In February 2022, Crypto.com and several other crypto firms paid millions of dollars to advertise their crypto offerings during Super Bowl LVI, a game watched by more than 96 million people.²¹

¹⁹ David Benoit, “Crypto Broker Voyager’s Marketing on Safety of Customer Accounts Draws FDIC Scrutiny,” *Wall Street Journal* (July 8, 2022), <https://www.wsj.com/articles/fdic-scrutinizing-voyagers-marketing-on-safety-of-customer-deposit-accounts-11657212266>; Rachel Louise Ensign & Angel Au-Eung, “They Thought ‘Crypto Banks’ Were Safe, and Then Came the Crash,” *Wall Street Journal* (July 23, 2022), <https://www.wsj.com/articles/they-thought-crypto-banks-were-safe-and-then-came-the-crash-11658568780>; Joshua Oliver, “Crypto voices: investors speak about the market shock,” *Financial Times* (July 15, 2022), <https://www.ft.com/content/77e83f6a-57fe-465c-ae1a-f9512923fca4>; Alexander Osipovich & Caitlin Ostroff, “TerraUSD Crash Led to Vanished Savings, Shattered Dreams,” *Wall Street Journal* (May 27, 2022), <https://www.wsj.com/articles/terrausd-crash-led-to-vanished-savings-shattered-dreams-11653649201>; Shubber & Oliver, *supra* note 18; Claire Williams, “Voyager is the tip of the iceberg,” *American Banker* (July 20, 2022), available on Westlaw at 22701994.

²⁰ Paul Krugman, “How cryptocurrencies became the new subprime,” *New York Times* (Jan. 30, 2022) (“According to a survey by the research organization NORC, 44% of crypto investors are nonwhite, and 55% don’t have a college degree. This matches up with anecdotal evidence that crypto investing has become remarkably popular among minority groups and the working class.”), <https://www.nytimes.com/2022/01/27/opinion/cryptocurrency-subprime-vulnerable.html>; Rob Lenihan, “Is Crypto the New Subprime?,” *TheStreet.com* (Jan. 30, 2022) (discussing survey results showing that “[t]wo-fifths of crypto traders are not white,” and “the average cryptocurrency trader is under 40 and does not have a college degree, . . . and over one-third have household incomes under \$60,000 per year”), <https://www.thestreet.com/investing/cryptocurrency/is-crypto-the-new-subprime-crash-hits-mainstream-investors-hard>; Taylor Nicole Rogers, “Crypto collapse reverberates widely among black American investors,” *Financial Times* (July 5, 2022) (reporting that “widespread losses caused by the cryptocurrency crash are even broader among black investors”), <https://www.ft.com/content/47d338e2-3d3c-40ce-8a09-abfa25c16a7f>; *see also* Claire Williams, “Black Innovators Did Some of the Earliest Work in Cryptocurrency. What Happens Now That It’s Mainstream?,” *Morning Consult* (Dec. 9, 2021) (describing poll results showing that black adults are “more interested in participating in a variety of crypto-related activities compared to U.S. adults overall, and white adults especially,” and warning that black adults could be “overexposed to [crypto-related] risks because of high adoption rates and interest”), <https://morningconsult.com/2021/12/09/black-cryptocurrency-influencers-polling/>.

²¹ Will Gotsegen, “Ads of the ‘Crypto Bowl’,” *CoinDesk* (Feb. 11, 2022), <https://www.coindesk.com/layer2/2022/02/08/ads-of-the-crypto-bowl/>; Terry Nguyen, “The winner of this year’s Super Bowl: Money,” *Vox* (Feb. 14, 2022) (“One of the consequences of crypto’s explosive growth throughout 2021 was a parallel boom in marketing.”), <https://www.vox.com/the-goods/22925225/super-bowl-ads-money-crypto-sports-betting>; Rogers, *supra* note 20; Williams, *supra* note 20.

Super Bowl LVI became known as the “Crypto Bowl” because of the prominent ads by crypto firms urging ordinary individuals to be “bold” and invest in crypto assets. The chief marketing officer for Crypto.com declared, “Crypto genuinely is for everybody,” and he explained that his company’s Super Bowl ad would “reach everybody where they are . . . [I]t’s as mass as you get.” The crypto industry’s advertising blitz during Super Bowl LVI was a disturbing echo of a similar mass marketing of high-risk investments during Super Bowl XXXIV in 2000. That game was called the “Dot Com Bowl” because more than a dozen dotcom firms bought ads touting their speculative stocks. Several of those firms subsequently failed during the stock market’s “dotcom crash” that began in March 2000.²²

The failure of a medium-sized stablecoin – Terra – caused a serious disruption of the crypto ecosystem. In view of the close ownership connections between leading cryptocurrency exchanges and the three largest stablecoins – Tether, USDC and BUSD – the collapse of any of those stablecoins could trigger a systemic meltdown in cryptocurrency markets. The risks of a generalized panic would be even greater if any of those stablecoins failed during a serious crisis affecting traditional financial markets.²³

The risks of a systemic investor run on stablecoins are magnified by widely-shared concerns about the adequacy of stablecoin reserves. Those concerns have not been allayed by limited disclosures that stablecoin issuers provide about their reserves. In the absence of federal rules governing stablecoin reserves, issuers are free to change the composition of their reserves or modify their disclosures without prior notice. Tether’s reserves reportedly include large amounts of risky commercial paper issued by Chinese firms and other Asian companies, and Tether’s disclosures about its reserves are notoriously opaque.²⁴ In addition, Tether could suffer a substantial loss if creditors of Celsius successfully challenge Tether’s recovery of an \$840 million loan of stablecoins that Tether made to Celsius. Tether reportedly recovered that loan less than 90 days before Celsius filed for bankruptcy, and Tether’s recovery could potentially be set aside by the bankruptcy court as a voidable preference.²⁵

²² JD Alois, Crypto Bowl? Super Bowl Ads Dominated by Crypto Firms,” *Crowdfund Insider* (Feb. 14, 2022), <https://www.crowdfundinsider.com/2022/02/186963-crypto-bowl-super-bowl-ads-dominated-by-crypto-firms-coinbase-promo-staggers-app/>; Gotsegen, *supra* note 21 (quoting Stephen Kalifowitz); Nguyen, *supra* note 21; *see also* Chaim Gartenberg, “Crypto’s big Super Bowl ads sold FOMO, not the future,” *The Verge* (Feb. 14, 2022), <https://www.theverge.com/2022/2/14/22933456/crypto-super-bowl-commercials-impact-advertisements-analysis-fomo>.

²³ Adachi et al., *supra* note 1, §§ 2 & 4; FSB Report on Risks of Crypto-assets, *supra* note 1, at 1-2, 13-14, 19-20; Gary B. Gorton, Chase P. Ross & Sharon Y. Ross, “Making Money” 3-5, 23-31 (Jan. 24, 2022), <http://ssrn.com/abstract=4021072>; Makarov & Schoar, *supra* note 1, at 3-4, 37-38; *Report on Stablecoins* (President’s Working Group on Financial Markets, the Federal Deposit Insurance Corp., and the Office of the Comptroller of the Currency, Nov. 2021), at 2-3, 10-12, 15 [hereinafter PWG Report on Stablecoins], https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

²⁴ Adachi, *supra* note 1, § 4; Bryce Elder & Kadhim Shubber, “Tether’s mystery commercial paper exposure,” *Financial Times* (June 30, 2022), <https://www.ft.com/content/59849743-850a-4f67-8e78-fdc68651d2d4>; Faux, *supra* note 14; FSB Report on Risks of Crypto-assets, *supra* note 1, at 11-15; Gary B. Gorton & Jeffrey Y. Zhang, “Taming Wildcat Stablecoins” (Sept. 30, 2021), at 6-8, <https://ssrn.com/abstract=3888752>; Arthur E. Wilmarth, Jr., “It’s Time to Regulate Stablecoins as Deposits and Require Their Issuers to Be FDIC-Insured Banks,” 41 *Banking & Financial Services Policy Report* No. 2 (Feb. 2022), at 2, 16 (notes 14 & 15) [hereinafter Wilmarth, “Stablecoins”], available at <https://ssrn.com/abstract=4000795>.

²⁵ Kadhim Shubber, “Tether’s recovery of an \$840m loan scrutinized in Celsius bankruptcy,” *Financial Times* (July 26, 2022), <https://www.ft.com/content/3e19e36e-b3c7-44ca-8afe-af7e43d7c7e4>.

The crypto crash following Terra’s meltdown has not yet caused significant problems in traditional financial markets. However, the next crisis involving the failure of a prominent stablecoin could have more severe consequences for traditional markets. During the past few years, mainstream institutional investors – including hedge funds, venture capital funds, exchange-traded funds, pension funds, and other asset managers – have significantly increased their investments in crypto firms and crypto assets.²⁶ BlackRock recently formed a partnership with Coinbase that will give allow Coinbase to provide digital assets and crypto trading and lending services to BlackRock’s customers. In particular, Coinbase will offer its crypto products and services to customers of Aladdin, BlackRock’s investment technology platform that “supplies essential plumbing to the global investment industry.”²⁷ Connections between crypto markets and traditional financial markets are likely to multiply, thereby creating the risk that future crises involving stablecoins and other crypto assets will have significant spillover effects on traditional institutions and markets.²⁸

The risks that stablecoins already pose to financial markets and investors demand a vigorous response by Congress and federal agencies. As shown in the next two sections, stablecoins will create even greater hazards for our financial system, economy, and society if they become widely accepted for general-purpose payments and are issued or distributed by Big Tech firms and other commercial enterprises.

2. Stablecoins will create great dangers for our financial system, economy, and society if they become a widely-used form of payment for consumer and commercial transactions.

At present, stablecoins are used mainly as payment instruments or collateral for trading, borrowing, and lending transactions involving cryptocurrencies and other digital assets.²⁹ However, as the report issued in November 2021 by the President’s Working Group on Financial Markets (PWG), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) pointed out, “several existing stablecoin issuers and entities with stablecoin projects under development have the stated ambition for the stablecoins they create to be used widely by retail users to pay for goods and services, by corporations in the context of supply chain payments, and in the context of international remittances.”³⁰ Several

²⁶ FSB Report on Risks of Crypto-assets, *supra* note 1, at 1, 4-6; Ekin Genç, “How Are Institutions and Companies Investing in Crypto?,” *CoinDesk* (June 24, 2022), <https://www.coindesk.com/learn/how-are-institutions-and-companies-investing-in-crypto/>; “Deep Dive: How Institutional Investors Are Driving Crypto Adoption,” *Vault* (May 1, 2022), <https://www.vault.com/insights/the-growing-institutional-interest-in-the-crypto-space/>; Paul Vigna, “Wall Street Takes Lead in Crypto Investments,” *Wall Street Journal* (Feb. 27, 2022), <https://www.wsj.com/articles/wall-street-takes-lead-in-crypto-investments-11645927004>.

²⁷ Oliver Ralph et al., “Coinbase forges deal to give BlackRock clients access to crypto,” *Financial Times* (Aug. 4, 2022), <https://www.ft.com/content/57435d7a-c384-4fe5-b2b6-747b44363c5b>; *see also* Brandy Betz, “BlackRock to Offer Crypto for Institutional Investors Through Coinbase Prime,” *CoinDesk* (Aug. 4, 2022), <https://www.coindesk.com/business/2022/08/04/blackrock-to-offer-crypto-for-institutional-investors-through-coinbase-prime/>.

²⁸ Adachi et al., *supra* note 1, § 4; FSB Report on Risks of Crypto-assets, *supra* note 1, at 4-20.

²⁹ Adachi et al., *supra* note 1, §§ 2 & 3; PWG Report on Stablecoins, *supra* note 23, at 1-10; Wilmarth, “Stablecoins,” *supra* note 24, at 1-2.

³⁰ PWG Report on Stablecoins, *supra* note 23, at 8.

companies that provide payment services for cryptocurrency transactions (including Circle and PayPal) are reportedly working on or considering projects to develop stablecoins that could be used for general-purpose payments in consumer and commercial transactions.³¹

As noted in the previous section, cryptocurrency markets have already established extensive and growing links with traditional financial markets. Those connections would become pervasive if stablecoins become a widely-accepted form of payment for consumer and commercial transactions. Under those circumstances, the collapse of a leading stablecoin could ignite a generalized panic in financial markets, paralyze the payments system, and inflict widespread losses on consumers, business firms, investors, and financial institutions.³²

It is not yet clear whether the blockchain (distributed ledger) technology currently used in stablecoins will be successful in achieving the scale, speed, and cost efficiency necessary to compete effectively with existing technologies for general-purpose payments, such as those used by Visa and MasterCard. While permissionless blockchains do not appear to be feasible for general-purpose payment applications, it is conceivable that permissioned blockchains could be developed with the necessary scale, speed, and efficiency.³³ Given the number of stablecoin projects currently underway, it would be prudent for the federal government to plan for the possibility that some types of stablecoins will be accepted as payment instruments for consumer and commercial transactions.

The importance of stablecoins to our monetary and payments systems would increase dramatically if they become a widely-accepted medium of payment for consumer and commercial transactions. In that event, stablecoins would represent a major category of “private money” comparable to money market funds (MMFs), which do not have explicit government backing but rely on general expectations of government support during severe economic downturns or financial crises.³⁴

Additionally, issuers and distributors of stablecoins would become an important new category of “shadow banks.” First-generation shadow banks – including securities broker-dealers, private equity firms, hedge funds, and other nonbank financial intermediaries – provide functional substitutes for deposits, such as MMFs, securities repurchase agreements, and short-term commercial paper. First-generation shadow banks also offer lending, payment, and other financial services that mimic the activities of banks. First-generation shadow banks have long engaged in regulatory arbitrage by offering bank-like services while avoiding compliance with federal laws that establish essential safeguards for the safety, soundness, and stability of our

³¹ John Adams, “Inside Stripe’s second shot at crypto,” *American Banker* (Mar. 25, 2022), available on Westlaw at 2022 WLNR 9424491; John Adams, “PayPal poses big threat to banks in race to develop stablecoins,” *American Banker* (Jan. 12, 2022), available on Westlaw at 2022 WLNR 1029010; FSB Report on Risks of Crypto-assets, *supra* note 1, at 8-9, 14.

³² PWG Report on Stablecoins, *supra* note 23, at 8-15; Wilmarth, “Stablecoins,” *supra* note 24, at 2-3.

³³ Adachi et al., *supra* note 1, § 3; Makarov & Schoar, *supra* note 1, at 3-6, 20-21, 26-42; see also Penny Crosman, “U.S. banks give multibank blockchains another try,” *American Banker* (Dec. 29, 2021) (discussing the development of “privately permissioned” blockchains that process payments for groups of participating banks), available on Westlaw at 2021 WLNR 42392795.

³⁴ Gorton & Zhang, *supra* note 24, at 3-13, 21-24; FSB Report on Risks of Crypto-assets, *supra* note 1, at 13-15; PWG Report on Stablecoins, *supra* note 23, at 1-2, 12-15, Wilmarth, “Stablecoins,” *supra* note 24, at 2-4.

banking system. The federal government bailed out first-generation shadow banks twice – in 2008 and 2020 – after those institutions assumed huge risks that contributed to the severity of both crises.³⁵ The federal government should not allow issuers and distributors of stablecoins to become a second generation of shadow banks, thereby creating the likelihood of even larger and more costly bailouts in the future.

3. Allowing Big Tech firms and other commercial enterprises to issue and distribute stablecoins would undermine our nation’s longstanding policy of separating banking and commerce.

Most leading stablecoins represent “deposits” under the generally-accepted functional meaning of that term because their providers receive funds from customers in exchange for stablecoins and promise to return their customers’ funds on demand or within an agreed period of time.³⁶ Unfortunately, federal authorities have not attempted to regulate stablecoins as deposits. In addition, federal regulators have allowed nonbank stablecoin providers to combine their de facto deposit-taking and other financial activities with commercial lines of business because regulators do not treat those providers as “banks” for purposes of the Federal Deposit Insurance Act (FDI Act) and the Bank Holding Company Act (BHC Act).³⁷

Thus, current regulatory approaches permit issuers and distributors of stablecoins – like first-generation shadow banks – to operate without regard to the BHC Act’s longstanding policy of separating banking and commerce.³⁸ The PWG’s report on stablecoins warned that combinations between stablecoin providers and commercial firms could have many harmful consequences for our financial system and economy:

[T]he combination of a stablecoin issuer or wallet provider and a commercial firm could lead to an excessive concentration of economic power. These policy concerns are analogous to those traditionally associated with the mixing of banking and commerce, such as advantages in accessing credit or using data to market or restrict access to products. This combination could have detrimental

³⁵ Gorton & Zhang, *supra* note 24, at 3-6, 21-24, 33, 38; Wilmarth, “Stablecoins,” *supra* note 24, at 3-4, 6, 11-13; Arthur E. Wilmarth, Jr., “The Pandemic Crisis Shows that the World Remains Trapped in a ‘Global Doom Loop’ of Financial Instability, Rising Debt Levels, and Escalating Bailouts,” 40 *Banking & Financial Services Policy Report* No. 8 (Aug. 2021), at 2-14, available at <https://ssrn.com/abstract=3901967>.

³⁶ See *Moneygram Int’l, Inc. v. Commissioner*, 999 F.3d 269, 274-77 (5th Cir. 2021) (applying a functional definition of “deposits”); *United States v. Jenkins*, 943 F.2d 167, 172-74 (2d Cir.) (same), *cert denied*, 502 U.S. 1014 (1991); see also Gorton & Zhang, *supra* note 24, at 6-16 (discussing the functional similarities between several stablecoins and bank deposits, and stating that “issuers of stablecoins are essentially unregulated banks,” *id.* at 6); Wilmarth, “Stablecoins,” *supra* note 24, at 7-9 (explaining why many stablecoins qualify as “deposits” under the generally-accepted functional meaning of that term).

³⁷ Wilmarth, “Stablecoins,” *supra* note 24, at 2-4, 7-12.

³⁸ *Id.* at 3-4, 11-13; see also Arthur E. Wilmarth, Jr., “The OCC’s and FDIC’s Attempts to Confer Banking Privileges on Nonbanks and Commercial Firms Violate Federal Laws and Are Contrary to Public Policy,” 39 *Banking & Financial Services Policy Report* No. 10 (Oct. 2020), at 1, 6-11 (discussing the great importance of the BHC Act’s policy of separating banking and commerce) [hereinafter Wilmarth, “Banking Privileges”], available at <https://ssrn.com/abstract=3750964>.

effects on competition and lead to market concentration in sectors of the real economy.³⁹

Despite the PWG’s warning, current regulatory practices would not stop Amazon, Apple, Google, Meta, Microsoft and other Big Tech firms from offering stablecoins to their customers as de facto deposits and payment devices along with other financial services. Big Tech firms already enjoy significant advantages over traditional providers of financial services in areas such as automation, artificial intelligence, data management, and mobile payments. The ability of Ant Financial (Alipay) and Tencent (WeChat Pay) to dominate Chinese consumer financial markets – particularly before the Chinese government cracked down on both companies in 2020 – stands as a clear warning sign concerning the dominant market power that Big Tech firms could potentially exercise over our financial system, economy, and society if they are allowed to offer stablecoins together with lending, payment, and other financial services.⁴⁰

The Consumer Financial Protection Bureau (CFPB) recently highlighted the “dramatic growth” of Ant Financial/Alipay and Tencent/WeChat Pay in China during the past decade. In 2021, Alipay and WeChat Pay offered payment, insurance, investment, and lending services to more than 2 billion customers. Based on China’s experience, the CFPB warned that Big Tech firms in the U.S. could potentially “leverage massive installed consumer bases to quickly gain scale in new payment businesses,” and “the market power of these companies would then be extended into the payments space.”⁴¹ CFPB Director Rohit Chopra highlighted the threats to consumer welfare that would arise if Big Tech firms are allowed to build financial services platforms that “intrusively” gain an “extraordinary window” into consumer preferences and behavior.⁴²

Preventing Big Tech firms from offering stablecoins as de facto deposits and payment devices should be a top priority for financial regulators and Congress. The treasure trove of

³⁹ PWG Report on Stablecoins, *supra* note 23, at 14.

⁴⁰ Wilmarth, “Stablecoins, *supra* note 24, at 2, 11-13; *see also* Raúl Carrillo, Testimony before the Subcommittee on Consumer Protection and Financial Institutions of the House Committee on Financial Services (April 15, 2021), at 5-9 [hereinafter Carrillo Testimony], <https://docs.house.gov/meetings/BA/BA15/20210415/111447/HHRG-117-BA15-Wstate-CarrilloR-20210415.pdf>; Kathryn Petralia, Thomas Philippon, Tara Rice & Nicholas Véron, *Banking Disrupted? Financial Intermediation in an Era of Transformational Technology* 25–38, 44–82 (Geneva Reports on the World Economy 22, 2019), https://www.cimb.ch/uploads/1/1/5/4/115414161/banking_disrupted_geneva22-1.pdf; *Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations* (Subcommittee on Antitrust, Commercial and Administrative Law of the House Committee on the Judiciary, 2020) [hereinafter 2020 House Majority Staff Report on Competition in Digital Markets], https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf;

⁴¹ *The Convergence of Payments and Commerce: Implications for Consumers* (Consumer Financial Protection Bureau, Aug. 2022), at 9-11, 16-18 (quotes at 10, 18),

https://files.consumerfinance.gov/f/documents/cfpb_convergence-payments-commerce-implications-consumers_report_2022-08.pdf; *see also* Arthur E. Wilmarth, Jr., “Wirecard and Greensill Scandals Confirm Dangers of Mixing Banking and Commerce,” 40 *Banking & Financial Services Policy Report* No. 5 (May 2021), at 1, 13 (explaining that Ant Financial and Tencent became “leading suppliers of deposit, payment, lending, and asset management services in China by leveraging their dominant positions in ecommerce and exploiting lenient government policies”) [hereinafter Wilmarth, “Wirecard and Greensill”] available at <https://ssrn.com/abstract=3849567>.

⁴² Stefania Palma, “Top US regulator fires warning shot after Apple’s push into lending,” *Financial Times* (July 27, 2022) (quoting Mr. Chopra), <https://www.ft.com/content/399c177f-e5da-491a-b653-afe953bbdce0>.

nonpublic customer information that Big Tech firms would capture by offering deposit and payment services is illustrated by the huge data set assembled by JPMorgan Chase Institute (JPMCI). JPMCI has compiled and analyzed a massive pool of information drawn from the records of JPMorgan Chase (JPMC), the largest U.S. bank. JPMCI's data pool documents the "saving, spending, and borrowing habits of the bank's customers." The strategic importance of JPMCI's data pool is confirmed by the decision of the Federal Reserve (Fed) to review JPMCI's research "when weighing interest-rate decisions."⁴³ Allowing Big Tech firms to compile similar data sets from their offerings of stablecoins would increase exponentially their existing ability to leverage and monetize their customers' personal information and to invade their customers' privacy by secretly transferring that information to third-party sellers of goods and services.⁴⁴

Our nation stands at a crossroads. We can maintain the BHC Act's longstanding policy of separating banking and commerce, thereby preserving a financial system, an economy, and a society that are not compromised by toxic conflicts of interest, exploited by unfair competitive advantages, and dominated by the overwhelming market power and political influence of Big Tech firms and other banking-and-commercial conglomerates. Or we can allow Big Tech firms and other commercial giants to use stablecoins as building blocks for massive shadow banking empires, thereby subverting the BHC Act's separation of banking and commerce. In that event, Big Tech firms and other commercial behemoths could potentially dominate our banking industry and financial system, thereby creating the evils that the BHC Act was designed to prevent.⁴⁵

4. Congress should designate stablecoins as deposits and require all issuers and distributors of stablecoins to be FDIC-insured banks, thereby bringing all stablecoin providers within the scope of the FDI Act and the BHC Act.

The PWG made the right decision when it recommended that Congress should pass legislation mandating that all issuers of stablecoins must be FDIC-insured banks.⁴⁶ Implementing the PWG's recommendation is vitally important to ensure the stability of our financial system and the welfare of our economy and society. Designating stablecoins as deposits and requiring all issuers and distributors of stablecoins to be FDIC-insured banks would ensure that all stablecoin providers and their parent companies must comply with the FDI Act and the BHC Act.⁴⁷

⁴³ David Benoit, "How JPMorgan Is Helping Washington Make Sense of the Pandemic Recovery," *Wall Street Journal* (Nov. 9, 2021), <https://www.wsj.com/articles/how-jpmorgan-is-helping-washington-make-sense-of-the-pandemic-economy-11636462980>.

⁴⁴ See 2020 House Majority Staff Report on Competition in Digital Markets, *supra* note 40 (describing how (i) Facebook and Google have exploited their access to the private information of hundreds of millions of customers to charge much higher prices for advertising, compared with their competitors, and (ii) Facebook and Google have repeatedly abused their customers' privacy rights without losing their dominance over social networking and Internet search markets).

⁴⁵ Carrillo Testimony, *supra* note 40, at 7-9; Wilmarth, "Stablecoins," *supra* note 24, at 3-4, 11-13; Wilmarth, "Wirecard and Greensill," *supra* note 41, at 1, 11-14.

⁴⁶ PWG Report on Stablecoins, *supra* note 23, at 2, 16.

⁴⁷ See 12 U.S.C. § 1841(c)(1)(A) (defining "bank" for purposes of the BHC Act to include all FDIC-insured banks).

The FDI Act and the BHC Act establish crucial safeguards that require FDIC-insured banks and their parent companies to operate in a manner consistent with the public interest. Those safeguards should apply to issuers of stablecoins as well as distributors of stablecoins issued by other companies. Firms that distribute stablecoins to the public should not be allowed to avoid compliance with the FDI Act and the BHC Act simply because their deposit-taking and payment networks use stablecoins issued by other companies.

The public interest mandates governing FDIC-insured banks include: (a) deposit insurance coverage, payment of risk-based deposit insurance premiums, and reporting and examination requirements under 12 U.S.C. §§ 1817, 1820 & 1821; (b) supervisory and enforcement powers granted to federal bank regulators under 12 U.S.C. § 1818; (c) procedures for resolving failed and failing banks under 12 U.S.C. §§ 1821(c), 1822 & 1823; (d) risk-based capital requirements and other safety and soundness standards under 12 U.S.C. §§ 1831p-1 & 3901-07; (e) prompt corrective action remedies under 12 U.S.C. § 1831o; (f) safety and soundness standards and protections for competition that must be considered when federal bank regulators review proposed changes in control of banks and bank mergers under 12 U.S.C. §§ 1817(j) & 1828(c); (g) prohibitions on abusive tying practices under 12 U.S.C. §§ 1971-77; (h) “source of strength” obligations and capital requirements for parent companies of FDIC-insured banks under 12 U.S.C. §§ 1831o-1 & 5371(b); (i) community reinvestment standards under 12 U.S.C. §§ 3901-08; (j) expedited funds availability requirements under 12 U.S.C. §§ 4001-10; and (k) disclosure requirements for deposits under 12 U.S.C. §§ 4301-13.

The BHC Act requires all companies that own or control FDIC-insured banks to comply with additional public interest safeguards, including (a) safety and soundness standards and protections for competition that must be considered when the Fed reviews proposed acquisitions of banks under 12 U.S.C. § 1842; (b) limitations on permissible nonbanking activities under 12 U.S.C. § 1843; (c) the authority of the Fed to conduct examinations, require reports, bring enforcement actions, exercise consolidated supervision, and impose risk-based capital requirements under 12 U.S.C. §§ 1818, 1844, 1847, & 5371(b); and (d) privacy protections that (i) prohibit financial holding companies from disclosing nonpublic customer information to unaffiliated third parties in violation of their customers’ instructions, and (ii) bar third parties from using false or deceptive practices to obtain such information (15 U.S.C. §§ 6801-09, 6821-27).

Section 4 of the BHC Act, 12 U.S.C. § 1843, prohibits companies that own or control FDIC-insured banks from engaging in commercial activities or owning commercial enterprises. The BHC Act’s longstanding policy of separating banking and commerce prevents the formation of large banking-and-commercial conglomerates that would be likely to create great dangers for our financial system, economy, and society, including (1) hazardous concentrations of economic and financial power and political influence, (2) toxic conflicts of interest that would destroy the ability of banks to act objectively in providing credit and other services, and (3) serious risks of systemic contagion between the financial and commercial sectors of our economy that could inflict enormous losses on the federal government’s safety net for banks – including the FDIC’s deposit insurance fund, the Fed’s discount window loans, the Fed’s guarantee for interbank payments made on Fedwire, and the federal government’s explicit and implicit backstops for “too big to fail” banking organizations. By adopting the PWG’s recommendation, Congress

would maintain the BHC Act’s separation of banking and commerce by prohibiting Big Tech firms and other commercial enterprises from owning or controlling stablecoin ventures.⁴⁸

Some stablecoin providers would not be able or willing to comply with the FDI Act, and some parent companies of stablecoin providers would not be able or willing to comply with the BHC Act. The federal government should compel those providers and their parent companies to leave our financial system. If we want to maintain a financial system that avoids systemic crises, protects investors and consumers, provides sound credit on objective terms, and ensures fair competition, we must require providers of deposit-like services and their parent companies to comply with the same laws that apply to banks and their corporate owners.

5. Federal authorities should reject alternative approaches for regulating stablecoins and their providers.

Congress and federal agencies should reject alternative approaches that have been proposed as methods for dealing with stablecoins and their providers. In particular, Congress and federal agencies should reject proposals that would allow uninsured banks to issue and distribute stablecoins or that would regulate stablecoin providers in the same manner as money market funds. In addition, the FDIC should not provide pass-through deposit insurance coverage for stablecoins that are issued or distributed by nonbanks.

a. Congress should not allow uninsured banks to issue and distribute stablecoins.

Congress should reject proposed legislation – such as the bill sponsored by Senators Kirsten Gillibrand (D-NY) and Cynthia Lummis (R-WY) – that would allow uninsured state banks and uninsured national banks to issue and distribute stablecoins. The Gillibrand-Lummis bill would require the Fed to provide master accounts to uninsured stablecoin banks. Those master accounts would enable uninsured stablecoin banks to receive Fed payment and settlement services, including Fed guarantees for payments made on Fedwire, daylight overdraft privileges, and instant payment services under the forthcoming FedNow program. In addition, uninsured national stablecoin banks would become Fed member banks and could borrow from the Fed’s discount window.⁴⁹

Until recently, a deposit-taking bank could not obtain a bank charter unless it was approved for federal deposit insurance by the FDIC. The OCC has not issued charters for uninsured deposit-taking national banks since Congress established the FDIC in 1933.⁵⁰ Prior to

⁴⁸ Wilmarth, “Banking Privileges,” *supra* note 38, at 6-11; Wilmarth, “Wirecard and Greensill,” *supra* note 41, at 1, 11-12; Arthur E. Wilmarth, Jr., “The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks,” 39 *Banking & Financial Services Policy Report* No. 5 (May 2020), at 1, 2-10, available at <https://ssrn.com/abstract=3613022>.

⁴⁹ Arthur E. Wilmarth, Jr., “Gillibrand-Lummis crypto bill ignores the lessons of history,” *American Banker* (June 17, 2022), available on Westlaw at 2022 WLNR 19024584 [hereinafter Wilmarth, “Gillibrand-Lummis bill”].

⁵⁰ See Wilmarth, “Banking Privileges,” *supra* note 38, at 6 (contending that federal law does not allow the OCC to approve charters for uninsured deposit-taking national banks); see also Lev Menand & Morgan Ricks, “Federal Corporate Law and the Business of Banking,” 88 *University of Chicago Law Review* 1361, 1411 (2021) (pointing out that the Federal Reserve Act “requires national banks to obtain deposit insurance”).

2019, every state required state-chartered banks that accepted deposits from the general public to obtain federal deposit insurance. State laws mandating federal deposit insurance for deposit-taking banks were the product of hard experience during the savings and loan and banking crises of the 1980s and early 1990s. During those crises, systemic failures occurred among state-chartered depository institutions that relied on private, state-sponsored deposit insurance schemes. The collapse of private deposit insurance schemes inflicted severe losses on depositors and local economies in several states, including Colorado, Ohio, Maryland and Rhode Island.⁵¹

Unfortunately, Wyoming (in 2019) and Nebraska (in 2020) decided to authorize charters for banks that accept crypto deposits but do not have federal deposit insurance. As shown by the collapse of the Terra stablecoin and the resulting turmoil in crypto markets, uninsured stablecoin banks would create very significant risks and could destabilize our financial system and greatly harm our economy. Congress should reject the Gillibrand-Lummis bill (and similar proposals) and require all stablecoin providers to be FDIC-insured banks.⁵²

b. Congress and federal regulators should not apply the regulatory model for money market funds to nonbank stablecoin providers.

Congress and federal regulators should also reject proposals that would allow nonbanks to issue and distribute stablecoins if they maintain reserves and provide disclosures similar to those required for money market funds (MMFs). The federal government has already bailed out MMFs twice – in 2008 and 2020 – when investors ran on MMFs because of widely-shared concerns about the adequacy of their reserves. In May 2022, investors ran on the Terra stablecoin and withdrew billions of dollars from the Tether stablecoin based on similar concerns about the sufficiency of their reserves.

Based on those experiences and the collapse of private deposit insurance schemes during the 1980s and early 1990s, it is abundantly clear that any regulatory model relying on private reserves for stablecoins will almost certainly fail during future crises in the stablecoin market (especially if those crises also affect broader segments of our financial markets). It would be a huge mistake for Congress and federal agencies to adopt the same deeply-flawed regulatory model that has repeatedly failed to ensure the stability and resilience of MMFs. Congress must provide a credible backstop from the federal government for stablecoins – and must also compel stablecoin providers to pay the regulatory price for that backstop – by mandating that all stablecoin providers must be FDIC-insured banks with full access to the federal government’s safety net for banks.⁵³

⁵¹ Wilmarth, “Stablecoins,” *supra* note 24, at 10.

⁵² *Id.* at 10-12; Wilmarth, “Gillibrand-Lummis crypto bill,” *supra* note 49.

⁵³ Gorton, Ross & Ross, *supra* note 23, at 2-5, 31-32; Gorton & Zhang, *supra* note 24, at 3-6, 33; Rosa Lastra & Arthur E. Wilmarth, Jr., “We must regulate stablecoin providers as banks,” *The Hill* (June 6, 2022), <https://thehill.com/opinion/finance/3513011-we-must-regulate-stablecoin-providers-as-banks/>; Wilmarth, “Stablecoins,” *supra* note 24, at 2-7, 10-12.

c. The FDIC should deny pass-through deposit insurance coverage for stablecoins that are issued or distributed by nonbanks.

The FDIC should not allow nonbank stablecoin providers to obtain pass-through deposit insurance coverage for their stablecoins by establishing custodial arrangements with FDIC-insured banks. Authorizing pass-through deposit insurance for funds held by custodial banks on behalf of stablecoin purchasers would involve a host of operational problems. One of the most significant challenges would be to ensure that either the nonbank stablecoin provider or the custodial bank maintained accurate and current records showing the identity of each customer whose funds are held by the custodial bank and the amount of that customer's funds. It would be extremely difficult for stablecoin providers and custodial banks to maintain and update such information in a continuous and timely manner, especially as the ownership of stablecoins by customers and the amount of their funds held by the custodial bank would be likely to change very rapidly.⁵⁴

Pass-through deposit insurance coverage would be likely to create confusion among customers holding stablecoins about the actual protection they receive from such coverage. Nonbank stablecoin providers would have perverse incentives to exploit customer confusion by overstating the amount of protection provided by pass-through coverage. The FDIC and the Fed recently issued a joint cease-and-desist letter demanding that Voyager Digital stop misrepresenting the scope of deposit insurance coverage provided to its customers under a custodial arrangement with Metropolitan Commercial Bank. According to the FDIC and the Fed, Voyager made "false and misleading" representations indicating that "(1) Voyager itself is FDIC-insured; (2) customers who invested with the Voyager cryptocurrency platform would receive FDIC insurance coverage for all funds provided to, held by, on, or with Voyager; and (3) the FDIC would insure customers against the failure of Voyager itself."⁵⁵

The FDIC's and Fed's joint letter provided cold comfort to Voyager's customers because Voyager had already suspended withdrawals of their funds and filed for bankruptcy before the letter was issued. Published reports indicate that other crypto firms have probably made similar misrepresentations about the scope of protection provided to their customers by custodial arrangements with FDIC-insured banks.⁵⁶ The FDIC should avoid the risk of such fraudulent practices in the future by denying pass-through deposit insurance coverage for all nonbank stablecoin providers, even if they establish custodial agreements with FDIC-insured banks.

The FDIC should deny pass-through deposit insurance coverage for another and more fundamental reason. Granting pass-through coverage would allow nonbanks – including Big Tech firms and other commercial enterprises – to offer stablecoins that function as de facto deposits and payment instruments and receive benefits from federal safety net protections that Congress has reserved for FDIC-insured banks. Commercial firms and other nonbanks would

⁵⁴ Wilmarth, "Stablecoins," *supra* note 24, at 13-14.

⁵⁵ FDIC and Fed, "Joint Letter Regarding Potential Violations of Section 18(a)(4) of the Federal Deposit Insurance Act," addressed to Voyager Digital LLC (July 28, 2022), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20220728a1.pdf>; see also Benoit, *supra* note 19 (reporting that, in 2019, Voyager told customers, "In the rare event your USD funds are compromised due to the company or our banking partner's failure, you are guaranteed a full reimbursement (up to \$250,000)").

⁵⁶ See *supra* note 19 and accompanying text.

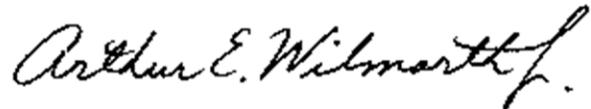
exploit those benefits without complying with the crucial safeguards mandated by the FDI Act and the BHC Act. Thus, granting pass-through deposit insurance coverage for nonbank stablecoins would (1) compromise the integrity and effectiveness of our bank regulatory system and facilitate the growth of a second generation of shadow banks, and (2) undermine our national policy of separating banking and commerce by enabling commercial firms to compete directly with FDIC-insured banks.⁵⁷ The FDIC should deny pass-through coverage to prevent such outcomes.

Conclusion

For the reasons set forth above, Congress and federal agencies should designate stablecoins as deposits and should require all issuers and distributors of stablecoins to be FDIC-insured banks. Congress and federal agencies should reject alternative approaches for regulating stablecoins and their providers. The foregoing steps are urgently needed to remove the great dangers that stablecoins pose to our financial system, economy, and society.

Thank you for your consideration of the foregoing comments.⁵⁸

Very truly yours,

A handwritten signature in black ink that reads "Arthur E. Wilmarth, Jr." with a stylized flourish at the end.

Arthur E. Wilmarth, Jr.
Professor Emeritus of Law
George Washington University Law School

⁵⁷ Wilmarth, "Stablecoins," *supra* note 24, at 3-4, 14-15.

⁵⁸ This comment letter sets forth my personal views and does not express the views of The George Washington University or its Law School.