MAXINE WATERS, CA
CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

PATRICK MCHENRY, NC
RANKING MEMBER

February 3, 2022

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: February 8, 2022, "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins"

The full Committee will hold a virtual hearing entitled, "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins" on February 8, 2022 at 10:00 a.m. ET on the virtual meeting platform Cisco Webex. This hearing will have one panel with the following witness:

- **The Honorable Nellie Liang**, Under Secretary for Domestic Finance, U.S. Department of the Treasury

Overview

The past decade has brought a wave of financial innovation, including an explosive growth of digital assets made possible by advances in cryptography and distributed ledger technology.[1] Digital assets such as cryptocurrencies, stablecoins, and central bank digital currencies (CBDCs) are all digital representations of value.[2] In response to this wave of innovation, the House Committee on Financial Services has held hearings examining the emergence of cryptocurrencies, exploring concerns about investor protection,[3] the implications of digital assets for consumer privacy and financial inclusion,[4] the promises and perils of central bank digital currencies,[5] and perspectives from CEOs of large cryptocurrency industry participants, including market exchanges and stablecoin issuers.[6] Building off this prior work, this hearing will focus on the rapid growth of stablecoins and will discuss findings from the "Report on Stablecoins" by the President's Working Group on Financial Markets (PWG).[7] The PWG consists of the U.S. Department of the Treasury, the Federal Reserve, the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC). The PWG was joined by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) in issuing this report.

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[1] *See* Congressional Research Service (CRS), *Financial Innovation: "Cryptocurrencies"* (Feb. 7, 2018).
[2] *What are cryptocurrencies and stablecoins and how do they work?*, Financial Times (May 28, 2021).
[3] House Financial Services Committee (HFSC), *America on "FIRE": Will the Crypto Frenzy Lead to Financial Independence and Early Retirement or Financial Ruin?*, 117th Cong. (June 30, 2021).
[4] HFSC, *Inclusive Banking During a Pandemic: Using FedAccounts and Digital Tools to Improve Delivery of Stimulus Payments,* 116th Cong. (June 11, 2020); HFSC, *Digitizing the Dollar: Investigating the Technological Infrastructure, Privacy, and Financial Inclusion Implications of Central Bank Digital Currencies*, 117th Cong. (June 15, 2021); and HFSC, *Banking the Unbanked: Exploring Private and Public Efforts to Expand Access to the Financial System*, 117th Cong. (June 21, 2021).
[5] HFSC, *The Future of Money: Digital Currency*, 115th Cong. (July 18, 2018); and HFSC, *The Promises and Perils of Central Bank Digital Currencies*, 117th Cong. (July 27, 2021).
[6] HFSC, *Examining Facebook's Proposed Cryptocurrency and Its Impact on Consumers, Investors, and the American Financial System*, 116th Cong. (July 17, 2019); HFSC, *An Examination of Facebook and Its Impact on the Financial Services and Housing Sectors* (Oct. 23, 2019); HFSC, *Digital Assets and the Future of Finance: Understanding the Challenges and Benefits of Financial Innovation in the United States*, 117th Cong. (Dec. 8, 2021).
[7] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins* (Nov. 2021).

Stablecoin Uses and Market Size

Stablecoins are a subset of cryptocurrencies that stablecoin issuers assert are pegged to a stable reserve asset such as the US dollar. Stablecoins are primarily used in the U.S. to buy or sell other cryptocurrencies or to lend or use as collateral to borrow other cryptocurrencies or fiat currency.[8] Stablecoins may have vastly different operational structures and reserve compositions.[9] Reserve assets backing stablecoins can include fiat currencies, traditional financial assets including commercial paper, or other digital assets or algorithms. Some have compared stablecoins to private currency issued by banks before the practice was curtailed with the National Bank Act of 1863, and a shift was made to a single sovereign currency.[10] Others have noted that stablecoins' management and structuring of the reserve funds resemble existing practices for registered securities products, such as money market funds (MMFs), exchange-traded funds (ETFs),[11] or security-based swaps.[12] Stablecoins could also find parallels in traditional payment systems, bank deposits,[13] or other forms of financial services and products.

As of February 3, 2022, stablecoins reached an estimated $174 billion in market capitalization.[14] Of note, the market value of the digital asset ecosystem as a whole has been volatile, expanding significantly from approximately $500 billion in 2020 to almost $3 trillion as of November 2021 before dropping to $1.63 trillion in January 2022.[15] Although stablecoins represent a relatively small fraction of the digital asset industry's total value at 5%, they facilitated more than 75% of trading on all digital asset trading platforms as of October 31, 2021.[16]

President's Working Group "Report on Stablecoins"

While stablecoins have the potential to address shortcomings of the existing payment system such as the potential for lower-cost and real-time payments,[17] they pose legal, regulatory, and oversight challenges, and may present risks to monetary policy, national security, financial stability, and fair competition.[18] In response to these challenges, the PWG released its "Report on Stablecoins" (the Report) on November 1, 2021, including recommendations to Congress on legislation to address market risks potentially created by stablecoin transactions. The Report provides a number of legislative recommendations to Congress to improve oversight and regulation of stablecoins in a manner that complements existing authorities with respect to market integrity, investor protection, and illicit finance.[19]

The Report analyzes the prudential risks posed by "payment stablecoins," defined as those stablecoins that are designed to maintain a stable value relative to a fiat currency and have the potential to be used as a widespread means of payment. The Report notes that stablecoins are often characterized by

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[8] *Id.* at 1.
[9] International Monetary Fund (IMF), *Global Financial Stability Report* (Oct. 2021).
[10] Gary Gorton & Jeffery Zhang, *Taming Wildcat Stablecoins*, SSRN (Oct. 1, 2021).
[11] *See, e.g.*, *Crypto Stablecoins and Prime Money Market Funds. If it walks like a duck . . .*, Finextra (July 5, 2021).
[12] *See* Senate Committee on Banking, Housing, and Urban Affairs, SEC Chair Gensler Testimony, *Oversight of the U.S. Securities and Exchange Commission*, 117th Cong. (Sept. 14, 2021).
[13] *See, e.g.*, Howell Jackson & Morgan Ricks, *Locating Stablecoins within the Regulatory Perimeter*, Harvard Law School Forum on Corporate Governance (Aug. 5, 2021).
[14] CoinMarketCap, Top Stablecoin Tokens by Market Capitalization (accessed Feb. 3, 2022); *see also* Appendix Figure #1: Stablecoins by Market Capitalization (in billions).
[15] CoinMarketCap, Today's Cryptocurrency Prices by Market Cap (accessed Jan. 27, 2022).
[16] Figures cited by SEC Chair Gary Gensler in his statement, *President's Working Group Report on Stablecoins* (Nov. 1, 2021); *see* Today's Cryptocurrency Prices by Market Cap (accessed Nov. 28, 2021); *see also* The Block, Spot (accessed Nov. 28, 2021).
[17] *See e.g.* Harvard Business Review, Stablecoins and the Future of Money (Aug. 10, 2021).
[18] *See, e.g.*, Douglas Arner, Raphael Auer & Jon Frost, *Stablecoins: risks, potential and regulation*, Bank for International Settlements (Nov. 24, 2020); Federal Reserve, *Financial Stability Report* (Nov. 2021); Financial Stability Board (FSB), *Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements* (Oct. 13, 2020); Financial Stability Oversight Council (FSOC), *FSOC Annual Report 2021* (Dec. 2021); Office of Financial Research (OFR), *OFR Annual Report 2021* (Nov. 2021).
[19] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins,* at 1 (Nov. 2021).

a promise or expectation that the stablecoin can be redeemed on a one-to-one basis for fiat currency, which may not always be accurate.[20] The Report also includes a discussion on interim measures that the Financial Stability Oversight Council (FSOC) can undertake to regulate stablecoins, such as designating them as systemically important for payment, clearing, and settlement activities.[21]

The Report notes that it builds upon prior research from international forums and is informed by their recommendations, standards, principles, and guidance regarding stablecoin arrangements. For instance, in October 2020, the Financial Stability Board (FSB) published 10 recommendations aimed at promoting regulation, supervision, and oversight of Global Stablecoin (GSC) arrangements. These high-level recommendations sought to address financial stability risks of stablecoins both in the U.S. and at the international level, while supporting innovation and granting flexibility for jurisdictions to establish domestic approaches.[22] In preparing the Report, the agencies' staff members held discussions with stakeholders, such as market participants, trade associations, and experts and advocates.[23]

Key Prudential Risks & Recommendations from PWG Report

Risks to Stablecoin Users and Stablecoin Runs – The Report outlines risks that stablecoins may present to market integrity, investor protection, and counteracting illicit finance. With regard to the risk of a run on stablecoins, the Report notes that an instrument can serve as a reliable means of payment or store of value only when there is public confidence in its value, particularly during periods of stress. The Report notes that public confidence in stablecoins is derived from its redeemability and support by a stabilization mechanism that will consistently function regardless of market conditions.[24] The Report lists certain factors that could weaken confidence in a stablecoin, including: "(1) use of reserve assets that could fall in price or become illiquid; (2) a failure to appropriately safeguard reserve assets; (3) a lack of clarity regarding the redemption rights of stablecoin holders; and (4) operational risks related to cybersecurity and the collecting, storing, and safeguarding of data."[25]

Of note, even without the influence of adverse market conditions, certain stablecoins have already displayed run-like behaviors, such as large numbers of investors withdrawing their investments simultaneously, which can potentially trigger negative feedback loops and contagion effects.[26] For example, the Iron Titanium (TITAN) token faced a run-like scenario in June 2021 and saw its price crash to near zero within one day, resulting in the related stablecoin Iron trading off its peg by more than $0.25, meaning the stablecoin was no longer fully backed by its reserve assets.[27] Additionally, certain stablecoins can use financial leverage (*i.e.*, fund their asset holdings with debt and derivatives), in the search for price stability or higher returns which introduces additional financial risks, and raises financial stability concerns when used excessively. Regarding run-risk, the Report concludes that "the internal dynamics of a stablecoin run, as well as the potential implications of such a run for the financial system and broader economy, would likely depend on the volume and liquidity characteristics of reserve assets sold, as well as on broader economic and financial conditions."[28]

The Report acknowledges the applicable existing regulatory frameworks by stating that the SEC and CFTC as market regulators currently have broad enforcement, rulemaking, and oversight authorities over digital assets, including stablecoins, especially in relation to market integrity and investor protection

[20] *Id.* at 2.
[21] *Id.* at 3.
[22] *Id.* at 22.
[23] *Id.* at 23. *See also* Appendix Figure #2 List of Outreach Participants.
[24] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 12 (Nov. 2021).
[25] *Id*.
[26] *See e.g.* *Stablecoins Could Pose New Short-Term Credit Market Risks*, Fitch Rating (July 1, 2021).
[27] *Iron Finance's Titan Token Falls to Near Zero in DeFi Panic Selling*, CoinDesk (June 17, 2021).
[28] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 12 (Nov. 2021).

risks and "speculative digital asset trading."[29] It also recognizes the Treasury Department's existing role in addressing anti-money laundering and countering the financing of terrorism-related risks. To address risks to stablecoin users and guard against stablecoin runs, the Report indicates that legislation should require stablecoin issuers to be insured depository institutions (IDIs), which are subject to safety and soundness supervision and regulation at the depository institution and the holding company level.[30]

Payment System Risks – In the Report, the agencies acknowledge that while stablecoin arrangements could theoretically provide support for more efficient and inclusive payment options, they may present risks to their participants and the broader financial system. Similar to traditional payment systems, the Report notes that stablecoins also face "credit risk, liquidity risk, operational risk, risks arising from improper or ineffective system governance, and settlement risk."[31]

The Report also addresses the use of digital custodial wallets by stablecoin users, which allow for the storage and transfer of these assets among users. Custodial wallets are computer software and applications that store cryptocurrencies and other digital assets, and maintain the keys necessary to access and sign the assets for transmission to blockchains, while storing the addresses on a blockchain where a particular asset resides.[32] Citing concerns over the central role that custodial wallet providers play within a stablecoin arrangement, the Report recommends that Congress subject custodial wallet providers to the proper amount of federal oversight, including "possibly restricting these service providers from lending customers' stablecoins and requiring compliance with appropriate risk-management, liquidity, and capital requirements."[33] The Report adds that Congress should consider other standards for custodial wallet providers, including limiting activity with other commercial enterprises and use of customer data.[34]

Risks of Scale: Systemic Risk and Concentration of Economic Power – Systemic risk arises from the possibility that losses or distress at entities in the digital asset industry could cause instability in the broader financial system. Common examples of systemic risk and financial stability concern include contagion effects on the broader economy and "run-like" behaviors. The first policy concern highlighted in the Report is the failure of a wallet custodian spilling over to the traditional financial system and the real economy, leading to systemic risk. Secondly, if a custodial wallet host has some other stablecoin-related role, such as being an issuer or commercial enterprise, this could lead to unhealthy concentrations of economic power in the real economy, which in turn would lead to decreasing competition.[35] Thirdly, if a stablecoin becomes widely adopted as a means of payment, it could create an anti-competitive environment, as users may find it difficult to switch from one form of payment to another.[36] Responding to these concerns, the Report recommends placing limits on custodial wallet providers' affiliation with commercial entities or on custodial wallet providers' use of user transaction data. [37] Furthermore, the Report recommends creating clear standards that promote interoperability among stablecoins.[38]

Regulatory Gaps – Presently, stablecoin arrangements are not subject to a consistent set of prudential regulatory standards that address all risks, but they are still subject to market regulatory oversight by the SEC and CFTC. The Report notes that certain stablecoin arrangements may be subject to

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[29] *Id.* at 8.
[30] *Id.* at 17.
[31] *Id.* at 12. *See also* Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures*, Bank for International Settlements (Apr. 2012).
[32] *What's A Crypto Wallet (and How Does It Manage Digital Currency)?*, Computer World (Apr. 17, 2019).
[33] *U.S. Stablecoin Regulation: Bringing Stablecoins Into The Regulatory Fold*, Fintech Foundry (Nov. 12, 2021).
[34] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 17 (Nov. 2021).
[35] *Id.* at 14.
[36] *U.S. Stablecoin Regulation: Bringing Stablecoins Into The Regulatory Fold*, Fintech Foundry (Nov. 12, 2021).
[37] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 17 (Nov. 2021).
[38] *Id.*

the Glass-Steagall Act.[39] Furthermore, consumer financial protection laws overseen by the Consumer Financial Protection Bureau (CFPB) provide some safeguards with respect to payments in general. However, both the number of parties involved in an arrangement as well as their operational complexity can pose increasing challenges for robust supervisory oversight.[40] Prudential and market regulators and other relevant agencies can continue to use their regulatory oversight and enforcement powers to ensure that certain types of entities involved in stablecoin arrangements such as issuers or custodial wallet providers comply with existing regulations. In the absence of Congressional actions, the Report recommends that the FSOC potentially designate certain stablecoin arrangements as systemically important payment, clearing, and settlement activities, which would subject them to heightened regulation.

Recent Developments on Stablecoins

After the release of the Report, industry and public responses have varied, with some observers arguing that that, while market regulators could handle current stablecoin activities, Congress could also provide jurisdiction for banking regulators to address financial stability concerns.[41] Other observers have argued that instead of directly treating stablecoin arrangements as banks, policymakers could subject certain stablecoins to heightened disclosure, capital, and liquidity requirements, or regulate them as securities products.[42] One reason that the Report suggests the IDI regulatory framework for stablecoin issuers is to provide access to federal safety nets such as deposit insurance, and emergency liquidity and Fed services for systemic risk mitigation and other concerns.[43] However, this could raise policy questions about whether stablecoin investors merit the same protection as regular depositors.

Subsequent to the release of the Report, its authors have stressed the need for Congressional action in this space. For instance, Nellie Liang, Under Secretary of the Treasury for Domestic Finance at the U.S. Department of the Treasury, emphasized in recent press interviews her opinion for the need for Congressional action, stating: "Congress is interested in how to address this. It feels like that's the first best alternative. Regulatory agencies, as I said, can do some things, but not everything. FSOC can do some things, but not everything. And so, trying to allow some room for Congress to make some progress in the fairly near term seems important."[44] Regulators have continued their digital assets-related activities. For example, on November 23, 2021, federal banking agencies issued a joint statement regarding their Crypto-Asset Policy Sprint Initiative.[45] On January 20, 2022, the Federal Reserve released "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," a report which examines the benefits and risks of a potential U.S. central bank digital currency (CBDC) that may compete with private-sector stablecoins, and opened a 120-day comment period from the public on whether a U.S. CBDC would improve the payments system.[46] On February 3, 2022, the Federal Reserve Bank of Boston, in partnership with the Digital Currency Initiative at the Massachusetts Institute of Technology, released findings on their technological research of a CBDC, including a description of a theoretical CBDC transaction processor.[47]

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[39] *See also* Howell Jackson & Morgan Ricks, *Locating Stablecoins within the Regulatory Perimeter*, Harvard Law School Forum on Corporate Governance (Aug. 5, 2021).

[40] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 13 (Nov. 2021).

[41] *Regulators Want to Push Crypto's Shadow Bankers Into the Light*, Bloomberg Law (Nov. 1, 2021).

[42] *Should stablecoins be regulated like banks, exchange-traded funds, or both?*, The Hill (Dec. 7, 2021).

[43] President's Working Group on Financial Markets, FDIC, and OCC, *Report on Stablecoins*, at 16 (Nov. 2021).

[44] *POLITICO Pro Q&A: Treasury Undersecretary Nellie Liang*, Politico (Nov. 17, 2021); *see also Treasury Says New Law Only Way to Fully Contain Stablecoin Risks*, Bloomberg (Dec. 18, 2021).

[45] OCC, Federal Reserve, and FDIC, *Joint Statement on Crypto-Asset Policy Sprint Initiative and Next Steps* (Nov. 23, 2021).

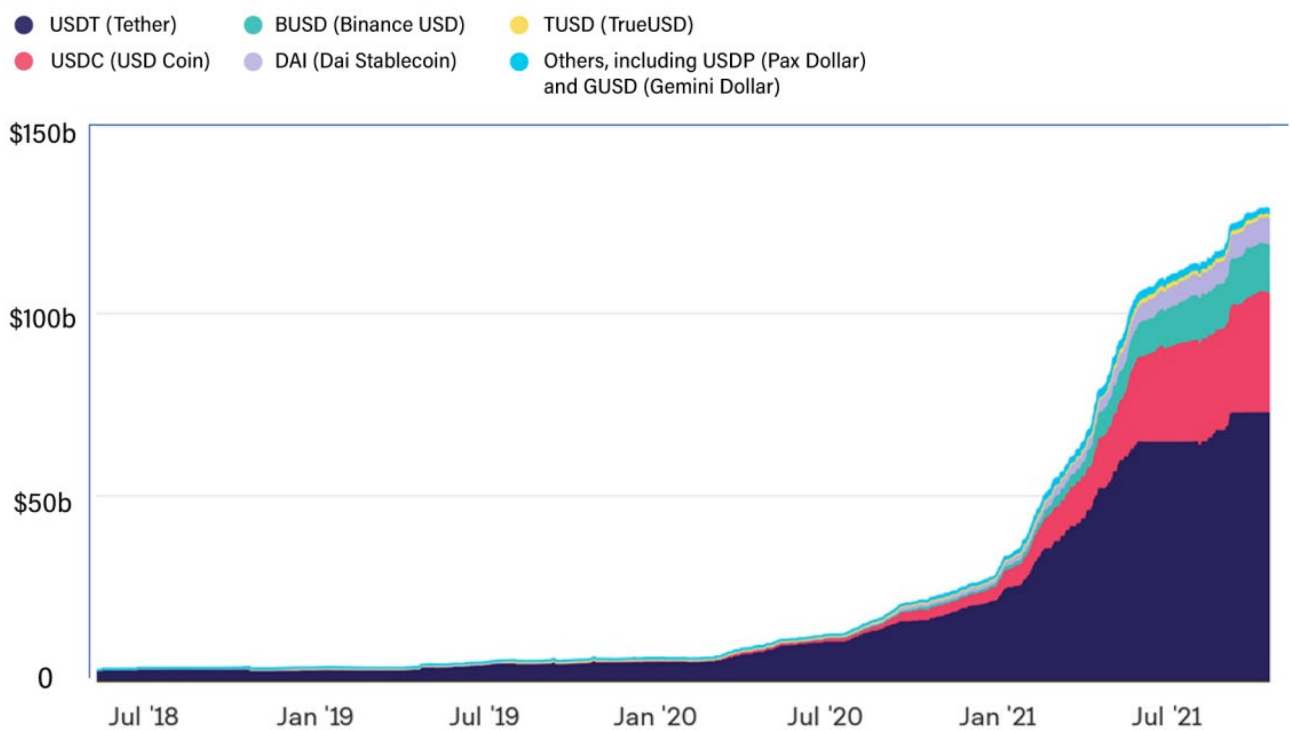
[46] Board of Governors of the Federal Reserve System, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation* (Jan. 20, 2022).

[47] Federal Reserve Bank of Boston, *The Federal Reserve Bank of Boston and Massachusetts Institute of Technology release technological research on a central bank digital currency* (Feb. 3, 2022).

Appendix – Figures

Sources below can be found in the President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency's *Report on Stablecoins*, (Nov. 2021).

Figure 1. Top Stablecoins by Market Capitalization (in billions)



The Report indicates that stablecoin supply grew approximately 495 percent, from $21.5 billion on October 19, 2020 to $127.9 billion as of October 18, 2021. *See* *Total Stablecoin Supply*, The Block, (Oct. 18, 2021).

Figure 2. List of Outreach Participants

Market Participants	
Anchorage Digital	Gemini
BlockFi	Kraken
Circle	Mastercard
Coinbase	Paxos
Cumberland DRW LLC	Square
Diem Association	Stripe
FIS	Tether
Fiserv	Visa
Fnality International	

Trade Associations	
Bank Policy Institute	Independent Community Bankers of America
Blockchain Association	National Association of Federally-Insured Credit Unions
Electronic Transactions Association	

Experts and Advocates	
AFL-CIO	Gary Gorton, Yale School of Management
AID-Tech	Howell E. Jackson, Harvard Law School
Americans for Financial Reform	Markus Brunnermeier, Princeton University
Better Markets	Morgan Ricks, Vanderbilt University Law School
Center for Responsible Lending	National Community Reinvestment Coalition
Coin Center	National Consumer Law Center
Dan Awrey, Cornell Law School	Open Markets Institute
Darrell Duffie, Stanford University Graduate School of Business	Raúl Carrillo, Yale Law School
FinRegLab	Stellar Development Foundation

In drafting the Report, the agency authors held discussions with the stakeholders listed above.