WRITTEN TESTIMONY OF
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IN A HEARING ENTITLED

Regulatory Whiplash: Examining the Impact of FSOC's Ever-Changing Designation Framework on Innovation

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Thank you, Chairman Hill, Ranking Member Lynch, and members of the Subcommittee for the opportunity to testify today on how the Financial Stability Oversight Council's ("FSOC" or "Council") final interpretive guidance on its nonbank financial company designation process (the "Final Guidance") and the corresponding analytic framework for financial stability risk identification and assessment (the "Analytic Framework") will impact the digital assets industry. I am grateful for the engagement and leadership of so many on this Subcommittee.

I am pleased to represent the Crypto Council for Innovation (CCI), a global alliance of industry leaders across the digital assets space. We believe that constructive partnership between government and business stakeholders is critical to crafting sound policy and regulation that benefits consumers, investors, and industry. We use an evidence-based approach to support governments that are shaping and encouraging the responsible regulation of this innovative technology.

The topic of today's hearing is an important one. CCI believes in the importance of sound, fit-for-purpose regulation that can safeguard consumers and markets, while fostering innovation necessary to maintain U.S. leadership in an evolving and dynamic global economy. As a threshold matter, CCI recognizes and appreciates that the FSOC has been tasked by Congress to play a critical role in identifying and assessing systemic risks to U.S. financial stability. Given the importance of this mandate, however, FSOC should remain focused only on risks of such magnitude that necessitate FSOC's unique intervention, while respecting the constitutionally and Congressionally defined roles of state and federal regulators to oversee the vast majority of financial services and broader market activity. Indeed, FSOC was established by Congress to identify and mitigate the most serious of risks that rise to the level of being "systemic," which is deliberately a very high bar. We are also supportive of ensuring a transparent and durable process for FSOC in using its nonbank financial company designation authority, which would include appropriate due process and procedural protections for nonbank financial companies reviewed for potential designation.

Against this backdrop, my testimony today aims to: (i) highlight key characteristics of the digital assets industry, which despite its growth and potential remains at an early stage and is not near the magnitude or interconnectedness required to be systemic; (ii) detail existing state and federal regulation capable of mitigating key risks; (iii) emphasize the benefits and appropriateness of Congress legislating a comprehensive framework to address gaps and ensure regulatory consistency, rather than FSOC taking over the role of Congress; and (iv) reinforce why it is currently unnecessary for FSOC to focus on the nascent and non-systemic digital asset industry, and important for FSOC to avoid having a detrimental impact on innovation and the competitiveness of U.S. markets.

I. Despite its Growth and Ability to Improve Financial Markets and Services, the Digital Asset Industry Remains in its Early Stages and Lacks the Magnitude or Interconnectedness to be Deemed Systemically Important.

Digital assets and related technologies are already improving how individuals and businesses are able to access and engage in financial transactions. Tokenized assets and new blockchain-based transaction rails can improve financial access and inclusion, reduce counterparty risk, enhance transparency, improve operational efficiencies, and lower costs. The industry collectively is working to improve on the legacy financial system and solve for gaps that have systematically harmed lower-income and historically disadvantaged populations.

As just one example, digital assets, particularly stablecoins, allow for low-cost and efficient cross-border transactions, making it easier for individuals to send money through remittance payments to their families abroad. In New York City alone, where my family and I reside, residents send approximately $10 billion to relatives overseas and were charged more than $500 million in fees to do so.[1] Traditional financial institutions typically charge between 5-10 percent

[1] *Reforming Remittances to Save Money When Sending Money*, YANG FOR NEW YORK, https://www.yangforny.com/policies/reforming-remittances (last visited May 22, 2023).

for remittances. Through crypto, these high fees can be cut down to a total cost of approximately one percent, and the transfer window can shrink from days to a few seconds.[2]

For the average remittance sender making two to three of these payments each month, the savings add up and is money that could be saved or spent on the local economy.

Globally, the remittance market shows no signs of slowing; some $626 billion in remittances were sent in 2022.[3] The market is expected to hit nearly $1 trillion by 2026.[4]

Yet, as previously substantiated by the FSOC,[5] the size, scale, and interconnectedness of the digital asset industry is dwarfed by the legacy system it seeks to improve. It is accordingly unnecessary for FSOC to consider an emerging but nascent industry as "systemically important" when it is in the earlier stages of challenging a well-entrenched status quo that remains many magnitudes of order larger and more central to all aspects of financial services and markets.

First, by one recent estimate, the *total* size of the entire *global* digital asset market measured approximately $1.7 trillion,[6] which is below the individual market cap of several U.S.-based public companies.[7] This global market is comprised of thousands of individual digital asset tokens and is facilitated by hundreds of exchanges and other intermediaries—most of which remain a fraction of the size of traditional financial institutions and intermediaries. By way of comparison, the market cap for U.S. equity markets in 2023 was approximately $45.5 trillion—more than 25 times the total size of the *global* digital asset market.[8] Additionally, the

[2] Kingsley Obinna Alo, *How Bitcoin is Helping African Migrant Workers and Their Families Save Money,* FORKAST, (Mar. 9, 2020), https://forkast.news/cryptocurrencies-remittance-africa-blockchain-bitcoin-money-transfers-fees/.

[3] Rebecca Ong, *Remittances Grow 5% in 2022, Despite Global Headwinds,* THE WORLD BANK (Nov. 30, 2022), https://www.worldbank.org/en/news/press-release/2022/11/30/remittances-grow-5-percent-2022.

[4] Polly Jean Harrison, *Global Remittance Market is Expected to Grow by $200 Billion by 2026*, THE FINTECH TIMES (June 29, 2021), https://thefintechtimes.com/global-remittance-market-is-expected-to-grow-by-200-billion-by-2026.

[5] Financial Stability Oversight Council, *Annual Report 2023*, available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (stating that "the nascent crypto-asset market is not significant in its size or broad connection to the traditional financial system, distress in that market has the potential to transmit to traditional financial firms").

[6] *Cryptocurrency Prices Today By Market Cap*, FORBES (last visited Jan. 8, 2024), https://www.forbes.com/digital-assets/crypto-prices/?sh=2734fe182478

[7] Motley Fool, *The Largest Cohttps://www.forbes.com/digital-assets/crypto-prices/?sh=2734fe182478mpanies by Market Cap in 2023* (Jan. 2, 2024), available at https://www.fool.com/research/largest-companies-by-market-cap

[8] SIFMA, *Quarterly Report: US Equity & Related, 3Q23* (Oct. 23, 2023), available at https://www.sifma.org/resources/research/research-quarterly-equities/.

total market cap of the top five U.S. dollar-pegged stablecoins is below $150 billion[9]—a figure that is smaller than many U.S. publicly traded companies.[10]

Second, digital asset exchanges and intermediaries are typically nonbanks, which means they lack direct access to critical financial services infrastructure, including Federal Reserve payments systems or taxpayer-backed deposit insurance regimes. Indeed, with respect to fiat money movement and payments, nonbank digital asset intermediaries are reliant on traditional financial institutions that serve as gatekeepers to such payments infrastructure. This lack of access to critical infrastructure and taxpayer support cuts heavily against finding the digital asset industry to be systemically important.

Third, digital assets lack significant interconnections with traditional financial systems, a point underscored by FSOC itself. In fact, in its 2022 "Report on Digital Asset Stability Risks," FSOC concluded that digital assets' "interconnectedness with the traditional financial system [is] currently relatively limited" and that such activities could pose risks to the stability of the U.S. financial system only if their interconnectedness with the traditional financial system or their overall scale were to grow without adherence to or being paired with appropriate regulation.[11] Further, FSOC most recently acknowledged that the digital asset market is "nascent" and "is not significant in its size or broad connection to the traditional financial system."[12]

As further detailed in the next two sections, "appropriate regulation" is necessary to mitigate risks, including potential risks to stability. In particular, to the extent that there are risks posed by the digital assets industry, (i) they are largely contemplated and mitigated by existing state and federal regulation and (ii) Congress is the appropriate institution to provide a comprehensive legislative framework that promotes further needed clarity and consistency, while addressing any outstanding gaps—an approach FSOC also recommends.[13]

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[9] CoinMarketCap, *Top Stablecoin Tokens by Market Capitalization* (last visited Jan. 3, 2024), available at https://coinmarketcap.com/view/stablecoin/.

[10] Stock Analysis, *Biggest Companies by Market Cap* (last visited Jan. 3, 2024), available at https://stockanalysis.com/list/biggest-companies.

[11] Financial Stability Oversight Council, *Report on Digital Asset Stability Risks and Regulation* (2022), available at https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf.

[12] Financial Stability Oversight Council, *Annual Report 2023*, p. 13, available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf.

[13] *Id.*

II. Existing State and Federal Regulation—Especially When Reinforced by Comprehensive Federal Legislation—are Capable of Addressing Key Digital Asset Risks.

In the Final Guidance, FSOC acknowledged the need to work with relevant federal and state financial regulatory agencies in assessing and addressing risks to the stability of the financial markets. Further, in order to best respect key tenets of federalism and avoid usurping the role of Congress and state and federal regulators, FSOC should consider whether existing regulation mitigates identifiable risks and obviates the need for FSOC action. To that end, Congress recognized the important role of existing primary regulators in the nonbank SIFI evaluation and designation process and required FSOC to consult with such regulators and consider "the degree to which the company is already regulated by one or more primary financial regulatory agencies."[14] In the case of digital assets, while further Congressional action would ensure clarity, consistency, and resolution of outstanding regulatory gaps (as discussed below), existing state and federal regulations are capable of addressing key digital asset risks in a manner that obviates the need for FSOC action.

More specifically, many digital asset intermediaries, including exchanges, are subject to state-based licensure and oversight. Following FinCEN's determination in 2013 that exchanges and other intermediaries meet the 2011 definition of "money transmitter" and are considered money service businesses (MSBs) under the Bank Secrecy Act ("BSA") regulations, many states required such market participants to secure a money transmission license ("MTL") pursuant to each state's respective law, with some states like New York creating tailored digital asset supervisory regimes.[15]

For example, the New York Department of Financial Services ("NYDFS") established two distinct licensing and chartering regimes, which allow for different types of activity and operate with guardrails tailored to the specific risks that digital assets activity entails. These frameworks mitigate key consumer protection and financial stability risks by focusing on requirements relating to capital reserves, prevention of money laundering, operational risk, consumer disclosures, cybersecurity and more—all of which are subject to examination, reporting, and supervision by the NYDFS.[16] NYDFS also established a framework for stablecoins, focused on (i) reserve requirements, to ensure the assets backing stablecoins are held on a segregated basis

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[14] 12 U.S. Code § 5323(a)(2)(h).

[15] *See The Future of Digital Assets: Identifying the Regulatory Gaps in the Digital Asset Market Structure: Hearing Before the U.S. House Fin. Services Comm., Sub. Comm. on Digital Assets.*, 118th Cong. 5 (2023) (statement of Daniel Gorfine, CEO, Gattaca Horizons, LLC).

[16] *See* Adrienne A. Harris, *Testimony Before the U.S. House Fin. Services Comm., Subcomm. on Digital Assets, Financial Technology, and Inclusion* (Apr. 19, 2023), available at https://democrats-financialservices.house.gov/uploadedfiles/hhrg-118-ba21-wstate-harrisa-20230419.pdf.

on behalf of customers, are fully reserved on a one-to-one basis, and are comprised of cash deposits and/or other cash equivalents; (ii) redemption rights ensuring that stablecoin users have the right to redeem their stablecoins on a one-to-one basis for US Dollars in a timely manner; and (iii) public transparency requirements including monthly attestations from independent CPAs that ascertain the value of reserves, their composition, the quantity of outstanding stablecoins, and whether the reserve is adequate to fully back the number of outstanding stablecoins.[17] [18] Other states apply existing money-transmission oversight frameworks or have followed New York's lead to implement tailored digital asset regimes.

Beyond state-based oversight, key federal regulations apply to digital assets, including (i) the Commodity Futures Trading Commission's (CFTC) anti-fraud provisions regarding digital assets that are commodities, the bank regulators' risk management frameworks and banking regulations when banks engage with digital assets or intermediaries, and FinCEN's financial crimes and money services business frameworks when considering the movement of digital assets.

Against this backdrop, it is unnecessary for the FSOC to interject itself into this space, which does not rise to a systemic level, and which is already subject to oversight and the jurisdiction of key state and federal financial regulators. In fact, FSOC has acknowledged that "Council members are enforcing existing rules and regulations applicable to crypto-asset activities."[19]

III. Congress is the Appropriate Federal Institution to Provide Further Policy Clarity and Consistency regarding Digital Assets

Despite the fact that the digital assets market does not currently rise to be a systemic risk warranting FSOC's direct intervention, FSOC has made certain recommendations to best address any potential outstanding risks. Specifically, FSOC has "urged" Congress to pass appropriate legislation that provides (i) federal financial regulators with explicit rulemaking authority over the spot market for crypto-assets that are not securities and (ii) for a comprehensive framework for stablecoin issuers that would address the associated market integrity, investor and consumer

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[17] *See Putting the "Stable" in "Stablecoins": How Legislation Will Help Stablecoins Achieve their Promise: Hearing Before the U.S. House Fin. Services Comm., Subcomm. on Digital Assets.*, 118th Cong. 5 (2023) (statement of Matthew Homer, Managing Member of Department of XYZ).

[18] As a general matter, dollar-pegged stablecoins offer tremendous potential in providing consumers with a new, more accessible, lower cost, and competitive payments option relative to the status quo. The dominant form of stablecoin in the U.S. is fairly straightforward—it is a token pegged 1:1 with a deposited U.S. Dollar and backed by cash and other high-quality cash equivalents, including U.S. government securities. To be sure, with any financial instrument it is important to have in place thoughtful regulations that mitigate risks, but there is nothing about dollar-pegged stablecoins relative to other payments options that implicates the need for FSOC oversight or requires a move away from well-established risk mitigation approaches.

[19] Financial Stability Oversight Council, *Annual Report 2023*, p. 13, available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf

protection, and payment risks.[20] I agree with FSOC and believe that it is critical for Congress to provide additional regulatory certainty through thoughtful and forward-leaning legislation.

Members of Congress have agreed with the benefits of creating a deliberate and consistent framework for digital assets by introducing dozens of related bills in recent years.[21] FSOC's involvement is therefore particularly unnecessary given pending legislation on both market structure and stablecoins, whose passage and adoption would provide beneficial clarity and further mitigate outstanding risks.

As detailed above, while some states have developed (or are developing) tailored regulatory frameworks for supervising digital asset activities, a comprehensive federal legislative framework can enhance clarity, ensure consistency, and further mitigate outstanding risks identified by FSOC.

First, as members of this Subcommittee are well aware, the *Financial Innovation and Technology for the 21st Century Act* (FIT21) would establish a comprehensive regulatory framework for the issuance and trading of digital assets by the CFTC and the Securities and Exchange Commission (SEC), including providing much needed clarity regarding which digital assets are regulated by each respective agency. In particular, to address certain potential risks, FIT21 would provide key consumer protections for purchasers of digital assets including, among others, business conduct standards, customer disclosures, segregation of customer funds, minimum capital requirements, reporting and recordkeeping, and more. FIT21 would provide the CFTC with clear authority to regulate the spot markets for digital commodities, addressing a specific area where FSOC has recommended Congress should act.

Second, the *Clarity for Payment Stablecoins Act* would provide a comprehensive framework for the regulation, supervision, and enforcement of stablecoin issuers. This bill addresses the requirements by which stablecoin issuers must abide, including, among others, reserve requirements, redemption procedures, general prohibition on rehypothecation, compliance with the BSA, and more. This bill could further rationally integrate effective state-based regulatory models.

Overall, FSOC itself has noted that digital asset markets remain relatively small and lack deep interconnections with the traditional financial services sector. Existing state and federal regulation further mitigate risks and accordingly further obviate the need for direct FSOC intervention. That said, as FSOC has noted, Congress should take additional legislative action, which can help clarify and ensure consistency across regulation, as well as mitigate outstanding

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[20] *Id.* at p. 47.

[21] Jason Brett, *Congress Has Introduced 50 Digital Asset Bills Impacting Regulation, Blockchain, and CBDC Policy*, FORBES (May 19, 2022), https://tinyurl.com/4wzwwzre.

risks resulting from gaps. This action, however, is the proper domain of the legislative branch and should not be preempted by the FSOC.

IV. Policy Should Foster Responsible Digital Asset Innovation and Competition with Legacy Services, Not Impede it.

FSOC was created to address the most significant risks posed by the largest, most critical, and most interconnected financial institutions in the economy—the types of entities that would logically be incumbents that gradually expand their role and influence to systemic levels. The digital asset industry represents the opposite of such dynamics, where challengers are working to compete with legacy systems, create alternatives and greater choice for consumers, and decentralize a financial system too often dominated by large gatekeeper institutions that may pose systemic risks and attain too big to fail status.

For these and other reasons, it is unnecessary to target through the FSOC a developing challenger industry that is just beginning to compete with financial sector incumbents. As FSOC has even acknowledged, it is critical for existing state and federal regulators to continue their oversight of the digital assets industry and for Congress to pass necessary legislation to further address remaining regulatory gaps or ambiguities, which would ensure additional needed regulatory certainty for the digital asset ecosystem and provide greater protections for individuals engaging in the ecosystem. It is critical to undertake the regulation of digital assets in a coordinated fashion to allow for this innovation to continue to grow responsibly in the United States. This important work, though, is the proper domain of this institution, Congress, and I am grateful for the work of this Subcommittee in pursuing this goal.

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Thank you again for the opportunity to testify before you today. I look forward to answering any questions.