



Report on Stablecoins by the President’s Working Group on Financial Markets Recommends Federal Prudential Regulation of Stablecoin Issuers and Stablecoin Arrangements

November 10, 2021

The President’s Working Group on Financial Markets (the “PWG”),¹ the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency issued a long-awaited Report on Stablecoins (the “Report”) on November 1, 2021.² While acknowledging that well-designed and appropriately regulated stablecoins could support faster, more efficient and more inclusive payments options for consumers and businesses, the Report focuses on analyzing prudential risks posed by stablecoins used as a means of payment and provides recommendations for addressing what it views as key gaps in the authority of the federal banking regulators to regulate and supervise stablecoin issuers and other entities that provide services supporting stablecoin arrangements. The Report recommends that Congress promptly enact legislation to:

- (1) prohibit entities that are not insured depository institutions from issuing payment stablecoins;
- (2) subject custodial wallet providers to appropriate federal oversight; and
- (3) provide the federal supervisor of a payment stablecoin issuer with the authority to require any entity that performs activities critical to the functioning of a stablecoin arrangement to meet appropriate risk management standards.

Pending any Congressional action, the Report outlines interim measures that can be effected under existing law by the Financial Stability Oversight Council (“FSOC”) and the federal regulators utilizing their existing authorities.

¹ The PWG was established by Executive Order 12631 of March 18, 1988 and is composed of the Secretary of the Treasury, who serves as the PWG’s chair, the Chair of the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Chair of the Securities and Exchange Commission (the “SEC”) and the Chair of the Commodity Futures Trading Commission (the “CFTC”) (or their respective designees).

² https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

Background on Stablecoins

Stablecoins are digital assets that are designed to maintain a stable value relative to a national currency or other reference assets. The Report focuses on “payment stablecoins,” which are designed to maintain a stable value relative to a fiat currency and, therefore, are potentially attractive to the public as a means of payment.³ A key feature of payment stablecoins is the ability of users to redeem their stablecoins for fiat currency on a one-to-one basis, although the details and mechanics of user redemption rights are not uniform and vary considerably among stablecoins.

The Report observes that stablecoins have not yet achieved mainstream use in the U.S. for general payments and are currently predominantly used to facilitate transactions in other digital assets.⁴ Nevertheless, current and prospective market participants have expressed ambitions that their respective stablecoins be used widely by retail users to pay for goods and services, by businesses to support supply chains, and to make international remittances. While the Report acknowledges the difficulty of projecting the likely extent of use of stablecoins, it posits that the transition to broader use of payment stablecoins could occur rapidly and concludes that this possibility raises significant prudential concerns.

The Report describes the complexity of the ecosystem supporting stablecoin arrangements, including (i) creation and redemption of the stablecoin, (ii) transfers of stablecoins among parties, and (iii) storage of the stablecoin by users or by custodial wallet providers.⁵ It also notes that one or more parties, in varying combinations, are typically responsible for the performance or support of key functions supporting stablecoin arrangements,⁶ often in ways that limit meaningful accountability to users and other constituencies.

Although the Report distinguishes stablecoins that are purportedly pegged to a national currency from “synthetic” or “algorithmic” stablecoins that use other means to attempt to stabilize the value of the instrument, it does not establish or recommend a position regarding the characterization of stablecoins under federal securities or commodities laws. Depending on the facts and circumstances, the Report points out that a stablecoin may be a security, a commodity and/or a derivative within the jurisdiction of the SEC and subject to the U.S. federal securities laws, or potentially subject to the jurisdiction of the CFTC under the Commodity Exchange Act.⁷ SEC Chair Gary Gensler has recently stated that “a stable value token backed by securities . . . [is] implicated by the securities laws.”⁸ Moreover, in October 2021, the CFTC applied the broad definition of “commodity” under the Commodity Exchange Act to bring an enforcement action against the issuers of U.S. dollar tether token (USDT) for making untrue or misleading statements about its reserves.⁹

³ Report at 2.

⁴ Report at 8.

⁵ Report at 6.

⁶ Activities that support key functions performed by stablecoin arrangements are described in the Report to include: (1) governance functions focused on compliance with standards related to the purchasing, redeeming, holding, and transferring of stablecoins; (2) management of reserve assets; (3) custody of reserve assets; (4) processing of stablecoin transactions; and (5) distribution services that allow users to obtain, hold and transact in the stablecoin. Report at 6-7.

⁷ Report at 11.

⁸ See Prepared Remarks of Gary Gensler, Chair of the Securities and Exchange Commission, Before the American Bar Association Derivatives and Futures Law Committee Virtual Mid-Year Program (July 21, 2021).

⁹ See Tether to Pay \$41 Million Over Claims that Tether Stablecoin was Fully Backed by US Dollars, CFTC Rel. No. 8450-21 (Oct. 15, 2021).

Identified Risks and Regulatory Gaps

While acknowledging that payment stablecoins raise significant concerns from a market integrity, investor protection and illicit finance perspectives,¹⁰ the Report's focus is on prudential risks potentially arising from increased use of payment stablecoins, particularly if stablecoin arrangements scale rapidly.

Risks to Stablecoin Users and Stablecoin Runs

The Report rests on the observation that stablecoins can serve as a reliable means of payment or as stores of value only when there is confidence in its value, particularly in periods of stress.¹¹ For stablecoins, user confidence is based at least in part on the belief that a stablecoin's redemption feature will function effectively both during normal conditions and in periods of stress. According to the Report, the mere prospect of a stablecoin not performing as expected could result in a "run" that could spread contagiously from one stablecoin to another or to other types of financial institutions that are believed to have a similar risk profile.¹² A run could trigger a cycle of redemptions and fire sales of reserve assets, which could in turn disrupt critical funding markets, depending on the type and volume of reserve assets involved. In the absence of prudential standards, a run occurring under strained market conditions could have the potential to amplify a shock to the economy and the financial system.

Payment System Risks

The Report asserts that the risks associated with payment stablecoins, including credit risk, liquidity risk, operational risk, risks arising from improper or ineffective system governance, and settlement risk,¹³ threaten the stability of the related payment systems and may facilitate the spread of financial shocks. Moreover, because payment stablecoins rely on technologies that are not well understood, and sometimes on decentralized transaction processes and governance structures, the risks have the potential to manifest in novel ways. According to the Report, payment system risks may remain inadequately addressed for stablecoin arrangements due to lack of consistent risk management standards among arrangements, the number of different key parties that may be involved in an arrangement, and the operational complexity of an arrangement.¹⁴

Systemic Risk and Concentration of Economic Power

While the volume of payment stablecoin transactions is still relatively small in comparison to traditional forms of private and public money, the Report observes that stablecoins have grown rapidly in the last year and may continue to do so.¹⁵ Three separate policy concerns are associated with the potential for individual issuers of payment stablecoins to scale rapidly. First, the failure or distress of a stablecoin issuer or a key participant in a stablecoin arrangement (e.g., a custodial wallet provider) could result in systemic risk. Second, excessive concentration of economic power in the hands of stablecoin issuers or wallet providers could create risks similar to those traditionally associated with the mixing of banking and commerce, such as an unfair advantage in accessing credit or the misuse of data to market or restrict access to products. Third, anti-competitive effects could result if users of a dominant stablecoin face undue frictions or costs in the event they choose to switch to other payment products or services.¹⁶ In particular, the Report suggests

¹⁰ The Report highlights the potential for stablecoins to be deployed illicitly. The regulatory agencies, however, seem persuaded that their existing tools, supplemented by those of Treasury's Financial Crimes Enforcement Network with respect to illicit activities, are likely sufficient to manage the related risks of stablecoins.

¹¹ Report at 12.

¹² *Id.*

¹³ *Id.*

¹⁴ Report at 13.

¹⁵ Report at 14.

¹⁶ *Id.*

that concerns about anti-competitive effects are likely to be greater absent interoperability standards for stablecoins and stablecoin arrangements.

The Report further observes that the aggregate growth of payment stablecoins could adversely affect the financial system if, for example, insured depository institutions lose retail deposits to stablecoins, and the reserve assets that back stablecoins do not support credit creation, in which case the aggregate growth of stablecoins could increase borrowing costs and impair credit availability in the real economy.¹⁷

Regulatory Gaps

The Report concludes that stablecoin arrangements are not currently subject to a consistent set of prudential regulatory standards that address their various risks.¹⁸ Moreover, the number of different key parties that may be involved in a stablecoin arrangement, as well as the operational complexities of these arrangements, pose challenges for supervisory oversight given that responsibilities within many stablecoin arrangements are broadly distributed and either fall within the jurisdiction of different regulatory agencies or operate outside of the regulatory perimeter.

To address these gaps, the Report asserts the need for a consistent and comprehensive regulatory framework to increase transparency into key aspects of stablecoin arrangements, provide clarity of governance and otherwise ensure that stablecoins function in both normal times and in stressed market conditions.¹⁹

Recommendations for Congressional Legislation

To address prudential risks arising from the use of stablecoins as a means of payment, the Report emphasizes that Congressional action is urgently needed to subject payment stablecoins and payment stablecoin arrangements to a federal prudential framework on a consistent and comprehensive basis.²⁰ The Report notes that, given the rapid pace of technological innovation in this space, legislation should provide regulators flexibility to respond to future developments and adequately address risks across a variety of organizational structures.²¹

Stablecoin Issuers

The Report recommends that legislation should limit payment stablecoin issuance, and related activities of redemption and maintenance of reserve assets, to entities that are insured depository institutions, subject to supervision and regulation by a federal banking agency at the depository institution level and consolidated supervision by the Federal Reserve at the holding company level. Congress should also impose activities restrictions that limit affiliation with commercial entities;²² mandate prudential standards; and potentially provide for access to the appropriate elements of the federal safety net.²³

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Report at 15.

²⁰ Report at 16.

²¹ *Id.*

²² These limitations, which appear to be similar to those imposed on bank holding companies subject to the Bank Holding Company Act of 1956, which limit affiliation between banking organizations and companies engaged in activities that are not closely related to banking or financial in nature, are presumably intended to minimize conflicts of interest and competitive harm that it is feared might result from such affiliation.

²³ Report at 16.

Custodial Wallet Providers

Noting the central role played by custodial wallet providers within a stablecoin arrangement and the risks attendant to the relationship between custodial wallet providers and stablecoin users, the Report also recommends legislation requiring custodial wallet providers to be subject to appropriate federal oversight, which should include authority to restrict such service providers from lending customer stablecoins and to impose risk-management, capital and liquidity requirements. To address concerns related to concentration of economic power, the Report suggests that Congress consider imposing other standards, such as limits on affiliation with commercial entities or on use of stablecoin users' transaction data.²⁴

Other Entities Involved in Stablecoin Arrangements

To ensure that stablecoin arrangements are subject to a comprehensive regulatory framework, the Report further recommends legislation providing the federal supervisor of payment stablecoin issuers with authority to require any entity critical to the stablecoin arrangement to meet appropriate risk-management standards.²⁵ Appropriate agencies should also be granted examination and enforcement authority with respect to stablecoin activities of these entities.

Recommendations to the FSOC

Pending any Congressional action, the Report recommends that the FSOC consider steps available to it to address the risks outlined in the Report, which may include designation of certain aspects of payment stablecoin arrangements as, or as likely to become, systemically important payment, clearing and settlement ("PCS") activities pursuant to the FSOC's authority under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").²⁶ Such designation, which presumably would need to be supported by evidence more comprehensive than that marshalled by the Report,²⁷ would permit the appropriate federal agency to establish risk management standards for entities that engage in designated PCS activities, including requirements in relation to the assets backing the stablecoin, requirements related to the operation of the stablecoin arrangement, and other prudential standards. Moreover, entities that engage in designated PCS activities would also be subject to an examination and enforcement framework.²⁸

The FSOC has not previously exercised its authority under Title VIII to designate PCS activities as systemically important.²⁹ As part of the designation process, the FSOC would be required to consult with the relevant federal regulatory agencies and the Federal Reserve,³⁰ provide notice to the financial institutions whose activities would be in scope for the designation and offer such institutions an opportunity

²⁴ Report at 17.

²⁵ *Id.*

²⁶ Report at 18. *See also* 12 U.S.C. § 5463. Under Title VIII, PCS activities may be designated to the extent that such activities do not involve the offer or sale of a security or any quotation, order entry, negotiation, or other pre-trade activity or execution activity. *See* 12 U.S.C. § 5462(7)(A).

²⁷ In determining whether a PCS activity is, or is likely to become, systemically important, the FSOC is required to take into consideration the following factors: (1) the aggregate monetary value of transactions carried out through the PCS activity; (2) the aggregate exposure of a financial institution engaged in PCS activities to its counterparties; (3) the relationship, interdependencies, or other interactions of the PCS activity with other PCS activities; (4) the effect that the failure of or a disruption to the PCS activity would have on critical markets, financial institutions or the broader financial system; and (5) any other factors that the FSOC deems appropriate. *See* 12 U.S.C. § 5463(a)(2).

²⁸ Report at 18.

²⁹ To date, the FSOC has used its financial market utility ("FMU") designation authority under Title VIII to designate two payment systems as systemically important – the Clearing House Payments Company, L.L.C. (on the basis of its role as operator of the Clearing House Interbank Payments System) and CLS Bank International, an Edge Act corporation that provides foreign exchange-related services. The FSOC also has authority to designate nonbank financial companies as "systemically important financial institutions" pursuant to Title I of the Dodd-Frank Act. *See* 12 U.S.C. § 5323.

³⁰ 12 U.S.C. § 5463(c)(1).

for a hearing.³¹ The designation of PCS activities as systemically important must be approved by a vote of at least two-thirds of the FSOC members, including an affirmative vote by its chairperson.³²

Regulatory Agency Actions

In the Report, the federal regulatory agencies expressed their commitment to taking action to address risks falling within each agency's jurisdiction and to continued coordination and collaboration on issues of common interest.³³ For example, the Report notes that, in evaluating a charter application, the banking agencies will seek to ensure that applicants address the risks outlined by the report, including risks associated with stablecoin issuance and other related services conducted by the banking organization or third-party service providers. The Report also notes that relevant authorities, including the Department of Justice, may consider whether or how section 21(a)(2) of the Glass-Steagall Act³⁴ may apply to certain stablecoin arrangements. Moreover, the Report points out that CFPB and consumer financial protection laws also provide a number of safeguards that may be applicable to stablecoins and stablecoin arrangements, including the Electronic Fund Transfer Act, the Gramm-Leach-Bliley Act, and the Consumer Financial Protection Act.³⁵

Following the issuance of the Report, several federal regulatory agency leaders issued statements undertaking to take action within their jurisdiction to address the risks identified in the Report.

- In a statement released on November 1, 2021, Acting Comptroller of the Currency Michael J. Hsu noted that the “rapid growth of stablecoins as *an innovative and unregulated means to engage in speculative digital asset trading, lending and borrowing is in equal measures awe-inspiring and unsettling*. While the salient risks may be mostly trading-related today, tomorrow the risks will be much broader than that and it behooves us as regulators to be strategic in how we approach this and think ahead.”³⁶
- In a speech two days later, Acting Comptroller Hsu stated that issuers of highly-circulated stablecoins “should embrace comprehensive, consolidated supervision,” while federal and state banking regulators “should prioritize the development of policies, staff, and supervisory approaches to bring such firms safely into the bank regulatory perimeter.”³⁷ Acting Comptroller Hsu’s speech is notable for its focus on the activities of crypto and other fintech firms that currently operate outside of the bank regulatory perimeter while seemingly providing banking and other financial services.

³¹ 12 U.S.C. § 5463(c)(2).

³² 12 U.S.C. § 5463(a)(1). The FSOC consists of ten voting members and five non-voting members. The voting members are the Secretary of the Treasury, who serves as the FSOC’s Chair; the Chair of the Federal Reserve; the Comptroller of the Currency; the Director of the Bureau of Consumer Financial Protection (“CFPB”); the Chair of the SEC; the Chair of the Federal Deposit Insurance Corporation; the Chair of the CFTC; the Director of the Federal Housing Finance Agency; the Chair of the National Credit Union Administration; and an independent member with insurance expertise. The non-voting members are the Director of the Office of Financial Research; the Director of the Federal Insurance Office; a designated state insurance commissioner; a designated state banking supervisor; and a designated state securities commissioner. See 12 U.S.C. § 5321(b).

³³ Report at 18.

³⁴ *Id.* See 12 U.S.C. § 378(a)(2), which prohibits any person or entity from engaging “to any extent whatever ... in the business of receiving deposits subject to check or to repayment upon presentation of a pass book, certificate of deposit, or other evidence of debt, or upon request of the depositor, unless such person, firm, corporation, association, business trust, or other similar organization” is subject to regulation and oversight in the U.S. similar to banks.

³⁵ Report at 18.

³⁶ Statement by the Acting Comptroller of the Currency Michael J. Hsu on the Report on Stablecoins (Nov. 1, 2021) (emphasis added), available at <https://www.occ.gov/news-issuances/speeches/2021/pub-speech-2021-112.pdf>.

³⁷ Michael J. Hsu, *Leveling Up Banking and Finance*, remarks before the American Fintech Council Fintech Policy Summit 2021 (Nov. 3, 2021) at 11 (“Hsu Speech”), available at <https://www.occ.treas.gov/news-issuances/speeches/2021/pub-speech-2021-115.pdf>.

Among other things, drawing on the lessons learned by the federal regulators over the last several decades, and particularly during the 2008 financial crisis, he warned that, without comprehensive, consolidated supervision, no single regulator can see and understand how a firm as a whole operates and takes risks, allowing risks to build out of the sight and reach of regulators.³⁸ Acting Comptroller Hsu further noted that the “rebundling of banking services by fintechs and the fragmented supervision of universal crypto firms pose *significant medium- to long-term risks to consumers, businesses, and financial stability*,” a significant problem that, in his view, should be addressed through modernizing and clarifying the bank regulatory perimeter to ensure appropriate supervision and regulation for such firms.³⁹

- In a statement released on November 1, 2021, CFPB Director Rohit Chopra stated that the United States “must do more to nurture a fast, safe, and competitive payments system.”⁴⁰ Noting that the Report highlights how stablecoins could be vulnerable to runs and fire-sales in ways that could create stress on the broader financial system absent adequate oversight, Director Chopra stated that “*the CFPB is actively monitoring and preparing for broader consumer adoption of cryptocurrencies*. Currently, stablecoins are primarily used for speculative trading in cryptocurrency markets. However, stablecoins may also be used for and in connection with consumer deposits, stored value instruments, retail and other consumer payments mechanisms, and in consumer credit arrangements. *These use cases and others trigger obligations under federal consumer financial protection laws, including the prohibition on unfair, deceptive, or abusive acts or practices.*”⁴¹
- In a statement released on November 1, 2021, SEC Chair Gary Gensler stated that “the use of stablecoins presents a number of public policy challenges with respect to protecting investors. Further, stablecoins may facilitate those seeking to sidestep a host of public policy goals connected to our traditional banking and financial system: anti-money laundering, tax compliance, sanctions, and other safeguards against illicit activity.”⁴² Chair Gensler further noted that “[w]hile Congress and the public evaluate this report, we at the SEC and our sibling agency, the [CFTC], will deploy the full protections of the federal securities laws and the Commodity Exchange Act to these products and arrangements, where applicable.”⁴³

Conclusion

The Report represents an important step by the U.S. federal regulators in making clear their position that stablecoin issuers and other stablecoin arrangement participants should be subject to federal prudential regulation. At the same time, the Report’s recommendations raise additional issues that have not been addressed in the Report. For example, the Report is silent on whether payment stablecoins should be treated as deposits for purposes of the federal banking laws. The Report also does not express a view as to whether a new type of a special purpose charter should be created for insured depository institutions that limit their activities to issuing stablecoins and whether such institutions would be subject to

³⁸ Hsu Speech at 9.

³⁹ Hsu Speech at 11-12 (emphasis added).

⁴⁰ Statement of CFPB Director Chopra on Stablecoin Report (Nov. 1, 2021), available at <https://www.consumerfinance.gov/about-us/newsroom/statement-cfpb-director-chopra-stablecoin-report/>.

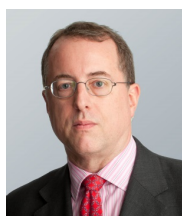
⁴¹ *Id.* (emphasis added).

⁴² Statement of Chair Gensler on the President’s Working Group Report on Stablecoins (Nov. 1, 2021), available at <https://www.sec.gov/news/statement/gensler-statement-presidents-working-group-report-stablecoins-110121>.

⁴³ *Id.*

requirements such as the Community Reinvestment Act. Overall, it remains to be seen whether the Report's urgent call for legislative action will be heeded by Congress and whether, in the interim, the FSOC will be able to successfully navigate a designation process for PCS activities under Title VIII of the Dodd-Frank Act.

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