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IN FOCUS

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Stablecoin Policy Issues for the 118th Congress

Stablecoins are digital financial instruments that use technology underpinning cryptocurrencies (e.g., Bitcoin and Ether) but attempt to eliminate volatility by pegging their value to a stable asset (e.g., one U.S. dollar). For more information, see CRS In Focus IF11968, *Stablecoins: Background and Policy Issues*. Stablecoins have garnered significant congressional attention because of the wider interest generated by cryptocurrencies and claims that they could improve payments. Recent instability and failures in stablecoin markets have also raised systemic risk concerns. This In Focus addresses current stablecoin-related policy issues and policymakers' efforts to regulate them.

Regulatory Framework

In the absence of an explicit overarching regulatory framework, various federal and state regulatory agencies have improvised a de facto framework comprising guidance and enforcement actions, applying existing banking and capital market regulations to stablecoins where applicable. Today, stablecoin issuance remains the domain of state-licensed nonbank entities (e.g., money services businesses), which face limited federal oversight outside of registration requirements for anti-money laundering purposes.

Federal bank regulators have established guidelines for potential bank stablecoin activity. In a series of interpretive letters in 2020 and early 2021, the Office of the Comptroller of the Currency (OCC) outlined various stablecoin activities permitted by banks, including custodying cryptocurrency and holding stablecoin reserves, among others. In late 2021, the OCC seemingly affirmed these previous views but imposed a requirement that a bank notify its regulatory supervisor of its intention to engage in such practices and not to engage until it receives written notification of "non-objection."

Similarly, the Federal Reserve Board issued a supervision and regulation letter mandating that banks confirm the permissibility of actions, establish appropriate risk management and other controls, and notify a point of contact prior to engaging in any crypto-related activity (including stablecoins). The Federal Deposit Insurance Corporation (FDIC) issued similar guidance. For more, see CRS In Focus IF12320, *Crypto and Banking: Policy Issues*.

Some stablecoins may also fall under the jurisdiction of the Securities and Exchange Commission (SEC). In 2023, the SEC took legal actions against Terraform Labs, issuer of the UST algorithmic stablecoin, alleging it had, among other things, issued unregistered securities in the form of stablecoin UST and its "balancer coin," LUNA. (Algorithmic stablecoins are generally not backed by any assets and use computer programs to monitor supply and demand and manage issuance of the stablecoins. For more, see CRS Insight IN11928, *Algorithmic Stablecoins and the TerraUSD Crash*.) According to the SEC, UST satisfied the *Howey test*, a legal standard it uses to identify a security with four prongs: (1) the investment of money, (2) in a common enterprise, (3) with a reasonable expectation of profits, (4) to be derived from the efforts of others. Stablecoins are not expected to appreciate or generate returns. However, the SEC cited Terraform's promotion of nearly 20% returns from the affiliated Anchor protocol as proof, in part, of the expectation of profits.

Policy Options

Congress may consider how the existing framework accommodates existing licensure and permissions for money service businesses and banks or whether legislation is needed requiring the former to acquire federal licenses and the latter to establish subsidiaries to continue engaging in such activity.

Regulatory Jurisdiction

Legislation has generally considered stablecoins in their prospective capacity as payment instruments. The term *payment stablecoin* is sometimes used to define such instruments. However, for a variety of reasons, such distinctions do not exist in practice. Stablecoins have not been widely adopted for retail payments but are considered a crucial component of crypto trading. Also, stablecoins are currently not issued directly by issuers for retail use, a perk for which one requires a business account. To the extent that legislation focuses on payment stablecoins, Congress could consider how much clarity to provide in statute—potentially defining it broadly or narrowly—or whether to defer to regulators to provide a definition. Given that major stablecoins are not currently used primarily for retail payments, how legislation defines *payment stablecoin* could determine whether they are included in any new regulatory framework. Congress may also consider whether stablecoin issuers are able to opt in/out of a framework or whether existing issuers should be grandfathered out of the framework.

As such, a key policy issue is regulatory jurisdiction. Congress can mandate that authorized stablecoins issuers be chartered or licensed at the federal level by one or more agencies, at the state level, or some combination thereof. In the absence of a dedicated federal payment regulator, bank chartering may serve as a model for such decisions. (For more information, see CRS Report R47014, *An Analysis of Bank Charters and Selected Policy Issues*.) In November 2021, the Treasury Department and regulators issued a *Report on Stablecoins*, which recommended that "legislation should limit stablecoin issuance, and related activities … to entities that are insured depository institutions," such as banks.

The report suggested, "Depending on the facts and circumstances, a stablecoin may constitute a security, commodity, and/or derivative implicating the jurisdiction of the SEC … or the CFTC [Commodity Futures Trading Commission]." While the report did not elaborate, the chair of the SEC listed various potential attributes to consider, such as whether or not the stablecoin pays interest, the mechanisms used to maintain its value, and how it is offered and subsequently used. Therefore, the question of whether stablecoins are securities or commodities remains open, with policy ramifications.

Congress may consider whether to regulate all stablecoins similarly or whether those that are backed by deposits and traditional securities and more closely resemble payment products should be regulated differently than those with a different structure. Similarly, if legislation puts stablecoins in the jurisdiction of banking regulators, it raises the issue of whether to absolve it from SEC or CFTC regulatory requirements or whether there may be overlapping jurisdictions. If various charter types (including nonbanks) with different regulators (including state regulators) are permitted, it would raise the issue of how to establish uniform requirements and whether such requirements can be applied evenly by various regulators.

Master Accounts

In recent years, the question of whether newer financial institutions—such as fintech companies or cryptocurrency firms—should have access to master accounts at the Federal Reserve has emerged as a key policy issue. Master accounts allow holders to access the Fed's wholesale payment systems and related Fed payment services. (For more on master accounts, see CRS Insight IN12031, *Federal Reserve: Master Accounts and the Payment System*.) In August 2022, the Fed issued final guidance stating that it may grant master accounts only to member banks or depository institutions. As such, if Congress permits nonbanks to continue issuing stablecoins, existing policy may prevent them from accessing master accounts.

Deposit Insurance

Federal deposit insurance protects bank depositors up to a limit from losses that could occur if an insured depository institution were to become insolvent. The FDIC oversees the deposit insurance fund. The FDIC has issued guidance clarifying that deposit insurance does not apply to digital assets. However, the *Report on Stablecoins* suggested that "with respect to stablecoin issuers, legislation should provide for … potentially, access to appropriate components of the federal safety net," which may include FDIC insurance.

Legislators therefore may consider whether deposit insurance would apply to stablecoins issued by banks, if permitted, and whether to extend insurance to nonbanks. If legislation were to omit stablecoins from deposit insurance protection, Congress may consider what priority to give stablecoin holders in the event of a failure. Congress could also consider what role the existence or absence of deposit insurance guarantees may have on issuers' decisions when selecting among potential types of licensure/charters, competition among issuers with different licenses, moral hazard and the need for safety and soundness regulations to protect the deposit insurance fund, and consumers' decision-making when choosing among stablecoins.

Consumer and Investor Protection

Relatedly, stablecoin issuers and the firms that trade stablecoins present customer and investor protection considerations. For example, an issuer is not currently required to disclose information about a stablecoin's underlying technology or its reserves, which may create operational risks and information asymmetry. Also, unlike traditional brokers, which must segregate customer funds, stablecoin issuers and cryptocurrency platforms may be co-mingling user funds with platforms funds. This could make it difficult for holders to retrieve funds if the exchange were hacked or went bankrupt, putting users in the disadvantageous position of being "unsecured creditors." (For more information, see CRS Legal Sidebar LSB10832, *Crypto Assets and Property of the Bankruptcy Estate: An Analysis*.) Instead, stablecoin transactions occur on exchanges, and issuers and exchanges may have undisclosed relationships that create conflicts of interest.

Considering the novel risks posed by stablecoins, Congress may choose to subject issuers to prudential regulation similar to that of banks, or it may adopt the same disclosure, segregation, custody, and conflict-of-interest rules that apply to traditional securities and intermediaries. Alternatively, it may opt to adopt stablecoin-specific measures to mitigate risks.

Reserves and Disclosure

Currently, there are no requirements regarding the types of assets an issuer must hold to back stablecoins, the ratio of assets to stablecoins at which assets must be held (for example, one to one), or the capital that issuers must hold. Similarly, there are no rules requiring issuers to disclose this information. Instead, issuers provide information at their own discretion, and reserve compositions vary. Some issuers opt to subject themselves to monthly attestations—financial reviews that are less robust than formal audits.

A key policy issue is whether Congress should prescribe the types and duration of assets that are permitted to back (or be held by) a fiat-backed stablecoin based on their liquidity and likelihood of default, for example, and the ratio in which they should be held. In addition, Congress may consider whether to impose certain reporting and auditing requirements on issuers.

Committee Legislative Proposals

The 117th Congress ended before the release of a bill reportedly negotiated by members of the House Committee on Financial Services. In the 118th Congress, the committee majority released the bill, which was quickly disowned by some minority lawmakers. Since then, the chair and ranking member have each issued stablecoin discussion drafts, a hearing for which was held on May 18, 2023. While the two bills include various areas of overlap, debate is likely to center on the several differences between the proposals.

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