Remarks by Under Secretary for Domestic Finance Nellie Liang to the Stanford Graduate School of Business

November 1, 2021

Thank you, Professor Duffie, for allowing me to speak here today and talk with you about the new report on stablecoins by the President’s Working Group on Financial Markets (PWG).

The PWG, which includes Treasury, the Federal Reserve Board, the SEC, and the CFTC, was created to strengthen U.S. financial markets. Secretary Yellen convened this group in July 2021 to assess the risks of stablecoins, identify regulatory gaps, and make recommendations to address those gaps. For this report, the PWG was joined by the FDIC and OCC. The agencies came together to produce a set of recommendations for payment stablecoins and payment stablecoin arrangements – meaning those stablecoins that are designed to maintain a stable value relative to a fiat currency and, therefore, have the potential to be used as a widespread means of payment.

The scope of this report is limited to stablecoins. Additional work on digital assets and other innovations related to cryptographic and distributed ledger technology is ongoing throughout the Administration. This report by independent financial regulators led by the Treasury Secretary is just one component of this agenda. The Administration and the financial regulatory agencies will continue to collaborate closely on ways to foster responsible financial innovation, promote consistent regulatory approaches, and identify and address potential risks that arise from such innovation.

Stablecoins have been growing rapidly, having grown about 500 percent in the past twelve months. Today, stablecoins are predominantly used to facilitate trading of other crypto assets. But looking ahead, there is potential for stablecoins that are designed to maintain a stable value relative to a fiat currency to become widely used by households and businesses for payments. We have been busy over the last few months, meeting with industry, public interest groups, Congress, our peers in other jurisdictions, and others. Many, including consumer advocates and stablecoin issuers themselves, generally acknowledged the need for more robust oversight and expressed a preference for greater regulatory clarity.
The primary recommendation in the PWG report is for Congress to enact legislation to ensure that payment stablecoins and payment stablecoin arrangements are subject to a federal prudential framework on a consistent and comprehensive basis. Absent urgently-needed legislation, the agencies can apply their existing authorities and consider FSOC authorities, but we believe legislation is the best way to address prudential regulatory gaps.

Having told you where the report comes out, let me tell you how we got there.

**PAYMENT STABLECOINS AND PRUDENTIAL RISKS**

Stablecoins that are designed to maintain a stable value relative to fiat currency typically offer an expectation of redemption at par. They are supported by a pool of reserve assets – which, according to some stablecoin issuers, may include Treasuries, commercial bank deposits, commercial paper, though transparency is lacking and no regulator is in a position to confirm the assets. While the market value of stablecoins remains small relative to the market cap for crypto assets, stablecoins have an outsized role because they support broader crypto trading and the functioning of decentralized finance.

If well-designed and appropriately regulated, stablecoins could support faster, more efficient, and more inclusive payments options. However, absent appropriate safeguards, stablecoins present potential risks to users, the financial system, and the economy. These risks include uses for illicit finance, and risks to investor protection and market integrity. They also include prudential concerns, which are the main focus of the report. In particular, the report and its recommendations focus on three major prudential risks:

First, run risk, in which a loss of confidence in the reserve assets backing a stablecoin prompts mass redemptions and forces asset sales. In addition, concerns about a stablecoin could lead to loss of confidence in other stablecoins given less than-full-transparency on their reserve holdings. These runs and resulting asset sales could disrupt funding markets, depending on the size and types of assets sold.

Second, payment system risks, including disruptions related to mechanisms that allow stablecoins to be stored or transferred among users. If stablecoins become widely used and the related service providers or technology are not resilient, this could lead to risks of substantial disruptions in a critical payments service.

Third, there are additional risks linked to the potential for some stablecoins to rapidly scale due to network effects, for example. Very large stablecoins could raise concerns about
systemic risk or concentration of economic power.

Currently, prudential oversight of stablecoins is inconsistent, with some stablecoins effectively falling outside the regulatory perimeter. Even where the issuer is regulated, supervision may be fragmented due to the complexity of stablecoin arrangements. These observations echo what we heard in stakeholder outreach – stablecoin issuers themselves tell us they would benefit from greater regulatory clarity.

**RECOMMENDATIONS TO ADDRESS GAPS IN PRUDENTIAL OVERSIGHT OF STABLECOINS**

The interagency group makes several recommendations to address prudential gaps. In brief, we urge Congress to act promptly to enact legislation to ensure that payment stablecoins and payment stablecoin arrangements are subject to a federal prudential framework on a consistent and comprehensive basis. Legislation would cover multiple parts, and should include appropriate prudential standards for issuers, wallets, and other key service providers.

To address run risk, the report urges Congress to consider requiring stablecoin issuers to be insured depository institutions, with appropriate supervision and regulation at the depository institution and holding company level.

To address payment system risk, the report recommends requiring custodial wallet providers, who play a key role in the storage/transfer of stablecoins, to be subject to appropriate federal oversight. We advise providing supervisors of stablecoin issuers with broad authority to require entities that perform critical activities in a stablecoin arrangement to comply with risk management standards for those activities.

To address additional concerns about systemic risk and concentration of economic power, the report recommends prohibiting stablecoin issuers from having commercial affiliates. Supervisors of stablecoin issuers should be provided with authority to promote interoperability across stablecoins, and between stablecoins and other payment instruments. In addition, Congress could consider prohibiting custodial wallet providers from affiliating with commercial companies.

The agencies believe that legislation is urgently needed to comprehensively address the prudential risks posed by payment stablecoin arrangements, given their rapid growth and potential to grow further. In the interim, regulators have some authorities. For example, in
evaluating a charter application, the banking agencies can seek to ensure that applicants address the risks outlined by the report. For those stablecoins that are securities, commodities, and/or derivatives, the federal securities laws and authorities of the Commodity Exchange Act (CEA) can provide important investor and market protections, as well as transparency benefits. In addition, the Consumer Financial Protection Bureau and consumer financial protection laws also provide a number of safeguards in the payments sector. Finally, the offer of “money transmission services” in stablecoin arrangements trigger federal obligations for anti-money laundering and countering the financing of terrorism controls.

In addition to these authorities, in the absence of urgently-needed Congressional action, the Financial Stability Oversight Council (FSOC) should consider steps available to it to address the risks outlined in the report, including the designation of certain activities conducted within a stablecoin arrangement as, or as likely to become, systemically important payment, clearing, and settlement activities.

All told, the authorities of the regulatory agencies and the FSOC may be able to address specific concerns, but they are unlikely to be a substitute for Congressional action establishing a prudential framework.

To summarize, in response to new technological advances and changing demand for financial services we believe new prudential safeguards are necessary for payment stablecoins and payment stablecoin arrangements. We lay out a roadmap for Congress to reduce prudential risk concerns to users and the broader financial system, provide regulatory clarity, and enable responsible financial innovation.

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