Remarks from Secretary of the Treasury Janet L. Yellen on Digital Assets

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WASHINGTON — Secretary of the Treasury Janet L. Yellen delivered remarks on digital assets policy, innovation, and regulation at American University's Kogod School of Business Center for Innovation.

Remarks as prepared

Thank you, President Burwell, for that kind introduction – it is good to be with you again. I am so happy to be at American University where changemakers are changing the world. Groundbreaking leaders in government, academia, and business have walked these halls, and I am pleased to be here to discuss the Biden Administration's approach to digital assets.

A few weeks ago, President Biden signed an Executive Order calling for a coordinated and comprehensive government approach to digital asset policy. Digital assets have grown explosively, reaching a market cap of $3 trillion last November from $14 billion just five years prior.

Digital assets may be relatively new, but they are part of a larger trend – the digitization of finance – that has been in the making for decades. In 1990, there were fewer than 3 million internet users. Now, there are about 4.5 billion, and we take for granted that many aspects of our financial lives can be managed from small internet-connected devices that fit into the palms of our hands.

This growth in digital services has opened a world of possibilities and risks that would have seemed fantastical only a few decades ago. Financial services – along with most industries – have evolved in response to exponential advances in computing power and connectivity.

Most recently, new technology has raised the possibility of reduced reliance on centralized intermediaries like banks and credit card companies. In 2008, a person – or group of people – using the pseudonym Satoshi Nakamoto proposed a decentralized peer-to-peer system for making and processing payments. A key challenge in digital payments is to prevent the same assets from being spent twice. The Bitcoin white paper proposed a novel method for validating transactions using cryptography that addressed the so-called "double spend" problem. This and other innovations related to distributed ledger technology are the foundation for blockchain-based digital assets.

Over time, the prices of Bitcoin and other cryptocurrencies have been quite volatile, which has inhibited their widespread use in payments. Adoption of cryptocurrencies for payments may be further inhibited by high fees and slower processing times than those associated with other forms of payment. As a practical matter, you'd have a hard time using cryptocurrency to buy a sandwich or a gallon of milk. Other digital assets – like stablecoins or potential Central Bank Digital Currencies – could succeed at being more widely used as a means of exchange, raising potential benefits and risks.

Proponents believe distributed ledger technology will transform other aspects of financial services like trading, borrowing, and lending. They point to capabilities, like smart contracts, which use computer code to automatically execute an agreement if certain prespecified conditions are met. To the extent that setup is more convenient, and costs are competitive with those required for traditional financial services, digital assets offer the potential to expand access.

President Biden's Executive Order tasked experts across the federal government with conducting in-depth analysis to balance the responsible development of digital assets with the risks they present. These tasks will be guided by six policy objectives: first, protect consumers, investors, and businesses; second, safeguard financial stability from systemic risk; third, mitigate national security risks; fourth, promote US leadership and economic competitiveness; fifth, promote equitable access to safe and affordable financial services; and, finally, support responsible technological advances, which take account of important design considerations like those related to privacy, human rights, and climate change. Over

approximately the next six months, Treasury will work with colleagues in the White House and other agencies to produce foundational reports and recommendations related to these objectives. In many cases, the work tasked by the Executive Order builds upon ongoing efforts at Treasury.

I won't predict where this work will take us, but that does not mean we are navigating without a compass. Digital assets may be new, but many of the issues they present are not. We have enjoyed the benefits of innovation in the past, and we have also confronted some of the unintended consequences.

Today, I want to share five lessons that apply as we navigate the opportunities and challenges posed by these emerging technologies. These lessons relate to the nature of responsible innovation, the structure of appropriate guardrails, the fundamentals of the financial system, our role in the global economy, and the value of collaboration.

The first lesson is…

I. Our financial system benefits from responsible innovation

New technologies build on older ones and a chain of innovation has transformed financial services over time. Seventy years ago, most Americans used coins, cash, and checks to manage most aspects of their financial lives. Then, in the 1960s, an engineer from IBM attached a magnetic strip to a plastic card and sparked a new category of payment products: credit and debit cards. Those innovations facilitated the growth of other technologies, like ATMs, which made cash available 24/7. More recently, computers, the internet, and mobile phones have driven the explosive growth of electronic payments and online commerce.

Although new technologies have made our financial system more efficient for most Americans, many transactions still take too long to settle. A combination of technological factors and business incentives have produced a common frustrating experience shared by tens of millions of Americans every week: their employer sends their paycheck, but it takes up to two days for the check to hit their bank account. The delay contributes to the use of high-

cost check cashers or 'pay day' lenders to get their money in time to pay their bills. Some are forced to draw against already low balances and are charged overdraft fees. Estimates suggest Americans spend $15 billion or more each year on such fees and services – essentially a tax of about $100 dollars per working American, due mostly to inefficiency, and disproportionately borne by people with lower incomes.

The system is even more expensive and frustrating when you zoom out and look internationally.

If you live in a G7 country, you may pay below two percent in transaction and conversion fees to send money across the border. If you live in the developing world, you may pay as high as ten percent. These high costs disproportionately impact the 250 million-plus migrants around the world who send an average of $200 to $300 in remittances to their families each month. Proponents of digital assets envision a more efficient payment system with instantaneous transactions and lower costs no matter where you live.

Will the technology live up to that promise? I think it's too early to tell. Issues like processing time, cost, and technological barriers to access will need to be overcome. The US is actively involved in the work of the G20 to address challenges and frictions with cross-border funds transfers. And, in 2023 the Federal Reserve plans to launch FedNow, an instant payment service that will enable payment in real time, around the clock, every day of the year within the US' payments system.

Some have also suggested that the introduction of a Central Bank Digital Currency, or "CBDC", could contribute to a more efficient payment system. As a liability of the central bank, a CBDC could become a form of trusted money comparable to physical cash, but potentially offering some of the projected benefits of digital assets.

Under the Executive Order, the Administration will publish a report on the future of money and payments. The report will analyze possible design choices related to a potential CBDC and implications for payment systems, economic growth, financial stability, financial inclusion, and national security.

Innovation that improves our lives while appropriately managing risks should be embraced. But we must also be mindful that "financial innovation" of the past has too often not benefited working families, and has sometimes exacerbated inequality, given rise to illicit finance risks, and increased systemic financial risk.

This brings me to my next lesson…

II. When regulation fails to keep pace with innovation, vulnerable people often suffer the greatest harm

We learned this painful lesson during the Global Financial Crisis. Financial institutions called "shadow banks" and an explosion of new financial products allowed dangerous levels of risks to accumulate. Beginning in 2007, investors grew wary of these risks, and some large institutions began to falter. Soon, people who'd never heard of a "shadow bank" or a subprime mortgage-backed security ended up losing their jobs and life savings. The S&P 500 fell by more than half and household net worth dropped precipitously. The resulting economic distress was most acute and long-lasting for Black Americans and other Americans of color. We need to ensure that the growth of digital assets does not allow similarly dangerous risks to emerge or lead to disproportionate impacts to vulnerable communities.

Already, the Treasury has worked with the President's Working Group on Financial Markets, the FDIC, and OCC to study stablecoins, a type of cryptocurrency pegged to a stable source of value, often the US dollar. Stablecoins raise policy concerns, including those related to illicit finance, user protection, and systemic risk. And, they are currently subject to inconsistent and fragmented oversight.

To peg their stablecoin to a dollar, most issuers say they back their coins with traditional assets that are safe and liquid. This way, whenever you want to trade your stablecoin back into a dollar, the company has the money to make the exchange. But, right now, no one can assure you that will happen. In times of stress, this uncertainty could lead to a run.

This is not hypothetical. A stablecoin run occurred in June 2021, when a sharp drop in the price of the assets used to back a stablecoin set off a negative feedback loop of stablecoin redemptions and further price declines.

The PWG report on stablecoins assesses these risks and proposes concrete solutions. And, we are now working with Congress to advance legislation to help ensure stablecoins are resilient to risks that could endanger consumers or the broader financial system. We are also working closely with our international partners to promote consistent regulation and supervision across jurisdictions.

Of course, stablecoins are just one piece of a much larger ecosystem of digital assets. Our regulatory frameworks should be designed to support responsible innovation while managing risks – especially those that could disrupt the financial system and economy. As banks and other traditional financial firms become more involved in digital asset markets, regulatory frameworks will need to appropriately reflect the risks of these new activities. And, new types of intermediaries, such as digital asset exchanges and other digital native intermediaries, should be subject to appropriate forms of oversight.

We must also be prepared for possible changes in the structure of financial markets. For example, some have suggested that distributed ledger technology could reduce concentration in financial markets. While this could make markets less vulnerable to the failure of any particular firm, it is critical to ensure we maintain visibility into potential build-ups of systemic risk and continue to have effective tools for tamping down excesses where they arise.

President Biden's Executive Order calls on the Financial Stability Oversight Council to identify specific financial stability risks and regulatory gaps posed by various types of digital assets and make recommendations to address them. While I don't know what the FSOC will find or conclude, there is one basic lesson that should apply…

III. Regulation should be based on risks and activities, not specific technologies

When new technologies enable new activities, products, and services, financial regulations need to adjust. But, that process should be guided by the risks associated with the services provided to households and businesses, not the underlying technology.

Wherever possible, regulation should be "tech neutral." For example, consumers, investors, and businesses should be protected from fraud and misleading statements regardless of whether assets are stored on a balance sheet or distributed ledger. Similarly, firms that hold customer assets should be required to ensure those assets are not lost, stolen, or used without the customer's permission. And, taxpayers should receive the same type of tax reporting on digital asset transactions that they receive for transactions in stocks and bonds, so that they have the information they need to report their income to the IRS. Under the Executive Order, we will work to make sure consumers, investors, and businesses have adequate protections from fraud and theft, privacy and data breaches, and unfair and abusive practices. Great care must also be applied to ensure innovations do not cause disparate harm to vulnerable communities or exacerbate social, racial, or economic inequities.

In many cases, regulators have authorities they can use to promote these objectives and Treasury supports those efforts. If people are breaking the law and exploiting the interests of others, they should be held accountable. To the extent there are gaps, we will make policy recommendations, including assessment of potential regulatory actions and legislative changes. Continuing to update and improve our regulatory architecture will support US economic competitiveness and reinforce leadership in the global financial system.

The principle of tech neutrality is also applicable to concerns related to tax evasion, illicit finance, and national security – topics that are particularly pertinent in the world today. It's illegal to evade taxes, launder money, or avoid sanctions. It doesn't matter whether you're using checks, wires, or cryptocurrency. For nearly a decade, Treasury has been monitoring innovations in digital assets and updating our rules and guidance to clarify the application of our Anti-Money Laundering and Countering the Financing of Terrorism framework to the digital asset ecosystem. We've also been working with our international counterparts to

strengthen AML/CFT programs abroad to better protect against exploitation by illegal actors. And, we'll continue to take action when appropriate. Just this week, Treasury's Office of Foreign Assets Control took strong action against the world's largest and most prominent darknet market, Hydra, as well as Garantex, a ransomware-enabling virtual currency exchange. Under the President's Executive Order, Treasury and colleagues across the Administration will build upon the recently published National Risk Assessments, which identify key illicit financing risks associated with digital assets. We'll also work with our allies and partners to help ensure international frameworks, capabilities, standards, and partnerships are aligned and adequately responsive to risks.

Although innovations in computing have accelerated the pace of change, even the most foundational building blocks of our economy – including our money itself – have evolved dramatically over time.

This ties into my next lesson…

IV. Sovereign money is the core of a well-functioning financial system and the US benefits from the central role the dollar and US financial institutions play in global finance

It took time for the United States to establish a uniform national currency.

In 1790, Secretary Alexander Hamilton bemoaned what he called the "immense disorder" of the US monetary system. At the time, Americans relied on a variety of domestic and international currencies circulating simultaneously. The proliferation of different forms of "money" made it difficult to run the economy. To help address these concerns, the Bank of the United States was formed in 1791 and issued notes that provided a relatively stable national currency. In 1792, the Coinage Act was passed, creating the US Mint and kicking off a century of debate about whether the dollar should be pegged to silver or gold.

While these important innovations helped standardize the backing of the dollar, the Bank of the United States did not have lasting political support. By the mid-1800s, the country relied

on a fragmented system of paper notes issued by private banks. New Jersey banks issued notes that were different from the ones issued in New Hampshire or New York. And, because different banks were not seen to carry the same risks, people valued the notes differently. This system of private money did function to a degree, but it made transactions expensive and inefficient, and it contributed to bank runs for many decades.

A crisis catalyzed reform. Embroiled in the Civil War, President Lincoln and Treasury Secretary Salmon Chase needed to introduce more stability to our financial system. Congress passed the National Bank Act, which allowed banks to issue national bank notes, but the banks had to be adequately supervised and the notes were required to be backed with U.S. Treasuries. This requirement ensured that a dollar in New Jersey was always as good as a dollar in New Hampshire. Later, the Federal Reserve Act further institutionalized the national objective of a uniform currency.

The development of our currency to its current form has been a dynamic process that took place over centuries. Today, monetary sovereignty and uniform currency have brought clear benefits for economic growth and stability. Our approach to digital assets must be guided by the appreciation of those benefits.

Some have suggested a CBDC could be the next evolution in our currency. A recent report by the Federal Reserve opened a public dialogue about CBDCs and the potential benefits and risks that could be associated with issuing one in the US. The President's Executive Order calls for us to consider this question from several perspectives. For example, what impact would a US CBDC have for implementing macro stabilization policies and private credit creation? Could it make the financial system more equitable, accessible, and inclusive? How could it be designed to manage risks associated with national security and financial crime, while including privacy protections? How might a US CBDC interact with existing national currencies, foreign CBDCs or private stablecoins?

We need to consider these important questions in the context of the central role the dollar plays in the world economy.

The dollar is the mostly widely used currency for global trade and finance. It is by far the most

traded currency, accounting for nearly 90% of one leg in foreign exchange transactions and over half of trading invoices. US dollar-denominated assets account for about half of cross-border bank claims and more than 40% of outstanding international debt securities. And with the dollar's strong trade and financial linkages—as well as strong US macroeconomic and monetary credibility—central banks have chosen to hold nearly 60% of their foreign exchange reserves in dollars.

The dollar's international prominence is strongly supported by US institutions and policies; US economic performance; open, deep and liquid financial markets; rule of law; and a commitment to a free-floating currency. As citizens of this country, we derive significant economic and national security benefits from the unique role the dollar and US financial institutions play in the global financial system. The President's Executive Order asks us to consider whether and how the issuance of a public CBDC would support this role.

I don't yet know the conclusions we will reach, but we must be clear that issuing a CBDC would likely present a major design and engineering challenge that would require years of development, not months. So, I share the President's urgency in pulling forward research to understand the challenges and opportunities a CBDC could present to American interests.

As we consider these big choices, we must also remember that technology-driven financial innovation is inherently cross-border and requires international cooperation. We have a strong interest in ensuring that innovation does not lead to a fragmentation in international payment architectures and that the development of digital asset technologies is consistent with our values and laws.

And this underscores my final lesson…

V. We need to work together to ensure responsible innovation

Many of the most groundbreaking innovations in our history have involved all of us: policymakers and businesspeople, advocates, scholars, inventors, and citizens. Think of the development of the national highway system, the space race, the creation of the internet, or

the ongoing revolution in biotechnology. All of these innovations have transformed the way we live our lives.

People have a wide range of views when it comes to digital assets. On one hand, some proponents speak as if the technology is so radically and beneficially transformative that the government should step back completely and let innovation take its course. On the other hand, skeptics see limited, if any, value in this technology and associated products and advocate that the government take a much more restrictive approach. Such divergence of perspectives has often been associated with new and transformative technologies.

In my view, the government's role should be to ensure responsible innovation – innovation that works for all Americans, protects our national security interests and our planet, and contributes to our economic competitiveness and growth. Such responsible innovation should reflect thoughtful public-private dialogue and take account of the many lessons we've learned throughout our financial history.

This sort of pragmatism has served us well in the past and I believe it is the right approach today.

Thank you again for having me, and for the important role American University plays in the civic and academic life of our country.

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