

April 18, 2023

The Honorable Patrick McHenry
Chair
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman McHenry and Ranking Member Waters,

The Bank Policy Institute (BPI) is writing to express views regarding the Committee's draft legislation on stablecoin issuers. Given the volatility of the crypto marketplace over the last year, BPI recognizes why Congress would wish to craft legislation to provide a regulatory framework that balances consumer protection and support for innovation in the financial sector. We thank the Committee for its attention to this important issue and engagement with key stakeholders throughout the process.

One provision of the bill, however, raises significant financial stability and other concerns: the inclusion of a provision that would allow nonbank stablecoin issuers access to accounts at the Federal Reserve.

Fed account access would increase systemic risk by allowing nonbank stablecoin issuers to (i) obtain Federal Reserve accounts and thereby back their respective stablecoins with central bank money and (ii) access the payments system without the strong regulatory and supervisory safeguards that currently apply to banks.

The Federal Reserve Act defines the institutions that are legally eligible for Fed accounts, and the Federal Reserve Board and Reserve Banks administer a review process for considering applications for master accounts that increases in rigor based on the applicant's insured status and federal oversight, if any. The applicant is also subject to assessment of potential risks it could pose to the payments and financial systems. The Board's recent decision to deny Custodia Bank – an uninsured, Wyoming-chartered Special Purpose Depository Institution – membership to the Federal Reserve highlights the dangers here. The Board's 86-page order describes a litany of risks inherent in Custodia's proposed activities, including its plan to offer a stablecoin product.¹ In its review, the Board said that a stablecoin issued by Custodia Bank backed by a Fed master account "could complicate the Federal Reserve's ability to manage the size of its balance sheet and overall conditions in the federal funds market."² The Board ultimately concluded that Custodia's proposed business model that "would focus almost exclusively on the crypto-asset sector and would aim to create further connections between traditional financial intermediaries and the crypto asset

¹ Federal Reserve System. (January 27, 2023). *Custodia Bank, Inc Cheyenne, Wyoming Order Denying Application for Membership*. <https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf>.

² Federal Reserve System. (January 27, 2023). *Custodia Bank, Inc Cheyenne, Wyoming Order Denying Application for Membership*. <https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf> (page 76).

ecosystem³ is inconsistent with the purposes of the Federal Reserve Act “[g]iven the speculative and volatile nature of the crypto-asset ecosystem.”⁴

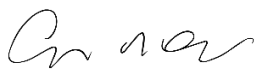
The Board’s decision reflects our concern that allowing stablecoin issuers the benefits of Federal Reserve membership would expose other depository institutions to potential risks by allowing institutions not subject to comprehensive consolidated regulation and supervision access to the payments system.⁵ Indeed, in light of the collapse of FTX and a long list of other crypto firms, the case for linking the crypto universe, of which stablecoins are a necessary part, to the Federal Reserve appears to have diminished significantly.

In addition to the significant financial stability and monetary policy risks of this provision, the draft legislation would also present significant illicit finance risks, if not properly addressed via robust safeguards. To effectively combat criminal activity, it is essential that stablecoin issuers be held to the same BSA/AML/sanctions requirements and standards as insured depository institutions. Currently, stablecoin issuers are state-licensed and generally regulated as money transmitters and are money service businesses for purposes of the Bank Secrecy Act, and therefore subject to FinCEN regulation; however, stablecoin issuers should be federally regulated and, more importantly, federally supervised to the same extent as banks in order to ensure compliance and avoid regulatory arbitrage.

While the bill would treat stablecoin issuers as “financial institutions” for purposes of the Bank Secrecy Act, this would leave important regulatory gaps. For example, it appears that the holders of stablecoins would not be “customers” and thus not subject to the “know your customer,” customer due diligence, and customer identification obligations that apply to banks. Similarly, the bill does not clearly provide for ongoing federal supervision and examination of stablecoin issuers for BSA/AML purposes, which is an important aspect of the United States’ framework to detect and combat illicit activity and actors.

As the Committee moves forward, any legislation must prioritize the safety, soundness, and resiliency of bank and nonbank stablecoin issuers, the protection of consumers, the preservation of U.S. financial stability and the prevention of financial crimes and illicit finance. We support the inclusion of text that clarifies the authority of FDIC-insured institutions to continue to issue and receive tokenized deposits and look forward to continuing to engage with the Committee as the stablecoin legislation is refined further to promote a safe, healthy, and competitive U.S. financial system.

Sincerely,



Edward Hill
Senior Vice President & Head of Government Affairs
Bank Policy Institute

³ Federal Reserve System. (January 27, 2023). *Custodia Bank, Inc Cheyenne, Wyoming Order Denying Application for Membership*. <https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf> (page 7).

⁴ Federal Reserve System. (January 27, 2023). *Custodia Bank, Inc Cheyenne, Wyoming Order Denying Application for Membership*. <https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf> (page 86).

⁵ Federal Reserve System. (January 27, 2023). *Custodia Bank, Inc Cheyenne, Wyoming Order Denying Application for Membership*. <https://www.federalreserve.gov/newsevents/pressreleases/files/orders20230324a1.pdf> (page 73).