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How We Can Regulate Stablecoins Now—Without Congressional Action

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Abstract

This White Paper presents a proposal for federal regulation of stablecoins under existing law. Following the recommendations of the 2021 President's Working Group's Stablecoin Report, we propose the creation of a federal framework for the issuance of stablecoins within the regulatory framework for insured depository institutions. Under current law, the Comptroller of the Currency could authorize a national trust bank charter, organized as an operating subsidiary of an insured depository institution, to create stablecoins through the use of a dedicated trust vehicle. With our proposal, the Comptroller would also adopt standards limiting the investment of stablecoin reserves to high quality assets and address redemptions and operational resilience, among other matters. The creation of this federal regulatory structure puts the "stable" in stablecoins, offering consumers a far higher level of protection than the state-level regulatory frameworks that currently govern most stablecoin issuers while providing protection against financial stability risks should the stablecoin market continue to grow. Our approach could promote increased competition in payments services and potentially safeguard the role of the dollar in international finance. While our framework would not be mandatory, we believe our approach would provide substantial benefits to stablecoin sponsors, increasing the likelihood that they would opt into the framework.

Although new legislation is not needed, coordination across government agencies would be necessary to implement our recommendations effectively. The federal banking agencies—the Federal Reserve Board, the OCC, and the FDIC—would all have to support this stablecoin framework and buy-in from both the SEC and CFTC would be highly desirable. We recommend that a working group of the Financial Stability Oversight Council quarterback this coordination. Our proposal is self-consciously incremental and cautious, imposing stringent and overlapping safeguards and preserving the separation of banking and commerce. If successful, our proposal might later be liberalized in a variety of ways. The experience gained in developing our approach could also be useful in drafting more comprehensive legislation.

What we propose here is simply a sensible but significant first step.

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Introduction

Our goal is to propose under current law a federal framework for regulating stablecoins that will promote consumer protection and the stability of the stablecoin market, while also creating a solid platform for the next generation of socially useful payments innovation. As outlined in Part I, the market capitalization of stablecoins has grown enormously in just two years.[1] While their use has thus far been largely confined to the crypto sector, they potentially have much broader application in mainstream payments. Recent events, most notably the collapse of Terra, an algorithmic stablecoin, have driven home the weakness of the current legal framework for stablecoins and the importance of creating a rigorous and functionally appropriate regulatory framework.[2] In our view, a well-designed regulatory platform would put the "stable" in stablecoins—protecting consumers from the risks of illiquidity and potential losses in the event of a stablecoin issuer's default, and protecting the financial system from instability as the stablecoin market grows in size and importance. The platform could also enhance competition in payments services in the United States and safeguard the role of the dollar in international finance. We conclude Part I by making the case for introducing an FSP under current law rather than waiting for the adoption of a more comprehensive legislative solution.

In Part II, we present our proposal. We recommend the creation of a federal stablecoin platform (FSP) within the regulatory framework for insured depository institutions (IDI) as also recommended by the November 2021 Stablecoin Report of the President's Working Group (PWG).[3] Our proposal, however, refines the PWG recommendation by stipulating that stablecoin activity should be managed through an operating subsidiary of an IDI and that this subsidiary should be organized as a national trust bank chartered by the Comptroller of the Currency (OCC) pursuant to 12 U.S.C. § 92a (an NTB). The payments vehicle itself would then be structured as a trust vehicle for which the NTB would serve as fiduciary. Consistent with current practice, the chartering of the NTB would be subject to a variety of conditions specified by the OCC, and we outline in Part II how these conditions could address the many legitimate public policy challenges that stablecoins pose. Our approach gives federal bank agencies considerable latitude in designing the structure to protect consumers especially in the event of financial distress. Critically, in the event of the insolvency of an NTB, a federal banking agency would serve as receiver and not a federal bankruptcy court. Our approach would ensure that stablecoin reserve assets are not co-mingled with other IDI assets, nor used to create loans. Our approach does not contemplate deposit

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1. *See* Figure 1 below; *see also* Katherine Greifeld, *Stablecoins Soar in Value as Everything Else in Crypto Shrinks*, Bloomberg (Feb. 24, 2022), https://www.bloomberg.com/news/articles/2022-02-24/stablecoins-soar-in-value-as-everything-else-in-crypto-shrinks#xj4y7vzkg.

2. *See, e.g.*, Alexander Osipovich and Caitlin Ostroff, *Crash of TerraUSD Shakes Crypto. "There Was a Run on the Bank,"* The Wall Street Journal (May 12, 2022), https://www.wsj.com/articles/crash-of-terrausd-shakes-crypto-there-was-a-run-on-the-bank-11652371839.

3. President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins* (Nov. 1 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf (hereinafter the "PWG Report"). Following the PWG, see *id.* at 17 & n.16, our proposal incorporates the definition of "insured deposit institution" set forth in 12 U.S.C. § 1813(c)(2), which does not include federally insured credit unions.

insurance for stablecoin liabilities issued by the trust vehicle. We close Part II with a short discussion of procedural matters, both the administrative steps that would need to be taken to implement our approach and future measures that might be contemplated if the FSP experiment proves successful.

In Part III, we turn to the benefits of the FSP framework from the perspective of stablecoin sponsors. We begin with the marketing advantage derived from being subject to prudential regulation at the federal level and then identify other benefits that would be conferred simply by operation of law. We also take up supplemental benefits that might be incorporated in the FSP model to increase the likelihood that stablecoin issuers would voluntarily agree to be subject to its requirements and restrictions. We conclude this section with thoughts about how the FSP model might be adapted to other types of payments platforms or refined in other ways. We also discuss how the development of the FSP model could prove useful for the development of the comprehensive approach to digital assets called for by a recent Biden Administration Executive Order.[4]

In Part IV, we take up the issue of coordination and cooperation, reviewing the critical need for inter-agency coordination in developing this regulatory approach. We envision a working group of the Financial Stability Oversight Counsel (FSOC) as the most promising vehicle for advancing this effort, and explore why initiatives of this sort fall within the FSOC's statutory mandate. We also discuss the importance of cooperation with the private sector.

I. Motivation

The regulation of stablecoins has rapidly become one of the top priorities in both U.S. and global financial regulatory policy. The publication of the PWG Report in November 2021 highlighted both the dramatic growth in stablecoins—whose market capitalization increased almost six fold from $22 billion in October 2020 to $128 billion a year later[5]—and their many risks, which include risks to consumer protection and, should this market continue to grow in size and importance, financial stability.[6] The PWG Report echoed many of the concerns noted by the Financial Stability Board, which in an October 2020 report called for regulation of so-called "global stablecoins"[7] as well as similar warnings from the Bank of England[8] and the Bank for International Settlements.[9] The PWG Report contained only one sentence on the potential benefits of stablecoins,[10] yet the possible use of stablecoins as a catalyst for payments innovation outside the crypto industry stands alongside the need to mitigate the attendant risks as an important driver of

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4. The White House, *Executive Order on Ensuring Responsible Innovation in Digital Assets* (Mar. 9, 2022), https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/ (hereinafter the "White House Executive Order").

5. PWG Report, *supra* note 3, at 7 n.20.

6. Ibid. at 12-14.

7. Financial Stability Board, *Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements: Final Report and High-Level Recommendations* (Oct. 13, 2020), at 1 https://www.fsb.org/wp-content/uploads/P131020-3.pdf.

8. Bank of England, *New Forms of Digital Money Discussion Paper* (June 7, 2021), https://www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money.

9. Bank for International Settlements, G-7 Working Group on Stablecoins, *Investigating the Impact of Global Stablecoins* (Oct. 18, 2019), at ii-iv, https://www.bis.org/cpmi/publ/d187.pdf.

10. PWG Report, *supra* note 3, at 1.

regulatory policy. The recent White House Executive Order on Ensuring Responsible Innovation in Digital Assets recognizes this potential,[11] as did a 2022 paper by the Board of Governors of the Federal Reserve on central bank digital currencies.[12] Indeed, stablecoins first captured regulators' attention not because of their rapid growth in the crypto industry but because of the proposal by Meta (formerly Facebook) to launch Libra (subsequently renamed Diem), which was to be a global stablecoin backed by a basket of several fiat currencies.[13] Meta's proposal was not directed toward the crypto market. Instead, Meta's stated goal was to improve cross-border payment efficiency and help the billions of people around the world who lacked access to basic financial services.[14]

As shown in Figure 1,[15] the stablecoin market continued to grow through the final months of 2021, reaching over $160 billion by year end. In the first half of 2022, the overall level of stablecoins outstanding declined due to the failure of Terra and the knock-on effects for other algorithmic and crypto-backed stablecoins. Other stablecoins—the focus of our proposal—have, in contrast, largely retained their market capitalization in 2022 at just under $130 billion, with a slight decline in Tether balances offset by an increase in USDC and other collateralized stablecoins (shown in Figure 1 in orange and grey, respectively). The market capitalization of all stablecoins (including algorithmic and crypto-collateralized) exceeded $140 million as of early August 2022.[16]

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11. White House Executive Order, *supra* note 4.

12. Board of Governors of the Federal Reserve, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation* (Jan. 14, 2022), https://www.federalreserve.gov/publications/files/money-and-payments-20220120.pdf.

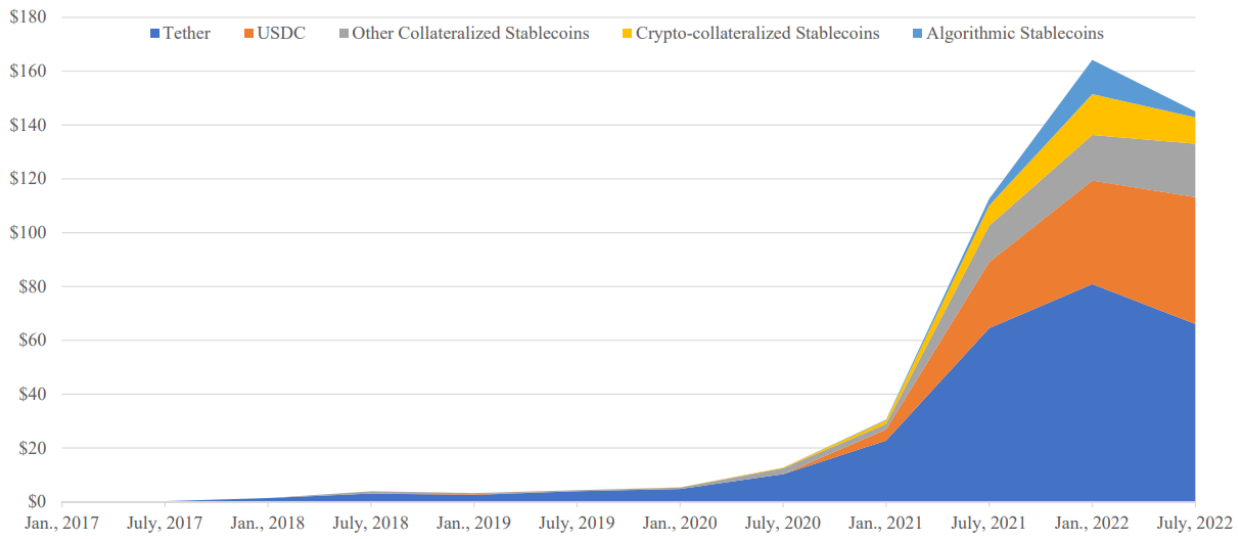
13. Meta, *A New Digital Wallet for a New Digital Currency* (June 18, 2019), https://about.fb.com/news/2019/06/coming-in-2020-calibra/.

14. Ibid.; *see also* Libra Association Members, *An Introduction to Libra: White Paper* (June 23, 2019), https://sls.gmu.edu/pfrt/wp-content/uploads/sites/54/2020/02/LibraWhitePaper_en_US-Rev0723.pdf.

15. In Figure 1, the "Other Collateralized Stablecoins" category refers to the major stablecoins (other than Tether and USDC) collateralized by non-crypto assets: BUSD, TUSD, GUSD, HUSD, and USDP. The "crypto-collateralized Stablecoins" category includes DAI, SUSD, MIM, LUSD, alUSD, and USDD. Finally, the line for "Algorithmic Stablecoins" combines market capitalization data for stablecoins whose supply is governed by smart contracts. These include FRAX, FEI, and UST. For a breakdown of the market capitalization fluctuations of each individual coin, and for month to month data, see The Block, *Total Stablecoin Supply* (July 9, 2022), https://www.theblock.co/data/decentralized-finance/stablecoins/total-stablecoin-supply-daily; *see also* PWG Report, *supra* note 3, at 7.

16. As Figure 1 illustrates, the value of stablecoins backed by financial assets has grown relatively steadily, while crypto-backed stablecoins have experienced some turbulence. Over the same period, algorithmic stablecoins have plummeted in value. *See* The Block, *supra* note **Error! Bookmark not defined.**.

Figure 1. Stablecoin Market Capitalization (in Billions USD)



Source: The Block, Total Stablecoin Supply (July 9, 2022), https://www.theblock.co/data/decentralized-finance/stablecoins/total-stablecoin-supply-daily

The rapid growth of the stablecoin market has generated intense debates and a wide range of conflicting perspectives.[17] We begin Part I with the observation that stablecoins are not truly "stable" today because the applicable legal frameworks often do little to protect holders in the event of an issuer's default. We then discuss the broader policy tradeoffs posed by technological imperatives, regulatory challenges, and competitive considerations.[18] Finally, we conclude Part I by making the case for proceeding with an administrative approach under current law rather than waiting for a potential legislative response to the challenges of stablecoin innovation. Although legislation may offer a more comprehensive solution over the long term, the risk that a legislative solution fails to materialize should not be underestimated. More importantly, the emergence and growth of the stablecoin market poses risks that can and should be addressed today—before any players in the market reach "escape velocity," pulling away from competitors as well as effective regulatory oversight.

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17. *See, e.g.*, Gary B. Gorton & Jeffery Zhang, *Taming Wildcat Stablecoins* (Sept. 30, 2021), University of Chicago Law Review, Vol. 90, Forthcoming, https://ssrn.com/abstract=3888752; Christian Catalini & Jai Massari, *Stablecoins and the Future of Money*, HARV. BUS. REV. (Aug. 10, 2021); Greg Baer, *Making Stablecoins Stable: Is the Cure Worse than the Disease?*, BPI (Sept. 27, 2021) https://bpi.com/making-stablecoins-stable-is-the-cure-worse-than-the-disease/; Douglas Arner, Raphael Auer & Jon Frost, *Stablecoins: risks, potential and regulation*, Bank for International Settlements Working Papers (Nov. 2020), https://www.bis.org/publ/work905.pdf.

18. See Howell E. Jackson, *The Nature of the Fintech Firm and Its Implications for Financial Regulation*, in HOWELL E. JACKSON & MARGARET E. TAHYAR, FINTECH LAW: THE CASE STUDIES (2020), https://projects.iq.harvard.edu/fintechlaw. *See also* Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235 (2019) (exploring the challenges regulators face in defining clear rules, maintaining market integrity, and encouraging innovation).

A. Putting the "Stable" in Stablecoins

At the core of the proposed FSP framework is the desire to protect the consumers who hold stablecoins from the potential illiquidity and losses stemming from the issuer's default. If stablecoin issuers ultimately want consumers to view their products as a credible medium of exchange—both within the crypto ecosystem and for mainstream payments—then these products must represent both a reliable store of nominal value and effective means of payment. At present, however, the ability of stablecoin issuers to credibly perform these important functions is subject to a binding legal constraint: bankruptcy.

With the conventional banking system, the problems posed by general corporate bankruptcy law have largely been resolved via the introduction of FDIC deposit insurance and a special bank resolution regime.[19] These regulatory frameworks work in tandem: enabling the government or an approved third-party purchaser to step into the shoes of a failing bank and honor its contractual commitments to return depositors' money. To address the moral hazard and other problems generated by these unique privileges and protections, banks are then subject to stringent capital and liquidity rules, activity and portfolio restrictions, and comprehensive prudential supervision.

But there are other ways of solving this problem without fomenting moral hazard or introducing new microprudential or macroprudential risks. As described in greater detail in subsequent sections, the FSP framework addresses this problem through the combination of three mechanisms. The first is structural subordination: combining an IDI parent with a national trust bank (NTB) subsidiary that would serve as a stablecoin's sponsor. This mechanism would enable the sponsor to continue to operate on a stand-alone basis, without interruption, even if the parent IDI were experiencing severe financial distress.[20] The second mechanism is a special purpose trust vehicle created and used solely for the purposes of (i) the issuance and transfer of stablecoin liabilities and (ii) holding collateral assets for the benefit of stablecoin holders. The third and final mechanism would then be the imposition of strict portfolio constraints on this trust: requiring that it only hold high quality liquid assets on a 1:1 basis with the value of its stablecoin liabilities and preventing it from incurring other debts. Together with the trust requirement, these portfolio constraints would ensure that stablecoin liabilities are fully collateralized, and that stablecoin holders would not be forced to compete with other creditors of the NTB or parent IDI in the event of bankruptcy. When combined with the possibility of resolution under the control of federal banking agencies, these mechanisms would functionally replicate the financial safety net enjoyed by depositors of conventional banks.

At present, many stablecoin issuers in the United States operate under a patchwork of state laws. As one of us has documented in other work, many of these statutory frameworks fail to adequately protect customers from the risks of illiquidity and losses that would almost inevitably follow from an issuer's

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19. *See, e.g.*, Richard M. Hynes and Steven D. Walt, *Why Banks are Not Allowed in Bankruptcy*, 67 Wash. & Lee L. Rev. 985 (2010), https://scholarlycommons.law.wlu.edu/wlulr/vol67/iss3/4.

20. To be sure, no system of financial regulation can guarantee the prevention of panic in times of extreme financial stress: the NTB might be affected by distress at the IDI level (and vice versa if the NTB experiences distress). The approach we advocate here is, however, similar to the single-point-of-entry approach to resolving financial conglomerates that many jurisdictions have adopted in the aftermath of the Global Financial Crisis and similar to bankruptcy remote special purpose vehicles that are widely utilized in modern financial markets. While the collapse of securitization vehicles did lead to financial stress in affiliated banks during the financial crisis, the complexity of intra-group transaction structures in mortgage underwriting was much greater than the structure contemplated by our proposal. These complexities included, amongst other features, contractual liquidity puts that required parents to provide financial support to the securitization vehicles they sponsored during periods of stress within wholesale money markets.

bankruptcy.[21] Moreover, stablecoin issuers typically need to comply with regulation in each state in which they carry on business, with stablecoin holders entitled to different protections from state to state. Our proposal would strengthen the protections available to stablecoin holders, and significantly reduce the regulatory hurdles through which stablecoin issuers must presently jump to achieve the national scale envisioned by their business models.

B. Technological Change, Regulatory Challenges & Competitive Considerations

The explosion of computing power coupled with the availability of high-speed internet access and the emergence of big data has led to a fintech revolution reaching every corner of the financial services industry.[22] Innovation in payment services is an entirely natural one as payments depend centrally upon communications infrastructure and information processing. A number of other countries have surpassed the United States in improving the speed and lowering the costs of their domestic payment systems, especially at the retail level. Cross-border payments, including not only the transfer of remittances but also wholesale payments, are an area where improvements are needed on a global basis. Payments innovation offers an opportunity for the United States to catch up, and perhaps even lead the world. As the Biden Administration's recent Executive Order recognized, the benefits to be derived from payments innovation are potentially substantial.[23]

Nevertheless, payments innovations generally, and stablecoins, in particular, pose genuine regulatory challenges. To date, our fragmented supervisory system coupled with the ability of new entrants to adopt business models that do not fit comfortably within existing regulatory perimeters have allowed much payments innovation to take place outside of existing regulatory structures at the federal level and to operate under partial or even negligible public oversight.[24] Stablecoins are an extreme example of this problem. Their emergence poses risks to consumers as well as potential risks to financial stability, not to mention problems for law enforcement and national security concerns.[25] In recent months, these risks have moved from the hypothetical to front page, with the collapse of Terra, the largest algorithmic stablecoin.[26] There have also been ongoing concerns about the stability and lack of transparency of Tether, the largest stablecoin and one that purports to be fully backed with liquid assets.[27] The expansion

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21. *See* Dan Awrey, *Bad Money*, 106 Cornell L. Rev. 1 (2020).

22. *See, e.g.* Irving Wladawsky-Berger, *The Digital Revolution Comes for Banking*, The Wall Street Journal (June 28, 2019), https://www.wsj.com/articles/the-digital-revolution-comes-for-banking-01561744478.

23. White House Executive Order, *supra* note 4.

24. *See, e.g.*, John Adams, *Can regulators keep pace with fintech innovation?*, American Banker (Sept. 29, 2021), https://www.americanbanker.com/news/can-regulators-keep-pace-with-fintech-innovation.

25. *See, e.g.*, Mengqi Sun, *'Stablecoins' Vulnerable to Criminal Abuse, Watchdog Says*, The Wall Street Journal (July 9, 2020), https://www.wsj.com/articles/stablecoins-vulnerable-to-criminal-abuse-watchdog-says-11594337509.

26. *See, e.g.*, Osipovich and Ostroff, *supra* note 2.

27. *See, e.g.* Yaffe-Bellany, *The Coin That Could Wreck Crypto*, The New York Times (June 17, 2022), https://www.nytimes.com/2022/06/17/technology/tether-stablecoin-cryptocurrency.html; *see also* Sandor and Coindesk, *Investors pulled $1.6 billion out of stablecoin Tether in just 2 days as fear spreads and the crypto crash continues*, Fortune (June 15, 2022), https://fortune.com/2022/06/15/tether-stablecoin-crypto-market-crash/; Timothy Massad, *Can a Cryptocurrency Break the Buck?*, Bloomberg (May 31, 2021), https://www.bloomberg.com/opinion/articles/2021-05-31/stablecoins-like-tether-should-face-regulators-scrutiny#xj4y7vzkg.

of an under-regulated shadow payments system also poses competitive challenges for our conventional payments systems, which operate in a quite different and more stringent regulatory and supervisory environment.

Of course, payment innovators—whether operating off distributed ledgers (like stablecoins) or more traditional technologies (like Venmo)—are not fully beyond the reach of government regulation. Much attention has been given to the regulatory structures provided by state money transmitter laws[28] and at least as much focus on the ways in which anti-money laundering and other law enforcement requirements apply to these firms.[29] One state (New York) recently issued specific guidance for stablecoins, which includes requirements on how reserves should be held and invested.[30] But state regulation of stablecoins generally provides only a light touch, and we believe state regulatory regimes generally are inadequate for payments platforms, given their typically national scope. As noted earlier, they do not protect stablecoin holders from the risks of bankruptcy, and stablecoin issuers face the burden of complying with multiple, inconsistent frameworks. And there are clearly many other areas of regulation—most notably those overseen by the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC)—where the application to certain payments innovations (e.g., Ripple's XRP) is hotly contested and tied up in litigation.[31]

At the federal level, one open question is the applicability of FSOC's authority under the Dodd-Frank Act to designate any non-bank financial company, financial market utility, or payment activities as systemically important, which triggers heighted supervision by the Federal Reserve. It is unclear how these authorities should be applied to stablecoins and payments innovations more generally.[32] There are also questions about the application of section 21 of the Glass-Steagall Act—which prohibits the

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28. *See, e.g.*, Awrey, *supra* note 21.

29. See, e.g., Ed Marcheselli, *Do You Know Your Digital Customer? Addressing the Anti-Money Laundering and Bank Secrecy Act Implications for P2P Payments*, Payments Journal (Mar. 29, 2019), https://www.paymentsjournal.com/digital-customer-anti-money-laundering-bank-secrecy-act-implications-for-p2p-payments/.

30. Adrienne A. Harris, Superintendent of Financial Services, New York State Department of Financial Services, *Guidance on the Issuance of U.S. Dollar-Backed Stablecoins* (June 8, 2022), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20220608_issuance_stablecoins; *see also* Jonathan Make, *Wyoming stablecoin efforts rejuvenated*, Wyoming Tribune Eagle (June 16, 2022), https://www.wyomingnews.com/wyoming-stablecoin-efforts-rejuvenated/article_74b645e6-3bf1-51d2-9ef7-adaf49a79cee.html. Although the New York requirements provide that stablecoin reserves must be segregated from the assets of the stablecoin issuer and held either at FDIC-insured depository institutions or by other custodians approved by NYDFS, the bankruptcy of the stablecoin issuer would still be governed by traditional bankruptcy law and consumers would not have the same degree of protection, or same ability to recover their assets quickly, as would be the case under our proposal.

31. *ee, e.g.*, Dave Michaels, *Ripple's Legal Brawl With SEC Could Help Settle When Cryptocurrencies Are Securities*, The Wall Street Journal (Feb. 2, 2022), https://www.wsj.com/articles/crypto-industry-hopes-looming-legal-brawl-will-thwart-secs-regulation-push-11643724002; Nathaniel Popper, *Cryptocurrency Company Ripple is Sued by S.E.C.*, The New York Times (Dec. 21, 2020), https://www.nytimes.com/2020/12/21/technology/ripple-cryptocurrency-sec-lawsuit.html.

32. Dodd Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203, §§ 112-13, 124 Stat. 1376, 1398 (2010) (codified at 12 U.S.C. §§ 5322-23); *see* Financial Stability Oversight Council, *Designations*, https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations; *see also* Howell Jackson & Morgan Ricks, *Locating Stablecoins within the Regulatory Perimeter*, Harvard Law School Forum on Corporate Governance (Aug. 5, 2021), https://corpgov.law.harvard.edu/2021/08/05/locating-stablecoins-within-the-regulatory-perimeter/.

acceptance of deposits by unregulated entities—to stablecoins and other payments innovations.[33] Finally, there have been recent challenges and controversies as to whether novel payment innovators should be able to obtain master accounts with the Federal Reserve.[34] All of this regulatory uncertainty impedes progress in payments innovations and wastes resources, public as well as private.

The multiple U.S. banking regulators that possess authority potentially relevant to the effective regulation of stablecoins also complicate progress. Whether the Federal Reserve Board should allow payments innovators access to master accounts is legitimately connected to the question of how the applicant in question will be supervised by its chartering authority, as well as how the supervised entity would be resolved were it to become insolvent. The PWG Report also noted the potential authority of the SEC and CFTC.[35] In this environment, there is little incentive for any single regulatory body to get out front in developing and rolling out an innovative regulatory framework in response to new payments innovations without some assurance as to how other agencies are going to proceed.

The resulting regulatory paralysis has costs. Potentially valuable innovations do not move forward, and even modest regulatory accommodations are not adopted in the face of so much uncertainty. The status quo, of course, has winners as well as losers. Incumbent payment providers, including banks and card networks like Visa and MasterCard, benefit hugely from existing payment practices, and one can readily observe their representatives engaged in opposing payments innovations with elaborate comment letters and occasional litigation.[36] Stakeholder interventions from both community banks and state authorities are also common in this space and often impede forward motion.[37] While payments innovation poses genuinely difficult issues of public policy concern, the debate is complicated by the presence of so many well-financed interest groups primarily concerned with private interests, not public ones.

Another issue is whether the primacy of the U.S. dollar is threatened by payments innovation that is taking place outside of the United States and that will not wait on regulatory developments inside our borders. The ongoing debate over the development of a U.S. central bank digital currency (CBDC) directly engages this topic with respect to public digital currencies,[38] but the dollar might also be challenged by the

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33. Glass-Steagall Act, Pub. L. 73-66, § 21, 48 Stat. 162 (1933) (codified at 12 U.S.C. § 378); *see also* Jackson & Ricks, *supra* note 32; Gorton & Zhang, *supra* note 17, at 10-12, 33-34.

34. *See e.g.*, Julie Anderson Hill, *Bank Access to Federal Reserve Accounts and Payment Systems* (Mar. 30, 2022) YALE J. ON REG., Forthcoming, https://ssrn.com/abstract=4048081. *See also* Peter Conti-Brown, *The Fed Wants to Veto State Banking Authorities*, Brookings Institution (Nov. 14, 2018), https://www.brookings.edu/research/the-fed-wants-to-veto-state-banking-authorities-but-is-that-legal/.

35. The PWG report noted that "depending on their structure, stablecoins, or certain parts of stablecoin arrangements, may be securities, commodities and/or derivatives." PWG Report, *supra* note 3, at 11.

36. *See, e.g.* Baer, *supra* note 17; *see generally* Richard Pike, *Disrupting the Equilibrium? Why stablecoins may struggle to challenge existing payment schemes*, Lexology (Nov. 8, 2021), https://www.lexology.com/library/detail.aspx?g=171eaf36-5442-4b85-a99e-a7fd6ffe8dee.

37. *See, e.g.* Brian Laverdure, *How the TerraUSD Collapse Affects Stablecoin Regulation and Community Banks*, Independent Community Bankers of America (June 7, 2022), https://www.icba.org/newsroom/blogs/main-street-matters/2022/06/07/how-the-terrausd-collapse-affects-stablecoin-regulation-and-community-banks; Ben Shreckinger, *Crypto's state-federal "flippening,"* Politico (June 10, 2022) https://www.politico.com/newsletters/digital-future-daily/2022/06/10/cryptos-state-federal-flippening-00038930 (citing NYDFS Stablecoin Guidance, *supra* note 30).

38. *See, e.g.* Andrew Ackerman, *Fed Launches Review of Possible Central Bank Digital Currency*, The Wall Street Journal (Jan. 20, 2022), https://www.wsj.com/articles/fed-launches-review-of-possible-central-bank-digital-currency-11642706158.

development of private stablecoins organized in foreign markets and tied to other currencies or baskets of currencies.[39] China has launched a CBDC, development of which was apparently accelerated at least in part in response to Meta's announcement of its Libra proposal.[40] The issuer of one of the largest dollar-based stablecoins has recently launched a Eurodollar-based stablecoin,[41] and the European Central Bank, as well as many other leading central banks, appears to be more firmly committed to the development of a CBDC than is the Fed.[42] Whether public or private digital currencies tied to currencies other than the dollar might ever pose a genuine threat to the dollar's dominance is an open question, but that possibility offers yet another competitive consideration counseling in favor of controlled experimentation on this score. And, while this experimentation is not a substitute for the research and development that would be necessary if the United States wishes to create a CBDC, it could nevertheless generate insights about the operation of digital currencies that could be useful in developing a CBDC.

Ultimately, we are agnostic about which nascent technologies will yield the next generation of socially useful payment innovations. While this question is hotly debated, we do not possess a crystal ball. Nor do we think that regulation—by itself—is sufficient to promote investment in these new technologies or successfully bring them to market. What regulation can do is provide a safe, secure, and level environment within which to build these innovations. This is what the FSP is designed to achieve.

C. The Case for an Administrative Approach

One approach to the challenges posed by stablecoins in particular, and payments innovation generally, would be legislation. The PWG Report made exactly that recommendation, calling for legislation to locate the issuance of stablecoins within the structure of FDIC-insured depository institutions.[43] Senators Cynthia Lummis (R-Wyoming) and Kirsten Gillibrand (D-New York) recently introduced the Responsible Financial Innovation Act, which partially responds to that request and also addresses a number of other issues related to digital assets.[44] Senator Patrick Toomey (R-Pennsylvania) and Representative Josh Gottheimer (D-New Jersey), among others, have introduced their own versions of stablecoin legislation,

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39. The possibility that other jurisdictions will facilitate the creation of stablecoins also means that U.S. firms may have the option of locating their stablecoin operations off-shore if this country does not develop a viable regulatory structure for these instruments.

40. See Anton N. Didenko et al., *After Libra, Digital Yuan and COVID-19: Central Bank Digital Currencies and the New World of Money and Payment Systems*, European Banking Institute Working Paper Series (June 1, 2021), at 28-29, https://ssrn.com/abstract=3622311; See also Timothy G. Massad, *Facebook's Libra 2.0: Why you might like it even if we can't trust Facebook,* Brookings Institute (June 22, 2020), at 59, https://www.brookings.edu/research/facebooks-libra-2-0/, (citing comments of Mu Changchun, then director of the PBOC Digital Currency Research Institute and Wang Xin, then director of the PBOC Research Bureau)

41. *See* Ken Sweet, *Firm behind popular US dollar stablecoin to launch Euro Coin*, ABC News (June 16, 2022), https://abcnews.go.com/Technology/wireStory/firm-popular-us-dollar-stablecoin-launch-euro-coin-85437278.

42. *See, e.g.*, European Central Bank, *Public money for the digital era: towards a digital euro* (May 16, 2022), https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220516~454821f0e3.en.html.

43. PWG Report, *supra* note 3, at 2, 16-18.

44. Lummis-Gillibrand Responsible Financial Innovation Act, S.4356, 117th Cong. (2022), https://www.gillibrand.senate.gov/imo/media/doc/Lummis-Gillibrand Responsible Financial Innovation Act %5bFinal%5d.pdf.

with the former providing that stablecoin issuers could be chartered at the state or federal level,[45] and the latter calling for either an IDI or narrow bank approach.[46] Given the diversity of views, there is good reason to believe that the legislative process in this area will be fraught. There is no clear bipartisan consensus on how reform legislation should be structured and vested interests from many quarters will no doubt be fully engaged, possibly slowing down progress further still, at least in the absence of a full-blown stablecoin crisis.

While legislative approaches are being debated, there are important reasons to pursue a concurrent administrative path. At a minimum, an administrative approach would create a baseline level of regulatory protection that would address the many risks that stablecoins pose today, while facilitating the type of payments innovation endorsed by the White House Executive Order. In addition, working through an administrative response to stablecoins will help flesh out critical issues and provide valuable insights to Congress, both in establishing substantive standards for payments platforms and identifying residual gaps in existing legislation. Moreover, at least from the perspective of the current Administration, devising a feasible approach under current law may well shift the terms of debate over legislative proposals, reducing the pressure to rush through new legislation and accede to potentially unpalatable compromises.

To be successful, the administrative approach would have to combine several elements. First, and critically, it would have to provide a clear and well recognized legal framework for stablecoins. Second, that framework would have to address, in a credible manner, the key public policy concerns surrounding stablecoins: consumer protection, market integrity, financial stability, and the prevention of illicit activity. Third, because the regulatory platform would not be mandatory,[47] it would have to offer sufficient benefits to motivate stablecoin issuers to apply for authorization. We believe our proposal would deliver on this element in multiple ways: by promoting market confidence in stablecoins that are well-regulated and that protect customer funds from bankruptcy risk, by ensuring greater legal certainty and operational efficiency for stablecoin issuers,[48] and by offering important ancillary benefits, such as access to Federal

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45. Stablecoin Transparency of Reserves and Uniform Safe Transactions Act, 117th Cong. § 6 (2022), https://www.banking.senate.gov/imo/media/doc/the_stablecoin_trust_act.pdf.

46. Stablecoin Innovation and Protection Act, 117th Cong. § 5(a) (2022), https://gottheimer.house.gov/uploadedfiles/dd._stablecoin_innovation_and_protection_act_of_2022.pdf.

47. Our proposal is based on current law, which lacks any explicit mandates with respect to regulation of stablecoins. This limitation means that federal authorities cannot simply require firms to make use of any particular legal framework, a constraint reflected in the "opt-in" nature of our proposal. Nevertheless, federal authorities could use some of the enforcement tools discussed below to restrict private parties from offering stablecoins without sufficient regulatory safeguards. While not formally a mandate, the appropriate use of these sticks could produce over time a similar result by encouraging stablecoin issuers to adopt the FSP framework or perhaps some substantial similar framework created under state law. By contrast, the European Union has recently agreed to a mandatory licensing regime for stablecoin issuers. *See, e.g.*, Jack Schickler, *EU Agrees on Landmark Crypto Authorization Law, MiCA*, Coindesk (June 30, 2022), https://www.coindesk.com/policy/2022/06/30/eu-agrees-on-landmark-crypto-authorization-law-mica/.

48. For a discussion of the consequences to stablecoin issuers of regulatory uncertainty, see, e.g., Noah Qiao, *How Can Stablecoins Evolve to Reach the Next Milestone?*, Bloomberg Law (June 14, 2022) https://news.bloomberglaw.com/ip-law/how-can-stablecoins-evolve-to-reach-the-next-milestone.

Reserve master accounts and other Fed services.[49] Fourth, achieving a coherent and workable regulatory platform would require a high degree of coordination among regulatory agencies. It would also require engagement with the private sector to ensure that the platform does not impose poorly tailored rules or unnecessary costs on stablecoin issuers.

II. A Federal Stablecoin Platform (FSP)

In its November 2021 Stablecoin Report, the PWG put forward a legislative approach along the following lines:

> [W]ith respect to stablecoin issuers, legislation should provide for supervision on a consolidated basis; prudential standards; and, potentially, access to appropriate components of the federal safety net. To accomplish these objectives, legislation should limit stablecoin issuance, and related activities of redemption and maintenance of reserve assets, to entities that are insured depository institutions. The legislation would prohibit other entities from issuing payment stablecoins. Legislation should also ensure that supervisors have authority to implement standards to promote interoperability among stablecoins.[50]

In other words, the PWG endorsed a mandatory regime for stablecoin issuers, operating under the consolidated supervision of federal banking authorities. Few details were spelled out. For example, it was not clear whether stablecoin tokens themselves would be protected, directly or indirectly, by federal deposit insurance (a key element of the federal safety net) or collateralized by a ring-fenced pool of assets, as is the case with money market mutual funds. What is clear, however, is that the PWG contemplated extensive prudential standards for stablecoin issuers as well as consolidated supervision. Furthermore, the requirement that stablecoins be issued by IDIs implicates a wide range of banking regulations, and effectively forces the separation of stablecoin issuers from commercial activities by operation of the federal Bank Holding Company Act (BHCA).[51] The PWG Report also noted the importance of subjecting insolvent stablecoin issuers to an FDIC resolution regime and the need for extending regulatory requirements not just to the stablecoin issuer itself, but also to various third-party arrangements, such as digital wallets and transfer arrangements, which play an essential role in stablecoin operations.[52]

Since the issuance of the PWG Report, Nellie Liang, the Under Secretary of the Treasury for Domestic Finance, has said there is "flexibility" in the IDI framework with respect to regulating stablecoins and that "it was not meant to be limited to current banks."[53]

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49. This could include access to Fedwire and the soon-to-be-launched FedNow platform. *See* The Federal Reserve, *Fedwire Funds Service*, https://www.frbservices.org/financial-services/wires and The Federal Reserve, *FedNow Service*, https://www.frbservices.org/financial-services/fednow.

50. PWG Report, *supra* note 3, at 16.

51. Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133 (1956) (codified at 12 U.S.C. §§ 1841-43).

52. PWG Report, *supra* note 3, at 2 & n.4, 16.

53. Jesse Hamilton, "US Treasury Open to Nonbanks Issuing Stablecoins, Official Says," Coindesk (July 18, 2022), https://www.coindesk.com/policy/2022/07/18/us-treasury-open-to-nonbanks-issuing-stablecoins-official-says/. *See also* Nellie Liang, Under Secretary of the Treasury for Domestic Finance, *Testimony of Under Secretary for Domestic Finance Nellie Liang*

Our proposal provides such flexibility: it attempts to implement the PWG's vision for a comprehensive regulatory structure for stablecoin issuers, but under administrative authorities granted by current law.[54] In our view, this approach addresses all the substantive concerns that the PWG Report raises about stablecoin issuers. Our proposal also incorporates several regulatory requirements for stablecoin issuers contemplated in pending legislative proposals.[55] We sketch out the basic elements of our proposal in this Part, explaining as we go how our approach addresses the PWG's concerns.

A. Overview of Legal Structure

While our proposal incorporates the PWG recommendation that stablecoin issuers be organized under the auspices of an IDI, we refine that recommendation by specifying that the stablecoin sponsor be organized as a wholly owned operating subsidiary of the IDI. As explained in more detail below, requiring that the issuer be a separate legal entity reduces risks to the IDI parent (and, indirectly, the FDIC's deposit insurance fund) while simplifying the supervision of stablecoin issuers. "Push out" strategies of this sort are common in financial regulation, as are operating subsidiaries of FDIC-insured banks.[56] So this approach builds on familiar supervisory models.

Our preferred legal structure for the stablecoin operating subsidiary would be a National Trust Bank (NTB) charter authorized under 12 U.S.C. § 92a and supervised by the OCC.[57] The Comptroller has a long history of chartering special purpose NTBs, with more than fifty such charters currently in operation.[58] NTBs typically specialize in fiduciary activities and do not take deposits from the general public. While some NTBs operate as free standing units, many are organized as operating subsidiaries of IDIs.[59] Although the Comptroller's legal authority to charter certain kinds of special purpose national banks has

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before the Committee on Financial Services, U.S. House (Feb. 8, 2022), https://home.treasury.gov/news/press-releases/jy0589.

54. This proposal is designed only for dollar-based stablecoins backed by high quality liquid assets, not so-called algorithmic or crypto-backed stablecoins. While we recognize that there exist significant policy concerns in relation to these other types of stablecoins, our view is that they are unlikely to emerge as an efficient or attractive form of payment instrument.

55. While our proposal relies solely on existing legal authorities, we believe that its legitimacy is enhanced by the fact that our approach is largely congruent with—if more conservative and incremental than—approaches being debated in Congress. For example, our proposal is similar to the "national limited payment stablecoin issuer" proposed by Senator Toomey. *See* accompanying text *infra* note 67. Our proposal, unlike his, does not include a state-chartering option, *see* discussion *infra* note 57 for a list of the advantages of a federal charter, although we note that the proposal could be extended to accommodate this option. *See* discussion *infra* note 114).

56. For example, under the Gramm-Leach-Bliley Act, national banks were required to locate certain securities activities in separate finance subsidiaries. 12 U.S. Code § 24a.

57. While one could also employ an alternative approach using a state trust charter, there are a number of advantages to utilizing a federal charter with respect to preemption, insolvency procedures, and possibly also access to Federal Reserve master accounts.

58. For a list of National Trust Banks Active as of 6/30/2022, *see* https://www.occ.treas.gov/topics/charters-and-licensing/financial-institution-lists/trust-by-name.pdf.

59. *See* Ibid.

been the source of controversy in recent years,[60] these concerns are not applicable to NTBs, as there is specific authority for the Comptroller to grant national banks trust powers under 12 U.S.C. § 92a. Congress has also stipulated in 12 U.S.C. § 27(a): "A National Bank Association, to which the Comptroller of the Currency has heretofore issued or hereafter issues such certificate, is not illegally constituted solely because its operations are or have been required by the Comptroller of the Currency to be limited to those of a trust company and activities related thereto."[61]

Under our approach, the NTB would serve as the stablecoin sponsor and operating entity: responsible for interacting with customers, coordinating with third-party vendors, and ensuring compliance with applicable legal standards. The NTB would then serve as the fiduciary of a separate trust—the payment trust vehicle (PTV)—that would hold dollars (USD) and stablecoin reserve assets, and through which both USD and stablecoin transfers would be cleared and settled. Again, this is a common legal structure for NTBs, many of which serve as trustees for collective investment trusts (CITs), including CITs with low-risk assets and daily redemption features based on the net asset value of the underlying trust

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60. For a recent law review article arguing against the OCC's authority to charter non-depository national banks, see Lev Menand & Morgan Ricks, *Federal Corporate Law and the Business of Banking*, 88 U. CHI. L. REV. 1381 (2021). For another leading analysis of bank chartering practices, see David Zaring, *Modernizing the Bank Charter*, 61 WM. & MARY L. REV. 1397 (2020). Much of the debate over the OCC's Fintech charter initiative has turned on the creation of national bank charters unaffiliated with deposit-taking functions. As our proposal envisions affiliation with an IDI parent, those concerns are not implicated here. And, as noted in the text, our reliance on an NTB charter also distinguishes our approach.

61. 12 U.S.C. § 27(a). There has been some additional controversy over the decision of a 2021 OCC interpretative letter regarding the authority of the Comptroller's national trust banks to engage in activities permitted for state trust companies but going beyond the fiduciary powers defined in 12 C.F.R. Part 9. *See* OCC Interpretive Letter 1176 (Jan. 2021). The Comptroller recently reaffirmed that interpretation. *See* OCC Interpretive Letter 1179 (Nov. 18, 2022). The controversy over these interpretations was primarily focused on the possibility that NTBs operating under this authority could escape consolidated supervision. *See, e.g.*, Steve Kenneally, *Regulatory Arbitrage in the Payments System is Risky Business*, ABA Viewpoint (Apr. 22, 2022), https://bankingjournal.aba.com/2022/04/regulatory-arbitrage-in-the-payments-system-is-risky-business/ (identifying risks of allowing access to payments system without consolidated and effective federal regulatory oversight). That concern is not applicable to our proposal as the NTB would be structured as an operating subsidiary of an IDI and also subject to BHCA oversight.

instruments.[62] The trust structure is also a popular approach for digital asset entrepreneurs. Both Paxos[63] and Custodia[64] currently employ trust structures.[65]

In theory, the NTB-PTV structure could also be used on a stand-alone basis: i.e., without requiring the NTB to be a subsidiary of an IDI. Indeed, given that we do not envision that the deposit liabilities of the stablecoin issuer would be covered by deposit insurance, it might be desirable to adopt a narrower, more tailored model of regulation and supervision than is currently imposed on IDIs. This more tailored model—incorporating those aspects of the regulatory and supervisory framework governing IDIs that are appropriate for a stablecoin issuer, but without deposit insurance or those aspects of the framework that would not be needed given the narrower scope of activities compared to a traditional bank—could potentially lead to more activity being brought within the perimeter of federal banking law without reducing its overall effectiveness.[66] Notably, this stand-alone model would bear a number of similarities with the "national limited payment stablecoin issuer" proposal introduced by Senator Toomey, the ranking member of the Senate Banking Committee. He envisions an entity chartered by the OCC solely for the purpose of stablecoin issuance and subject to a variety of requirements that address associated risks.[67] Although Senator Toomey's proposal does not include a prohibition against affiliations with commercial firms—which would apply to a subsidiary of an IDI under our proposal because of the applicability of the

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62. *See* Office of the Comptroller of the Currency, *Collective Investment Funds*, https://www.occ.treas.gov/topics/supervision-and-examination/capital-markets/asset-management/collective-investment-funds/index-collective-investment-funds.html. As explained below, the SEC would likely need to acquiesce in the utilization of the CIT structure for stablecoin issuances, but it has the statutory authority to do so.

63. *See* Paxos, *About Us*, https://paxos.com/company/; *see also* Office of the Comptroller of the Currency, *OCC Conditionally Approves Chartering of Paxos National Trust* (April 23, 2021), https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-49.html. Paxos characterizes itself as "a regulated blockchain infrastructure platform." It currently sponsors two stablecoins: USDP or Pax Dollar, and BUSD, which was developed by the crypto exchange Binance. Paxos Trust Company, LLC, is a New York State-chartered limited purpose trust company which is licensed by the New York State Department of Financial Services. Both USDP and BUSD, according to Paxos, are fully reserved with cash and cash equivalents and reserves are held in "FDIC-insured US banks or backed by US-government treasuries". *See* Paxos, *Pax Dollar*, https://paxos.com/usdp/ and Paxos, *USDP White Paper*, https://424565.fs1.hubspotusercontent-na1.net/hubfs/424565/USDP-White-Paper.pdf. In Figure 1, USDP and BUSD are included in the category of "Other Collateralized Stablecoins." Paxos has received conditional approval from the OCC for a national trust bank but has not launched operations under that approval at this time.

64. *See* Custodia, *About*, https://custodiabank.com/about/. Custodia is chartered as a special purpose depository institution under Wyoming law, which contemplates the legal segregation of reserves for "customer fiat deposits." *Id* Custodia describes its proposed product "Avit" as a "tokenized, programmable dollar" that is "backed 100% by deposits and high-quality liquid assets." Custodia does not refer to Avit as a stablecoin and says "Avits settle with the same mechanics of a cryptocurrency but leverage established [Wyoming] commercial laws that address the accounting, tax and legal problems of existing stablecoins." The firm has an application for a master account pending before the Federal Reserve. *Id.*

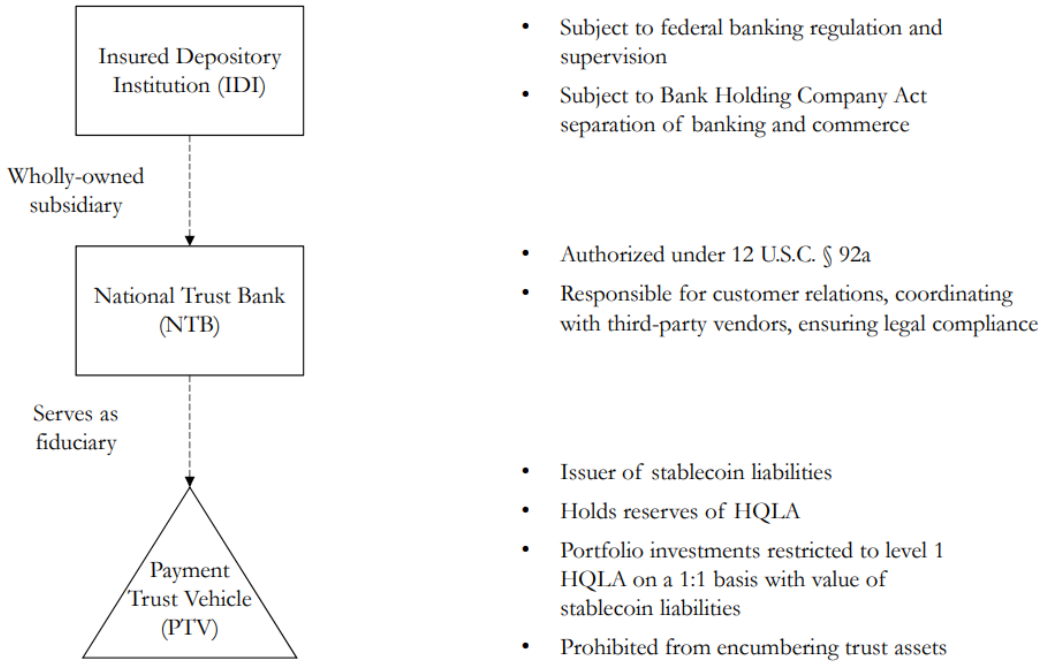
65. Trust instruments have also been utilized in the highly successful MPESA mobile banking model in Kenya and other developing countries. *See* Jonathan Greenacre & Ross P. Buckley, *Using Trusts to Protect Mobile Money Customers*, SINGAP. J. OF LEG. STUD. 59 (July 2014), http://classic.austlii.edu.au/au/journals/UNSWLRS/2015/27.pdf; *see also* Jonathan Greenacre, *Regulating mobile money: a functional approach*, Pathways for Prosperity Commission Background Paper Series; no. 4 (2018), https://pathwayscommission.bsg.ox.ac.uk/sites/default/files/2019-09/regulating_mobile_money.pdf.

66. For a more fully fleshed out version of a regulatory framework along these lines, see Dan Awrey, *Unbundling Banking, Money, and Payments*, 110 GEORGETOWN L.J. 715 (2022).

67. Stablecoin Transparency of Reserves and Uniform Safe Transactions Act, *supra* note 45, at § 2(8).

BHCA—such a prohibition could be added, in the same way as in Senator Lummis and Gillibrand's proposed legislation.[68] While we think this stand-alone model is worth consideration, this paper advances a framework under which an NTB is incorporated as a subsidiary of an IDI, as we believe a more conservative approach is warranted, especially because existing administrative authority is the basis for creating the framework.

Figure 2 offers a visual presentation of the legal structure we envision.



B. Key Features of the FSP Framework

We now outline the key design features of the FSP framework and discuss in the next section how these features could be implemented in practice.

Comprehensive Federal Oversight. Perhaps most critically, the FSP framework provides a comprehensive system of federal oversight for stablecoin issuers within our traditional system of banking regulation, as recommended by the PWG Report.[69] Stablecoin issuers subject to this framework would operate as subsidiaries of IDIs, thus ensuring that they were subject to oversight by either the FDIC, OCC, or Federal Reserve. The NTB itself would also be subject to OCC approval and supervision, including ongoing OCC examinations of both the NTB and PTV that would hold stablecoin reserve assets.[70] Finally,

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68. See discussion *infra* Part III.D, "Refinements and Extensions."

69. PWG Report, *supra* note 3, at 2.

70. 12 U.S.C. §92(a).

because the FSP framework is located within the IDI structure, the separation of banking and commerce would be assured under the BHCA.[71]

Legal Separation of Stablecoin Operations from FDIC-insured Banks. By requiring that stablecoin issuers be located in legally distinct operating subsidiaries, the FSP framework eliminates the possibility that stablecoins would gain direct (or indirect) protection from FDIC deposit insurance. It would also avoid complexities that would inevitably arise if a stablecoin offering were made by the same entity that carried FDIC-insured deposits on its balance sheet. As long as IDI investments in an NTB operating subsidiary are appropriately reflected in the IDI's own capital requirements—an issue we address below—the insolvency of the NTB, or collapse of the associated stablecoin, would not threaten the solvency of the parent IDI. There would also be no co-mingling of stablecoin reserve assets with insured deposits, and the FSP requirements could prohibit leveraging such assets.

High-Quality Asset Restrictions on Stablecoin Reserve Assets. As to the stablecoins themselves, we envision a narrow-bank approach whereby the stablecoins issued by authorized NTBs would be fully backed by portfolio assets held within the PTV. These portfolio restrictions would be at least as strict as the "level 1" high-quality liquid asset (HQLA) requirements currently imposed on banks: a category that includes central bank reserve balances, Treasury securities, and securities issued and unconditionally guaranteed by U.S. government agencies.[72] Conceivably, some degree of overcollateralization might also be required, as discussed below. These asset restrictions would protect the stability of the stablecoin by ensuring that there were always sufficient liquid assets to honor customer redemption requests. If, however, those assets were impaired in some unanticipated way, the loss would be borne by holders of the stablecoins, and neither insured by the FDIC nor eligible for any form of direct Federal Reserve Board emergency lending.[73] This segregation of assets also protects the parent IDI from stablecoin losses. In designing these portfolio restrictions, the Fed, OCC, and FDIC would need to consider a number of potentially competing considerations around the use of central bank reserve balances *versus* Treasury securities and other types of level 1 HQLA, including effects on yields, liquidity risk, and monetary policy

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71. Bank Holding Company Act, *supra* note 51.

72. *See* 12 CFR § 249.20.

73. To be sure, if the Fed were to support the overall market for government securities or other high-quality assets held in the PTV, then the holders of those instruments would benefit indirectly as would many other market participants.

implications.[74] Beyond the quality of reserve assets, regulators may also need to give consideration to the yield and allocation of returns on these assets.[75]

Resolution of Insolvent NTBs by Federal Banking Agencies. While the FSP framework contemplates the creation of a legally separate and adequately capitalized NTB operating subsidiary, there is always a risk that in the event of an NTB's failure, claims might be brought by its parent IDI, affiliates, or third-party creditors. In theory, these claims could compete with those of the customers holding the failed stablecoin, leading to potential losses. Importantly, however, unlike other business entities—which are subject to the strictures of general corporate bankruptcy law—the resolution of an NTB would be overseen by a federal banking agency—most likely the OCC or FDIC— operating as a receiver.[76] Compared with general corporate bankruptcy law, the involvement and authority of the federal banking agencies to serve

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74. For example, where market yields were higher than the interest payable on central bank reserve balances (IORB), the ability to hold a wider range of safe assets would make the FSP framework more attractive to stablecoin issuers. By the same token, the ability—and perhaps requirement—to hold a broader range of level 1 HQLA would alleviate some of the "pass-through" concerns that the Fed has recently raised around the application of The Narrow Bank (TNB) for a Fed master account. While this concern could also be addressed by adopting a less generous IORB framework for stablecoin issuers, this would come at the expense of the attractiveness of our proposal. In addition, reliance on HQLA over central bank reserve balances presents two challenges relating to microprudential liquidity risk and monetary policy implementation. In theory, of course, there should be no liquidity risk associated with level 1 HQLA so long as an IDI can swap it at the discount window for central bank reserve balances. In practice, however, the use of the Fed's discount window has almost completely dried up, raising the question of whether the threat of stigma might lead to suboptimal decision-making by stablecoin issuers facing mounting liquidity pressures. (The fact that digital assets settle instantly and HQLA is typically T+1 could increase that pressure.) On the monetary policy side, allowing stablecoin issuers to hold HQLA could potentially work at cross purposes with the Fed's open market operations. Specifically, if the Fed were to sell Treasuries in order to take money out of the financial system, then the fact that the buyers would be using those same Treasuries on a 1:1 basis to create new money-like instruments—i.e. stablecoins—would necessarily lessen the impact and effectiveness of those operations.

75. We have not addressed the issue of what a stablecoin issuer can or cannot do with the income stream from holding HQLA, which can be significant, especially as interest rates rise; for example, 2% on $25 billion of reserves is $50 million a year. The allocation of this income may be an issue that regulators would need to consider as the market grows. Our understanding, based on conversations with market participants, is that many stablecoin issuers currently utilize these returns to cover their own operational costs, but that some stablecoin issuers are allocating part of the reserve to attract business from institutional clients. While avoiding the pass-through of investment income to stablecoin holders may help sponsors avoid the application of federal securities laws to these arrangements, *see* discussion *infra* note 124, revenue sharing arrangements by stablecoin sponsors may raise other issues, such as conflicts of interest. *See generally* Howell E. Jackson, *The Trilateral Dilemma in Financial Regulation*, in IMPROVING THE EFFECTIVENESS OF FINANCIAL EDUCATION AND SAVINGS PROGRAMS, Anna Maria Lusardi, ed., University of Chicago Press (2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1300419.

76. Under the National Banking Act, the Comptroller is authorized to appoint receivers for insolvent national banks and in 2016, the Comptroller adopted regulations dealing with the receivership of uninsured national banks, including NTBs of the sort contemplated here. *See* 12 U.S.C. § 191; OCC Final Rule on Receiverships for Uninsured National Banks, 81 Fed. Reg. 92,594 (Dec. 20, 2016). These regulations contemplate that either the OCC itself or the FDIC would serve as receivers. (The FDIC automatically serves as receiver of insured depository institutions, but also has authority to agree to serve as receiver for an insolvent uninsured national trust bank if appointed by the OCC. *See* 12 U.S.C. § 1821(c)(2)(B), (6); *see also* 81 Fed. Reg. at 92, 597 & n. 15.) While less extensive than the more familiar and robust receivership powers of the FDIC with respect to insured depository institutions, the OCC rules establish a streamlined set of procedures for the resolution of insolvent NTBs.

as receivers for NTBs would serve to dramatically simplify the resolution process, prioritize the return of customer funds, and greatly reduce the risk of confusion or unanticipated interpretations of legal claims.[77]

Bringing Stablecoins within the Regulatory Perimeter. A key feature of the FSP framework is that it offers a pathway to bring stablecoin issuers fully within the federal regulatory framework within a structure that can address a host of public policy concerns: consumer protection, market integrity, financial stability, and preventing illicit activity. To be sure, as the framework would be voluntary, the pathway must be attractive to stablecoin issuers—a topic we address below—but the creation of an attractive pathway inside the federal regulatory perimeter would be a substantial public policy achievement.

C. The FSP Application Process

Under our proposal, stablecoin issuers would have to apply to the Comptroller of the Currency for a national trust bank charter under 12 C.F.R. § 5.26 application procedures. As is customary in such submissions, applicants would be required to address operational resilience, disclosure and auditing procedures, management personnel, compliance programs, illicit finance risks, distribution/marketing plans, and settlement arrangements.[78] In addition, applicants would have to submit business plans including growth projections that would allow regulatory authorities to judge the potential significance of an applicant's operations and the appropriate degree of supervisory safeguards.[79] The approval of FSP applications would be subject to a number of conditions designed to address risks outlined in the PWG Report. At a minimum, those conditions would cover the following topics:

- *Tight portfolio restrictions*. As described above, the FSP would include tight portfolio restrictions on assets held within the PTV to ensure that a stablecoin issuer's obligations to customers were fully collateralized, thereby minimizing the risk of destabilizing runs. The PWG Report, the FSB Report and other commentary on stablecoins have all highlighted the risk of a stablecoin run, whether due to illiquidity, decline in value of portfolio investments, or other factors.[80]

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77. The federal bankruptcy code expressly excludes any "bank" from eligible debtors. *See* 11 U.S.C. § 107(b)(2), (d). While some academic commentary has questioned whether this exclusion reflects sound public policy, *see* Matthew Bruckner, *Who's Down with OCC('s Definition of 'Banks')?*, 24 U. PENN. J. BUS. L. 1 (2021) (focusing primarily on the application of this exclusion to fintech charters rather than NTBs), the textual basis of the bankruptcy code exclusion for any "bank" is relatively straightforward and separate references to "uninsured state member banks" in 11 U.S.C. § 107(d) support the view that uninsured national trust banks are included within the term "bank" in 11 U.S.C. § 107(b)(2). The Comptroller, moreover, notes in its 2016 rulemaking that "[t]he OCC is not aware of any opinion of a U.S. Bankruptcy Court, or any other U.S. court, finding that an uninsured national bank is eligible to be a debtor subject to a petition under the Code." 81 Fed. Reg. at 92,598 n.14.

78. *See* 12 C.F.R. § 5.26(e)(2).

79. As noted below, these projections—along with optimistic and pessimistic scenarios—could be useful for FSOC determinations of potential systemic importance.

80. PWG Report, *supra* note 3, at 12; Financial Stability Board*, supra* note 7, at 35, 52;. *see also* Massad, *supra*, note 27.

- *Bank capital, liquidity, and affiliate-transaction requirements*. The NTB operating subsidiary itself would also need to satisfy applicable bank capital and liquidity requirements,[81] as well as the restrictions on transactions with affiliates under sections 23A and 23B of the Federal Reserve Act. As envisioned, the NTB would be subject to these requirements on a consolidated basis with its parent IDI. Conceivably, special capital charges at the parent IDI level would be imposed to ensure that the NTB could fail without causing any impairment of the parent IDI. The restrictions under Section 23A and 23B could be applied to transactions and relationships between the parent IDI, the NTB, and the PTV.
- *Portfolio assets held in segregated trust*. The PTV, in contrast, would be considered off-balance sheet for the capital requirement purposes of both the parent IDI and NTB operating subsidiary, as is currently the case with CITs sponsored by national trust banks. As explained above, restrictions on the investment of the PTV's reserve assets (in addition to prohibitions on leveraging these assets) would protect the holders of stablecoins from the risk of loss or illiquidity. If additional protections were required, OCC application procedures could specify some degree of credit support from the NTB operating subsidiary to the PTV, effectively creating a contingent capital cushion. This would be desirable to the extent that reserve assets significantly deteriorated in value, became subject to claims by outside creditors, or to provide a cushion against operational and other types of risks. Such support should then also be reflected in the NTB's capital requirements.
- *Robust KYC/AML/Antiterrorism requirements*. Applicants would also need to satisfy operational security and resilience standards as well as cybersecurity standards analogous to the obligations that federal authorities impose on other financial firms.[82] In addition, and of particular importance for stablecoin issuers, Know Your Customer (KYC)/Anti-Money

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81. As noted in a 2016 rulemaking on receiverships for uninsured national banks, "the OCC typically requires [national trust] banks to hold capital in a specific minimum amount; as a result they hold capital in amounts that exceed substantially the 'well capitalized' standard that applies when national banks calculate their capital pursuant to the OCC's rules in 12 CFR part 3." 81 Fed. Reg. at 92,595.

82. *See* SEC Regulation S-P, 17 CFR Part 248, Subpart A; FINRA Regulatory Notice 21-29 (Aug. 13, 2021), https://www.finra.org/sites/default/files/2021-08/Regulatory-Notice-21-29.pdf (outlining member firms' supervisory duties related to third party vendors); 15 U.S.C. §§ 7241, 7262 (Sarbanes Oxley security requirements); 15 U.S.C. § 16801 (Gramm-Leach-Bliley Act provision authorizing agencies to promulgate security regulations); Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers, 86 Fed. Reg. 66,424 (Nov. 23, 2021) (collecting cybersecurity regulations, including 31 U.S.C. § 5311 *et seq.*; 31 CFR subtitle B, chapter X; 15 U.S.C. § 6801; 12 CFR pt. 30, app'x B, supp. A (OCC); 12 CFR part 208, app'x D-2, supp. A, 12 CFR 211.5(l), 12 CFR part 225, app'x. F, supp. A (Board); 12 CFR part 364, app'x B, supp. A (FDIC)); *see also* 12 CFR Part 53 (requiring that national banks notify regulators of cybersecurity breaches); SEC Regulation SCI, 242 CFR §§ 1000-07.

Laundering (AML)/Anti-Terrorism standards should be required to address the risk of illicit activity, which was also highlighted in the PWG Report.[83]

- *Federal consumer protection law*. Applicants should also be required to meet federal consumer protection standards pertaining to redemptions, rights of recourse, protection and use of customer data, and disclosure policies.[84] There could also be requirements pertaining to the periodic performance and disclosure of audits of trust reserve assets.
- *Service to Low and Moderate Income Households*. CRA-like requirements might also be imposed, conceivably focused on increasing low and moderate-income citizens' access to payments innovations (rather than through lending activities, as the investment of stablecoin assets would be tightly constrained).[85]
- *Governance Issues*. Lastly, the FSP would need to address the challenges arising from the fact that stablecoin operations may be performed by multiple parties, and certain functions can be carried out through decentralized processes that pose particular risks. The PWG Report notes the complexity of stablecoin operations: the key functions of creation and redemption of stablecoins, transfer between parties and custody can be performed by different parties, and the governance structures associated with different functions can vary from highly centralized to decentralized and distributed processes. The PWG Report proposed that all "stablecoin arrangements" that are critical to the functioning of a stablecoin be subject to "appropriate risk-management standards," but the report was not specific as to what such standards would look like or how they would be imposed.[86]

  While we have assumed that any stablecoin issuer that submits to the FSP would be a centralized entity that can be held accountable, certain critical functions might not be under its direct control. We believe the approval of a stablecoin issuer could and should be conditioned on requirements that the issuer take appropriate or reasonable steps to ensure compliance with risk-management standards—including KYC/AML/Antiterrorism standards and operational resilience and cybersecurity standards—with respect to all critical functions. The OCC can draw on existing

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83. *See* FINRA, Rule 2090 (July 9, 2012) (KYC); FINRA Rule 2011 (amended June 30, 2020) (suitability); Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29,398 (May 11, 2016) (codified at 31 CFR Parts 1010, 1020, 1023, 1024, & 1026); 31 U.S.C. § 5330 & 31 C.F.R. § 1022.380 (MSB registration requirements); 31 U.S.C. § 5318(a)(2), (h) & 31 C.F.R. § 1022.210(a) (AML program maintenance requirements); 31 U.S.C. § 5313(a) & 31 C.F.R. § 1010.311 (currency transaction reporting requirements for transfers of more than $10,000); 31 U.S.C. § 5318(g)(1) & 31 C.F.R. § 1022.320(a)(2) (suspicious activity reporting requirements); FinCEN, *Anti-Money Laundering and Countering the Financing of Terrorism National Priorities* (June 20, 2021), https://www.fincen.gov/sites/default/files/shared/AML_CFT%20Priorities%20(June%2030%2C%202021).pdf; 31 C.F.R. § 1022.320(a)(2); 31 CFR Parts 566, 594-97 (antiterrorism sanctions); *see also* U.S. Department of the Treasury, *Counter Terrorism Sanctions*, https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/counter-terrorism-sanctions.

84. See *infra* notes 121-122 & accompanying text on CFPB jurisdiction.

85. As a technical matter, the Community Reinvestment Act applies only to insured depository institutions. *See* 12 U.S.C. § 2901(a) (defining CRA to reach "regulated financial institutions"); *id.* at § 2902(2) ("the term 'regulated financial institution' means an insured depository institution"). So any benefit from CRA commitments within an FSP framework would accrue to its parent IDI.

86. WG Report, *supra* note 3, at 1.

regulatory models where a function is performed by another centralized entity, just as we require traditional financial institutions to be responsible for the selection and performance of third-party technology or other vendors. It becomes more challenging insofar as decentralized processes are involved, particularly with respect to the transfer and settlement of stablecoins on public blockchains or decentralized digital asset trading platforms. Nevertheless, there should be some duty on the part of the issuer to the extent it takes action to select or support a particular blockchain or platform or to the extent it can prevent activity related to its stablecoin on a non-compliant chain or platform.[87] And after approval of a new issuer, the framework would need to ensure that no decision or event triggered by a decentralized process could potentially jeopardize a stablecoin's ongoing compliance with applicable regulatory requirements. Along the same vein, the FSP would need to ensure that holders were sufficiently protected in the event of any changes to a chain or other protocol, commonly known as "forks."[88]

- *Trading and Exchange of Stablecoins*. Insofar as the trading or exchange of stablecoins or other stablecoin arrangements fall under the jurisdiction of the SEC or the CFTC, coordination with such agencies will be important. In a separate paper, two of the authors propose how the SEC and CFTC might collaborate to establish a joint self-regulatory organization (SRO) to create an appropriately supervised trading environment.[89] Were such an SRO created, approval of a stablecoin issuer could be conditioned on a requirement that exchanges or other trading venues for its stablecoin be limited to entities or protocols that satisfy the SRO standards.
- *Concentration of Power and Interoperability*. Finally, we believe the application process should include measures to address the PWG Report's concern with concentration of economic power.[90] This consideration is partially addressed by the application of the BHCA, which would prohibit

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87. Circle, for example, refers to its "support" for the trading of USDC on certain blockchains. *See* Circle, *Announcing Support for Polygon USDC*, The Official Blog of Circle and USDC (June 7, 2022), https://www.circle.com/blog/announcing-support-for-polygon-usdc.

88. See sources cited *supra* notes 82-83; *see* Reg SCI, *supra* note 82 (imposing obligations on issuers with respect to third parties). To be sure, there may be limits to a stablecoin issuer's ability to police such activity. For example, an FSP-compliant stablecoin might be "wrapped" for trading as a separate token on a blockchain that does not satisfy such standards, without any interaction with the issuer. Alternatively, there might be situations where a blockchain or platform meets the standards, but a subsequent event—such as a fork or other change approved by holders of governance tokens in a decentralized process—results in non-compliance with such standards. Should the stablecoin issuer be required to take action to limit the ability of the underlying stablecoin to be traded on that blockchain or platform? Or to the extent that the concerns pertain to money laundering or other illicit activity risk, is it sufficient if the trading is on-chain and can at least be examined by law enforcement authorities? These are questions that would need to be worked out in the implementation of the FSP framework as well as any other comprehensive system of regulation for stablecoin issuers.

89. Timothy Massad & Howell Jackson, *How We Can Improve Regulation of Crypto Today—Without Congressional Action—And Make the Industry Pay For It* (forthcoming 2022). We note there are also legislative proposals regarding the regulation of crypto trading generally which would affect the jurisdiction of the SEC and CFTC, including the Lummis-Gillibrand legislation, *supra* note 44, as well as a proposal by Senators Debbie Stabenow (D-Michigan), John Boozman (R-Arkansas), Cory Booker (D-New Jersey) and John Thune (R-South Dakota): Digital Commodities Consumer Protection Act of 2022, 117th Cong. (2022), https://www.agriculture.senate.gov/imo/media/doc/crypto_bill_section_by_section1.pdf; *see also* Pete Schroeder, *Senate bill would hand bitcoin, ether oversight to commodities regulator*, Reuters (Aug. 3, 2022), https://www.reuters.com/markets/us/senate-bill-would-hand-bitcoin-ether-oversight-commodities-regulator-2022-08-03/s.

90. PWG Report, *supra* note 3, at 3.

affiliation of a stablecoin issuer with a commercial firm.[91] The PWG Report also proposed that supervisors of stablecoin issuers have authority to implement standards to promote interoperability among stablecoins, as well as restrictions on the use of users' transaction data, both of which could be included in the conditions of approval.[92] In addition, for applicants already in existence when the FSP is rolled out, the application review process should be implemented in such a way that approvals are issued simultaneously for proposals received by a given date, so that no single firm gains a timing or marketing advantage by being first.

D. Notice and Comment Rulemaking

While it might be possible for the Comptroller to implement the FSP framework under current regulatory standards, there would be an advantage to proceeding under notice and comment rulemaking to establish both the substantive conditions we contemplate as well as a tailored application process. Though rulemaking procedures take time, they facilitate public input and reduce legal risks.

III. Why Stablecoin Issuers Would Opt Into the FSP Framework

Although stablecoin issuers would not be required to comply with the FSP, we believe the benefits of the proposed framework would spur many existing and newly created firms to apply for authorization. While incumbent stablecoin issuers might initially resist our approach, the advantages of the FSP framework could be considerable, especially if new entrants chose to adopt this approach. In our view, the FSP framework would offer stablecoin issuers three distinct benefits. The first is the marketing advantage that would accrue to issuers subject to the framework, because consumers and businesses would be more willing to use a stablecoin for everyday payments if it is issued by a federally regulated financial institution. We describe this benefit in Section A. The second benefit stems from the privileges that these firms would enjoy by operation of law, as a result of being brought within the perimeter of federal banking regulation. We outline this benefit in Section B. Third, bringing these firms into the regulatory perimeter would give federal banking authorities the option to grant them access to core financial market infrastructure—including Federal Reserve master accounts and the conventional payment system—now largely limited to IDIs. These supplemental benefits are reviewed in Section C. Finally, in section D, we explore the extent to which FSP benefits might be refined and extended in the future.[93]

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91. Bank Holding Company Act, *supra* note 51.

92. Ibid.

93. We acknowledge that some stablecoin issuers may say they should not be subject to the full scope of regulation and supervision applicable to IDIs because their business model is narrower. They may also claim that because of the burdens that come with such regulation, only large, existing banks will find the platform attractive, thus reducing its potential to increase competition in payments. As we noted earlier, we believe the stand-alone NTB-PTV model is worth considering but believe the approach we have outlined makes more sense in the absence of new legislative authority.

A. The Basic Marketing Advantage

Despite the dramatic growth in the market capitalization of stablecoins over the past two years, their use at present is still largely confined to the crypto-asset industry.[94] But the prospect of wider adoption beyond the crypto industry is clearly a goal that many stablecoin issuers aspire toward.[95] We believe stablecoin issuers that comply with the proposed framework would have a significant advantage in marketing their stablecoins for broader use. Individuals and businesses are likely to have greater confidence in a stablecoin that is approved and regulated by federal banking authorities. Investors in a federally regulated stablecoin issuer would likely also have greater confidence, making it easier for an issuer to raise capital, contract with third party vendors, and attract other types of support. More specifically, the OCC approval process, strict portfolio restrictions, ongoing supervisory reviews and periodic examinations, and compliance with required disclosures will send a positive signal to the marketplace regarding the safety and soundness of stablecoin issuers and their coins. Some stablecoin issuers emphasize regulation in their marketing. For example, the website for one popular issuer states: "By working within regulatory frameworks, we're creating an ecosystem built with integrity."[96] We believe the value of this potential benefit would be significant. The benefit would also be enhanced by the extent to which banking authorities make it easier for traditional banks to transact with approved stablecoin issuers.[97]

B. Benefits by Operation of Current Law

The FSP structure would also provide authorized stablecoin issuers with specific, substantial benefits simply by operation of current law.

- *Enhanced legal and regulatory certainty*. The FSP would eliminate the risks of unanticipated enforcement actions that exist under current law. As the PWG Report reviewed, there has been considerable confusion over the application of current financial regulations to many digital assets, including stablecoins, producing regulatory risks and often costly litigation.[98] The FSP

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94. *See, e.g.*, Andrew Ackerman, *Stablecoins in Spotlight as U.S. Begins to Lay Ground for Rules on Cryptocurrencies,* The Wall Street Journal (Sept. 25, 2021), https://www.wsj.com/articles/stablecoins-in-spotlight-as-u-s-begins-to-lay-ground-for-rules-on-cryptocurrencies-11632562202.

95. *See, e.g.*, Ibid. (Circle CEO Jeremy Allaire stated that "Circle believes that well-regulated digital dollars, built on public blockchains, can play a vital role in making the movement of value faster, safer and less expensive"); *see also* Paxos, *supra* note 63 (well-regulated stablecoins will allow for the "trustworthy and instantaneous movement of any asset at any time").

96. Paxos, *supra* note 63.

97. [97] The OCC already has issued a number of releases and interpretative letters dealing with the authority of national banks to engage in certain activities involving digital assets, including statements regarding the importance of adequate controls. *See generally* OCC, *Digital Assets*, https://www.occ.gov/topics/supervision-and-examination/digital-assets/index-digital-assets.html (providing links to OCC materials on digital assets).

98. [98] *See, e.g.*, Michaels, *supra* note 31; Matt Levine, *The Fed Versus the Narrow Bank*, Bloomberg (Mar. 8, 2019), https://www.bloomberg.com/opinion/articles/2019-03-08/the-fed-versus-the-narrow-bank#xj4y7vzkg; James J. Black & Marc-Alain Galeazzi, *Cannabis Banking: Proceed with Caution*, ABA (Feb. 6, 2020), https://www.americanbar.org/groups/business_law/publications/blt/2020/02/cannabis-banking/; Pete Schroeder, *Republican senator says Fed has revoked master account for controversial fintech*, Reuters (June 9, 2022),

framework would provide legal certainty to qualified stablecoin issuers. This benefit would become more pronounced if the FSP framework were adopted and federal authorities focused their enforcement activities on stablecoin issuers operating outside the framework.

- *Potential federal preemption*. With appropriate OCC findings under the Dodd-Frank Act,[99] the use of national trust bank charters could preempt the application of the patchwork of inconsistent state consumer financial protection laws that currently govern many stablecoin issuers, thereby allowing them to operate nationwide under a unified set of federal regulations. Under this authority, the Comptroller could preempt any consumer financial laws that "substantially interfere[]" with the exercise of any national bank powers, including the powers of NTBs, as well as any "substantially equivalent" law of other states. While the determinations must be undertaken on a case-by-case basis with input on certain determinations from the Consumer Financial Protection Bureau, this authority would be sufficient to free firms operating under the FSP framework from certain aspects of state money transmitter laws and other state-level requirements that could inhibit stablecoin issuers from operating efficiently on a nation-wide basis. The potential for preempting state law is a major advantage of the FSP framework, which operates out of a federal charter as opposed to the state trust companies relied upon for many existing stablecoin issuers and contemplated in some legislative proposals.
- *Streamlined Resolution Procedures Overseen by a Federal Banking Agency*. The FSP structure we propose would also effectively pre-empt the application of general corporate bankruptcy law. Once a commercial enterprise enters bankruptcy, corporate bankruptcy law in the U.S. and elsewhere envisions the application of two foundational rules that dramatically interfere with its ability to honor its contractual commitments. The first rule is a procedural requirement—an automatic stay—that suspends any enforcement action against the assets of the bankrupt enterprise by its creditors until the conclusion of the bankruptcy process.[100] The second rule is a substantive requirement—the pari passu rule—that forces unsecured creditors to share in any distribution of the bankrupt enterprise's assets on a pro rata basis.[101] This means that the claims of each unsecured creditor against the bankrupt enterprise will be pooled together with those of other unsecured creditors, with each creditor then eventually paid on a proportionate basis out of any assets that remain after other, more senior, creditors have been paid back.

  Together, these two bankruptcy rules currently undermine the credibility of stablecoins in two fundamental ways. First, the automatic stay prevents stablecoin holders from transferring or withdrawing their money for the duration of the bankruptcy process. In a world where this process may last several years, the practical effect is to "freeze" the holder's money within the estate of the bankrupt enterprise—thereby suspending its use as a means of payment. Second, insofar as stablecoin holders are unsecured creditors, the pari passu rule may ultimately force

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https://www.reuters.com/business/finance/republican-senator-says-fed-has-revoked-master-account-controversial-fintech-2022-06-09/.

99. *See* 12 U.S.C. § 25b (2022) (setting up standards for OCC preemption of state consumer financial laws that "prevent[] or significantly interfere[] with the exercise of a national bank of its powers"). *See also* Michael S. Barr, Howell E. Jackson & Margaret E. Tahyar, FINANCIAL REGULATION: LAW AND POLICY 641-45 (3d ed. 2021).

100. *See e.g.*, 11 U.S.C. § 362.

101. *See e.g.*, 11 U.S.C. § 1123(a)(4).

them to write down the value of their contractual claims against the bankrupt enterprise. By definition, these write-downs stand in sharp tension with the expectation that stablecoins represent a reliable store of nominal value. Compounding matters, especially when enterprises combine stablecoin issuance with investments in risky and potentially illiquid investments, the prospect that the issuer might be forced into bankruptcy can trigger a "first come, first served" dynamic that resembles a conventional bank run. Put bluntly: the very *threat* of bankruptcy can be enough to bring down a stablecoin issuer.

With the conventional banking system, the destructive impact of general corporate bankruptcy law has largely been addressed via the introduction of FDIC deposit insurance and, importantly, a special resolution regime for failing banks.[102] As an uninsured national bank, the NTB operating subsidiary would be resolvable under the OCC's 2016 resolution procedures, thereby reducing legal uncertainty, avoiding the strict application of the automatic stay and pari passu rules, and ensuring that holders of a failed stablecoin were paid out rapidly and in full.[103]

C. Supplemental Benefits for FSPs

To further encourage stablecoin issuers to comply with the proposed framework, federal authorities could grant approved issuers access to certain features of the public payments infrastructure that are currently available in the ordinary course only to IDIs. In designing the OCC's application procedures for stablecoin issuers, consideration could simultaneously be given to what limitations would be necessary to allow for these additional benefits to be made available. We have identified two potential supplementary benefits, but others may well be possible.

1. Federal Reserve Master Accounts

To reduce settlement risk and facilitate interoperability with other payments systems, approved stablecoin issuers could be given some type of access to Federal Reserve master accounts. These master accounts are accounts on the balance sheet of the Federal Reserve that enable member banks and a very limited number of other financial institutions to transfer funds between one another, and with the Fed itself, using central bank reserve balances as the ultimate settlement asset. These accounts are also necessary to directly participate in Fedwire, CHIPs, and other financial market infrastructure.[104] Master account access has, of course, been the subject of considerable controversy in recent times.[105] The FSP framework proposed here is designed to finesse these controversies and, as a result, granting approved

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102. *See, e.g.*, Richard M. Hynes and Steven D. Walt, *Why Banks are Not Allowed in Bankruptcy*, 67 WASH. & LEE L. REV. 985 (2010), https://scholarlycommons.law.wlu.edu/wlulr/vol67/iss3/4.

103. *See* OCC Final Rule on Receiverships for Uninsured National Banks, 81 Fed. Reg. 92,594 (Dec. 20, 2022) (codified at 12 C.F.R. Part 51).

104. *See* Awrey, *supra* note 21.

105. See, e.g., Kyle Campbell, *Should the Fed decide who gets a master account?*, American Banker (June 10, 2022), https://www.americanbanker.com/news/should-the-fed-decide-who-gets-a-master-account; Schroeder, *supra* note 98. *See* sources cited *supra* note 34.

issuers access to Federal Reserve master accounts would not require federal authorities to establish new precedents.

First, starting with legal authority, the critical point is that the NTBs serving as authorized stablecoin issuers would automatically be members of the Federal Reserve as a result of their status as national banks and, hence, presumptively eligible for master account access.[106] Under guidelines recently proposed by the Federal Reserve, these NTBs would be considered "Tier 2" entities: presenting more risks than FDIC-insured banks (Tier 1), but fewer risks than uninsured institutions not subject to regulation and supervision at the federal level (Tier 3).[107] Indeed, a number of NTBs have already obtained access to Federal Reserve master accounts.

A second, operational concern relates to the manner in which the payments vehicle—i.e. the PTV in the FSP framework—would interact with the master account, since the account itself (along with the associated routing number) would be in the name of the NTB. While this operational detail is likely best left for future study, we would note here that Federal Reserve master accounts routinely include subaccounts for correspondent banking relationships and affiliate transactions.[108] Accordingly, there would seem to be ample precedent for ensuring that master account holdings for the FSP payments vehicle could be appropriately segregated.

In terms of policy, there are two primary concerns about expanded access to Federal Reserve master accounts. The first is that firms operating under novel state charters, such as Wyoming's Special Purpose Depository Institutions (SPDIs), are not subject to robust federal regulation.[109] However, the FSP framework is designed to ensure that qualifying stablecoin issuers are fully subject to federal oversight. As noted earlier, a second concern—typically associated with "The Narrow Bank (TNB)" application—is that allowing expanded access to master accounts could potentially interfere with monetary policy in some unanticipated manner.[110] But there is no need to allow stablecoin issuers to invest all, or even most, of their assets in central bank reserve balances.[111] Accordingly, the OCC's approval of the original NTB

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106. *See* 12 U.S.C. § 342 (2022) ("Any Federal reserve bank may receive from any of its member banks, or other depository institutions, and from the United States, deposits of current funds in lawful money."). Much of the controversy over access to master accounts from novel charters concerns the term "other depository institutions," which picks up, via cross reference in 12 U.S.C. § 461(b), a further requirement of eligibility to make an application to FDIC insurance. But that cross reference is not applicable to national banks, which are defined as member banks in 12 U.S.C. § 221. For an excellent overview of these issues, see Hill, *supra* note 34.

107. Guidelines for Evaluating Account and Services Requests, 87 Fed. Reg. 12,957 (Mar. 8, 2022), https://www.govinfo.gov/content/pkg/FR-2022-03-08/pdf/2022-04897.pdf.

108. For examples, see Federal Reserve Board, *Federal Reserve Account Structure, Transaction Settlement and Reporting Guide* (Nov. 2017), https://www.frbservices.org/binaries/content/assets/crsocms/resources/rules-regulations/operating-circular-1-accnt-structure.pdf.

109. *See e.g.* Tory Newmyer, *Bill to Grant Crypto Firms Access to Federal Reserve Alarms Experts*, Washington Post (July 3, 2022), https://www.washingtonpost.com/business/2022/07/03/crypto-banks-risk-lummis/ (although, notably, the analysis in the article is based on the 2019 regulations governing SPDIs, which were subsequently strengthened to prohibit the type of activities that the article cites as sources of alarm). This concern is reflected in the Federal Reserve Board's evolving policies with respect to master account access. *See* Proposed Guidelines for Evaluating Account and Services Requests, 86 Fed. Reg. 25,865 (May 11, 2022).

110. *See* discussion *supra* note 74; *see also* Levine, *supra* note 98; John Cochrane, *The Safest Bank the Fed Won't Sanction*, Chicago Booth Review (Nov. 30, 2018), https://www.chicagobooth.edu/,review/safest-bank-fed-wont-sanction.

111. *See* discussion *supra* note 74.

charter could conceivably include rules around the fraction of the PTV's total assets that must or could be held in a Federal reserve master account.

Finally, a separate concern about expanded Federal Reserve master account access pertains to the possibility that a payments innovator with master account access would be engaged in broader commercial activities, especially if the payments innovator were already a major presence in the tech market, such as Meta or Google. Our proposal, however, addresses this concern by requiring the stablecoin issuer to be an operating subsidiary of an IDI, which ensures the application of the BHCA and thus restricts the NTB from undertaking commercial activities.[112]

2. FedNow Access

Another potential benefit that could be offered to stablecoin issuers operating under the FSP framework is direct access to FedNow, the real-time payment system that the Federal Reserve Board is scheduled to launch over the next few years.[113] While the operational details of FedNow have not yet been finalized, some analysts have identified benefits to competition in payments services if non-traditional payments providers and not just incumbent banks are provided direct access.[114] Exactly how such FedNow access should be provided—whether via APIs or in some other manner—remains to be determined. But once an approved issuer had master account access, these additional FedNow privileges could also presumably be included as well, enhancing both the benefits of the FSP framework and competition in payments services more generally.

D. Refinements and Extensions

Were the FSP framework to be adopted along the lines we propose above, there are three potential refinements and extensions that might be considered down the road, and possibly adopted administratively or endorsed through new legislation.

The first would be to consider the FSP framework as a model for other alternative payments processors, such as Venmo. As one of us has explored in considerable detail in prior work, these alternative payments providers are subject to an inadequate patchwork of state laws and are also forced to partner with incumbent banks to gain access to the federal payments infrastructure.[115] The FSP structure would provide these alternative payments providers with a consistent and modern regulatory framework for their operations, including potentially the supplemental benefits we envision with respect to master

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112. Bank Holding Company Act, *supra* note 51.

113. *See* The Federal Reserve, *About the FedNow Service*, https://www.frbservices.org/financial-services/fednow/about.html#:~:text=The%20FedNow%20Service%20is%20a,every%20day%20of%20the%20year.

114. *See, e.g.*, William Towning, *FedNow: The Road to Non-Bank Access to US Instant Payments*, Central Banking (Apr. 27, 2020) https://www.centralbanking.com/central-banks/payments/7532666/fednow-the-road-to-non-bank-access-to-us-instant-payments; Peter Feltman, *Banks see Fed payments proposal opening door to fintech rivals*, Roll Call (Nov. 19, 2019), https://rollcall.com/2019/11/19/banks-see-fed-payments-proposal-opening-door-to-fintech-rivals/; Brian Murphy, Robert Pile, & Hannah Winiarski, *What FedNow means for faster payments in the US*, Eversheds-Sutherland Legal Alerts (Apr. 15, 2020), https://us.eversheds-sutherland.com/NewsCommentary/Legal-Alerts/231305/What-FedNow-means-for-faster-payments-in-the-US.

115. Awrey, *supra* note 21.

account access and direct connectivity into FedNow real-time payment settlements. To be sure, some details of the FSP framework might need to be adjusted to reflect the operations of alternative payments providers as opposed to stablecoin issuers, but the FSP framework as a model of a federal payments platform could prove extremely attractive.[116]

Another refinement could be to explore extending the FSP framework to appropriately structured state-chartered entities. While some aspects of our proposal—such as OCC preemption of state consumer financial laws and FDIC oversight in the event of insolvency—may not be available to state-chartered entities in the absence of new legislation, others, like master account access, might be possible if acceptable supervisory arrangements could be established to meet Federal Reserve Board requirements. Either way, some effort to extend the FSP framework to align with our dual banking traditions would be possible.

Finally, at some point down the road, once we have sufficient experience with the FSP framework, federal authorities might consider whether some of the restrictions imposed here might be modified to some degree. No doubt, we have proposed a belts-and-suspenders approach. One could imagine eventually relaxing the requirement that the FSP framework be located within an IDI structure—i.e. permitting *stand-alone* NTBs to sponsor stablecoins. Such a change would increase the attractiveness of the FSP framework for firms that are reluctant to subject themselves to Federal Reserve Board consolidated oversight under the BHCA as well as those that want to remain free to engage in commercial activities. Alternatively, one could imagine an intermediate position of the sort contemplated in the Lummis-Gillibrand legislation that imposes restrictions on commercial affiliations, but without application of the BHCA.[117] Many different approaches are possible, but we leave them all for future consideration and follow, at least for the time being, the PWG's recommendation that stablecoin issuers not affiliate with commercial firms.[118]

IV. Coordination and Cooperation to Implement the FSP Framework

We now turn to the critical issues of coordination among government entities and cooperation with private firms to implement the framework.

A. Coordination among Federal Regulators

Coordination among federal regulators will be critical to the design and implementation of the framework. Financial regulation in the United States is highly fragmented and payments innovation, especially with stablecoin issuers, implicates several regulatory agencies. President Biden's Executive Order[119] has called for a government-wide approach to ensuring responsible innovation in digital assets and nowhere is that approach more needed than with respect to the development of an FSP framework. We briefly reprise the key roles that various agencies would need to play to implement an FSP framework,

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116. For a blueprint of a basic model along these lines, see Dan Awrey, *Unbundling Banking, Money, and Payments*, 110 GEORGETOWN L.J. 715 (2022).

117. See Lummis-Gillibrand, *supra* note 44, at § 605.

118. PWG Report, *supra* note 3, at 3.

119. White House Executive Order, *supra* note 4.

and these roles and the agencies' respective views would need to be considered collectively in designing the framework:

- *The Comptroller of the Currency*. The OCC would establish criteria and procedures for approving stablecoin issuers operating under the FSP framework, as well as for their ongoing supervision. It would also need to make determinations on the preemption of state consumer financial laws.
- *Federal Deposit Insurance Corporation*. FDIC input would be valuable for ensuring that the approach did not pose risks to affiliated IDIs or the FDIC insurance fund, as well as for ensuring that NTBs participating in the FSP framework could be safely resolved in the event of their insolvency.
- *Federal Reserve Board*. The Fed would determine access to master accounts, Fedwire and FedNow, sources of potentially important benefits of the FSP framework. It would also need to play an important role in the design and implementation of the technological and operational standards and protocols necessary to ensure the interoperability of authorized stablecoin issuers with the components of the conventional payment system.
- *Combined Federal Banking Regulators*. Our proposal contemplates that the stablecoin sponsor will be an OCC-chartered NTB organized as an operating subsidiary of an IDI. Coordination will therefore be required between the primary banking regulator of the parent IDI and the NTB. Even if the parent IDI is a national bank, coordination will be necessary given differences in supervisory procedures for insured national banks and national trust banks. Further coordination would be required if the parent IDI were a state member bank (for whom the Federal Reserve would be the primary regulator) or a state nonmember bank (in which case the FDIC would fulfill this role).[120]
- *Consumer Financial Protection Bureau*. Given its mandate with respect to consumer protection issues related to payments practices,[121] the CFPB would likely need to have a seat at the table in designing the FSP framework.[122] The Bureau's jurisdiction also extends to certain "enumerated" consumer financial laws, such as the Electronic Funds Transfer Act, which might apply to aspects

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120. If our proposal were extended to state-chartered trust companies organized as operating subsidiaries of IDIs, coordination with state authorities would be needed, and the framework—for example, with respect to preemption and receiverships—might work differently.

121. The CFPB has exclusive authority to enforce federal consumer laws against nondepository covered persons. *See* 12 U.S.C. § 5514. The Bureau also has specific powers with respect to consumer financial products and services, which are defined to include "providing payments or other financial data processing products or services to a consumer by any technological means." *Id.* at § 5481(15)(vii); *see, e.g., id.* at § 5531 (granting the Bureau authority to police any "unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service."). To the extent that a stablecoin issuer regulated under the FSP framework was organized as an operating subsidiary of an IDI with more than $10 billion in assets, the Bureau would also have exclusive supervisory authority and primary enforcement authority over the parent with respect to consumer financial protection laws. See *id.* at § 5515

122. As the CFPB's authority does not extend to persons regulated by the SEC, 12 U.S.C. § 5481(12), the Bureau's responsibilities with respect to the FSP framework might depend on the extent to which the SEC also regulated aspects of a stablecoin issuer's operations. *See id.* at § 5517(i)(1). However, even in these cases, the Bureau is supposed to coordinate with the SEC with respect to the oversight of financial products that are functionally similar to those under direct CFPB supervision. *See id.* at § 5517 (i)(2).

of stablecoin operations. The Bureau also has statutory responsibilities with respect to OCC preemption determinations under the Dodd-Frank Act.[123]

- *Federal Financial Institutions Examination Council*. As FSPs would be subject to OCC examination and those examinations could raise novel issues, the FFIEC would have a role in developing reporting requirements and supervisory practices.
- *Securities and Exchange Commission/Commodity Futures Trading Commission*. While the FSP framework is designed to bring stablecoin issuers within the jurisdiction of banking regulators as the PWG Report recommended, capital market authorities will still have a role here. To qualify for exemption from registration requirements of federal securities laws, the SEC may need to offer some degree of exemptive relief.[124] In addition, to the extent that stablecoins are issued or traded on exchanges, protocols, or other facilities subject to SEC and CFTC oversight, coordination on that score may also be needed. Conceivably, OCC approval procedures might incorporate requirements that stablecoin issuers take certain steps to ensure that their stablecoins are transferred only on exchanges, protocols, or facilities that meet SEC/CFTC approved standards.
- *State Authorities:* While our proposal is focused on a federal platform for stablecoin issuers, refinements of the proposal could be envisioned for state-chartered entities, and so input from state authorities may also be appropriate, including on the extent of state law preemption.

B. Cooperation with Private Entities

As outlined above, the FSP framework would be voluntary and not mandatory. We believe the approach would be sufficiently compelling to stablecoin sponsors to bring them to the table. Regulators will need to be engaged with private firms to refine the approach and make sure it addresses practical issues and concerns that we have undoubtedly not considered. The Administrative Procedure Act's notice and comment rulemaking procedures[125] are one way to facilitate this engagement, but other processes, such as roundtables and industry outreach, will be important.

C. FSOC Role

Coordination among federal agencies along the lines outlined above needs to have an institutional structure, and we recommend the creation of a digital assets working group operating under the FSOC.

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123. 12 U.S.C. § 25b(b)(3)(B).

124. A number of different federal securities laws are potentially relevant to the FSP framework. Initially, there would be a question of whether interests in the trust instruments constitute securities. If so, there would be secondary questions as to registration requirements under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940, as well as the SEC requirements applicable to secondary market transactions in these instruments—that is, the other arrangements mentioned in the text. The SEC has considerable latitude in providing exemptions from all of these registration requirements as well as the power to determine that stablecoins issued under the FSP framework do not constitute securities in the first place. There are a variety of ways in which these issues could be resolved, but their resolution should, we think, be worked out in advance with an appropriate amount of cross-agency consultation and coordination.

125. 5 U.S.C. § 553.

FSOC has a statutory mandate[126] to address regulatory gaps of the sort that stablecoin issuers clearly implicate, and the Council has authority to establish FSOC committees as needed to carry out the Council's mission.[127] Establishing an FSOC working group to implement the FSP framework also increases the likelihood that federal policy in this area will not fluctuate or suddenly reverse direction with changes of personnel at member agencies. To the extent that deliberations lead to the conclusion that new legislation is necessary, the FSOC is also charged with making such recommendations to Congress.[128]

A further advantage of locating the implementing group within the FSOC structure is the ability of the Council to encourage regulators to align enforcement activities with the FSP framework. One of the sticks that will help make the FSP framework attractive to market participants is the degree to which enforcement actions are focused on activities that are undertaken outside of the framework. Because enforcement actions are typically undertaken by individual regulatory agencies, the FSOC could also play a role in ensuring that these actions operate in a coherent manner. Especially in cases where the boundaries of the regulatory perimeter are blurred—for example, applying the definition of securities to various kind of digital assets—the FSOC's collective endorsement of a member agency's legal position could be influential in judicial rulings. The FSOC could also coordinate with the Justice Department regarding other enforcement efforts, such as actions against a stablecoin issuer brought under section 21(a) of the Glass-Steagall Act, a possibility flagged in the PWG Report.[129] In short, there are numerous ways in which FSOC input could help coordinate and rationalize enforcement efforts in this area.

Conclusion

Stablecoin issuers present a unique challenge to federal authorities. While stablecoins could produce important consumer benefits and valuable competition in the payments space, the current regulation of these firms is woefully inadequate. Legislative solutions are possible but may not be forthcoming any time soon. In the meantime, markets continue to evolve, and other regulatory systems may well move further ahead of the United States in terms of payments innovation. The proposal we advance in this paper offers a path forward for this country to establish a federal platform for stablecoin issuers that is consistent with the PWG Report's recommendations and authorized under current law. Implementing the proposal would, no doubt, be a substantial administrative lift. But it represents a viable and realistic way forward. It is a step we should take.

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126. 12 U.S.C. § 5322(a)(2)(G).

127. 12 U.S.C. § 5321(d).

128. 12 U.S.C. § 5322(a)(2)(D), (N); 12 U.S.C. § 5322(c).

129. PWG Report, *supra* note 3, at 18; *see also* Jackson & Ricks, *supra* note 32. We acknowledge that the coordination role we are suggesting might be a more active one than is typical for FSOC, but we think it is well within its statutory mandate.

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