

November 5, 2021

# President's Working Group on Financial Markets Issues Report on Stablecoins

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**On November 1, 2021, the President's Working Group on Financial Markets Published a Report on Stablecoins, Outlining a Potential Regulatory Regime for Stablecoin Arrangements in the U.S.**

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## SUMMARY

The President's Working Group on Financial Markets (the "PWG"),<sup>1</sup> the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency (the "OCC") published the *Report on Stablecoins* on November 1, 2021.<sup>2</sup> The Report (1) provides a high-level background description of stablecoins, (2) outlines potential risks and regulatory implications, building on prior publications by other regulators and international regulatory bodies, and (3) sets forth recommendations for legislation (or, pending congressional action, interim measures by regulators) to ensure that "payment stablecoins"<sup>3</sup> and payment stablecoin arrangements are subject to a consistent and comprehensive federal prudential framework. These recommendations include that legislation should require that (1) all stablecoin issuers be insured depository institutions, (2) all custodial wallet providers be subject to federal oversight, and (3) all other entities that perform functional activities within any stablecoin arrangement be subject to federal oversight. The Report follows a number of other recent U.S. and global regulatory studies and proposals relating to stablecoins, which are also summarized below.

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## A. BACKGROUND

The rising prevalence and use of digital assets have prompted regulators around the world to consider the risks associated with these assets and potential regulatory approaches to address them. One particular form of digital asset – stablecoins – has become a recent focus for banking and markets regulators in the U.S., reflecting what the Report refers to as an "urgent" need for new federal legislation setting out a comprehensive regulatory regime.<sup>4</sup>

## 1. What is a Stablecoin and How Does it Differ from Other Digital Assets?

The Report defines “stablecoins” as “digital assets that are designed to maintain a stable value relative to a national currency or other reference assets.”<sup>5</sup> Similar to other digital assets, a stablecoin is generally part of an electronic, token-based system that permits peer-to-peer exchange through a blockchain without the use of an intermediary.<sup>6</sup> In contrast to other digital assets, the creator of a stablecoin seeks to stabilize the value of the stablecoin by pegging its value to one or more fiat currencies, a basket of stable assets or, in some cases, other digital assets.<sup>7</sup> The pegged value of the stablecoin is generally supported by a reserve fund consisting of some amount of the reference fiat currencies or other assets.<sup>8</sup>

The Bank for International Settlements (the “BIS”) has published guidance summarizing some of the potential benefits associated with stablecoins. Specifically, the G7 Working Group on Stablecoins (the “G7 Working Group”), in connection with the BIS Committee on Payments and Market Infrastructures, noted that what the PWG has termed “payment stablecoins” have the potential to serve as a more “readily usable” form of payment than what the PWG considers to be more volatile digital assets, such as Bitcoin, and could “potentially foster the development of global payment arrangements that are faster, cheaper and more inclusive than present arrangements.”<sup>9</sup> The BIS also suggested that stablecoins present opportunities to facilitate online purchases, peer-to-peer digital payments, micro-payments, cross-border payments, settlement for smart contracts and the development of programmable money.<sup>10</sup> The Report notes that, although stablecoins have not yet been adopted as a widely accepted means of payment in commerce in the U.S., they are commonly, and increasingly, used to facilitate trading, lending or borrowing of other digital assets on digital asset trading platforms.<sup>11</sup>

Stablecoins may also present risks, some of which may be less prevalent in the context of fiat currencies and traditional payment systems, that have become an increasing focus of domestic and international regulatory organizations. The G7 Working Group, for example, categorizes these risks as either (1) general legal and regulatory challenges that are applicable to all stablecoin arrangements, or (2) those specific to global stablecoins, *i.e.*, stablecoins that have the potential to develop into a global payment system. General legal challenges include: (i) legal certainty (*i.e.*, what legal regime applies); (ii) governance and risk management; (iii) financial integrity (*i.e.*, anti-money laundering and countering the financing of terrorism (“AML/CFT”)); (iv) safety, efficiency and integrity of payment systems; (v) cyber and other operational risks; (vi) market integrity (*i.e.*, fairness and transparency in primary and secondary markets); (vii) data protection and privacy; (viii) consumer and investor protection; and (ix) tax compliance.<sup>12</sup> Global stablecoins present additional risks for: (i) monetary policy; (ii) financial stability; (iii) the international monetary system (*i.e.*, currency substitution and monetary sovereignty issues); (iv) fair competition (*i.e.*, antitrust considerations and payments data regulations); and (v) cross-jurisdictional AML/CFT efforts.<sup>13</sup> As discussed further in Part C of this memorandum, the Report generally contemplates all of these potential risks, but focuses on certain risks in particular, including systemic risks to payment systems and financial stability, and anticompetitive effects in the banking and payment sectors.<sup>14</sup>

## 2. What is a Stablecoin Arrangement?

Stablecoin regulation is often discussed in the context of a “stablecoin arrangement,” which generally refers to the combination of the stablecoin itself along with the core functions that support the use of the stablecoin.<sup>15</sup> The Financial Stability Board (“FSB”) categorizes these functions into four groups:

- (1) **Governance.** Rules governing the entities that interact within the stablecoin arrangement, including the mechanisms used for validating transactions and stabilizing the value of the stablecoin and the oversight of participants in the stablecoin arrangement;
- (2) **Issuance, Redemption and Stabilization of Stablecoin Value.** The mechanisms by which stablecoins are issued or destroyed, the procedures for management of reserve assets to maintain the value of the stablecoins, and the custodial services for reserve assets and the stablecoins;
- (3) **Stablecoin Transfer.** The maintenance of the infrastructure and mechanisms governing access to the system and that authorize and validate transactions on the system; and
- (4) **Interaction with Users.** The user interface that supports the purchase, exchange or holding of stablecoins, as well as services, such as storing private keys, providing access to digital wallets, trading and market-making functions.<sup>16</sup>

This framework has been referenced by numerous international regulatory bodies, including the FSB, the BIS and the International Organization of Securities Commissions (“IOSCO”), to describe the core functions of a stablecoin arrangement.<sup>17</sup> The Report references similar categories of functions in its description of stablecoin arrangements.<sup>18</sup>

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## B. REGULATORY GUIDANCE PRIOR TO THE REPORT

### 1. The OCC’s Preliminary Regulatory Guidelines for Banks and Other Deposit-Taking Institutions

U.S. banking regulators had generally been silent as to the regulatory treatment of stablecoins (and digital assets more generally), and the ability of banking entities to engage in related activities, until late 2020. Beginning in 2020, the OCC published a series of interpretive letters that provide guidance on the potential role of OCC-regulated national banks and federal savings associations within stablecoin arrangements. In July 2020 and September 2020, respectively, the OCC noted that it was permissible for banks to provide digital asset custody services generally, and to hold reserve assets for stablecoin issuers specifically.<sup>19</sup> In both letters, the OCC included cautionary language requiring banks to “effectively manage the risks and comply with applicable law,” including implementing effective due diligence and risk management systems.<sup>20</sup> The September 2020 interpretive letter on stablecoin reserve account custodial services further noted that banks should “manage liquidity risks with sophistication equal to the risks undertaken and complexity of [the] exposures,” and that banks should consider “enter[ing] into appropriate contractual agreements with a stablecoin issuer governing the terms and conditions of the services that the bank provides to the issuer.”<sup>21</sup>

More recently, in January 2021, the OCC published an interpretive letter stating that it is permissible for banks subject to OCC oversight to use distributed ledger technology and stablecoins to facilitate payment

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activities.<sup>22</sup> Once again, the interpretive letter included cautionary language requiring banks to ensure that the stablecoin arrangement has the “appropriate systems, controls and practices in place to manage these risks, including to safeguard reserve assets.”<sup>23</sup>

### 2. BCBS Preliminary Guidance on Prudential Regulation

Actions taken by regulators in various jurisdictions and increasing bank involvement in digital asset-related activities more broadly raised new questions as to how banks should be expected to manage their cryptocurrency exposure risk. Similar concerns across multiple jurisdictions led to the publication of a consultative document by the Basel Committee on Banking Supervision in June 2021, which seeks input as to the appropriate prudential treatment of cryptoasset exposure at banks (the “BCBS Prudential Regulatory Framework”).<sup>24</sup> The BCBS Prudential Regulatory Framework outlines a potential approach to applying traditional Basel capital, liquidity, supervisory and disclosure requirements to cryptoasset exposure.

The core feature of the BCBS Prudential Regulatory Framework is a “same risk, same activity, same treatment” approach that attempts to classify cryptoasset exposure relative to the risk of traditional assets.<sup>25</sup> In doing so, the BCBS Prudential Regulatory Framework groups cryptoassets into three categories for purposes of assessing risk:

- (1) **Group 1a: Tokenized Traditional Assets.** Cryptoassets that are tokenized traditional assets would generally be subject to the same capital requirements as the underlying traditional asset (but with potential capital add-ons where appropriate).
- (2) **Group 1b: Cryptoassets with Stabilization Mechanisms.** Cryptoassets that have a stabilization mechanism “that is effective at all times in linking its value to an underlying traditional asset or a pool of traditional assets” would generally be subject to the same capital requirements as the underlying pool of assets (but with potential capital add-ons where appropriate), subject to additional requirements based on additional risks associated with the stabilization mechanism.
- (3) **Group 2: All Cryptoassets that do not qualify as Group 1.** Cryptoassets that do not fit within the stabilization criteria provided by the BCBS Prudential Regulatory Framework (e.g., Bitcoin) would be subject to significantly more conservative capital requirements based on a 1250% risk weight.<sup>26</sup>

Not all stablecoins would be treated the same under this framework. Based on the criteria outlined in the BCBS Prudential Regulatory Framework, banking entities holding stablecoins may be required to hold capital at the level that would be applicable to the reserve assets relating to the stablecoin (Group 1a cryptoassets), or at the level applicable to the reserve assets plus additional capital requirements reflecting the particular structure of the stablecoin and the role of the banking entity in the stablecoin framework (Group 1b cryptoassets), or at a level sufficient to “absorb a full write-off of the cryptoasset exposure” (Group 2 cryptoassets).<sup>27</sup> The criteria for assigning stablecoins to these categories would go beyond assessing the assets against which the stablecoin is pegged or held in the related reserve; it would also include (i) the effectiveness of the stabilization method; (ii) the legal rights, obligations and interests arising from the cryptocurrency arrangement; (iii) the functions of the cryptoasset and the network on which it operates; and

(iv) whether entities that execute redemptions, transfers or settlement finality of the cryptoasset are regulated and supervised.<sup>28</sup> The BCBS Prudential Regulatory Framework would require banks to classify their cryptoasset exposures into the three groups.<sup>29</sup>

### 3. BIS and IOSCO Preliminary Guidance on Application of the Principles of Financial Market Infrastructure

In October 2021, the BIS and IOSCO published a joint consultative report on the *Application of the Principles for Financial Market Infrastructures to Stablecoin Arrangements* (the “CPMI-IOSCO Report”).<sup>30</sup> The Principles for Financial Market Infrastructure (the “PFMI”) are a set of international standards applicable to systemically important financial market infrastructures (“FMIs”) – *i.e.*, payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories<sup>31</sup> – which provide a comprehensive framework for regulation and supervision of such infrastructures that reflects their operational, legal and other characteristics.<sup>32</sup>

The CPMI-IOSCO Report notes that “[t]he transfer function of [a stablecoin arrangement] is comparable to the transfer function performed by other types of financial market infrastructure” and, as a result, “is considered an FMI for the purpose of applying the PFMI.”<sup>33</sup> Accordingly, the CPMI-IOSCO Report provides that systemically important stablecoin arrangements, including “entities integral to such arrangements,” should be required to abide by all of the “relevant principles” that apply to traditional payment and clearing/depository systems.<sup>34</sup> The CPMI-IOSCO Report provides recommendations on how the PFMI should be applied to stablecoin arrangements, including with respect to governance, risk management procedures, settlement finality (*i.e.*, technical and legal finality) and reconciliation methods and money settlements (*i.e.*, liquidity and credit risk, custodianship and management of reserve assets).<sup>35</sup> The CPMI-IOSCO Report also seeks responses from stakeholders to a number of questions regarding stablecoin arrangements and FMIs, which are due by December 1, 2021:

- (1) **Applicability of the PFMI to Stablecoin Arrangements.** Is it clear when stablecoin arrangements are considered financial market infrastructures for the purposes of applying the PFMI?
- (2) **Considerations for Determining the Systemic Importance of a Stablecoin Arrangement.** Are the suggested considerations for determining the systemic importance of stablecoin arrangements clear, comprehensive and useful? Are there any risks or considerations missing?
- (3) **Governance.** Is the guidance provided on governance clear and actionable to inform how stablecoin arrangements will need to ensure clear and direct lines of accountability and set up governance arrangements to observe the PFMI? What are the challenges that stablecoin arrangements may face due to the use of distributed and/or automated technology protocols and decentralization, when seeking to observe the principle on governance and when ensuring the clear allocation of responsibility and accountability?
- (4) **Interdependencies.** Is the guidance on comprehensive risk management clear and actionable to inform how stablecoin arrangements will need to comprehensively manage risks from other stablecoin arrangement functions and entities and their interdependencies?
- (5) **Settlement Finality.** Is the guidance on settlement finality clear and actionable to inform how stablecoin arrangements will need to manage risks arising from a misalignment between technical and legal finality?<sup>36</sup>

- (6) **Money Settlements.** Is the guidance on money settlements clear and actionable to inform how stablecoin arrangements will need to manage risks associated with the use of a stablecoin as a settlement asset? In particular, is the guidance clear on the considerations which a stablecoin arrangement should take into account when choosing a stablecoin as a settlement asset with little or no credit or liquidity risk as an appropriate alternative to central bank money?
- (7) **General.** Are there other issues or principles of the PFMI where additional guidance for stablecoin arrangements would be useful? If so, what is the issue identified and how is it notable for stablecoin arrangements? Are there any terms used in this report for which further clarification would be useful for stablecoin arrangements when seeking to observe the PFMI?<sup>37</sup>

#### 4. FSB Guidance on Regulating Global Stablecoins

In October 2020, the FSB published its recommendations on *Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements* (the “FSB Recommendations”).<sup>38</sup> The FSB Recommendations provide guidance for stablecoin arrangements with the potential to operate across multiple jurisdictions and achieve a level of transaction volume that may create systemic risk.<sup>39</sup> Accordingly, the FSB Recommendations propose that regulators develop enhanced regulation for these “global stablecoins” with respect to governance, risk management (including reserve management, operational resilience, cybersecurity and AML/CFT measures), data management, recovery and resolution plans disclosure, and legal clarity.<sup>40</sup>

In October 2021, the FSB published an updated report on the implementation of its FSB Recommendations across jurisdictions (the “FSB Update Report”). The FSB Update Report highlights some challenges facing regulators, including (i) uncertainty as to what should qualify as a “global stablecoin”; (ii) the application of prudential regulation, investor protection and custodian regulations to global stablecoin functions (e.g., wallet providers); (iii) redemption rights; (iv) challenges coordinating cross-border and cross-sectoral regulation; and (v) requirements for stablecoin issuers.<sup>41</sup>

The FSB Update Report also provides an overview of certain recent international regulatory efforts. In Europe, the EU has published a proposal for regulating cryptoasset markets (the “EU Proposal”).<sup>42</sup> The EU Proposal provides for different regulatory standards depending on whether a stablecoin is backed by a single official currency or a basket of assets.<sup>43</sup> What the EU refers to as “E-Money Tokens” would be subject to existing money and payments regulations, provided they are fully backed by the reserve of assets.<sup>44</sup> For other stablecoins, the EU Proposal includes different categories of regulation depending on a variety of factors, including transaction volume, the size of the issuer’s reserve assets and the interconnectedness with the financial system.<sup>45</sup> Other market participants, such as wallet providers and trading platforms, would also be subject to an authorization requirement under the EU Proposal.<sup>46</sup> In the UK, HM Treasury has issued a public consultation on cryptoassets and stablecoin regulations that considers introducing a new authorization regime under the Financial Conduct Authority’s jurisdiction, with additional enhanced regulations from the Bank of England to control systemic risks.<sup>47</sup> Stablecoin arrangements that more closely resemble a traditional payment system, however, may be regulated by the UK Payment Systems Regulator.<sup>48</sup>

### C. THE REPORT

The publication of the Report comes in the midst of this series of regulatory pronouncements and publications, as well as the increasing usage of stablecoins. In July 2021, Treasury Secretary Janet Yellen convened a meeting of the PWG with the goal of strengthening the U.S. financial markets by addressing the perceived risks of stablecoins, identifying potential regulatory gaps and making recommendations to address those gaps.<sup>49</sup> The PWG, which is comprised of the Treasury Department, the Federal Reserve Board (the “Federal Reserve”), the Securities and Exchange Commission (the “SEC”) and the Commodity Futures Trading Commission (the “CFTC”), was joined by the FDIC and the OCC (the FDIC and the OCC, together with the PWG, the “Agencies”) in drafting the Report, which was released on November 1, 2021.<sup>50</sup> The Report begins with a background section on stablecoins, focusing on the mechanisms that support the creation and redemption, transfer and storage of stablecoins.<sup>51</sup> The Report then details the key risks and regulatory gaps associated with the use of stablecoins as a means of payment.<sup>52</sup> Finally, the Report describes the Agencies’ recommendations for addressing the risks associated with stablecoin arrangements and the use of stablecoins as a means of payment.<sup>53</sup>

Before discussing the risks and regulatory gaps associated with stablecoins, the Report notes that it is limited to analyzing prudential risks arising from the use of stablecoins as a means of payment, and highlights several categories of risks posed by stablecoins that fall outside of its scope. The Report does not address the issues or risks arising under the federal or state securities laws or the Commodity Exchange Act as they pertain to digital assets, digital asset trading platforms, decentralized finance (“DeFi”), stablecoins or stablecoin arrangements, and the interactions between stablecoins and digital trading asset platforms and DeFi.<sup>54</sup> The Report notes that these and other issues arising under the securities and commodities laws are under consideration by the CFTC and the SEC.<sup>55</sup> Similarly, the Report notes that stablecoins also pose illicit finance concerns and risks related to financial integrity, including those related to AML/CFT compliance.<sup>56</sup> To help prevent the misuse of stablecoins – and other digital assets – by illicit actors, the Report notes that Treasury will continue to lead the efforts of the Financial Action Task Force to encourage other countries to implement international AML/CFT standards and pursue additional resources to support the supervision of domestic AML/CFT regulations.<sup>57</sup> Treasury will also continue to assess the illicit financing risks to the U.S. associated with stablecoins and other digital assets, including through the forthcoming National Risk Assessments on Money Laundering and Terrorist Financing, which are expected to be released in January 2022.<sup>58</sup>

Within the scope of prudential concerns arising from the use of stablecoins as a means of payment, the Report identifies four key categories of prudential risks and regulatory gaps.

The first is run risk and the risk of loss of value, in which the failure of a stablecoin to perform according to expectations could result in a “run” on that stablecoin – that is, a self-reinforcing cycle of fire sales of reserve assets, which could disrupt critical funding markets and spread to other stablecoins (or other assets deemed

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to be similar).<sup>59</sup> According to the Report, a run on a particular stablecoin would not only harm users of those particular stablecoins, but could also pose systemic risks to the broader financial system.<sup>60</sup> The primary recommendation, as discussed in further detail below, to address this risk is to require that all “stablecoin issuers” must be insured depository institutions (“IDIs”) subject to federal supervision and regulation at the depository institution and holding company level.

The second category of risk highlighted by the Report is payment system risk, which stems from the fact that payment stablecoins face many of the same risks as traditional payment systems, including credit risk, liquidity risk, operational risk, risks arising from improper or ineffective system governance and settlement risk.<sup>61</sup> The Report notes that payment stablecoins are “often, although not always, characterized by a promise or expectation that the stablecoin can be redeemed on a one-to-one basis for fiat currency.”<sup>62</sup> In contrast to traditional payment systems, where risk is managed centrally by the payment system operator, the Report notes that some stablecoin arrangements feature decentralized decision-making and complex models where no single organization is fully accountable for risk management.<sup>63</sup> According to the Report, regardless of whether such risks are managed centrally, if they are not managed comprehensively, they can ultimately result in financial shocks or operate as a channel through which financial shocks can spread.<sup>64</sup>

Third, given the rapid growth of stablecoins over the past year and the potential for continued growth, the Report also highlights the potential risks of scale posed by stablecoins. The potential for any individual stablecoin to scale rapidly raises three potential policy issues: (1) that a stablecoin issuer or a key participant in a stablecoin arrangement could pose systemic risk, (2) that the combination of a stablecoin issuer or wallet provider and a commercial firm could lead to an excessive concentration of economic power and therefore result in market concentration in sectors of the real economy, and (3) that a stablecoin that becomes widely adopted as a means of payment could present anticompetition concerns.<sup>65</sup> According to the Report, the aggregate growth of stablecoins could have implications for the stability of the broader financial system and the macroeconomy. For example, the Report identifies the potential risk that insured depository institutions may lose retail deposits to stablecoins. If this were to occur, and the reserve assets that back such stablecoins do not support credit creation, then the aggregate growth of stablecoins could increase borrowing costs and impair credit availability in the real economy.<sup>66</sup>

Finally, the fourth category of risks posed by stablecoins addressed in the Report is the existence of gaps in the existing regulatory regime. According to the Report, stablecoin arrangements currently are not subject to a consistent set of prudential regulatory standards that address all of the aforementioned risks.<sup>67</sup> Moreover, the number of parties that may be involved in such arrangements, as well as the operational complexity of these arrangements, may pose challenges to comprehensive oversight.<sup>68</sup> The Report emphasizes the need for a consistent and comprehensive regulatory framework in order to reduce the systemic risks posed by stablecoins in normal stressed market conditions.<sup>69</sup>

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The principal recommendation of the Report to address these prudential risks and the current lack of a consistent and comprehensive regulatory framework is that Congress should promptly enact legislation to ensure that payment stablecoins and payment stablecoin arrangements are indeed subject to such a framework. The Report advocates for legislation that would complement existing authorities with respect to market integrity, investor protection and illicit finance, and address the key prudential risks highlighted in the Report, as follows:

- To address the risk of stablecoin runs, such legislation should limit stablecoin issuance and require stablecoin issuers to be IDIs, which are subject to supervision and regulation both at the depository institution and the holding company level.<sup>70</sup> The Report notes that IDIs are subject to capital and liquidity standards that are designed to address safety and soundness and, for larger banking organizations, also include enhanced prudential standards.<sup>71</sup> Further, under the Federal Deposit Insurance Act, IDIs are subject to a special resolution regime that enables the orderly resolution of failed IDIs by, among other mechanisms, according priority to deposit claims over those of general creditors, thereby protecting customers' insured deposits and limiting potential negative systemic impacts as a result of bank failure.<sup>72</sup>
- To address payment system risks, such legislation should require that custodial wallet providers be subject to appropriate federal oversight.<sup>73</sup> Such oversight should include authority to restrict these service providers from lending customers' stablecoins and to require compliance with appropriate risk-management, liquidity and capital requirements.<sup>74</sup> Congress should also provide the federal supervisor of a stablecoin issuer with the authority to require other entities that perform activities that are critical to the functioning of the stablecoin arrangement to meet appropriate risk-management standards (perhaps similar to the manner in which third-party service providers to banks are regulated).<sup>75</sup>
- To address the risks of scale associated with stablecoins, such legislation should also require stablecoin issuers to comply with activities restrictions that limit their affiliation with other entities.<sup>76</sup> Specifically, supervisors should have the authority to implement standards that promote interoperability among stablecoins.<sup>77</sup> Moreover, Congress should also consider other standards for custodial wallet providers, such as limits on affiliations with commercial entities or on the use of users' transaction data.<sup>78</sup>

Although the Agencies believe that congressional legislation is urgently needed to comprehensively address the risks posed by stablecoins and stablecoin arrangements, the Report also describes actions that the Financial Stability Oversight Council ("FSOC") may take in the absence of such congressional action. Such steps may include the exercise of the authority contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act to designate payment, clearing and settlement ("PCS") activities that are, or are likely to become, systemically important.<sup>79</sup> This designation would give the Federal Reserve the same authority that it currently has to supervise existing systemically important payment systems, whose payment volumes currently vastly exceed the current volume of stablecoins and stablecoin transactions.<sup>80</sup> Designation as a systemically important payment system would subject a stablecoin arrangement to the PFMI, through the Federal Reserve's Regulation HH, including imposing requirements in relation to the amount and type of assets backing the stablecoin, the arrangements for holding those assets and the operation of the stablecoin arrangement.<sup>81</sup> Stablecoin issuers or arrangements that are designated would also be subject to an examination and enforcement framework, which would also increase the level of regulatory oversight over such payment stablecoin arrangements, as well as recovery and resolution

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planning requirements.<sup>82</sup> The Report also emphasizes that, even absent congressional action, the Agencies can, and will, continue to use their existing authority to address the risks highlighted in the Report.<sup>83</sup>

The Report notes that, although its scope is limited to stablecoins, with a particular emphasis on payment stablecoins, and does not address digital assets generally or other innovations related to cryptographic and distributed ledger technology, the Agencies will continue to collaborate closely on how best to foster financial innovation, promote consistent and comprehensive regulatory approaches and identify and address potential risks that arise from such innovation.<sup>84</sup> The Report notes, in particular, the potential for action taken by other regulators in an effort to mitigate the risks posed by stablecoins, even in the absence of legislation, under existing statutory authority. For example, the Report notes that the Department of Justice (the “DOJ”) may consider whether or how section 21(a)(2) of the Glass-Steagall Act may apply to certain stablecoin arrangements.<sup>85</sup> In addition, the Consumer Financial Protection Bureau (the “CFPB”) may also use its authority under various consumer financial protection laws, including the Electronic Fund Transfer Act, the Gramm-Leach-Bliley Act and the Consumer Financial Protection Act, all of which provide a number of safeguards in the payment sector that may be relevant to stablecoin regulation.<sup>86</sup> Finally, the Report also notes that a stablecoin arrangement may also offer “money transmission services,” which could trigger federal AML/CFT obligations under the Bank Secrecy Act, as well as supervision and enforcement by the Financial Crimes Enforcement Network (“FinCEN”).<sup>87</sup>

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### D. IMPLICATIONS

The Report provides the first indication of how the relevant U.S. regulators, as a group, view stablecoins generally and what a potential stablecoin regulatory framework might look like in the U.S. However, although the Report begins to answer some questions, it also leads to new ones.

For example, the Report does not provide a precise definition of “stablecoin issuer.” As a result, it is not clear which of the functions described in the Report must be conducted by the IDI that is the stablecoin issuer, and which may be handled by other parties involved in operating the stablecoin arrangement. The details of this definition will determine the extent to which other market participants may participate in the development of new products and services in the payments market and, as a result, the extent to which the proposed approach will affect the future of banking and payments in the U.S.<sup>88</sup>

The Report also does not recommend the adoption of guidance by banking regulators to facilitate the ability of banks to carry out the functions that are proposed for them in the Report. The OCC interpretive letters discussed above provide guidance to national banks, but the Federal Reserve and the FDIC have not issued corresponding guidance to the banks for which they are the primary federal regulators. Although the OCC interpretive letters do provide a strong basis for national banks to engage in many types of digital asset-related activities, it will be important that any legislation that limits stablecoin activities to IDIs also provide all types of IDIs with clear authority to play their designated roles.

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Similarly, the Report also does not resolve or provide any new guidance on the hotly debated role of existing regulators with respect to stablecoin regulation. For example, with respect to the SEC and the CFTC, the Report refers generally to the fact that “stablecoin arrangements and digital trading activities *may* implicate the jurisdiction of the SEC and/or CFTC,” and that “depending on the facts and circumstances, a stablecoin *may* constitute a security, commodity, and/or derivative.”<sup>89</sup> The Report does not express a view on this issue, or on the question of whether the SEC and the CFTC currently have regulatory or enforcement jurisdiction over transactions in stablecoins or participants in stablecoin arrangements. Based on recent comments from commissioners of both agencies, further regulatory and enforcement efforts in the areas of digital assets, cryptocurrency trading platforms and DeFi are expected, even without a comprehensive regulatory regime.<sup>90</sup>

Finally, though the Report references investor protection and market integrity concerns in connection with stablecoins, it does not address consumer protection issues in depth, beyond noting that the CFPB can provide safeguards in the payment sector, even though consumer protection is likely to be a focus of legislators and regulators going forward.<sup>91</sup> The Report also does not address state regulation of stablecoin arrangements and whether future federal legislation would preempt such regulation. Although the Report mentions the potential roles of other entities, including the DOJ, FinCEN, FSOC and international standard-setting bodies, in regulating stablecoins, in many cases, concrete actions or proposals have not yet been finalized.<sup>92</sup> Given the heightened focus on digital assets, and stablecoins in particular, market participants should expect further scrutiny from Congress, the banking and markets regulators and other regulatory bodies in the U.S. and internationally.

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## ENDNOTES

- 1 The President's Working Group on Financial Markets is comprised of the U.S. Department of the Treasury, the Federal Reserve Board, the Securities and Exchange Commission and the Commodity Futures Trading Commission. In the past, the PWG has addressed other significant market and regulatory issues that implicate the regulatory schemes implemented by these agencies.
- 2 The President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, *Report on Stablecoins* (November 1, 2021), [https://home.treasury.gov/system/files/136/StableCoinReport\\_Nov1\\_508.pdf](https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf) (the "Report").
- 3 The Report defines "payment stablecoins" as those "that are designed to maintain a stable value relative to a fiat currency and, therefore, have the potential to be used as a widespread means of payment." *Id.* at 2.
- 4 Report, *supra* note 2, at 3, 18.
- 5 *Id.*
- 6 Douglas Arner, Raphael Auer and Jon Frost, *Stablecoins: Risks, Potential and Regulation*, Bank for International Settlements Working Paper No 905 (November 2020), <https://www.bis.org/publ/work905.pdf>, at 3.
- 7 G7 Working Group on Stablecoins, *Investigating the Impact of Global Stablecoins* (October 2019), <https://www.bis.org/cpmi/publ/d187.pdf>, at ii. See also Arner, Auer & Frost, *supra* note 6.
- 8 *Id.* While the use of a stablecoin reserve made up of traditional assets is the most common method of maintaining the pegged value of the stablecoin, there are alternative methods, such as the use of an algorithm to manipulate stablecoin supply in response to fluctuating demand. See Arner, Auer & Frost, *supra* note 6; Report, *supra* note 2, at 4 n.5.
- 9 G7 Working Group on Stablecoins, *supra* note 7, at 1.
- 10 Arner, Auer & Frost, *supra* note 6, at 3.
- 11 Report, *supra* note 2, at 1, 2 n.2, 9.
- 12 See generally G7 Working Group on Stablecoins, *supra* note 7, at 5-11. See also Financial Stability Board, *Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements: Final Report and High-Level Recommendations* (October 13, 2020), <https://www.fsb.org/wp-content/uploads/P131020-3.pdf>.
- 13 G7 Working Group on Stablecoins, *supra* note 7, at 11-16.
- 14 Report, *supra* note 2, at 2-3.
- 15 See, e.g., Financial Stability Board, *supra* note 12, at 10.
- 16 *Id.* at 11-12. See also Arner, Auer & Frost, *supra* note 6.
- 17 Bank for International Settlements and the International Organization of Securities Commissions, *Application of the Principles for Financial Market Infrastructures to Stablecoin Arrangements* (October 6, 2021), <https://www.bis.org/cpmi/publ/d198.pdf> (the "CPMI-IOSCO Report"), at 22; Financial Stability Board, *supra* note 12, at 11-12.
- 18 Report, *supra* note 2, at 6-7.
- 19 Office of the Comptroller of the Currency, *Re Authority of a National Bank to Provide Cryptocurrency Custody Services for Customers* (July 22, 2020), Interpretive Letter #1170, <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf> (the "July 2020 Interpretive Letter"); Office of the Comptroller of the Currency, *OCC Chief Counsel's Interpretation on National Bank and Federal Savings Association Authority to Hold Stablecoin Reserves* (September 21, 2020), Interpretive Letter #1172, <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1172.pdf> (the "September 2020

## ENDNOTES (CONTINUED)

- Interpretive Letter”). In conjunction with the September 2020 Interpretive Letter, the staff of the SEC’s Strategic Hub for Innovation and Financial Technology (“FinHub”) issued a statement encouraging issuers of stablecoins, generally, to contact them with any questions they may have to help ensure that such stablecoins are structured, marketed and operated in compliance with the federal securities laws. The statement notes that FinHub staff are prepared to engage with market participants and, depending on the specific facts and circumstances, consider providing a “no-action” position regarding whether activities with respect to a specific stablecoin may invoke the application of the federal securities laws. Securities and Exchange Commission, *SEC FinHub Staff Statement on OCC Interpretation* (September 21, 2020), <https://www.sec.gov/news/public-statement/sec-finhub-statement-occ-interpretation>.
- 20 July 2020 Interpretive Letter, *supra* note 19.
- 21 September 2020 Interpretive Letter, *supra* note 19.
- 22 Office of the Comptroller of the Currency, *OCC Chief Counsel’s Interpretation on National Bank and Federal Savings Association Authority to Use Independent Node Verification Networks and Stablecoins for Payment Activities* (January 4, 2021), Interpretive Letter #1174, <https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2a.pdf> (the “January 2021 Interpretive Letter”).
- 23 *Id.*
- 24 Basel Committee on Banking Supervision, *Prudential Treatment of Cryptoasset Exposures* (June 10, 2021), BIS Consultative Document, <https://www.bis.org/bcbs/publ/d519.pdf>.
- 25 *Id.* at 2.
- 26 *Id.* at 3.
- 27 *Id.* at 7-14.
- 28 *Id.* at 4-6.
- 29 *Id.* at 6-7.
- 30 CPMI-IOSCO Report, *supra* note 17.
- 31 Bank for International Settlements, *Principles for Financial Market Infrastructures (PFMI)* (April 2012), <https://www.bis.org/cpmi/publ/d101a.pdf>. The PFMI are updated from time to time to reflect changes in global standards for the supervision of financial market infrastructures. The PFMI have been implemented with respect to systemically important payment systems in the United States through the Federal Reserve’s Regulation HH.
- 32 The PFMI consist of 24 principles addressing the general organization of the relevant financial market infrastructure (including demonstrating a sound legal basis for the financial market infrastructure’s operations), credit and liquidity risk management, settlement (including settlement finality), default management, general business and operational risk management, access, efficiency and transparency.
- 33 CPMI-IOSCO Report, *supra* note 17, at 4.
- 34 *Id.*
- 35 *Id.* at 4, 12-20. The Report notes that it does not address how all the principles included in the PFMI would apply to a systemically important stablecoin arrangement, but it does indicate that they should comply with all relevant principles, whether or not addressed by the CPMS-IOSCO Report.
- 36 The Uniform Laws Commission has established a Drafting Committee on the Uniform Commercial Code and Emerging Technologies that has proposed language addressing settlement finality in relation to assets recorded on a distributed ledger, which would include stablecoins. If adopted by the states, this statute could improve the certainty of settlement finality with respect to stablecoins in a manner similar to the manner in which Article 4-A of the Uniform Commercial Code brought clarity to the finality of wholesale wire transfers.

ENDNOTES (CONTINUED)

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- 37 CPMI-IOSCO Report, *supra* note 17, at 7.
- 38 Financial Stability Board, *supra* note 12.
- 39 *Id.* at 1-3.
- 40 *Id.* at 4, 29-36.
- 41 Financial Stability Board, *Regulation, Supervision and Oversight of “Global Stablecoin Arrangements: Progress Report on the Implementation of High-Level Recommendations* (October 7, 2021), <https://www.fsb.org/wp-content/uploads/P071021.pdf>, at 11.
- 42 *Id.* at 7.
- 43 *Id.*
- 44 *Id.*
- 45 *Id.*
- 46 *Id.*
- 47 *Id.* at 9-11.
- 48 *Id.*
- 49 Nellie Liang, *Remarks by Under Secretary for Domestic Finance Nellie Liang to the Stanford Graduate School of Business*, U.S. Department of the Treasury (November 1, 2021), <https://home.treasury.gov/news/press-releases/jy0455>.
- 50 Report, *supra* note 2.
- 51 *Id.* at 4.
- 52 *Id.* at 12.
- 53 *Id.* at 15.
- 54 *Id.* at 2 n.2.
- 55 *Id.* The Report does acknowledge, however, that a stablecoin *may* constitute a security, implicating the federal securities laws and therefore the jurisdiction of the SEC, or a commodity or derivative, implicating the Commodity Exchange Act and therefore the jurisdiction of the CFTC. *Id.* at 11, 15.
- 56 *Id.* at 1.
- 57 *Id.*
- 58 *Id.* at 19.
- 59 *Id.* at 12.
- 60 *Id.*
- 61 *Id.*
- 62 *Id.* at 2.
- 63 *Id.* at 13.
- 64 *Id.* at 12.
- 65 *Id.* at 14.
- 66 *Id.*
- 67 *Id.*
- 68 *Id.*
- 69 *Id.* at 15.

## ENDNOTES (CONTINUED)

70 *Id.* at 2.

71 *Id.* at 16.

72 *Id.*

73 *Id.* at 2.

74 *Id.* at 17.

75 *Id.* at 2, 15-17. See 12 U.S.C. § 1867(c); see generally 12 U.S.C. §§ 1861-1867. Section 7 of the Bank Service Company Act (the “BSCA”) provides the Federal Reserve, the FDIC and the OCC with the authority to regulate and examine the performance of certain services by a third-party service provider for a depository institution “to the same extent as if such [banking-related] services were being performed by the depository institution itself on its own premises.”

76 Report, *supra* note 2, at 3.

77 *Id.*

78 *Id.*

79 *Id.* at 18. See Dodd-Frank Wall Street Reform and Consumer Protection Act Title VIII.

80 The two payment systems currently designated under the Dodd-Frank Act are The Clearing House Payments Company, L.L.C. (PaymentsCo), on the basis of its role as operator of the Clearing House Interbank Payments System (CHIPS), and CLS Bank International (CLS). CHIPS currently settles approximately \$6,500 trillion in large dollar payments on an annualized basis. CLS settles an average daily value of \$4.77 trillion in foreign exchange transactions.

81 *Id.*

82 *Id.* See 12 C.F.R. Part 234. Part 234 does not restrict affiliations between FMI and commercial entities.

83 Report, *supra* note 2, at 15. See, e.g., *In the Matter of Tether Holdings Limited, Tether Operations Limited, Tether Limited, and Tether International Limited*, CFTC Docket No. 22-04 (October 15, 2021), <https://www.cftc.gov/media/6646/enftetherholdingsorder101521/download>; *In the Matter of Poloniex, LLC*, SEC Administrative Proceeding File No. 3-20455 (August 9, 2021), <https://www.sec.gov/litigation/admin/2021/34-92607.pdf>.

84 Report, *supra* note 2, at 3.

85 *Id.* at 18. See also 12 USC § 378 (making it unlawful for “any person, firm, corporation, association, business trust, or other similar organization to engage, to any extent whatever with others than his or its officers, agents or employees, in the business of receiving deposits subject to check or to repayment upon presentation of a pass book, certificate of deposit, or other evidence of debt, or upon request of the depositor, unless such person, firm, corporation, association, business trust, or other similar organization (A) shall be incorporated under, and authorized to engage in such business by, the laws of the United States or of any State, Territory, or District, and subjected, by the laws of the United States, or of the State, Territory, or District wherein located, to examination and regulation, or (B) shall be permitted by the United States, any State, territory, or district to engage in such business and shall be subjected by the laws of the United States, or such State, territory, or district to examination and regulations or, (C) shall submit to periodic examination by the banking authority of the State, Territory, or District where such business is carried on and shall make and publish periodic reports of its condition, exhibiting in detail its resources and liabilities, such examination and reports to be made and published at the same times and in the same manner and under the same conditions as required by the law of such State, Territory, or District in the case of incorporated banking institutions engaged in such business in the same locality.”).

86 Report, *supra* note 2, at 18.

87 *Id.*

ENDNOTES (CONTINUED)

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- 88 The Report also does not indicate whether the proposed legislation would leave open the possibility of stablecoins backed by other types of reserves, including money market funds complying with applicable SEC regulations.
- 89 Report, *supra* note 2, at 15 (emphasis added).
- 90 In October 2021, SEC Chair Gary Gensler testified before the United States House of Representatives Committee on Financial Services. In his testimony, Chair Gensler compared stablecoins to the “wild west” that existed before securities laws were enacted and referenced new projects with respect to regulations concerning the offer and sale of crypto tokens, crypto trading and lending platforms, stablecoins, cryptoasset investment vehicles and custody of cryptoassets. See Gary Gensler, *Testimony Before the United States House of Representatives Committee on Financial Services*, SEC Testimony (October 5, 2021), <https://www.sec.gov/news/testimony/gensler-2021-10-05>; in June 2021, former CFTC Commissioner Dan M. Berkovitz took a strong stance against decentralized finance, noting that “Not only do I think that unlicensed DeFi markets for derivative instruments are a bad idea, I also do not see how they are legal under the CEA. ... [I]t is untenable to allow an unregulated, unlicensed derivatives market to compete, side-by-side, with a fully regulated and licensed derivatives market.” See Dan M. Berkovitz, *Keynote Address of Commissioner Dan M. Berkovitz Before FIA and SIFMA-AMG, Asset Management Derivatives Forum 2021* (June 8, 2021), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opaberkovitz7>.
- 91 Report, *supra* note 2, at 18.
- 92 *Id.*

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