February 8, 2022

Enhanced Regulation of Digital Assets Will Promote Responsible Innovation

The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing titled: "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins."

We appreciate the Committee's examination of fundamental issues related to stablecoins and are pleased to share the community bank perspective. To ensure that innovation is undertaken safely, ICBA advocates for a comprehensive, coordinated regulatory approach for the reasons described below.

Community Banks and Digital Assets

Wider adoption of digital assets, including stablecoins and other cryptocurrencies, is altering global digital commerce and the global financial system. Community banks keep pace with innovation to remain viable, relevant and continue to serve their communities. Numerous financial service providers, including financial technology companies, now offer consumers and businesses access to cryptocurrency-related activities, such as investments, lending, and custodial services. Although stablecoins and other cryptocurrencies are still not widely used for payments, several crypto companies are developing solutions to enable crypto payments for consumers and businesses. Community banks are beginning to explore offering digital assets services to meet customer demand and want to ensure they can do so safely.

ICBA is working with community bankers to educate their staffs on all forms of digital assets, follow market and regulatory developments, and evaluate their exposure to these assets through customer activities. Community bank involvement, as regulated financial institutions, will help mitigate risks presented by stablecoins and other cryptocurrencies, provided it can be done under a rigorous and thoughtful regulatory framework.

Community banks have a strong interest in ensuring that digital assets such as stablecoins do not create systemic, investor, or consumer risk. As described below, ICBA is concerned with stablecoins' potential risks to end-users, the financial system, and national security. These risks must be addressed by appropriate safety and soundness requirements.

Stablecoins

Stablecoins are digital assets that are issued and transferred using distributed ledger technologies and are purported to maintain a stable value relative to a national currency or other reference asset or assets. ICBA is concerned that stablecoins, including those backed by fiat currencies, may erode monetary authority, threaten financial stability, and risk community bank disintermediation. This is particularly true of privately issued stablecoins.

The President's Working Group on Financial Markets (PWG) report on digital assets rightly reflects ICBA concerns that continued, rapid stablecoin growth creates accelerating risks for consumers, the financial system, and the broader economy. In addition, the November 2021 Financial Stability Report of the Board of Governors of the Federal Reserve, quoted below, identifies the following risks associated with stablecoins:

- "Certain stablecoins, including the largest ones, promise to be redeemable at any time at a stable value in U.S. dollars but are, in part, backed by assets that may lose value or become illiquid. **If the assets backing a stablecoin fall in value, the issuer may not be able to meet redemptions at the promised stable value."**

- "Accordingly, these stablecoins have structural vulnerabilities similar to (…) certain money market funds and are susceptible to runs.

- "These vulnerabilities may be exacerbated by a lack of transparency and governance standards regarding the assets backing stablecoins**. The potential use of stablecoins in payments and their capacity to grow can also pose risks to payment and financial systems."**

To amplify the analysis of the Federal Reserve, stablecoins create the risk of a destabilizing run on redemptions which could ripple through the financial system. This risk is compounded by a lack of transparency into reserves backing stablecoins, which is needed to reassure investors in times of uncertainty. Moreover, the dramatically increasing scale of stablecoins in circulation represents a concentration of economic power and risk, potentially distorting American finance and commerce.

Policy Recommendations

ICBA encourages policymakers to harmonize regulations to ensure strong, clear, and consistent oversight of all cryptocurrency providers, including those that deal in stablecoin.

- Congress should act to ensure that stablecoins are subject to appropriate federal prudential oversight. Any regulatory regime applied to cryptocurrency, including stablecoin, should be comparable to the same regulations applicable to traditional, functionally similar payments products and services offered by the banking system.

- The scope of regulation should include capital adequacy and reserves; activity restrictions; due diligence; information security and privacy; business resiliency; ownership and control of data; anti-money laundering and anti-terrorist financing; reporting and maintenance of books and records; consumer protections; safeguarding customer information; vendor and third-party management; and ongoing examination.

- A more comprehensive, coordinated regulatory approach by banking and market regulators, including the Securities and Exchange Commission and the Commodity Futures Trading Commission, could help address risks, dispel confusion in the marketplace, and prompt more community banks to explore digital asset products and services to address customer needs. Stablecoin companies are not subject to comprehensive consolidated supervision, which allows for risks to multiply and creates an unequal playing field with banks.

- The harmonization of regulations will not only address risk—the additional clarity can level the playing field and create opportunities for more community banks to consider offering digital products and services, including stablecoin. Without such information, many banks may choose not to engage in digital asset activities.

- Collaboration can also help to ensure that the development of digital assets will not harm the integrity of the U.S. financial system by disintermediating community banks. Without harmonization among all the banking regulators, community banks that are not regulated by the OCC may find they are at a competitive disadvantage relative to their OCC-regulated peers and non-bank digital asset companies.

- Stablecoins must be brought within the regulatory perimeter. Appropriate federal oversight is needed to close regulatory gaps and mitigate the risk of regulatory arbitrage regardless of how these digital assets are classified by policy makers. The regulatory framework should address risks posed by any entity within a stablecoin arrangement that participates in the creation, transfer, or storage of stablecoins. Unregulated entities should not be permitted to issue stablecoins.

- A consistent federal regulatory framework for stablecoins should balance their benefits and risks and preserve the separation of banking and commerce.

Decentralized Finance

A further reason for regulation of stablecoins is their role in enabling the rise of a shadow banking system known as decentralized finance (DeFi). DeFi is a growing ecosystem of financial applications that run on public blockchains, such as Ethereum. DeFi applications, known as dApps, rely on smart contracts – or complex automated programming most consumers would find difficult, if not impossible, to evaluate and understand – to execute specific functions in an effort to replicate traditional products and services like payments and lending. However, DeFi is designed to deliver this variety of financial services without the use of centralized parties, such as banks, insurance companies, or brokerages. DeFi relies on stablecoins to function.

Policymakers must recognize that DeFi threatens to disintermediate community banks and create a shadow banking system filled with unregulated platforms that pose risks to consumers, the financial system, and U.S. national security. DeFi protocols are also frequent targets of hacks and other malicious activity that result in substantial losses for users. Last August, $600 million was stolen from Poly Network in a hack, though the funds were later recovered, and just last week, $320 was stolen from Wormhole. Between October 2020 and April 2021, nearly 7,000 consumers filed complaints with the Federal Trade Commission reporting crypto scam losses exceeding $80 million.

For these reasons, ICBA encourages regulators to collaborate on a comprehensive approach to DeFi to address the significant risks it poses as a shadow banking system.

Special-Purpose Bank Charters

ICBA strongly opposes granting special-purpose bank charters to stablecoin or other cryptocurrency companies that do not fully meet the requirements of federally insured chartered banks. These novel charters for non-banks firms raise a number of regulatory concerns—such as violation of the long-standing principle of the separation of banking and commerce, lack of application of traditional banking statutes and regulations governing safety and soundness and consumer protection, and the potential introduction of systemic risk into the payments system. We welcome the choice of certain stablecoin companies to pursue a standard bank charter.

Closing

ICBA and community bankers look forward to continuing to work with policymakers to balance the benefits of innovation in digital assets with their safety and soundness risks.

Thank you for your consideration of the community bank perspective.