INDEPENDENT COMMUNITY BANKERS of AMERICA®

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Cryptocurrencies, including stablecoins, must be subject to comprehensive and effective regulation

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: "Protecting Investors and Savers: Understanding Scams and Risks in Crypto and Securities Markets."

Community banks have a strong interest in ensuring that digital assets such as stablecoins do not create systemic, investor, or consumer risk and that resulting risks created by non-banks operating in this manner do not spillover into the traditional banking system. 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, without loopholes.

The risks posed by cryptocurrencies are ripe for congressional examination and comprehensive solutions. We hope that this hearing will address the emerging investor and systemic risk created by a proliferation of unregulated stablecoins. Proposals to regulate stablecoins are currently before Congress, and we urge this committee to play an active role in ensuring that regulatory solutions are effective. As we discuss further below, ICBA believes that stablecoin regulation must be comprehensive. Incomplete measures replete with loopholes would only delay more comprehensive efforts. **In particular, any stablecoin regulation that does not limit issuance to insured and highly regulated banks would perpetuate a source of unacceptable risk.**

Rapid Expansion of Cryptocurrencies

Cryptocurrencies are expanding from a niche investment class to function as means of payment and stores of value. Limited regulation and oversight applied to the cryptocurrency marketplace and transactions mean that consumers and investors that use or hold cryptocurrency are exposed to significant risks, including highly volatile fluctuations in value. Cryptocurrencies also present several operational risks and concerns, including flaws in smart contract programming and the loss of cryptographic keys that can jeopardize users' assets.

Especially concerning are the efforts of certain crypto firms to market themselves as the equivalent of chartered and insured banks. Recent events have shown the fallacy of this representation. In June, depositors in Celsius abruptly lost confidence in the crypto firm, demanding their funds in what amounted to a "bank run." Celsius was forced to halt withdrawals, which in turn shook confidence across the crypto industry.

Celsius is but one among a number of firms that have received cease and desist orders from state and federal regulators, including BlockFi and Voyager – stark illustrations of the investor and systemic risk created by crypto firms offering bank-like services without the protections offered by regulated banks. Unlike these crypto firms, banks are subject to deposit insurance, comprehensive oversight and examination, and capital requirements, among other safeguards which are designed to ensure customer access to funds under adverse economic circumstances.

Policymakers are just beginning to respond to the hazards of broader crypto adoption.

Stablecoins Among the Highest Risk Forms of Cryptocurrency

Private stablecoins pose substantial threats, including the potential to erode monetary authority and disrupt financial stability. Inadequate capitalization and hacks have caused a number of stablecoins to collapse in value. Recent, high-profile examples include UST-cum-USTC (Terra/TerraClassic), which lost its dollar peg in May and fell to just ten cents, and USDT (Tether), the largest stablecoin by market capitalization, which also lost its dollar peg in May due to concerns about its opaque reserves. Terra faced a precipitous loss in its value as investor confidence collapsed, which spread to Tether, the largest stablecoin by market cap, as users grew more concerned about Tether's assets. Because stablecoins are used in the exchange of other cryptocurrencies, the collapse of a stablecoin creates a ripple effect through the broader crypto market.

Risk to Community Banks

Community banks are at risk of disintermediation if private stablecoins become more widely adopted for payments. A migration of commercial deposits to alternative currencies held in digital wallets could reduce community banks' source of credit funding, with severe implications for the thousands of communities across our country that depend on their local bank for credit and other financial services.

Systemic Risk Created by Stablecoins

When investors lose confidence in the assets backing a stablecoin, its "stable" value is undermined. We have already witnessed this in cases of Terra and Tether described above. These runs on redemptions carry the potential to ripple through the financial system. This risk is compounded by misleading representations by stablecoin issuers and a lack of transparency into reserves backing stablecoins, which is needed to reassure investors in times of uncertainty. Moreover, the dramatic increase in the volume of stablecoins in circulation represents a concentration of economic power and risk, potentially distorting American finance and commerce.

Recommendations for Stablecoin Legislation

ICBA encourages policymakers to harmonize regulations to ensure strong, clear, and consistent oversight of all stablecoin issuers.

- Congress should act to ensure that stablecoin arrangements are subject to comprehensive federal prudential oversight and examination. Any regulatory regime applied to stablecoins should be comparable to 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 would not only address risk—the additional clarity would level the playing field and create opportunities for more community banks to consider offering digital products and services, including stablecoins. 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.

Closing

Thank you for convening today's hearing to highlight the significant risks created by the rise in cryptocurrencies. ICBA encourages the Senate Banking Committee to continue to play an active role in creating a comprehensive regulatory framework for cryptocurrencies.