News Analysis

US Stablecoin Report Gets Mixed Reviews From Crypto Industry

Issuers' reactions ranged from effusive to diplomatic, but lobbyists pushed back against recommendations by the President's Working Group on Financial Markets.

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Nov 5, 2021 · · CoinDesk Insights

"The crypto industry is trying to walk a fine line between benefiting from the legitimacy provided by government oversight while trying to stay clear of extensive and intrusive regulation," says one academic. (Art Institute of Chicago)

To hear them tell it, stablecoin issuers' prayers have been answered.

Two of the top 10 issuers hailed this week's report from the President's Working Group (PWG) on Financial Markets, which recommended stricter oversight of this mushrooming part of the cryptocurrency market, as a welcome step toward regulatory clarity.

“We are fully supportive of the call for Congress to act and establish federal banking supervision for stablecoin issuance,” said Jeremy Allaire, co-founder and chairman of Circle, which manages USD coin (USDC), the second-largest such token.

“This is huge progress in the acceptance of stablecoins and provides a path for their adoption,” Allaire said in an emailed statement. Tether, the market leader, gave a similarly upbeat statement. While less effusive, Paxos, the No. 7 issuer, and Gemini, the company behind the 16th-largest stablecoin, were diplomatic in their comments.

By sharp contrast, lobbyists for the cryptocurrency industry were critical of the 22-page report’s prescriptions. Both Coin Center and the Chamber of Digital Commerce argued that the recommended regulatory oversight could stifle innovation and unfairly single out stablecoins among payment systems like PayPal that work in similar ways.

The discrepancy between the practitioners’ praise and the advocates’ attacks highlights the delicate spot the community finds itself in, given its precarious regulatory status, and mixed public perception of crypto.

“The crypto industry is trying to walk a fine line between benefiting from the legitimacy provided by government oversight while trying to stay clear of extensive and intrusive regulation that deters innovation,” said Eswar Prasad, a Cornell University economist and author of “The Future of Money: How the Digital Revolution is Transforming Currencies and Finance.”

Long overdue?

As the global stablecoin market – currently worth some $134 billion – continues to grow, regulators all over the world are getting nervous. Stablecoins are cryptocurrencies tethered 1:1 to the value of other assets like the U.S. dollar, and issuers maintain the fixed value of these currencies by backing them with reserves that match the value of the coins in circulation. This year, Tether, issuer of USDT, revealed that about 50% of its reserves were made up of unspecified commercial paper.

Last month, Circle disclosed it was under investigation by the U.S. Securities and

Exchange Committee (SEC). Tether may also be under the SEC's microscope. Meanwhile, Europe is gearing up to approve a 168-page framework to regulate crypto, which proposes additional standards for major stablecoin issuers in particular.

The report compiled by the President's Working Group, along with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, is the first step towards establishing federal-level regulatory oversight of the stablecoin sector in the U.S.

The regulators behind the report called on Congress to bring stablecoins under federal supervision. The report indicated that should lawmakers fail to do so, the regulators themselves may step in through the interagency Financial Stability Oversight Council (FSOC), which could designate stablecoin activities "systemically important" and thus subject to tighter supervision.

Although the report said that the rapid growth of the stablecoin market increases the urgency of establishing oversight, Stanford economist and professor Darrell Duffie said he doesn't feel things are being rushed.

"If anything, we were already past the due date for regulatory action," he said.

"It is desirable, though, for market participants to get a clearer sense of the rules," Duffie said.

Issuers' reactions

In public, the big players in stablecoins appeared to agree, or at least to not protest.

"The ecosystem has been waiting for clarity about stablecoin regulation for a long time. ... This will be a pivotal moment in fintech history," a spokesperson for Tether said.

Tether, which is incorporated in Hong Kong and registered in the British Virgin Islands, says it stopped serving U.S. customers in 2018. For it to resume doing business in the U.S. would require big changes under the report's proposed regime.

"Tether is not an insured depository institution. So it would have to apply for a charter and be reviewed in that sense," said Timothy Massad, former chairman of the Commodity Futures Trading Commission (CFTC) in an interview on CoinDesk TV's "First Mover" program Thursday.

When asked whether Tether, which settled two separate investigations by federal and state U.S. agencies this year over its reserves, is ready to become a federally regulated bank, the spokesperson referred CoinDesk to the previous statement.

A spokesperson for Paxos said the company looks forward to "engaging further with all policymakers regarding the future of stablecoins."

It took Paxos, issuer of stablecoin USDP, three years to be approved for a trust charter in the state of New York.

Gemini, the issuer of GUSD, said it appreciated the opportunity to share its input with the President's Working Group.

"We look forward to continued dialogue," a Gemini spokesperson said in an email.

The Diem Association, the consortium set up by Facebook to build stablecoin hopeful diem, formerly known as libra, did not respond to a request for comment by press time.

Fighting words

Following the release of the report on Monday, Perianne Boring, the founder of the blockchain advocacy group Chamber of Digital Commerce, tweeted that, if multiple agencies step in to regulate stablecoins, things could get messy.

"The report suggests that multiple federal agencies have jurisdiction over #stablecoins, without defining the parameters of this jurisdiction or indicating which agency has superior expertise in the function being regulated," Boring tweeted.

Boring also tweeted that the recommendation in the report to consider designating activities of stablecoin payments systems "as, or as likely to become" systemically important would open the door to regulators applying this authority to other payment systems that are already used by "tens of millions of consumers every day."

While the Financial Stability Oversight Committee (FSOC) already has the authority to designate financial activities as systemically important, it has never before exercised this authority successfully, Boring later told CoinDesk, so this would be a first.

"It would create a slippery slope – credit card networks and other companies could be next," Boring tweeted on Monday.

The FSOC's track record includes previously voting to designate, and then rescinding, three companies whose "material financial distress – or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities" – could pose a threat to U.S. financial stability. One such company was MetLife Inc. but the insurance giant filed suit against the regulators in 2015, challenging the designation. In 2018, both the FSOC and MetLife filed a joint motion to dismiss the case and the U.S. Treasury Department recommended the FSOC refrain from targeting individual companies and focus on broader risks.

Imposing these regulations on all stablecoin payments systems, regardless of size, would be regulatory overreach that would hinder innovation with stablecoins and other payments systems that may be designated, Boring said in an email to CoinDesk.

Jerry Brito, executive director of crypto think tank Coin Center, tweeted that the way the report lays out the nature of stablecoins and the risks they pose is similar to how one would describe PayPal or other payment apps.

"I don't see how they distinguish it, yet there's no legislation recommended for payments apps," Brito said in the tweet.

Boring also pointed out that the report overlooks the regulatory efforts of individual U.S. states.

"The current regulatory framework for payments systems – including stablecoin payment systems – primarily takes place at the state level through money transmission laws and trust licenses," Boring said. By ignoring these efforts, the report disregards the majority of regulation that currently applies to crypto.

"It's essential to analyze a current regulatory frameworks' strengths and weaknesses, and to learn from that experience, before imposing a new framework," Boring said.

Some states are innovating through new laws designed specifically for digital assets, Boring continued, citing New York's BitLicense and Wyoming's special purpose depository institution charter.

"We believe that regulators should allow the 'laboratories of democracy' – the states – to continue to innovate in this space, rather than imposing one size fits all federal mandates," Boring said in an email.

DeFi implications

According to Duffie, the treatment of stablecoin issuers as banks may come as a blow to proponents of decentralized finance (DeFi).

"The PWG Report proposes legislation that would require stablecoins to be issued only by banks, under prudential standards and supervision. That's a significant step that will help with financial stability but surely generate lots of disappointment among some DeFi enthusiasts," said Duffie.

Jacob Franek, partner at the DeFi Alliance, said he doesn't believe DeFi enthusiasts will be disappointed by the general concept of regulating stablecoin issuers.

"The devil, however, is in the details," Franek said.

A delegate for DeFi platform MakerDAO, who goes by the pseudonym PaperImperium, said that the report only applies to fiat-redeemable stablecoins, referring to footnote 5 of the document which states:

"Stablecoins that are purportedly convertible for an underlying fiat currency are distinct from a smaller subset of stablecoin arrangements that use other means to attempt to stabilize the price of the instrument (sometimes referred to as "synthetic" or "algorithmic" stablecoins) or are convertible for other assets. Because of their more widespread adoption, this discussion focuses on stablecoins that are convertible for fiat currency."

The stablecoin DAI, generated by Maker, is convertible for other assets like bitcoin or ethereum and not fiat currency, and therefore does not fit the report's parameters, PaperImperium said.

"So it was a big win for DeFi," he said.

Former CFTC official Massad said on CoinDesk TV that one of the standout contributions of the report is a call for DeFi regulations because it's an area that hadn't been wholly addressed by regulators and lacks transparency.

"It's not exactly clear what kind of regulation they're envisioning. So, you know, that is something that will have to be developed," Massad said.

Meanwhile, PaperImperium argued the report was instead a blow to more centralized stablecoin issuers like Circle and particularly Diem.

"The report read to me like a huge shot at Facebook, to be quite honest," he said, referring to the social media giant's early involvement in diem, which he said inspired the proposed crypto asset guidelines in Europe.

What's next?

According to Prasad, regulators are in for a hard time. Regulatory requirements and associated compliance costs often tend to favor larger, established players and put potential new entrants at a disadvantage, he explained.

"Hence, even open-minded regulators face a difficult balance in mitigating financial risks while leaving room for innovation and ensuring a level playing field between incumbent firms and new ones," Prasad said.

As an immediate next step, regulators should take a step back and assess the current state and federal regulatory framework that applies to stablecoins, according to Boring, starting with assessing how states are looking to regulate the space.

"The report acknowledges that stablecoins currently operate at a small scale so there is time to get the regulatory solution right," said Boring.

Duffie added that the president's working group has clearly passed the baton to Congress.

"Let's see what happens there," said Duffie.

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Sandali Handagama is a CoinDesk reporter with a focus on crypto regulation and policy. She does not own any crypto.

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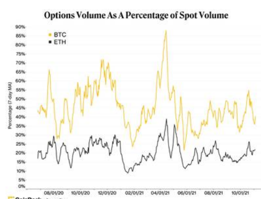

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