MEMORANDUM

TO: Clients

FR: FS Vector

DT: July 25, 2022

RE: Stablecoin Legislation Update

As has been publicly reported, House Financial Services Committee Chair Maxine Waters (D-CA) and Ranking Member Patrick McHenry (R-NC) are working on a bipartisan proposal to regulate stablecoin issuers. The Treasury Department has been the lead negotiator in this process for the Biden Administration.

State of Play (updated 7/25)

Any potential action on this legislation has been postponed until September at the earliest. Negotiations continue on the text. A final agreement between Chair Waters and Ranking Member McHenry has not been reached.

Although it is a moving target, the first likely date the House Financial Services Committee could move to mark-up the bill is Wednesday, September 14th. The Committee is likely to use the extra time to engage interested Members and stakeholders over the August Congressional Recess.

Draft legislative text could be circulated as early as this week.

Bill as it has been described*

- Stablecoins are defined as "payment stablecoins" under the bill. Similar verbiage was used in both the Responsible Financial Innovation Act introduced by Senator Lummis (R-WY) and Senator Gillibrand (D-NY), as well as the Stablecoin TRUST Act released by Senator Toomey (R-PA).
- These stablecoins will be required to be backed 1:1 by dollars and a subset of high-quality liquid assets (HQLA).
- Banks and credit unions can issue through a subsidiary licensed by the Fed, their primary regulator will remain their current federal functional regulator.
- Non-banks can be licensed and supervised as stablecoin issuers by the Federal Reserve. The Fed has the authority to provide a master account.
- There will be a four-factor test for approval, including liquidity, capital, and recovery and resolution planning requirements.
- Under the current construct, there is no grandfathering or pathway for state charters, trusts or other entities.

- ➢ Existing stablecoins will have one-year to apply for a Fed license while still operating.
- ➢ There will be a 60-day period for public comment on all applications.
- ➢ If no action by the Federal Reserve in 90-day period, it is deemed approved.
- ➢ A three-tiered tailored non-bank regulatory structure (potentially $50M, $150M, and above) to ensure right-sized regulatory burden.
- ➢ No deposit insurance fund for stablecoin issuers.
- ➢ Risk management and capital liquidity rulemakings by the Fed for non-banks. Similar rulemakings by relevant regulators for banks and depository institutions.
- ➢ Prohibition on commercial companies, such as big box retailers and big tech platforms, being issuers.
- ➢ Mandated interoperability between stablecoins to prevent anti-competitive behavior.
- ➢ The Fed will be required to do another report on CBDCs.
- ➢ Continued authority to regulate contracted third-party service providers, such as custodial services, to ensure delivery of assets.
- ➢ Prohibition of foreign-issued payment stablecoin being offered to U.S. persons.

**We caution that this summary is based on the best available and reported information, some of these provisions may still change before committee consideration.*

Potential speed bumps

Lack of state regulatory pathway. States like New York and Wyoming with robust regulatory and licensing programs are likely to continue to push vigorously for a state pathway, something Treasury has opposed. This could be addressed before or during the mark-up next week.

Algos. The treatment of algorithmic stablecoins in the legislation has been a particular sticking point. Democrats and the Administration have pushed an outright two-year ban with a study. Republicans prefer no ban. Compromise is likely to include a sunset and/or ban on new issuance that grandfathers existing coins.

The Senate. While aware of the ongoing discussions, Senate Banking Committee Chairman Sherrod Brown (D-OH) has not been directly at the negotiating table. His support - or at least active indifference - will be needed for Senate passage this year.

Progressive policy priorities. Consumer advocates and progressive policymakers are likely to seek a more robust, explicit role for the CFPB in this bill. They may also want to use this as an opportunity to push other priorities including a retail central bank digital currency (CBDC), ESG metrics, as well as financial inclusion provisions.

The other regulators. While banking regulators have been part of the drafting process, the Securities and Exchange Commission (SEC) and the Consumer Financial Protection Bureau (CFPB) have not been directly consulted. Explicit language will be included in the bill preserving the SEC's and CFPB's existing regulatory authority, however their direct exclusion from the process could firm up opposition to the bill.

Banker opposition. The Independent Community Bankers of America wrote a letter, on Friday, in opposition to quick action on this legislation. The letter specifically states that it is "premature to markup legislation of this scope and scale" without consulting with the ICBA and other stakeholders. The community banks reiterated in the letter that they are "concerned with stablecoins' potential risks to end-users, the financial system, and national security." The big banks have voiced concerns as well. The Bank Policy Institute, on Saturday, released an 'insight' that clearly stated their position: "Stablecoins issued by nonbanks pose run risk, illicit finance risk, and cyber risk… If nonbank stablecoin issuers are not regulated in the same way banks are regulated, consumers and our economy could be at risk of another financial crisis."